Nikko Asset Management

Factsheet 28 February 2019

# NIKKO AM NZ BOND STRATEGY

Applies to: Nikko AM Wholesale NZ Bond Fund and Nikko AM NZ Bond Fund (retail)

## Market Overview

- Longer-term interest rates continued to fall over February, short term rates were stable.
- NZ economic growth rate is slower than desirable however our inflation rate is also low and stable.
- The US Federal Reserve has paused in their path towards further rate rises but strength in equity markets may make them review their decision.

## Fund Highlights

- Longer-term bonds performed well as interest rates fell.
- Shorter maturity bonds provided low but stable returns.
- Corporate and Bank bonds with strong credit ratings continue to perform well.

## Performance

| | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|---|---|---|---|---|---|---|
| Wholesale[1] | 0.62% | 2.38% | 6.42% | 4.88% | 6.10% | 6.24% |
| Benchmark[2] | 0.54% | 2.15% | 6.15% | 3.84% | 5.29% | 5.00% |
| Retail[3] | 0.57% | 2.20% | 5.66% | 4.11% | 5.25% | |

1. Returns are before tax and before the deduction of fees
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, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

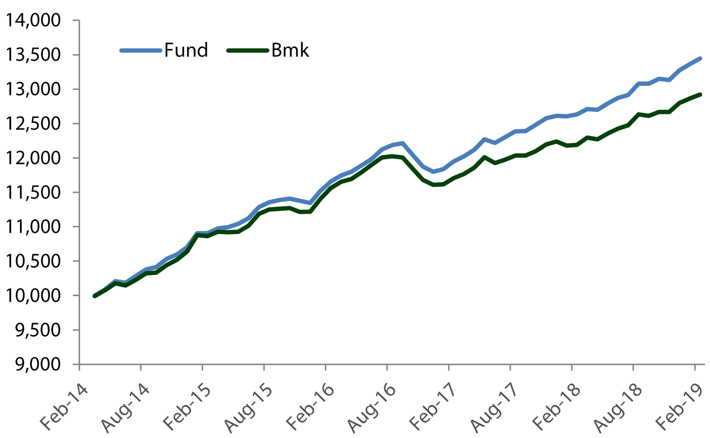
## Overview

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.

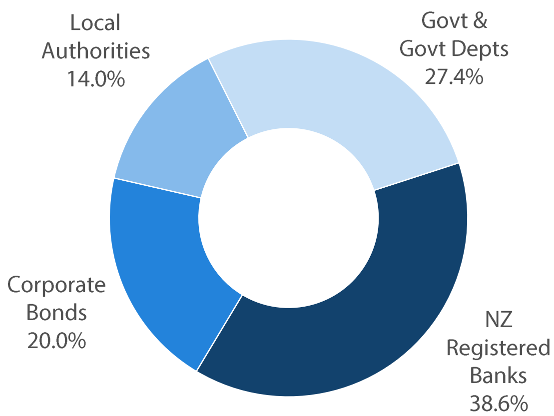
## Objective

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[1&2]




## Asset Allocation



| Top 5 Corporate Issuers* | (%) |
|---|---|
| Bank of New Zealand | 7.76 |
| Local Government Funding Authority | 7.45 |
| Westpac Banking Corporation | 6.73 |
| Fonterra Cooperative Group | 6.00 |
| ANZ Bank New Zealand | 4.22 |

*excludes central government

| Credit Quality | (%) |
|---|---|
| AAA | 14.18 |
| AA | 62.49 |
| A | 19. 21 |
| BBB | 4.12 |

| Duration |
|---|
| Fund 4.63 years vs Benchmark 3.91 years |

| Yield |
|---|
| Fund (gross) 2.68% vs Benchmark 2.20% |

## Market 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. As we mentioned in last month's commentary the catalyst for the moves in 2019 has been the US Federal Reserve. In an announcement that surprised markets, the Federal Reserve delivered a 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 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. It is possible however that the Fed moves back to its hiking path as US equity prices recover and global trade tensions subside. If risks continue to diminish we see the possibility of one or perhaps two further 0.25% rate increases in the second half of 2019. 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.

## Fund Commentary

The fund outperformed the Bloomberg NZ Bond Composite benchmark over February. Longer duration assets and bank and credit issues added value to the portfolio as longer term interest rates continued to decline. The increased yield associated with non-government bonds benefited the fund while a modestly long duration positioning added value relative to the composite benchmark.

## Key Fund Facts

**Distributions**

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter

**Estimated annual fund charges**

Wholesale: Negotiated outside of unit price
Retail: 0.725%, refer PDS for more detail

**Hedging**

All investments will be in New Zealand dollars

**Buy / Sell spread**

0.00% / 0.00%

**Strategy size**

$302.98m

**Strategy Launch**

October 2007

## Compliance

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

## Contact Us

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