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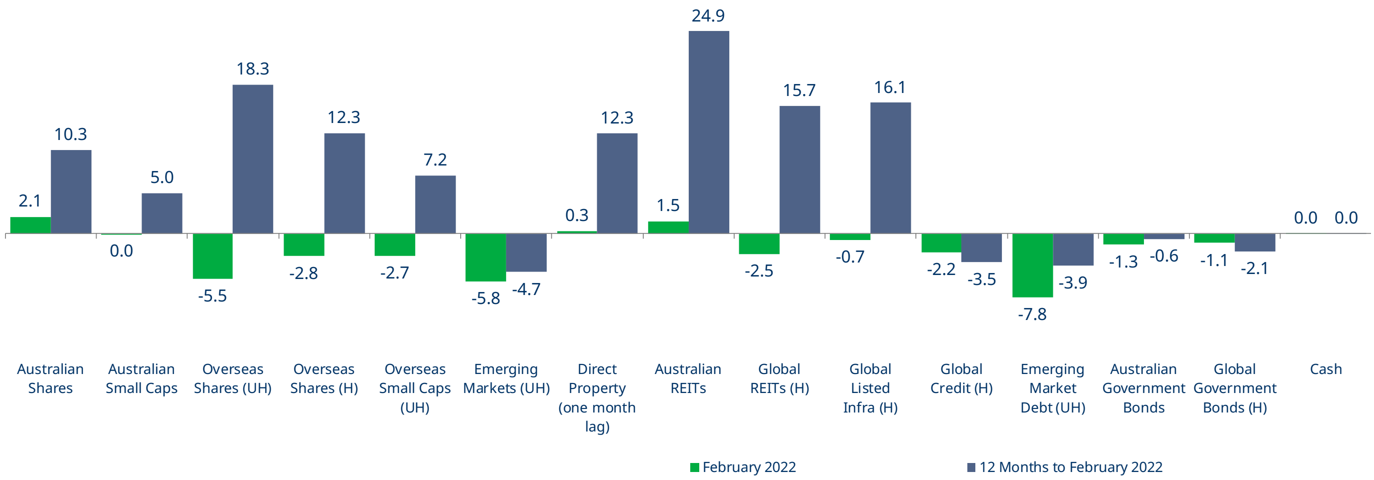
February 2022

Australian monthly market review

Selected market indicators commentary

Asset class returns as at 28 February 2022



February was dominated by the Russian invasion of Ukraine which caused a spike in market volatility and energy prices that rippled across the market. February began against the backdrop of soaring inflation and the increased pace and magnitude of monetary policy tightening. As the Ukraine situation escalated mid-month markets rapidly shifted gears and began repricing for war. Energy prices were directly impacted by the conflict with Oil increasing by 10.8% to just US$101.22 by the end of the month. The one silver lining during February was that Covid cases began to decline in Australia and many other developed countries as restrictions continued to be eased.

Over February, Hedged developed market overseas shares returned -2.8% with most developed and emerging markets suffering from the uncertainty brought about by the Russia-Ukraine conflict.

US equities, European markets and economies with heavy exposure to global trade such as Germany performed poorly in February. Australia managed to post a positive return in February due to its exposure to commodities and energy. Unhedged Emerging market shares underperformed over February returning -5.8%. The collapse of the Russian stock market and poor market performances from China and India was partially offset by Brazil's positive performance, resulting from their natural resource exposure. The weakening of the US dollar against currencies of commodity producers, such as Australia, South Africa and Brazil, also impacted on unhedged returns.

Hedged overseas government bonds returned -1.1% over the month as 10-year government bond yields for major developed markets ended the month higher.

Australian 10-year government bond yields moved in the same direction, increasing by 25bps to 2.13% and the Bloomberg Ausbond Treasury index returned -1.3% over the month. In spite of the elevated market volatility brought about by the Russia-Ukraine conflict, developed market government bonds in February did not exhibit their usual safe haven characteristics. Instead yields have continued to rise due to uncertainty around inflation and monetary policy. Spreads have risen considerably in February, with high yield and emerging market debt bearing the brunt of the Russia-Ukraine conflict. The yields on Russian hard currency debt has soared to over 25% following the imposition of sanctions, freezing of Russia's hard currency reserves and the cut-off of major Russian banks from the SWIFT system.

Australian shares posted positive performance over February, with the S&P/ASX300 returning 2.1%. The S&P/ASX Mid 50 Accumulation Index (-0.3%) and the S&P/ASX Small Ordinaries (0.0%) dragged down the S&P/ASX300, all other domestic indices posted positive returns in February. The best performing sectors were Energy (8.4%) and Consumer Staples (5.4%). The worst performing sector for the third consecutive month was IT (-6.8%) reflecting the market's risk off repositioning and caution around interest rate expectations. The largest negative contributor to the IT sector for February was Xero which returned (-17%).

Significant Developments

- During its March 2022 meeting, the Reserve Bank of Australia (RBA) decided to maintain the current target cash rate at 0.10% per annum and the interest rate on exchange settlement balances at zero. While the global economy is continuing to recover from the pandemic, the war in Ukraine is a major new source of uncertainty. Inflation in parts of the world has increased sharply due to large increases in energy prices and disruptions to supply chains at a time of strong demand. The prices of many commodities have increased further due to the war in Ukraine. Bond yields have risen and policy interest rate expectations have increased. The Australian economy remains resilient and is picking up following Omicron. Household and business balance sheets, business investments and construction work are all looking stronger. Macroeconomic policy settings remain supportive of growth. The unemployment rate is at a 14-year low of 4.2%. Hours worked declined significantly in January due to the Omicron outbreak however is expected to bounce back. The RBA's central forecast is for the unemployment rate to fall to below 4% later in the year and to remain below 4% next year. Wages growth has picked up and is expected to rise. The central forecast is for underlying inflation to increase further in coming quarters to around 3.25%, before declining to around 2.75% over 2023 as the supply-side problems are resolved and consumption patterns normalise. The CPI inflation rate will spike higher than this due to the higher petrol prices resulting from global developments. The outlook of this is uncertain. Financial conditions in Australia continue to be highly accommodative. Interest rates remain at a very low level, although some fixed rates have risen recently. The Australian dollar exchange rate is around its lows of the past year or so. Housing prices have risen strongly. The board will not increase the cash rate until actual inflation is sustainably within the 2-3% target range. While inflation has picked up, it is too early to conclude that it is sustainably within the target range due to the uncertainties surrounding global energy markets and supply side issues.
- Australian seasonally adjusted employment increased by 12,900 in January, above expectations of zero and below the prior month's increase of 64,800. The unemployment rate did not change at 4.2% for January, which was in line with expectations. The participation rate increased by 66.2%, above expectations of 66.1%. Part time jobs increased by 30,300 and full time jobs decreased by 17,500.
- Australian building approvals decreased by 27.9% month-on-month to January, compared to the increase of 9.8% (revised) for December.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 58.6 in February, above consensus for 58.0 and above the 57.6 recorded in January. Of the 18 manufacturing industries, Apparel, Leather & Allied Products and Textile Mills were the two industries that reported the highest growth. The only industry reporting a decrease in February compared to January is Wood Products. The ISM Services Index recorded 56.5 in February, below consensus of 61.1 and below the 59.9 recorded in January. Of the 18 services industries, the top performers were Construction and Transportation & Warehousing. The four industries reporting a decrease in February were Real Estate, Rental & Leasing; Arts, Entertainment & Recreation; Agriculture, Forestry, Fishing & Hunting; and Accommodation & Food Services.

- US Non-Farm Payrolls increased by 679,000 in February, above the 481,000 increase (revised) recorded for January. The unemployment rate decreased to 3.8% over February, below expectations of 3.9%.
- US GDP second estimate for Q4 2021 is 7.0% quarter on quarter (QoQ) annualised, which was in line with expectations
- The Caixin Manufacturing PMI in China recorded 50.4 in February, above expectations of 49.1, as business conditions improve slightly.
- The preliminary estimate of the European Core CPI recorded 2.7% over the year to February, above expectations of 2.6%.
- The Eurozone composite PMI decreased to 55.5 in February, below expectations for 55.8.
- The first estimate recorded for Q4 2021 Eurozone seasonally adjusted GDP is 0.3% QoQ and 4.6% YoY.

Australian Shares

The Australian share market outperformed its hedged overseas counterpart over the month, as the S&P/ASX 300 Index returned 2.1%. The S&P/ASX 50 Accumulation Index was the strongest relative performer, returning 2.8%, while the S&P/ASX Mid 50 Accumulation was the weakest, returning -0.3% over the month.

The best performing sectors were Energy (8.4%) and Consumer Staples (5.4%), while the weakest performing sectors were IT (-6.8%) and Consumer Discretionary (-5.0%). The largest positive stock contributors to the index return were Westpac, South32 and NAB with absolute returns of 12.7%, 25.3% and 6.9%, respectively. In contrast, the most significant detractors were Wesfarmers, Fortescue Metals and ANZ with absolute returns of -8.3%, -7.5% and -1.6%, respectively.

Overseas Shares

The broad MSCI World ex Australia (NR) Index returned -5.5% in unhedged terms and -2.8% in hedged terms over the month. In AUD terms, the strongest performing sectors were Energy (1.9%) and Materials (-1.9%), while Communication Services (-8.2%) and IT (-7.5%) were the weakest performers. In AUD terms, the MSCI Small Caps (TR) Index was down by 2.7%, while the MSCI Emerging Markets (NR) Index was down by 5.8% over February.

Over the month, the NASDAQ (-3.4%), the S&P 500 Composite Index (-3.0%) and the Dow Jones Industrial Average (-3.3%) decreased, all in USD terms.

In local currency terms, major European share markets experienced mixed returns as the FTSE 100 (UK) (0.3%) increased, while the CAC 40 (France) (-4.9%) and the DAX 30 (Germany) (-6.5%) decreased. In Asia, the Chinese SSE Composite (3.0%) increased, whilst the Indian S&P BSE 500 (-4.1%), Japanese TOPIX (-0.4%) and Hong Kong Hang Seng (-4.6%) decreased, all in local currency terms.

Real Assets

The Real Assets sector produced broadly negative returns over February. The Global Real Estate Investment Trusts (REITs) Index decreased by 2.5% over the month and the FTSE Global Core Infrastructure 50/50 Index decreased by 0.7% (both in AUD hedged terms). Domestic REITs increased by 1.5% over February, whilst Australian Direct Property (NAV) returned 0.3% (one-month lag).

Fixed Interest

Global bond markets were negative over February, with the Barclays Capital Global Aggregate Bond Index (Hedged) returning -1.3% and the FTSE World Government Bond (ex-Australia) Index (Hedged) returning -1.1%. Ten-year bond yields moved higher over the month, increasing in the UK (8bps to 1.39%), the US (6bps to 1.84%), Germany (15bps to 0.12%) and Japan (2bps to 0.18%). Two-year bond yields were mixed over the month, increasing in the UK (1bp to 1.05%), Japan (2bps to -0.03%), and the US (27bps to 1.42%), whilst decreasing in Germany (-2bps to -0.58%).

Returns for Australian bondholders were negative over February, with 10-year bond yields (25bps to 2.13%), five-year bond yields (28bps to 1.83%) and two-year bond yields (20bps to 1.12%) increasing. Of the Bloomberg Ausbond indices, the Bloomberg Ausbond Bank Bill produced the highest monthly return, returning flat whilst the Bloomberg Ausbond Treasury produced the lowest return of -1.3%.

Currency Markets

The AUD Trade Weighted Index increased to 60.6 over February, up by 2.2% from January. The AUD appreciated against the Pound Sterling (3.0%), Euro (2.8%), Japanese Yen (2.9%), and the US Dollar (3.0%).

Commodities

Iron Ore decreased by 4.9%, finishing the month at US$136.5 per metric tonne. The S&P GSCI Commodity Total Return Index increased by 5.6% over the month. Gold prices increased by 6.0% finishing the month at US$1,903.75 per ounce and the oil price increased by 10.8% to US$101.22 per barrel over February.

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Chart Constituents

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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- The value of Gilts, bonds, and other fixed income investments including unit trusts can go down as well as up and you may not get back the amount you have invested.
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- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
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