Nikko Asset Management

Factsheet 30 September 2019

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail)

Market Overview

- The month started as a reversal of August, and volatility increased as there were large movements higher in US interest rates on optimism that US-China trade negotiations were improving.
- US 10-year bonds traded at 1.43% over the month, close to the GFC low of 1.37% before closing the month at 1.67%.
- Over September the performance from bonds was muted by rising interest rates and returns from NZ bonds were generally low to negative.

Fund Highlights

- The fund outperformed its benchmark in September.
- The Option Fund gained 3% over the month. As a result of increased volatility in financial markets we have seen a rise in income the fund receives from sell short dated options on US Treasury Bonds. We are hopeful this increase will be maintained and leads to the fund generating higher than average returns over the months ahead.
- The Corporate Bond Fund marginally underperformed the Bloomberg NZ Bond Composite benchmark over the month as credit margins widened on supply/demand dynamics. A higher running yield through holding quality credit should continue to benefit the fund.

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

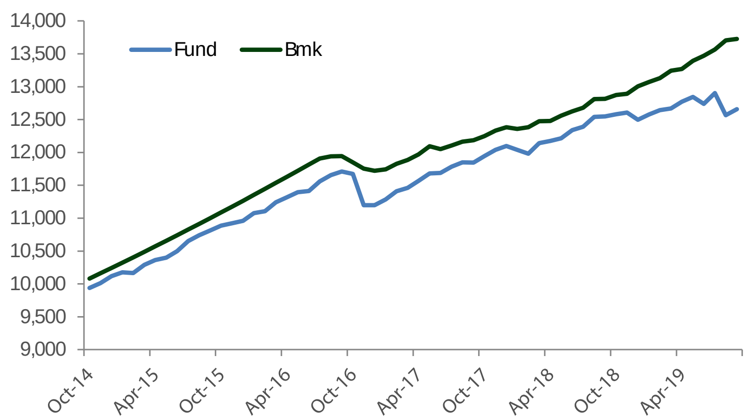
The aim is to construct a portfolio that earns a return of 6.5% per annum over a rolling three year period before fees, expenses and taxes.

Performance

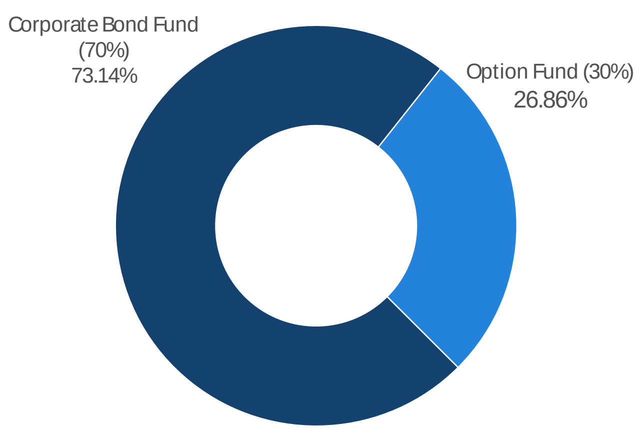
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	0.72%	-0.64%	0.88%	2.63%	4.83%	6.34%
Benchmark[2]	0.16%	1.89%	7.10%	4.74%	6.54%	8.26%

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[1,2]



Asset Allocation



Top 5 Corporate Issuers*	(%)
Westpac New Zealand	12.84
ASB New Zealand	10.78
Kiwibank	7.72
Bank of New Zealand	6.55
ANZ Bank New Zealand	5.42

Credit Quality*	(%)
AAA	1.38
AA	53.96
A	20.36
BBB	19.11
Collateral & options & NR	5.19

Yield – Corporate Bond Fund
Fund (gross) 2.12% vs Benchmark 1.68%

*Aggregation of Option and Corporate Bond Funds

Option Fund Commentary

The fund gained 3.48% over the month however the past year has been a difficult one for the fund. Ten year US Treasury bond rates fell close to their Global Financial Crisis low points as investors fretted about lower economic growth and trade issues. While additional rate cuts to short term rates 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 47 basis point range over the month, moving between a high of 1.9% and a low of 1.43% before closing the month at 1.65%. The large fall in rates we have seen over the past year may have come to an end, at least for the time being. The fall has been significant with US 10 year Treasury bonds falling from a high point of 3.25% in November last year to a low of 1.43% in September 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 but as mentioned above the frequency and cost of options being struck will also determine the total return of the fund.

Corporate Bond Fund Commentary

Over September the performance from bonds was muted by rising interest rates and returns from NZ bonds were generally low to negative. The month started as a reversal of August, and volatility increased as there were large movements higher in US interest rates on optimism that US-China trade negotiations were improving. Also some of the spike higher in rates was perhaps exacerbated by an “unwinding” as interest rates had over done the move lower in yield the previous month. The NZ 10-year bond moved approximately 35 basis points (bps) higher in yield following the direction of the US 10-year bond which spiked 40bps. However by mid- month the interest rate sell-off had lost momentum following the Saudi oil attack and renewed disappointment over trade negotiations and yields subsequently retreated to close only marginally higher than where they started the month. Locally the NZ Reserve Bank left rates unchanged and said they would wait to see if more stimulus is necessary. The bank would like to encourage more spending and investment although this appears difficult as consumer and business confidence has continued to decline. While growth is below potential and inflation is low the bank appears to see little risk from adding stimulus to the economy and we may see further rate cuts if economic data deteriorates further. This will likely keep NZ interest rates low for some time.

Over the month funds with exposure to longer maturity bonds and credit underperformed. NZ government bond rates finished the month from 1 to 5bps higher in yield across the curve with longer maturities rising more than shorter bonds. Swap rates were the best performing sector outperforming similar maturities of government bonds as they reduced their spread to government bonds by 1 to 6bps. NZ credit spreads widened by approximately 3-10bps as supply soaked up demand and there was selling to buy new bond issues. On a positive note we opportunistically added some bonds to the fund at higher yields.

The fund marginally underperformed the Bloomberg NZ Bond Credit benchmark over the month. A longer duration positioning, and some of the funds longer maturity bonds, including a widening of credit margins detracted value as NZ interest rates moved higher in yield. We will focus on maintaining a higher portfolio yield through buying quality non-government bond issues. We think there continues to be good opportunities to pick up yield through selling short to maturity bonds and investing longer in maturity along the credit curve. We will focus on this area to add value to the fund over the months ahead.

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

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