

Factsheet 31 July 2019

NIKKO AM NZ BOND STRATEGY

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

Market Overview

- NZ fixed income assets produced solid returns as interest rates moved lower in yield and credit margins contracted over the month of July.
- 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 reduce the cash rate further. (Postscript: OCR cut by 0.5% 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.
- A higher running yield through holding quality credit continues to benefit the fund.

Performance

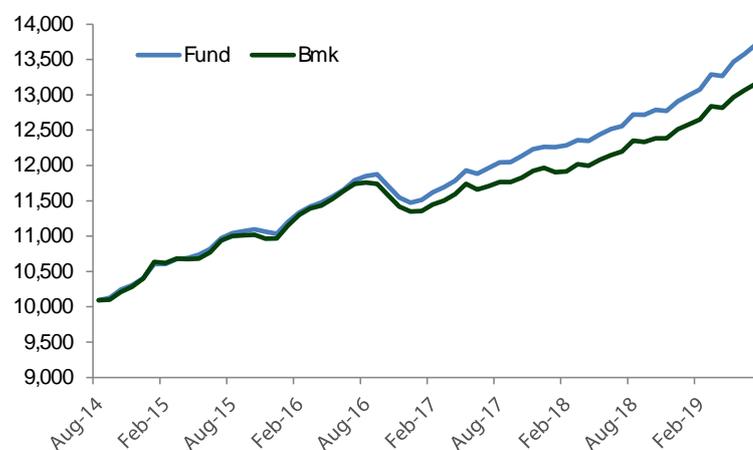
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	0.97%	3.35%	9.18%	5.16%	6.51%	6.96%
Benchmark ²	0.71%	2.66%	7.88%	3.88%	5.64%	5.60%
Retail ³	0.91%	3.15%	8.38%	4.39%	5.66%	

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)

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

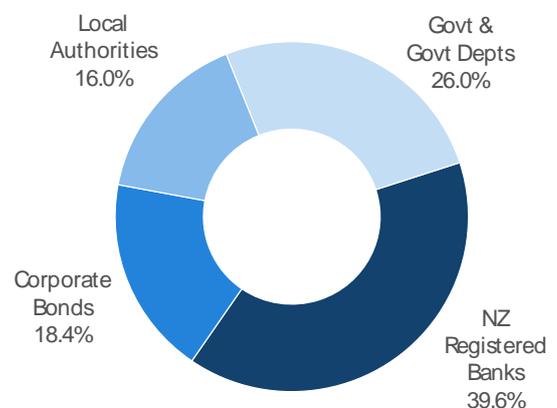
Overview

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.

Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Duration
Local Government Funding Agency	9.80	AAA	12.35	Fund 4.90 years vs Benchmark 4.46 years
Bank of New Zealand	7.93	AA	61.51	
ANZ Bank New Zealand	6.68	A	21.67	Yield
Fonterra Co-Operative Group	5.42	BBB	4.47	Fund (gross) 1.94% vs Benchmark 1.50%

*excludes central government

Market 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. Swap rates performed similarly to government bonds and were 6 bps lower in yield in the shorter maturity dates, but falling up to 15 basis points lower in yield in longer dates. Credit was generally the best performing sector over the month, benefiting the fund return through a higher running yield and some credit margin contraction.

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. Late in July Westpac NZ were able to issue a 5-year senior bond deal in large volume at a yield of 2.22% and a margin of 85 basis points. The deal was principally supported by bank balance sheets and institutional investors but is indicative of strong demand for quality credit issues. The yield gap between high retail term deposit rates and NZ bank bonds has continued to expand and retail investors have been holding a higher portion of term deposits and favouring investing in bond issues with higher yields. 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.

Fund Commentary

The fund outperformed the Bloomberg NZ Bond Composite benchmark over the month. A higher portfolio yield plus margin contraction on credit holdings added value to the portfolio as longer term interest rates continued to decline. The increased yield associated with non-government bonds continues to benefit the fund while a modest long duration position added value relative to the composite benchmark. While interest rates have declined significantly, 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 opportunities to pick up yield through selling short to maturity bonds and investing longer in maturity along the credit curve.

Key Fund Facts			
Distributions		Estimated annual fund charges (incl GST)	
Wholesale fund:	Calendar quarter	Wholesale:	Negotiated outside of unit price
Retail fund:	Calendar quarter	Retail:	0.74%, refer PDS for more detail
Hedging		Buy / Sell spread	Strategy size
All investments will be in New Zealand dollars		0.00% / 0.00%	\$345.98m
		Strategy Launch	October 2007

Compliance

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

Contact Us

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