

Factsheet 31 July 2019

# NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail)

## Market Overview

- The US Federal Reserve cut interest rates for the first time in more than a decade in July.
- Federal Reserve Chairman Powell said downside risks to the US economy have increased, reinforcing the case for lower rates and that the overarching goal is to sustain the US economic expansion.
- The RBNZ is concerned about falling business confidence levels and the impact this may have on employment, while both growth and inflation are weaker and access to bank borrowing may become more restrictive further muting investment intentions.
- It is likely that the Reserve Bank (RBNZ) will likely reduce the cash rate further. (Postscript: OCR cut by 0.50% to 1.0% on 7 August 2019).

## Fund Highlights

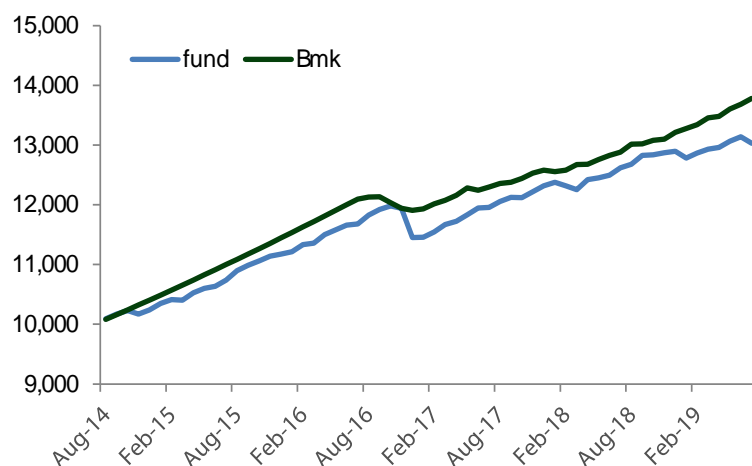
- NZ bonds continued to deliver strong returns as interest rates fell.
- The supply/demand dynamics remain supportive of credit holdings as investors seek yield.
- As a result of increased volatility in financial markets, the Option Fund saw a rise in the income the fund receives from selling short dated options on US Treasury Bonds.

## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail <sup>1</sup>	1.29%	1.03%	4.13%	3.73%	5.52%	6.84%
Benchmark <sup>2</sup>	0.70%	2.24%	6.98%	4.44%	6.63%	8.30%

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, \$10,000 invested<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.

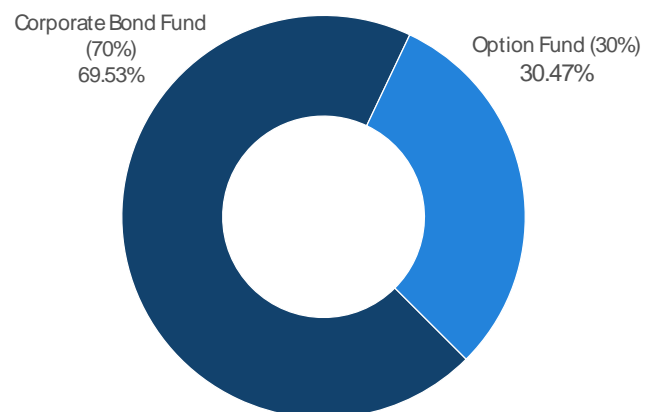
## Overview

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	13.15	AAA	1.42	Fund (gross) 2.43% vs Benchmark 1.98%
ASB New Zealand	11.34	AA	52.30	
Bank of New Zealand	7.56	A	24.52	
Kiwibank	6.66	BBB	17.79	
ANZ Bank New Zealand	5.41	Collateral & options & NR	3.97	

\*Aggregation of Option and Corporate Bond Funds

## Option Fund Commentary

Federal Reserve (Fed) Chairman Jerome Powell likes to tell reporters that the Fed has one over-arching goal: to sustain the economic expansion. That means keeping the economy growing at or ideally above its long run cruising speed of about 2%, and running a strong labour market by holding unemployment down at levels many economists think is unsustainable. Cutting rates is one thing the Fed can do to help achieve its goals and help the people who have been left behind in the economic expansion. The Fed started down this track by cutting short term rates for the first time in more than a decade by 0.25%. This move disappointed some, including President Trump, who were looking for deeper cuts, but may not be the last cut in this easing cycle. Trade tensions between the US and China do not look like reducing in the short term and will remain a source of uncertainty in global trade and growth outlooks. Lower interest rates looks like the path of least resistance.

The fund returned 2.84% for the month. Interest rates moved in a modest range after recent large falls as financial markets continue to price in rate cuts from the Federal Reserve. While additional rate cuts are still data dependent it seems likely the Fed will deliver further rate cuts to help support the economy.

The US 10-year bond yield traded in a 19 basis point range over the month, moving between a high of 2.14% and a low of 1.95% before closing the month at 2.01%. The trading range is smaller than we have seen over recent months however follows on from steady falls in the yield on US Treasury bonds. US 10-year Treasury bonds have fallen from a high point of 3.25% in November last year to below 2.0% in July 2019. Income levels generated from selling options has increased as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets. If volatility remains elevated for an extended period the income generating potential of the fund looks attractive.

## Corporate Bond Fund Commentary

NZ fixed income assets produced solid returns as interest rates moved lower in yield and credit margins contracted over the month of July. The move lower in NZ government bond interest rates was fairly consistent along the yield curve with rates finishing the month 10 to 12 basis points (bps) lower. The market demand /supply dynamics remain supportive of NZ credit with a shortage of new bond issuance to the market, and investors continue to seek yield with interest rates moving lower. So far this year NZ bonds have continued to outperform term deposits due to capital gains from falling interest rates and credit margin contraction. While expectations for global and domestic growth continue to be revised lower we expect financial conditions to remain accommodative. Many Central Banks are concerned about further headwinds and uncertainty around global trade impacting their economies and they will likely provide more stimulus by cutting short term rates further. The RBNZ is concerned about falling business confidence levels and the impact this may have on employment, while both growth and inflation are weaker and access to bank borrowing may become more restrictive further muting investment intentions.

The fund outperformed the Bloomberg NZ Bond Credit benchmark over the month. A longer duration positioning and higher yield including margin contraction on credit holdings added value to the portfolio as longer term interest rates continued to decline.

We expect further modest declines in interest rates and our focus will be on maintaining a higher portfolio yield through buying quality non-government bond issues. We think there are still some good opportunities to pick up yield through selling short to maturity bonds and investing longer in maturity along the credit curve.

## Key Fund Facts

### Distributions

Retail fund: Calendar quarter

### Estimated annual fund charges (incl GST)

Retail fund: 1.07%, refer PDS for more details

### Hedging

All investments will be in New Zealand dollars

### Buy / Sell spread:

0.0% / 0.0%

### Strategy size

\$13.3m

### Strategy Launch

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).