

Nikko AM NZ Bond Strategy

Monthly Update 31 March 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 a mixed quarter with January and February returns flat to negative, followed by a positive return for March.
- Looking forward we expect bond returns will be supported by cash rate cuts later this year and longer rates moving lower.
- It was a slow start for new issuance (ex-government bonds), however there were several corporate deals in March which were well supported.

Fund Highlights

- The funds had flat to negative returns for January and February with longer maturity bonds underperforming shorter maturities as rates moved higher. March was positive as rates moved lower.
- We increased the fund's duration when rates spiked higher over the quarter which was helpful for returns.
- We like the higher yield of quality credit but are mindful governments have cheapened relative to swap rates and this will likely reverse over time.

Performance

| | One month | Three months | One year | Three years (p.a.) | Five years (p.a.) | Ten years (p.a.) |
|------------------------------|-----------|--------------|----------|--------------------|-------------------|------------------|
| Wholesale¹ | 1.33% | 0.26% | 5.22% | -0.32% | 1.25% | 3.81% |
| Benchmark² | 1.11% | 0.25% | 3.95% | -1.31% | -0.03% | 2.76% |
| Retail³ | 1.24% | 0.09% | 4.54% | -0.95% | 0.57% | 3.05% |

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).

Five Year Cumulative Performance, \$10,000 invested^{1,2}



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.

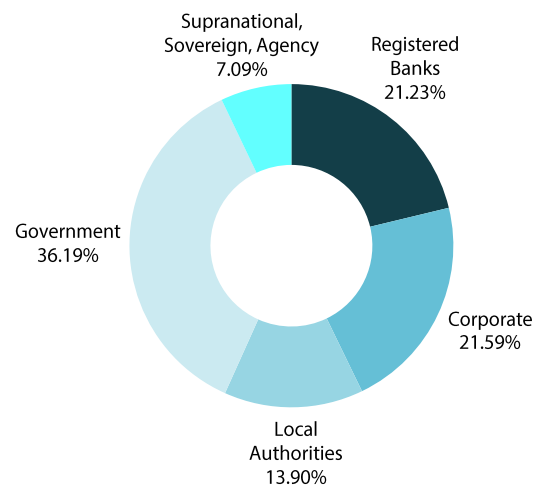
Overview

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.

Sector Allocation



| Top 5 Corporate Issuers* | (%) | Credit Quality | (%) | Green, sustainable and social bonds |
|---------------------------------------|-------|----------------|-------|--|
| New Zealand Local Govt Funding Agency | 10.14 | AAA | 62.81 | 23.49% of the fund |
| Housing New Zealand | 7.05 | AA | 13.67 | Duration |
| Kiwibank | 6.18 | A | 19.38 | Fund 5.48 years vs Benchmark 4.5 years |
| Westpac New Zealand | 3.37 | BBB | 4.14 | Yield to Maturity* |
| Bank of New Zealand | 3.24 | | | Fund (gross) 5.1% vs Benchmark 4.81% |

* Excludes NZ central government

* Excluding the inflation component of government inflation linked bonds

Market Commentary

NZ bonds had a mixed start to the first quarter. Yields finished higher in both January and February delivering flat to negative monthly returns, and then happily a positive return for March as yields moved lower.

Over the quarter moves in interest rates were the main driver of absolute and relative returns. Volatility in rates was heightened by differing views around the RBNZ's February update and whether they would remain on hold or hike rates. Over the quarter we took the opportunity to add some longer maturity bonds at better levels extending the fund's duration which benefited returns.

In terms of sector performance swaps performed better than similar maturities of government bonds which isn't surprising given the larger supply of government bonds. Over the quarter movements in government yields were 2yr +23 bps, 5yr +26 bps and 10yr +25 bps. For comparison swap maturities were 2yr +13 bps, 5yr +16 bps and 10yr +18 bps. It was a slow start for corporate issuance, but fortunately there were several new bonds issued in March which received strong support. Credit margins remain slightly tight which is consistent with offshore credit markets.

The RBNZ's February update acknowledged that conditions are likely restrictive enough to slow the economy, and inflation has likely reduced the topside volatility for NZ interest rates. Markets have been reactive to data releases looking for justification to take rates lower, however rates remain volatile.

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 to occur. 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 positive return in March and outperformed the Bloomberg NZ Composite benchmark. Over the quarter returns were modest with January and February returns flat to negative. Moves in yields were the main driver of absolute and relative returns. We have participated in new deals and added some longer maturity bonds when yields were higher which was of benefit over the quarter. 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. NZ government bonds are approximately 2/3rds of the benchmark and we have marginally increased our holdings of NZ government bonds.

Key Fund Facts

| | | | | | |
|--|-----------------------------------|----------------------|--|---------------------------|-------------------------------|
| Distributions | | Hedging: | Any foreign currency exposure are hedged to NZD within operational range of 95%-105% | Strategy Launch: | October 2007 |
| Wholesale: | Calendar quarter | Exclusions: | Controversial weapons | Strategy size: | \$534.6m |
| Retail: | Calendar quarter | Restrictions: | 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 https://www.nikkoam.co.nz/invest/retail . | Buy / Sell spread: | Click to view |
| Estimated annual fund changes (incl. GST) | | | | | |
| Wholesale: | Negotiated outside of unit price | | | | |
| Retail: | 0.65%, refer PDS for more details | | | | |

Compliance

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

Contact Us

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