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Summary of Key Views

There's been one thing occupy investor's minds in recent months being rising bond yields and the prospect of inflation. 10 year US treasuries have been on the rise since the beginning of 2021. Rising bond yields are typically a sign of economic recovery which is a good thing, however the rapid rate at which bond yields have risen has caused markets to become worried about inflation. As a result we have seen government bonds sell off and we have also seen a rotation away from growth parts of the equity market which tend to be longer duration in nature towards cyclical and value parts of the stock market.

The key thing to watch in the coming months will be whether inflation rises at a steady rate or whether we see inflation spike. A key factor to watch will be wage growth as we believe that in order for inflation to rise substantially, we need to see wage growth increase which we have not seen to date.

Market developments during February 2021 included:

Australian Equities

Earnings season revealed a corporate environment still impacted by Covid-19, with earnings down in aggregate and companies opting to hold more cash, although the lift in dividends has been a key positive development for Australian investors. Cyclical shares have benefitted from greater confidence, spurred on by the vaccine rollout and the return to more normal economic conditions. After falling out of favour during the pandemic, major banks have reported dividend increases and rising payout ratios. The sticking point has been the recent rise in yields, which has had a significant impact on growth sectors such as IT, although fundamentals remain largely unchanged.

Recent earnings releases include Woolworths, which reported 1H21 sales growth of 11% on the prior corresponding period. Australian Food total sales grew 11%, benefitting from Covid-19 related demand, but sales moderated over 2Q21 as pandemic restrictions eased. CSL's interim 1H21 results showed exceptionally strong performance from its influenza vaccine business Seqirus, which reported a 38% jump in revenue on the prior corresponding period, compensating for Covid-19 related headwinds in plasma collection. A2 Milk reported a 16% fall in revenue and 32% decline in EBITDA driven by disruptions in the daigou and CBEC distribution channels.

Global Equities

Global equity markets had a positive month in February despite rising yields spooking investors and raising the prospect of inflation. The S&P 500 Index rose 2.8% over the month and has gained a remarkable 31.3% over the past 12 months since the end of February 2020, before the world entered lockdown. Reaching the end of reporting season, S&P 500 companies reported positive earnings growth in aggregate for the first time since Q4 2019. However, only five out of eleven sectors delivered positive growth, with earnings from technology, materials and financials doing the heavy lifting.

Value shares continued their rally through the start of 2021, but performance has not been uniform, with cyclical stocks benefitting strongly from renewed confidence while value with a quality bias has struggled. European shares joined in the global rally in February as vaccine progress and stimulus measures pushed the Stoxx 600 Index higher and just shy of its February 2020 all-time high. Value and cyclical sectors such as banks, commodities producers and travel companies have been leading the reflation trade-driven advance. In Asian markets, Japan's Nikkei 225 Index rose 4.8%, Hong Kong's Hang Seng Index rose 2.5%, and China's CSI 300 Index fell 0.3%.

Fixed Interest

The main story through February was the continued rise in longer-dated yields and a steepening of the yield curve, with implications for equity market valuations and central bank policy. For context, the spread between the Australian 10-year and 2-year yields was 177 basis points at the end of February 2021 versus 28 basis points at the same time in 2020. While QE and lower cash rates have done the job of flattening the short end of the yield curve, the long end has proved more stubborn.

The RBA minutes for the February meeting noted the risk of ceasing the bond purchase program when the market widely anticipated an extension, stating it could lead to "unwelcome significant upward pressure on the exchange rate". Regarding its yield curve control policy, the RBA will "consider whether to shift the focus of the yield curve target from the April 2024 bond to the November 2024 bond" later this year. In the US, Treasury yields rose from 1.11% to 1.44% over February and continued to push higher in early March. Spreads on municipal bond yields have narrowed notably, reflecting expectations of additional fiscal stimulus and aid to state and local governments, while spreads on corporate bond yields over Treasury yields have also narrowed.

REITs (listed property securities)

Australian listed property continued to trend down through February as Covid-related headwinds—including the longer-term consequences of how occupiers utilise property going forward—were exacerbated by the rise in yields. After bearing the brunt of lockdown measures, shopping centres were in the green over February, with gains from Vicinity Centres (+6.8%) and Scentre Group (+5.5%). National Storage REIT released its 1H21 results, with underlying earnings growing 14% and storage revenue rising 12%, boosted by occupancy and rate growth. Service station and convenience store owner Waypoint REIT (formerly Viva Energy) released its FY20 results, announcing a 7.0% rise in total income and a 6.1% rise in distributable earnings.

CoreLogic data showed Australian house prices rose 2.1% in February—their fastest rate in 17 years— with growth in every capital city thanks to improving economic conditions. According to the ABS the value of new housing loans rose 10.5% in January and is up 76% since its May 2020 low. In the US REIT market, the post-vaccine sector rotation has been the prevailing theme as investors favour reopening-sensitive sectors such as retail, hotels and offices over 'essential' sectors like housing, industrial and technology.

Alternatives

Preliminary estimates for February indicate that the index increased by 3.6 per cent (on a monthly average basis) in SDR terms, after increasing by 7.8 per cent in January (revised). The rural, non-rural and base metals sub-indices all increased in the month. In Australian dollar terms, the index increased by 3.1 per cent in February.

Over the past year, the index has increased by 23.9 per cent in SDR terms, led by higher iron ore prices. The index has decreased by 12.1 per cent in Australian dollar terms.