Market and Economic Review
March 2021

You can't keep a good yield down

It's rare that government bond markets attract widespread attention, primarily because they are typically sedate investments. But the sharp falls in government bond prices last month has implications for assets of all stripes, so investors should take notice. Falling bond prices are the markets' way of determining that governments should pay higher interest rates (known as bond yield) to borrow going forward.

The interest rate on NZ government bonds with 10yrs to maturity leapt from around 1% in January to as much as 1.9% during February, echoing similar moves in other global bond markets. The NZX 50 share market's almost 7% plunge in the month was partly related to this bond market move.

Higher interest rates make shares with high dividends relatively less attractive, sending utility and property company share prices lower. Fast growing company share prices also suffer as higher interest rates diminish the value of long term cashflows. This saw the share prices of growth companies fall in February, including Fisher & Paykel Healthcare (-15.6%) but also the large US technology companies.

The rapidly improving global economic picture is behind the rise in bond yields, i.e. they are reflecting expectations of strong economic growth over the next few years. This 'good' rise in yields also reflects an improving outlook for cyclical companies and diversified financials such as banks, areas we have been adding to recently. Barclays Bank in the UK (+20.3%) and Rio Tinto (+15.3%) are just two examples of these last month.

The chance of higher government bond yields has been on our radar for a while. In addition to stock selection, we have been reducing exposure to government bond markets across many of our funds. Nonetheless, given the sharp falls in bond markets, it is the lower risk funds that have seen some negative returns last month (lower risk funds tend to hold more bonds). Individual fund commentaries provide further detail on how each fund has managed the risks.

We remain constructive on the outlook. Further increases in bond yields and moderately expensive valuations will likely constrain broad returns from shares but provide plenty of opportunity to position in companies best placed to capture the improved growth ahead.

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