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Summary of Key Views

Insights from our CIO: Are we in the midst of a new cold war era?

After several weeks of diplomatic tensions, over the last few days the word has watched in shock as Russia invades Ukraine. By way of background, the Ukraine was part of the former Soviet Union and gained independence from the USSR in 1991 following the gradual collapse of communism in central and eastern Europe in 1989. The recent tensions can be traced back to 1994 when the Budapest Memorandum was signed by the US, UK, Russia and the Ukraine when the Ukraine essentially agreed to give up their nuclear weapons and in return recognition of their sovereignty and 'assurances' of assistance should they face aggression. The west also opened the door for former Soviet states such as the Ukraine and Georgia to become members of NATO which was deemed to be unpalatable to the Russian government. Roll forward and we have seen Russian annex the Ukrainian region of Crimea in 2014 as well as making incursions into the eastern Ukrainian regions of Donetsk and Luhansk. The situation is complex and the coming days and weeks will provide us greater clarity on the direction tensions may take.

From a market perspective, we have seen markets price in the risk of a conflict with five-year credit default swaps blowing out for Russia and the Ukraine debt reflecting the additional risk for swapping out sovereign default risk. Equity markets are likely to be volatile until there is more clarity on the situation.

Market developments during February 2022 included:

Australian Equities

The Australian share market finished February 2022 with the S&P/ASX 200 rebounding +2.14% and seven out of eleven sectors finishing higher. In particular, the Energy sector (+8.6%) led the Index higher with Consumer Staples (+5.6%) and Materials (+5.2%) also performing well. The Information Technology sector (-6.6%) continued its fall whilst the Consumer Discretionary sector (-5.0%) performed poorly.

The Energy sector was driven higher by surging oil prices amid the geopolitical tensions between Russian and Ukraine. Meanwhile, Consumer Staples performed strongly as investors looked for defensive exposure, with the Materials sector also finishing positively due to surging commodity prices. The Information Technology sector continued its slide as volatility and impending worldwide interest rate rises provided a headwind for growth stocks. Overall, the catalysts for the month were the geopolitical issues in Ukraine as the war and sanctions continued to intensify. This resulted in market volatility as investors mulled the effects on worldwide monetary policy response and inflationary concerns.

In February, Enhanced Value (+5.3%) and Value (5.0%) were the top performers amongst factors. All factors finished positive except for growth (-0.6%). Over the past 12 months, both value strategies (+17.5%) are the strongest performers, with growth (-9.0%) providing the lowest year-to-date returns.

Global Equities

Global markets were battered over the month of February as geopolitical fears evolved into a reality in Ukraine. Developed markets closed -5.5% lower by month end, Global small caps fared better than their large cap counterparts closing with a -2.5% loss. Emerging and Asian markets followed similar downward trends with monthly returns of -5.8% and -4.3% respectively. Noting that all aforementioned figures are reported in Australian dollar terms.

As expected, the emerging conflict between Russia and Ukraine commanded the attention of investors over the month dampening confidence across the globe. Momentum and growth factors led the pack over the month returning -0.2% and -0.9% respectively, the worst performing factors were quality and momentum closing -4.1% and -2.2% lower respectively according to MSCI ACWI Single Factor Indices reported in local currency terms.

Fixed Interest

Fixed Income markets continued their poor start to 2022, posting significant losses in February. In the Australian market, the bulk of the poor returns came from markets continuing to sell-off over fears of higher inflation and corresponding rate hikes, with the yield for 10-year Australian Government Bonds increasing by more than 25bps over the course of February. This increase hit across the entire Yield Curve, with the 2-year yield increasing by a similar amount. Despite these selloffs, in their meeting on 1 March the Reserve Bank of Australia (RBA) maintained the Cash Rate at 0.1% and reiterated that they intend to see both inflation sustainably within their 2-3% target range, and higher levels of wage growth, before increasing rates, and currently the RBA's board does not have sufficient conviction that either of these criteria have been met.

As such, the movement of the risk-free curve was the main factor driving Australian bond market performance, with the Bloomberg AusBond Composite 0+ Yr Index returning -1.2% over the course of February. Australian credit spreads also widened substantially over the course of the month, which further contributed to the observed poor performance.

International bond markets also sold off during February, primarily driven by the US, which balked at a CPI level of 7.5% over the year to January 2022. Market participants are almost unanimously expecting a rate rise in the Federal Reserve's March meeting, with the bulk of discussion concerning the size of the increase rather than whether or not one is likely to occur. This resulted in a return of -1.3% in the Bloomberg Global Aggregate Index (AUD Hedged), with a weakening AUD resulting in a return of -4.1% for the unhedged variant. Notably, this index features a small 0.3% allocation to Russian markets, which experienced huge devaluations resulting from international sanctions following Russia's invasion of Ukraine, contributing to the month's negative return.

REITs (listed property securities)

The S&P/ASX 200 A-REIT Index (AUD) consolidated during February, finishing 1.4% higher MoM.

Global real estate equities (represented by the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)) continued its drawdown, closing a further -2.7% lower for the month of February and totalling -8.1% YTD. Within the AREIT landscape, industrial REITs have significantly outperformed office and retails over the past 12 months and during the recovery, but COVID-related restrictions easing across the community could see improved sentiment within the office and retail subsector. Additionally, February HY22 results were generally positive across the AREIT sector, with a number of index constituents beating earnings expectations.

February saw some activity across the retirement and lifestyle segments. Stockland (ASX: SGP) announced the sale of its retirement living business to EQT Infrastructure for $987m, broadly in line with its book value. Ingenia Communities Group (ASX: INA) announced both an acquisition of a partially developed lifestyle community in South East Queensland and the acquisition of three lifestyle communities in Melbourne. The domestic housing market rose by 0.3% MoM in February, as reported by CoreLogic's 5 capital city aggregate. Sydney 'all dwellings' was the only negative reading, with -0.1% MoM change. Brisbane (inc. Gold Coast) led the charge, advancing 2.0% MoM.

Interestingly, CoreLogic reported that the lower value segments of the market are now outperforming, with the lowest 25% of capital city home values increasing by 3.5% in three months to January, compared to the top 25% of capital city home values rising by 1.9% for the same period.

Alternatives

Preliminary estimates for February indicate that the index decreased by 2.6% (on a monthly average basis) in SDR terms, after increasing by 6.9% in January (revised). The rural and base metals indices increased in the month, while the non-rural index decreased. In Australian dollar terms, the index decreased by 2.3% in February.

Over the past year, the index has increased by 16.7% in SDR terms, led by higher LNG, coking coal and thermal coal prices. The index has increased by 23% in Australian dollar terms.