

Factsheet 28 February 2019

# NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail)

## Market Overview

- Longer-term interest rates continued to fall over February, short term rates were stable.
- US 10-year US Treasury bond interest rates moved in a modest 12 basis point range, trading between 2.62% and 2.74% over February.
- There are signs US economic activity is moderating, trade tensions and US politics continue to create uncertainty but the risk of extreme outcomes have lessened.

## Fund Highlights

- The fund returned 0.50% (before tax after fees and expenses) over February, outperforming benchmark.
- The investment strategy of investing in NZ bank bonds and selling short term option contracts on 10-year US Treasury bonds remains unchanged.
- If the US interest rates stabilise around current levels premium income received from selling option contracts will benefit the fund.

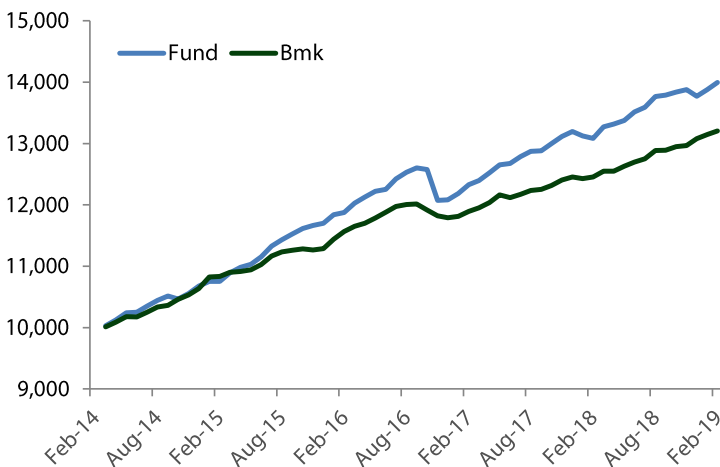
## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail <sup>1</sup>	0.50%	0.27%	5.53%	4.42%	5.76%	7.12%
Benchmark <sup>2</sup>	0.46%	1.85%	6.04%	4.69%	6.78%	8.38%

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any)

2. Current benchmark: Composite of (from 1 July 2016) of 70% Bloomberg NZBond Credit 0+ Yr Index and 30% Bloomberg NZ Bond Bank Bill Index plus 4%pa. No tax or fees.

## Five Year Cumulative Performance<sup>1&2</sup>



## 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.

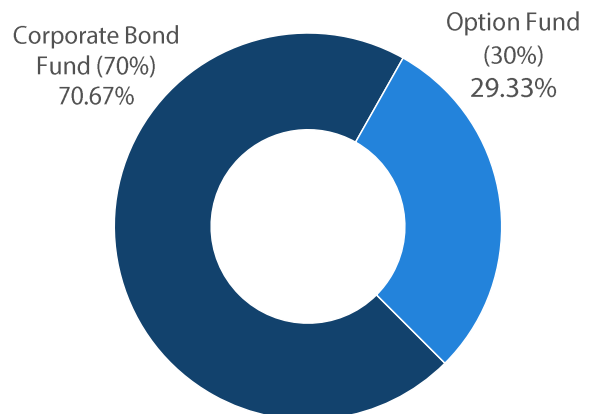
## Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio while protecting the capital value of investors' funds.

## Objective

The aim is to construct a portfolio that earns a return of 6.5% per annum over a rolling three year period before fees, expenses and taxes.

## Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Yield – Corporate Bond Fund
Westpac New Zealand	10.43	AAA	1.35	Fund (gross) 3.17% vs Benchmark 2.73%
Kiwibank	9.62	AA	54.35	
ANZ	7.77	A	20.70	
Bank of New Zealand	7.39	BBB	19.23	
ASB Bank	7.33	NR (incl options)	4.38	

## Option Fund Commentary

In a move that surprised markets by the extent of their change in stance, the Federal Reserve delivered a likely move towards a neutral monetary policy stance and away from their previous path of scheduled rate rises over 2019 and beyond. The Fed said it will be patient on any future interest rate moves and signalled flexibility on the path to reducing the size of its balance sheet. These statements were a significant move away from its bias toward higher borrowing costs. The Federal Open Market Committee “will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support” a strong labour market and inflation near 2%. In a separate statement, the Fed said it is prepared to adjust any of the details for completing the balance sheet normalisation in light of economic and financial developments. The central bank also said it would be ready to alter the balance sheet size and composition if the economy warrants a looser monetary policy than the federal funds rate could achieve on its own. With less pressure on interest rates from the Fed likely over 2019, the extent of any increase in longer-term rates is also diminished. If current levels of volatility are maintained, income generated by the fund should remain at satisfactory levels however the speed and magnitude of yield changes in the US 10-year Treasury bond will continue to determine the total return of the fund in the months ahead. From the Fed’s statements, it looks like it is now safer for investors to go back into risk assets as liquidity and interest rate risk is now diminished and is underwritten by the US Federal Reserve. We have seen a strong rebound in the price of US equity markets and other risk assets since the Fed’s announcements earlier in the year. If prices stabilise at these higher levels and global trade risks diminish further it is likely in our view the Fed revisits its decision to halt rate rises and delivers one, possibly two 0.25% rate rises in the second half of 2019.

## Corporate Bond Fund Commentary

Financial markets continue to bask in the warm glow of newly found confidence after a disappointing end to 2018. Equity markets have traded strongly and short term interest rates remain low and stable and longer-term bond rates are supported by the low short-term rates and the general lack of local and global inflationary pressures. With less pressure on interest rates from the Fed likely over 2019, the extent of any increase in longer-term rates is also diminished with the Fed once again seen as providing a backstop or circuit breaker should financial market activity become too volatile or uncertain to risk damaging the wider economy. With US rates on hold and global bond rates falling New Zealand markets followed suit and longer-term rates declined. Short term rates remained stable as the RBNZ is not yet ready to change the Official Cash Rate higher or lower until it becomes more evident that risks to the NZ economy require an adjustment. Over the month we saw the yield curve flatten with 10-year Government bond rates down 12 basis points to 2.07% and small falls in short term rates. Government bond rates are all below 2% out as far as the 15 April 2025 maturity. Similar falls were seen in swap and corporate bond yields. We continue to see strong investor demand for investment grade bonds especially as there is a large volume of maturities in the first half of 2019. The cash from these bond maturities will need to be reinvested into the market which creates additional pressure for interest rates to stay low. With NZ interest rates expected to remain stable over the months ahead higher-yielding bonds from well-rated issuers should continue to add value to the portfolio much in the same way, as they did over 2018. This sector of the market continues to have appeal and we will continue to focus our attention on selecting quality assets for the fund.

## Key Fund Facts

<b>Distributions</b>	<b>Estimated annual fund charges</b>		
Retail fund: Calendar quarter	Retail fund: 1.05%, refer PDS for more details		
<b>Hedging</b>	<b>Buy / Sell spread:</b>	<b>Strategy size</b>	<b>Strategy Launch</b>
All investments will be in New Zealand dollars	0.0% / 0.0%	\$13.47m	October 2007

## Compliance

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

## Contact Us

[www.nikkoam.co.nz](http://www.nikkoam.co.nz) | [nzenquiries@nikkoam.com](mailto:nzenquiries@nikkoam.com)

This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme. This information is for the use of researchers, financial advisers and wholesale clients. This material has been prepared without taking into account a potential investor’s objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party. For full details on the fund, please refer to our Product Disclosure Statement on [nikkoam.co.nz](http://nikkoam.co.nz).