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February 2022 Market Commentary

MARKET REVIEW

The month of February was a busy period of news and events for the market. And, frankly, after all said and done the Australian share market held up reasonably well given some of the news coming from overseas, specifically the news on Russia & Ukraine war and consequently soaring prices of not just oil, coal, and gas but across the full commodities' complex.

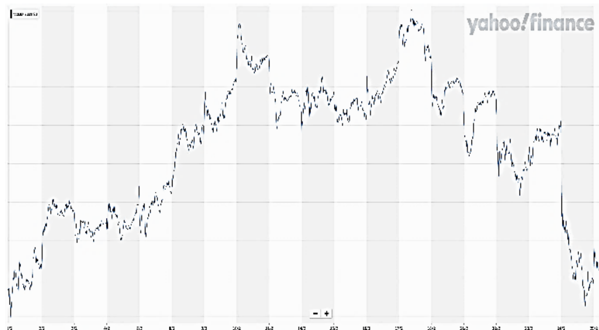

Chart: Yahoo Finance

The Australian share market as measured by the ASX200 index started the month of February at 6,971 points and ended the month slightly ahead at 7,049 as illustrated by the chart above.

February was also a busy month for the Australian stock exchange listed companies as they reported their full year or half year result to 31 December 2021. Many companies reported that the next 12 to 18 months are going to be challenging as they try to absorb higher costs due to rising energy costs, higher wages bill, and range of other imported materials that are now 20-30% more expensive than even a year ago. The challenge for most companies is to protect their profit margins by passing on the higher costs to their customers by raising the prices of goods and services they are selling. Customers don't always absorb higher prices!

Positively though, a lot of large companies ranging from the banks, insurers, to telcos such as Telstra and consumer staples companies such as Woolworths and Coles are operating large, efficient, and monopoly like businesses who do have considerable power over their customers to pass on higher costs by raising their prices. We have noticed exactly that recently with Telstra which has used its strong market position in mobile phone communication business where it has raised prices by 10% in some cases with customers having little option but to absorb the price rises. Similarly, insurers such as IAG and Suncorp reported hiking the insurance premiums by around 7% to protect the higher cost of claims due to fires and floods over the past 12 months. The story is similar for a lot of other large companies. The smaller companies on the other hand will have a harder time raising prices as they face greater competition and are more susceptible to profit margins being squeezed due to higher costs.

The other very topical issue in the market right now is how should the investment portfolios be positioned right now in the rising interest rate environment. Investors should be cautious of being in government bonds as they tend to experience a certain negative return when interest rates move up considerably. The market is expecting the official interest rate to be 1.5% by this time next year, this is what the market is expecting but it may or may not come to pass. The Reserve Bank of Australia remains more measured in lifting the cash rate and so far, it is holding out. Certainly, the latest consumer confidence surveys are showing easing of the sentiment which may take the urgency out of raising rates. Time will tell. But if interest rates don't rise to expectations then in that case maintaining some exposure to bonds in portfolios is justified as they will come back in favour then. The other place to invest for yield in a rising interest rate environment is listed hybrids which

pay coupon payments based on floating (variable) interest rates, so as rates rise they should also offer higher interest payments to investors.

We do continue to believe that the likelihood of interest rates going back up to the levels of 15 years ago remains low when you could invest in a bank deposit and earn 5% p.a. The hunt for yield will likely continue across asset classes and beyond the fixed income asset class. Investors will continue to augment their income by investing in asset classes higher up the risk curve such as property, infrastructure and dividend paying stocks. On the mention of dividend paying stocks, it was observed in this reporting season that the ASX listed companies remain very tuned in to Australian investor's need for dividends. And broadly speaking, companies did not disappoint with most either maintaining their dividend payment, some increasing the dividend and or giving pretty comforting outlook for continuing their dividend payment regime in the future.

So, what does this mean for investors? Investors should continue to hold diversified portfolios customised for their individualised financial objectives and goals. The ultimate goal of all investment portfolios is to maintain or grow your savings and harvest income to support you when you need it. A diversified investment portfolio should provide you that by giving you exposure to Australian shares, international shares, government bonds and/or hybrids, high quality property & infrastructure assets and other alternative investment options. To help you decide where and how much to invest under each of the asset classes is the job of a professional and experienced advisor.

MOVERS FOR THE MONTH

Top 10 Monthly Contributors

ASX 200		Performance		
Stock	Ticker	1mth perf	6mth perf	1yr perf
CIMIC GROUP LTD	CIM	34.8%	4.4%	3.8%
SIMS LTD	SGM	28.1%	20.1%	35.2%
SILVER LAKE RESOURCES LTD	SLR	25.9%	34.5%	27.6%
PERSEUS MINING LTD	PRU	25.4%	17.7%	56.7%
SOUTH32 LTD	S32	24.9%	53.2%	73.6%
NORTHERN STAR RESOURCES LTD	NST	24.4%	5.6%	1.0%
NUFARM LTD	NUF	23.1%	22.6%	14.2%
EVOLUTION MINING LTD	EVN	22.0%	9.2%	1.7%
WHITEHAVEN COAL LTD	WHC	19.8%	26.9%	111.2%
NEWCREST MINING LTD	NCM	19.1%	3.8%	4.2%

SHAKERS FOR THE MONTH

Bottom 10 Monthly Detractors

ASX 200		Performance		
Stock	Ticker	1mth perf	6mth perf	1yr perf
BORAL LTD	BLD	-38.2%	-40.5%	-29.9%
LIFE360 INC-CDI	360	-36.6%	-42.8%	19.5%
NOVONIX LTD	NVX	-32.9%	11.3%	70.5%
TYRO PAYMENTS LTD	TYR	-31.5%	-58.5%	-49.0%
ZIP CO LTD	Z1P	-30.1%	-67.6%	-78.8%
TELIX PHARMACEUTICALS LTD	TLX	-27.2%	-27.2%	29.0%
APPEN LTD	APX	-27.2%	-34.8%	-58.1%
POINTSBET HOLDINGS LTD	PBH	-27.0%	-65.8%	-74.1%
IMUGENE LTD	IMU	-24.2%	-43.4%	135.0%
POLYNOVO LTD	PNV	-23.7%	-55.2%	-58.5%

GLOBAL MARKETS OVERVIEW

	Units	Month End Value	Price Performance (% Chg) 1-day	1-mth	6-mths	1-year
Developed Markets Equities						
ASX 200	AUD	7,049	0.73%	1.11%	-6.45%	5.6
ASX 200 Futures	AUD	7,023	1.02%	2.26%	-4.84%	8.9
Dow Jones	USD	33,893	-0.49%	-3.53%	-4.15%	9.5
S&P 500	USD	4,374	-0.24%	-3.14%	-3.29%	14.
Stoxx Europe 600	EUR	453	-0.09%	-3.36%	-3.77%	11.
FTSE 100 (UK)	GBP	7,458	-0.42%	-0.08%	4.76%	15.
DAX (Germany)	EUR	14,461	-0.73%	-6.53%	-8.68%	4.8
CAC (France)	EUR	6,659	-1.39%	-4.86%	-0.32%	16.
Nikkei 225	JPY	26,527	0.19%	-1.76%	-5.56%	-8.4
Emerging Markets Equities						
MSCI Emerging Markets	USD	1,171	-0.06%	-3.06%	-10.50%	-12.
Shanghai Composite	CNY	3,462	0.32%	3.00%	-2.30%	-1.3
South Korea	KRW	2,699	0.84%	1.35%	-15.63%	-10.
Taiwan	TWD	17,652	0.00%	-0.13%	0.93%	10.
Brazil	BRL	113,142	0.00%	0.89%	-4.75%	2.8
South Africa	ZAR	69,624	2.81%	2.66%	14.06%	14.
Foreign Exchange						
AUDUSD	Currency	0.7263	0.51%	2.77%	-0.72%	-5.7
AUDGBP	Currency	0.5412	0.38%	2.97%	1.76%	-2.1
AUDEUR	Currency	0.6473	0.87%	2.91%	4.49%	1.4
AUDCNY	Currency	4.57	0.07%	1.64%	-3.17%	-8.9
Commodities						
LME ALUMINUM 3MO ($)	USD/mt	3,369	0.33%	11.50%	23.93%	56.
LME COPPER 3MO ($)	USD/mt	9,884	0.11%	3.97%	3.82%	8.8
LME NICKEL 3MO ($)	USD/mt	24,282	-0.32%	8.75%	24.22%	30.
SILVER FUTURE May22	USD/oz	24.37	1.45%	8.62%	1.11%	-8.4
ICE Newc Coal Fut Apr22	USD/mt	251.50	13.83%	38.22%	88.67%	208.
62% Import Fine Ore in USD	USD/t	122.92	0.00%	-7.23%	-19.73%	-25.
Gold Spot $/Oz	USD/oz	1,909	1.04%	6.22%	5.26%	10.
WTI Oil	USD/bbl	95.72	4.51%	10.67%	44.11%	72.
Henry Hub	USD/mmBtu	4.30	-5.53%	-22.33%	-0.81%	63.
Corn	USD/Bu	697.50	5.76%	11.42%	30.62%	25.
Wheat	USD/Bu	928.00	10.08%	21.90%	31.31%	41.
Fixed Interest						
10-Yr Bond Yield						
Australia	AUD	2.14%	-0.10%	+0.24%	+0.98%	+0.
US	USD	1.83%	-0.14%	+0.05%	+0.52%	+0.
Germany	EUR	0.14%	-0.10%	+0.12%	+0.52%	+0.
Japan	JPY	0.19%	-0.02%	+0.01%	+0.17%	+0.
Italy	EUR	1.71%	-0.13%	+0.41%	+1.00%	+0.
Australian Rates						
Cash Rate	AUD	0.10%	+0.00%	+0.00%	+0.00%	+0.
90-Day BBSW	AUD	0.08%	-0.00%	+0.00%	+0.06%	+0.
180-Day BBSW	AUD	0.26%	-0.01%	+0.01%	+0.23%	+0.
CBOE Options						
CBOE VIX (Volatility Index)	Index	30.15	9.28%	21.43%	82.95%	7.8

Data as of 28 February 2022

ECONOMIC NEWS

Reserve Bank of Australia's (RBA) decided to keep its cash rate at the record low of 0.1%, while highlighting Ukraine war poses upward risk to inflation. The bank did upgrade its expectation of inflation to reach 3% p.a. in the months ahead for the first time since 2010, before settling around 2.75%

through to mid-2024. The unemployment rate is expected to continue falling to around 3.75% by the end of 2023. The RBA is expecting the wage pressure to build up only gradually with wage price index expected to advance to 2.75% p.a. in 2022, then edge up to 3% p.a. over 2023.

Over in the U.S., its central bank's (Federal Reserve) chairman Jerome Powell said the U.S. economy is expanding with enough force to withstand rate hikes, noting he's inclined to back a 0.25% rate hike in March and is open to "series of rate increases" in 2022. This is despite research by the same bank showing maximum employment in the U.S. will remain out of reach for now. The two key U.S. labour-market metrics, the labour-force participation rate and the employment-to-population ratio, may take until 2024 to recover to their pre-pandemic growth trend. Aging population is gradually taking people out of employment participation and thus keeping both survey series well below trend.
US manufacturing and business activity advanced in February and consumer sentiment improved but held at a decade-low as inflation concerns remained elevated. Consumers are now expecting an inflation rate of 5% p.a. over the next year, up from last month's reading of 4.9% p.a., the highest since 2008.

While in South East Asia manufacturing activity advanced in February, with manufacturing PMI of China, Vietnam and Malaysia improving from prior month. Thailand's index rose to a record, and Philippines rebounding to highest in three years.

In Australia, the private sector output and demand expanded to an eight-month high in February as a receding coronavirus wave helped lift demand. However, inflation rose +3.5% p.a. as reported in February, the largest yearly increase since April 2011. Inflation here is being driven by rising prices in private motoring and new dwellings, which increased +2.2% p.a. and +1.1% p.a., respectively.

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In Europe, the European Central Bank (ECB) kept deposit rate unchanged at -0.5% p.a. However, the European Union (EU) downgraded euro-area economic (GDP) growth forecast for 2022 by -0.3% p.a. to +4% p.a. and upgraded 2023 forecast by +0.3% to 2.7% p.a. It is predicted that all EU member-states will have reached pre-pandemic levels of GDP by the end of 2022, while upgrading Consumer Price Index (CPI) forecast for 2022 by 1.3% p.a. to 3.5% p.a. and then expecting it to slow down in 2023 to 1.3%, below ECB's 2% target.

United Kingdom's Central Bank (BOE) raised its key interest rate by +0.25% to 0.5% p.a. and signalled it would start selling down its previously purchased stash of bond holdings in an effort to push up the bond rates and slow down inflation. Inflation in the U.K. is growing at the fastest pace seen in three decades, predicting inflation will peak at 7.25% p.a. in April vs prior forecast of 6% p.a., more than triple the BOE's 2% p.a. target. The Chancellor of the Exchequer Rishi Sunak also announcing a GBP 9bn program to help consumers shoulder rising energy bills. The U.K. economy expanded at the fastest pace (+7.5%) since World War II in 2021 after suffering a milder hit than expected in December, making Britain the fastest-growing advanced economy in 2021.

Over in India, its central bank (RBI), in a surprise move, stuck to its dovish tone (i.e. not raising interest rates) to ensure economic recovery remains well supported. The RBI is predicting economic (GDP) growth to slow to 7.8% p.a. in 2022 and lowered the inflation outlook to 4.5% p.a. over 2023 from 5.3% p.a. this year.

In political news:

Geopolitical tensions flared up after Russia started invading Ukraine and set his nuclear arsenal on a "special regime of high alert combat duty", leading to U.S. and allies announcing a new tranche of sanctions on Russia, including targeting Russia's sale of sovereign debt abroad, an asset freeze on major banks and cutting off various Russian banks from the critical SWIFT financial messaging system.

THE LONG READ

CLIMATE'S CREDIT SIDE

Your portfolio, as well as the environment, can benefit from tougher carbon emission regulations

We recently spent some weeks conducting webinar sessions with investors sharing our view of how the long-touted risk of climate change is no longer a perceived risk but is becoming a living reality.

Fourteen of the 15 hottest years since record keeping began over 130 years ago have been since the year 2000. The intensity of extreme weather-related events has also increased. Reports from the Inter-governmental Panel on Climate Change (IPCC) and other similar bodies paint a dire picture of the consequences for us all if we don't stop the rise in global temperatures. The dangerous effects of hotter climate are already showing up in agriculture, water resources, ecosystems, human health, and economic losses.

I am not sure if you have noticed but the heat during peak summer, on real hot days, is becoming physically unbearable here in Australia. Researchers from Harvard University recently spoke of how heat is the silent killer and is already becoming extremely dangerous to public health. On the other hand, the record-breaking rainfall on the east coast of Australia in February and March so far has devastated the affected communities. Some forecasts are suggesting the heavy rains could continue for months; these are all signs that climate change is happening.

So, what is the solution? The solution is that we stop pushing up more and more greenhouse gasses (GHG), mainly CO2 (Carbon Dioxide) and CH4 (Methane), into the atmosphere and come up with a plan to take out the molecules from the atmosphere that we have already sent up.

The GHG molecules that we have already blown up into the atmosphere, due to our fossil fuel powered energy consumption over at-least the past century, has locked-in Earth to warm by 1.5 degrees Celsius by the year 2050. This doesn't sound much of an increase, but in reality, it will lead to even more of the serious issues I mentioned earlier. But wait there is more; since we humans are showing very slow progress to reduce our consumption of coal, gas, and oil anytime soon, the climate modelling suggests that earth's average temperature will rise an additional 2-4 degrees Celsius within this century.

Allow me to now turn our attention to a tool that will become essential to tackling the climate change emergency. My base case at the moment is that high GHG emitting industries and countries are not going to pivot their activities to the renewables fast enough in the coming decades. To deal with these laggards the progressive countries around the world will increasingly unify, stirred by the science and rising incidents of climate catastrophes, to impose carbon pricing mechanisms on high emitters.

The delays in energy transition will inevitably raise the cost of the transition and make it more disruptive. There are several paths governments can take to price carbon, all leading to the same result i.e. to bring GHG emissions under control. Carbon pricing mechanisms can capture what are known as the external costs of carbon emissions borne by the general community instead of the emitters specifically – these are costs that the public pays for in various ways, such as damage to crops and property from droughts or the floods, health care costs from heat waves, dislocation of communities from rising sea levels. The idea, thus, of carbon pricing is to package up these costs in a carbon price and apply directly on the true sources of emissions i.e. the emitters.

Essentially, a price on carbon helps shift the burden for the damage back to those who are responsible for it, and who can reduce it. The carbon price also stimulates investment in clean technologies and market innovation, fuelling new, low-carbon drivers of economic growth.

By way of a background, there are two main types of carbon pricing models: emissions trading systems (ETS) and carbon taxes. An ETS – also referred to as a cap-and-trade system – caps the total level of greenhouse gas emissions and allows those industries with low emissions to sell their extra allowances to larger emitters. The cap ensures that there is overall reduction of GHG at the country and industry level.

On the other hand, a carbon tax directly sets a price on carbon by defining a tax rate on greenhouse gas emissions or on the carbon content of fossil fuels. It is different from ETS in that the emission reduction outcome of a carbon tax is not pre-defined but the carbon price (tax) is. So, the higher you tax the carbon emissions the quicker the emitters will reduce their emissions.

There are around 40 countries and 20 cities, states and provinces that have introduced carbon pricing mechanisms, with more planning to implement them in the future. For investors this represents an opportunity to think about positioning their portfolios in sides of the economy that will be net producers of carbon credits and reduce risks to those who will be in the deficit as the price paid for their emissions will be an additional cost for them to bear, thus reducing the economics of their activity.

This document is produced in conjunction with our research partner Banyan Tree Investment Group. The information contained in this report is for general information only, it does not take into account an investor's needs or objectives. You should not undertake any investment decisions without first contacting your adviser.

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