

# Nikko AM NZ Bond Strategy

## Monthly Update 29 February 2024

Assets are held in the Nikko AM Wholesale NZ Bond Fund. The Nikko AM NZ Bond Fund (retail) invest in units in the wholesale fund, which the commentary refers to.

### Market Overview

- NZ bonds had flat to negative returns for the month as interest rates finished higher.
- Looking forward, for 2024 we expect bond returns will be supported by cash rate cuts later this year and longer rates moving lower.
- There has been plenty of NZ government bond supply, but little new credit issuance so far this year.

### Fund Highlights

- The fund had a flat to negative return for the month with longer maturity bonds underperforming shorter maturities as rates moved higher.
- We increased the fund's duration when rates spiked higher mid-month, which was helpful by month end.
- We like the higher yield of quality credit but are mindful government bonds have cheapened relative to swap rates and this may reverse.

### Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
<b>Wholesale<sup>1</sup></b>	-0.26%	2.29%	6.13%	-0.57%	1.31%	3.68%
<b>Benchmark<sup>2</sup></b>	-0.24%	1.97%	4.77%	-1.48%	0.05%	2.64%
<b>Retail<sup>3</sup></b>	-0.31%	2.13%	5.49%	-1.19%	0.63%	2.92%

1. Returns are before tax and before the deduction of fees and including tax credits (if any).
2. Current benchmark: Bloomberg NZBond Composite 0+ Yr Index. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

### 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, Senior Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

### Overview

The fund aims to provide investors with regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

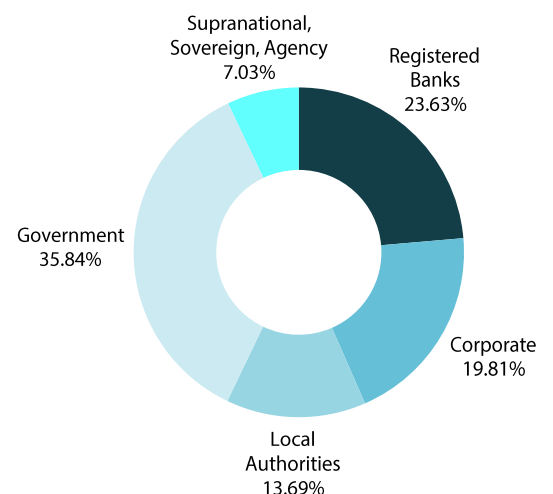
### Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

### Five Year Cumulative Performance, \$10,000 invested<sup>1,2</sup>



### Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
New Zealand Local Govt Funding Agency	9.74	AAA	61.17	23.00% of the fund
Housing New Zealand	6.83	AA	18.38	<b>Duration</b>
Kiwibank	6.01	A	16.88	Fund 5.46 years vs Benchmark 4.56 years
Westpac New Zealand	5.06	BBB	3.57	<b>Yield to Maturity*</b>
Bank of New Zealand	4.31			Fund (gross) 5.23% vs Benchmark 4.97%

\* Excludes NZ central government

\* Excluding the inflation component of government inflation linked bonds

## Market Commentary

Bond returns finished flat to marginally negative for the month as interest rates closed higher in yield. The move higher in yields was the main driver of absolute and relative returns. February was “a month of two halves” with interest rates around 40 bps higher mid-month, then retracing half this move by month end. Volatility in rates was heightened by differing views around the RBNZ February update and whether they would remain on hold or hike rates. We took the opportunity to add some longer maturity bonds at better levels extending the fund’s duration mid-month.

The syndication of the new NZ government 2054 bond weighed on the market, which is normal with rates moving higher before new supply. Something we have previously commented on is the anomaly that NZ government bonds have been trading at a margin above swap rates. As a result we have increased holdings of government bonds where appropriate. Credit holdings remain helpful providing a higher fund yield with margins stable, and to date there has been very little new issuance. Movements in government yields were 2yr +20 bps, 5yr +22 bps and 10yr +18 bps. For comparison swap maturities were 2yr +20 bps, 5yr +16 bps and 10yr +15 bps.

The RBNZ took a more balanced approach in their latest update and acknowledged conditions are likely restrictive enough to slow the economy and inflation, however this will still take some time. We are positive for the bond outlook for 2024 and over the next 12 to 18 months we have a high conviction that the ultimate direction in rates is lower, although there may be some bumps along the way.

We think it makes sense locking in higher rates for longer, but “keep some powder dry”. We don’t want to miss capital gains when rates fall, but keep in mind we need inflation lower for rate cuts. Also, longer maturity NZ bonds are highly correlated with moves in the US. We expect there will be opportunities to add value through duration when bonds are cheaper/or expensive in the range. Expectations are for plenty of government supply and NZ credit issuance in the next few months, so we will remain patient and add on cheapening moves.

## Fund Commentary

The fund had a modest negative return and performed in line with the Bloomberg NZ Composite benchmark. The move higher in yields was the main driver of absolute and relative returns. We did add some longer maturity bonds when yields spiked higher mid-February which benefited returns by month end. The fund has a moderate long duration with a view that the ultimate direction of rates is lower over the next 12-18 months. Our preference is to hold higher yielding quality credit, but we are mindful that NZ government bonds have become much cheaper relative to swap rates. NZ government bonds are approximately 2/3rds of the benchmark and we have marginally increased our holdings of NZ government bonds.

## Key Fund Facts

<b>Distributions</b>		<b>Hedging:</b>	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%	<b>Strategy Launch:</b>	October 2007
<b>Wholesale:</b>	Calendar quarter	<b>Exclusions:</b>	Controversial weapons	<b>Strategy size:</b>	\$545.1m
<b>Retail:</b>	Calendar quarter	<b>Restrictions:</b>	Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information, please refer to the Statement of Investment Policy and Objectives (SIPO) on our website <a href="https://www.nikkoam.co.nz/invest/retail">https://www.nikkoam.co.nz/invest/retail</a> .	<b>Buy / Sell spread:</b>	<a href="#">Click to view</a>
<b>Estimated annual fund changes (incl. GST)</b>					
<b>Wholesale:</b>	Negotiated outside of unit price				
<b>Retail:</b>	0.65%, refer PDS for more details				

## Compliance

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

## Contact Us

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