nikko am
Nikko Asset Management

Factsheet 28 February 2021

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- February was a difficult month for financial markets especially in New Zealand bond and equity markets - both delivering negative returns. Global markets performed better however still delivered negative returns to investors.
- The United States S&P 500 index and the Japanese Nikkei 225 index both gained 1.9%, the UK FTSE 100 index gained 2.5%, the Australian ASX 200 index added 1.6% and the MSCI World index ended the month up 1.7%. The S&P/NZX 50 index was a stand-out exception falling 6.9% for the month.
- With interest rates rising, short and medium term bonds were the best performers in the fixed income sector. After long term bonds out performing shorter term bonds for most of 2020, long bonds performed poorly again this month.

Fund Highlights

- The fund delivered a negative return for the month despite strong returns from some of the fund's equity holdings. Unfortunately this was not enough to compensate for the electricity sector which all fell by 10% or more. Interest rates increased over the month with the largest movements occurring in longer maturities, the fixed income sector posting negative returns with the option fund return being between the returns of the bond and equity sectors.

Distributions

- The defined distribution rate (which is used to calculate the distribution you receive from the fund) will be set at the start of each calendar year, based on the price of the fund at that point.
- The defined distribution rate for 2021 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2021.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	-3.91%	-0.67%	1.88%	2.32%	2.94%	4.86%
Benchmark[2]	0.25%	0.79%	4.30%	5.39%	4.83%	7.38%

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).
2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.

Portfolio Manager

Fergus McDonald,

Head of Bonds and Currency

Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

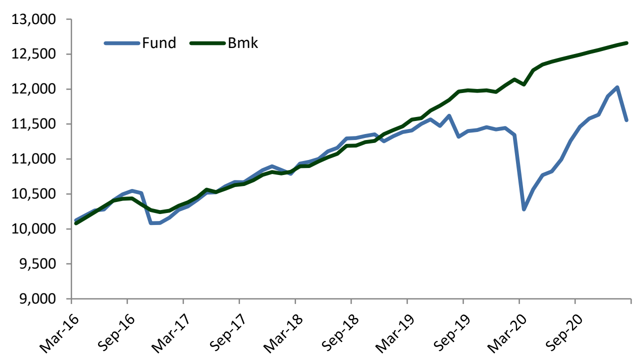
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

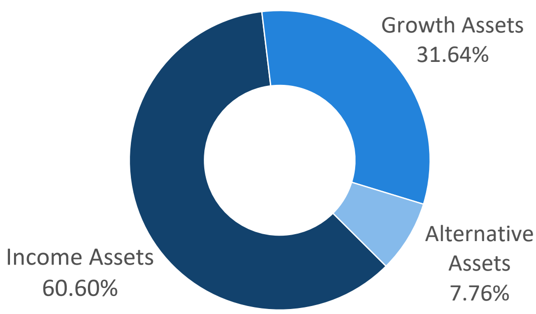
Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00 % p.a. over a rolling three year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July these were amended to include equities.

Five Year Cumulative Performance, $10,000 invested[1,2]



Asset Allocation



Top 5 Fixed Income Issuers*	(%)
Nikko AM Option Fund	7.76%
NZ Local Govt. Funding Agency	7.39%
Kiwibank Ltd	4.76%
Infratil Ltd	3.77%
Liberty Finance	3.58%

*Aggregation of directly held assets and Option Fund

Top 10 Equities	(%)		(%)
Heartland Group	3.22	Chorus Limited	2.21
Stride Property Ltd	3.00	Argosy Property	2.12
Skellerup Holdings	2.85	Mercury Energy	2.10
Works Finance	2.48	Scales	2.05
Spark	2.27	Investore Property	1.92

Duration
Fund 5.02 years
Yield
Fund (gross) 2.51%
(applies to fixed income only)

Fund Commentary

February was a difficult month for financial markets especially in New Zealand bond and equity markets - both delivering negative returns. Global markets performed better however still delivered negative returns to investors.

Of the fund's holdings the equity returns of Skellerup and Heartland Group stand providing strong monthly returns of over 13% and 1.5% respectively on the back of strong operational results. Unfortunately this was not enough to compensate for the electricity sector which all fell by 10% or more with Meridian trailing the field. Meridian is the smallest equity exposure at 1.25% of the fund's assets. The market believes there is a likely large seller of particularly Meridian and Contact shares over the next month or so and are not keen to add to their positions just yet even though prices seem to be reaching attractive levels and dividends will continue to be paid. The fund has an exposure of close to 29% in equities in 13 names with a small additional holding in preference shares. The balance of the fund is held in fixed income securities and an 8% weighting to the Nikko Option Fund. Interest rates increased over the month with the largest movements occurring in longer maturities. This resulted in the fixed income sector posting negative returns with the Option Fund return being between the returns of the bond and equity sectors. With interest rates rising, short and medium term bonds were the best performers in the fixed income sector and in general higher yielding lower quality bonds outperformed higher rated securities. After long term bonds out performing shorter term bonds for most of 2020, long bonds performed poorly again this month. The Reserve Bank seems less convinced of the need to further lower the Official Cash Rate as the economic recovery is stronger than anticipated and many of the stimulatory programmes remain in place. Market participants have turned their attention to trying to pick when the RBNZ will start to raise interest rates, especially as global optimism for an economic bounce increases as vaccine programs are rolled out across a wider spectrum of the population.

Inflation increased more than market expectations and the unemployment rate surprised by falling below 5% - both of which are indicators that New Zealand's economic recovery is well entrenched. Additional lock downs and yo-yoing between alert levels however highlight the fact that risks to New Zealand's economic recovery remain. The Reserve Bank's Funding for Lending Programme (FLP) provides banks with low cost funding which should help keep lending rates low. With the Government and Reserve Bank focused upon reviving the economy to a robust state before thinking of removing stimulatory monetary policy settings we believe low cash rates will be with us well into 2022 or 2023 however longer term bond rates will be more influenced by global trends.

Banks have cut their term deposit rates and they are likely to remain low while the RBNZ keeps the cash rate at 0.25%. As mentioned above the banks may become less reliant on retail deposit funding over 2021 as they are able to borrow cheaply from the Reserve Bank if they wish to do so. In return the Reserve Bank will want to see some of this interest cost savings the banks enjoy being passed on to borrowers and in particular borrowers who want to invest in employment related activities.

With these dynamics at play we believe it is appropriate for investors to seek income from more diverse sources than just interest rates alone. Even though equity prices have fallen this month we continue to believe the environment remains attractive for the equity market. The bond sector of the fund is invested primarily in medium to longer duration assets. At present we are happy to have exposure to longer term assets as the Official Cash Rate looks increasingly likely to remain low over the next two years at least. The prospect of low cash rates and the RBNZ keeping downward pressure on longer term rates by buying bonds in the secondary market will likely keep a lid on the size of any future interest rate rises for many years to come.

Key Fund Facts

Distributions

Distributions for this fund are defined annually and are effective for the calendar year. The annual defined income rate for 2020 is effective on a pro rata basis from 1 July 2020 for the balance of the calendar year.

The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.

Estimated annual fund charges (incl. GST)

0.81%, refer PDS for more details

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread:	Strategy size	Strategy Launch
Click to view	$4.2m	October 2007

Compliance

The fund complied with its investment mandate and trust deed during the month.

Contact Us

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