Markets Monthly

19 March 2021

Yields keep lifting and NZ sharemarket struggles on

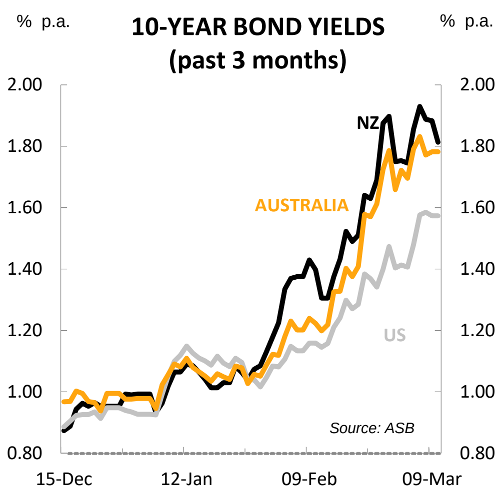
Two key themes in financial markets have continued to assert themselves over February and the beginning of March: rising long-term yields and sharemarket volatility.

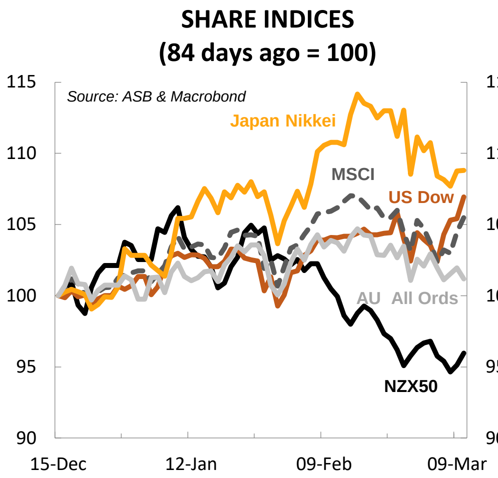
With the global economic outlook steadily improving and inflation expectations rising, speculation has continued to mount around when central banks will begin to contemplate rate hikes and the bond market has felt the influence. With the NZ economy outperforming many of its peers, the NZGB 10-year yield has continued to lift higher than its Australian and US equivalents, moving back towards 2% for the first time since early 2019.

Central banks are wary of yields lifting faster than is desirable, and generally kept a dovish tone through the month. To that end, the RBNZ kept the OCR unchanged on 24th February. The RBNZ is expected to remain on hold over the course of 2021. But financial markets are pricing in the probability of a rate hike in 2022.

International sharemarkets were volatile but overall positive in February. The MSCI of world shares up 2.5% in USD terms. In early March, many US and European sharemarket indices traded at all-time highs, though there was some tech-induced volatility on the Nasdaq. **By contrast, the New Zealand sharemarket continued to underperform over February.** The NZSE 50 benchmark slipped circa 10% from its early January record high. Over recent weeks the local sharemarket has been more buoyant, and the NZSE 50 index has recovered to trade around 7% off its peak at the time of writing.

In currency markets, the NZD was strong over February, supported by the prospect of higher relative interest rates and whopping commodity prices. The NZD gained 3% against the USD and 2.4% on a trade-weighted basis. The AUD has showed similar strength, leaving NZD/AUD little changed over the month.





For the latest performance information on ASB's funds click [here for ASB KiwiSaver Scheme](), click [here for ASB Investment Funds](). More information on [ASB Securities is here.]()

Chris Tennent-Brown – (649) 301 5915 chris.tennent-brown@asb.co.nz

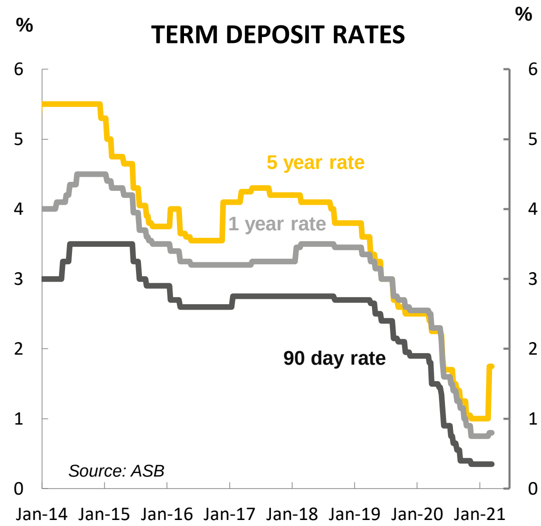
Please refer to the important disclosures at the end of this document.

Date		28-Feb-21	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	0.25	0.00	0.00	-0.75	-2.25
	NZ 90-day bank bill	0.31	0.02	0.06	-0.75	-2.26
Fixed	NZ 5-year gov't stock	0.70	0.29	0.41	-0.16	-1.75
Interest	NZ 10-year gov't	1.90	0.77	1.05	0.84	-1.06
	AUS 10-year gov't	1.79	0.70	0.89	0.93	-0.61
	US 10-year gov't	1.47	0.43	0.64	0.21	-0.27
Australasian	NZ - NZX50 Capital (NZ$)	5119	-6.9%	-4.5%	6.2%	65.3%
	- NZX50 Gross (NZ$)	12227	-6.9%	-4.2%	8.6%	96.2%
Equities	AUS - All Ords (A$)	6941	1.0%	2.9%	6.6%	40.3%
International	JAP - Nikkei (¥)	28966	4.7%	9.6%	37.0%	80.7%
Equities	UK - FT100 (£)	6483	1.2%	3.5%	-1.5%	6.3%
	US - S&P500 (US$)	3811	2.6%	5.2%	29.0%	97.2%
	WORLD - MSCI (US$)	2727	2.5%	5.6%	27.4%	76.3%
	- MSCI return in NZD		-0.5%	0.7%	8.1%	57.4%
Exchange	NZD/USD	0.7364	3.0%	4.8%	17.8%	12.0%
Rates	NZD/AUD	0.9373	0.1%	-1.4%	-2.0%	1.7%
	NZD/JPY	78.12	4.5%	7.0%	14.4%	4.9%
	NZD/GBP	0.5266	0.9%	0.0%	8.4%	11.0%
	NZD/EUR	0.6055	2.4%	3.2%	6.4%	0.6%
	NZ TWI	76.13	2.4%	2.9%	8.7%	5.9%

Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ. Source ASB, Macrobond.

Income Assets

Cash



Term deposits hadn't changed since mid-November 2020, but some of the longest terms finally nudged in a favorable direction for savers over the past month. The better-than-expected performance of the economy over recent months has significantly reduced the likelihood that New Zealand interest rates will get lower, as we speculated about in 2020, and in fact, now we are seeing longer term interest rates starting to lift.

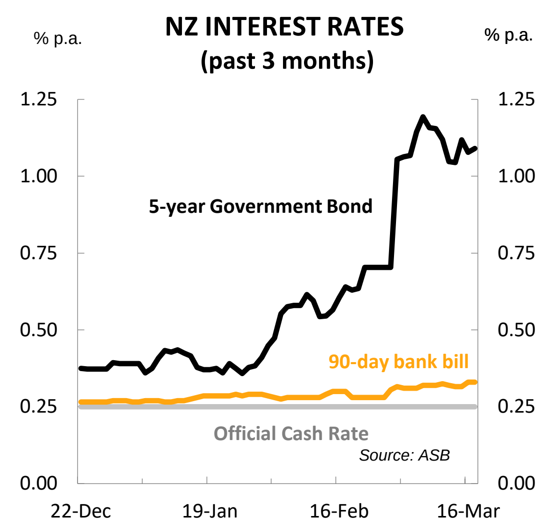
At the time of writing, ASB's term deposit interest rates for amounts over $5,000 are largely between 0.35% and 0.80% for terms between 90 days and 1 year, and between 1% and 1.75% for terms between 18 months and 5 years. Although the lift this month could be a turning point, rates are still incredibly low. Term deposit interest rates have averaged around 2% to 3% higher than the current rates available for the various terms over the past 10 years. **Furthermore, term deposit returns are still expected to remain low relative to historical averages over the year ahead.**

For the popular term deposit rates – short terms up to 1 year – a key influence is what the RBNZ does with the Official Cash Rate (OCR). Our review of the RBNZ's February meeting is here. In our view, the most likely course for the OCR is that the RBNZ holds it steady over 2021 and early 2022. Then we expect the RBNZ to gradually lift the OCR over several years, with the OCR only 1% higher than it is today in 2024. Over this time term deposit rates should lift, but by a similar modest amount. **Still, we continue to emphasize the uncertainty around the outlook: if the economy struggles again, the OCR could get cut lower than the current 0.25% setting**. We are hopeful that won't transpire, but the surprise weakness in NZ's recent Q4 GDP is a reminder of the risks to our nascent recovery.

You can read more in our Term Deposit report, and the ASB term deposit rates can be found here.

NZ Fixed Interest

NZ Government bond yields continued to press higher February, extending the lift from the late September 2020 lows. Back in September, the 5-year yield went negative, and the 10-year yield dipped below 0.5%. The 5- and 10-year yields have recently traded well over 1% higher than last year's lows, at around 1.2% and 1.9% respectively.



This lift in yields is not unique to NZ. Yields are also rising off last year's lows in key offshore markets as improved economic growth prospects and the associated inflation expectations are priced into investment decisions. NZ market pricing of instruments such as overnight index swaps and the 1- and 2-year swap rates are consistent with the RBNZ lifting the OCR sometime next year. **This timing implied by wholesale interest rate pricing may be premature, but the upward direction of yields makes sense, given the improving economic outlook and data flow over recent months.**

However, the RBNZ and other central banks continue to talk about maintaining extremely supportive policy settings via low cash rate settings and asset purchases, and that is anchoring short-term fixed interest yields. But long-term local yields have shifted higher, leading to a significant steepening of the interest rate curve (i.e., long term yields are lifting by a lot more than the shorter-term yields). The RBNZ's bond purchases will continue over the year ahead, and keep a cap on government bond yields, albeit probably not as low as they were last year. Corporate bond yields have also been on the rise, but the improving economic prospects and confidence in the outlook has kept credit spreads tight.

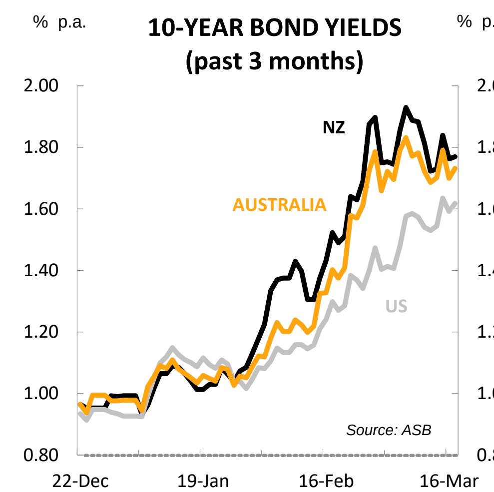
The yield lift on government and corporate bonds over Q4 2020 and early 2021 has led to a drop in the capital value of bonds (particularly longer-dated issues), and negatively impacted portfolio returns over recent months.

International Fixed Interest

Rising long-term yields remains the main story in global financial markets, and long-term government bond yields have been lifting higher over the past month. Meanwhile, central bankers are keeping shorter-term yields low by maintaining their respective record-low target rate settings and sounding as dovish as possible when talking about the outlook.

The US 10-year yields rose a whopping 43 basis points over February, and at the time of writing is trading with a yield around 1.6%. That's over 100 basis points or 1% above the lows set last year. The lift over the last quarter means long-term yields in the US are up over a 12 month period, and this will have dented global bond portfolio valuations.

The yield on the Australian 10-year yield rose 70bps over the month, and 89bps over the past three months, to be up 93bps on a year ago. The RBA continues to expect that the cash rate will remain around current settings for the next three years, and continues to anchor the 3-year yield in Australia at 0.1%.



Yields on soveriegn bonds in Europe are mostly lower than Australasia and the US, but have also lifted off last year's lows, and continue to trade at or near the near the top of the ranges over the last three months. 10-year yields remain negative in France, Germany, the Netherlands and Switzerland, but have been lifting towards zero.

UK yields have also lifted, with the 10-year yield near 0.82% at the time of writing, while Japanese 10-year yields have lifted from near zero to 0.11%.

Growth Assets

Asset	Index	28-Feb-21 Level	Month %	Quarter %	Year %	5-Year %p.a.
			Change			
Equities	NZ - NZX50 Capital (NZ$)	5119	-6.9%	-4.5%	6.2%	10.6%
	- NZX50 Gross (NZ$)	12227	-6.9%	-4.2%	8.6%	14.4%
	AUS - All Ords (A$)	6941	1.0%	2.9%	6.6%	7.0%
	All Ords in NZD	7405	0.9%	4.5%	8.8%	6.6%
	JAP - Nikkei (¥)	28966	4.7%	9.6%	37.0%	12.6%
	UK - FT100 (£)	6483	1.2%	3.5%	-1.5%	1.2%
	US - S&P500 (US$)	3811	2.6%	5.2%	29.0%	14.6%
	WORLD - MSCI (US$)	2727	2.5%	5.6%	27.4%	12.0%

Australasian Equities

Australasian equities have had a mixed start to the year, with the Australian market posting gains over the nearly complete first quarter, while the NZ market has been on a slide. Having set an all-time high in early January, the New Zealand sharemarket was down by over 10% at one stage. Over the month of February, the NZ market declined 6.9%, while the Australian market continued to lift. A more buoyant period in March for NZ shares has the NZ sharemarket trading around 7% off the January highs at the time of writing. Meanwhile the Australian market is around 2% off its peak, and global share indices are similarly buoyant, with the MSCI index of world shares trading within 1% of its all-time high at the time of writing.

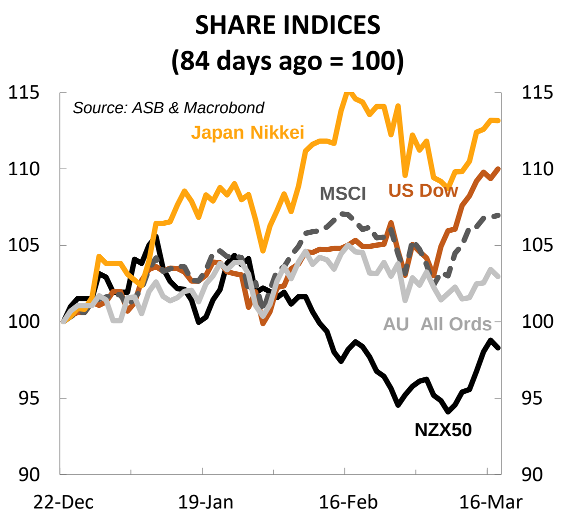
There are several factors behind the local sharemarket's underperformance this year. **As we mentioned in this report last month, one part of the divergence of the local market's performance this year has been a function of the strong performance of NZ shares in late December and early January.** An influence over this time was the interest in clean energy stocks that drove up the share prices of Contact Energy and Meridian. In February, we saw this lift unwind. Furthermore, the global economic recovery is positive for financials and natural resource companies, which represent close to 50% of the Australian market, but a very small part of the local market – strength in these two sectors is a factor behind the Australian market's outperformance. Australian company earnings were better than expected in the latest earnings results for H2 2020, with improved margins leading to better-than-expected earnings per share growth. Rio Tinto was up 15.3% over February, with the size of its latest dividend catching the market by surprise. Rio's declared final dividend of US$4.02 per share was 24% ahead of market expectations.

The local market includes several "defensive" stocks which pay good dividends that have benefited from both solid earnings and elevated investor interest at a time of low interest rates. The "Gentailers" (companies that generate and sell electricity), and other defensive stocks in the local market have been sensitive to the change in the interest rate expectations this year. You can read more in last month's report. New Zealand's company results were still good but somewhat lackluster compared to Australia in the latest reporting season. A profit warning from a2 Milk was one result that impacted both the company and index performance. Fisher and Paykel Healthcare has also given up some of its earlier gains due to the positive global vaccination developments but is back trading above $31 per share at the time of writing, having dipped towards $27 in early March.

International Equities

The MSCI index of world shares was down 1.1% in USD terms in January but recovered in 2.5% February. That strength has continued into March, and the with the MSCI index of world shares trading within 1% of its all-time high at the time of writing. **However, sharemarkets have been volatile at times, as investors respond to the rapid lift in long-term yields taking place in bond markets.**

Nonetheless, over the month the US Dow Jones index rose 3.2%, and the S&P 500 index rose 2.6%, while the NASDAQ index rose a more modest 0.9%. In March the Dow and S&P 500 indices have pressed on to fresh highs.



The rapid rise in bond yields rattled investor sentiment with mega-cap growth technology shares slumping in late February. That slump left the NASDAQ down over 10% at one stage. Although the tech-heavy index has recovered some ground, at the time of writing the NASDAQ is still around 4% off the highs set in mid-February.

In Europe, the German DAX index lifted 2.6% and the UK FTSE rose 1.2% over February. Japanese shares outperformed in February, with the Nikkei index up by 4.7% over the month.

ASB Securities has more information on sharemarkets and trading [here.](#)

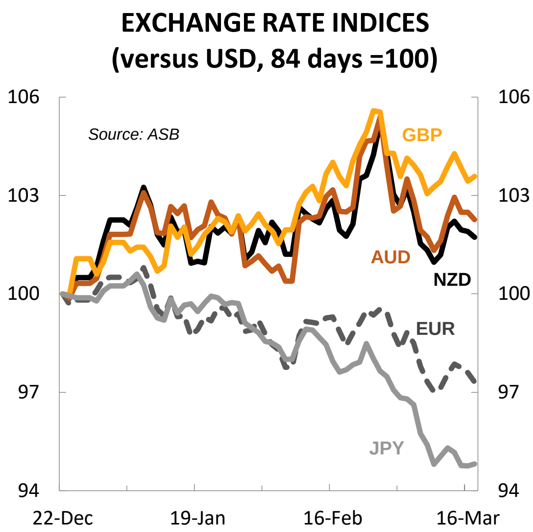
Exchange Rates

The NZD largely appreciated over February, gaining 3% against the USD, and 2.4% on a trade-weighted basis. The improving global growth outlook and reduced expectations for additional RBNZ rate cuts supported NZD.

Local data, including a lower-than-expected unemployment rate also supported the sentiment and the NZD during February. The NZD traded above 0.7400 vis-à-vis the USD late in the month but has eased to below 0.7200 during March.

The AUD also lifted 2.4% on a trade-weighted basis over February and has been following a similar pattern to the NZD recently. The upshot is the NZD/AUD cross rate has been trading in a tight range around 0.9300 over recent months.

More information about currencies is available in ASB's weekly economic report which can be downloaded here.



ASB Economics & Research

			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets