

NIKKO AM NZ BOND STRATEGY

Assets are held in the Nikko AM Wholesale NZ Bond Fund. The Nikko AM NZ Bond Fund (retail) invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- NZ bond markets moved higher in yield and the curve steepened during October.
- Market sentiment has become less negative with some positives emerging regarding improved economic data.
- The pricing in of further interest rate cuts has been reduced as a consequence.

Fund Highlights

- The fund outperformed its benchmark, although NZ bond returns were generally negative as yields moved higher over the month. Credit margins stabilised on supply/demand dynamics.
- A higher portfolio yield through holding quality credit should continue to benefit the fund.

Performance

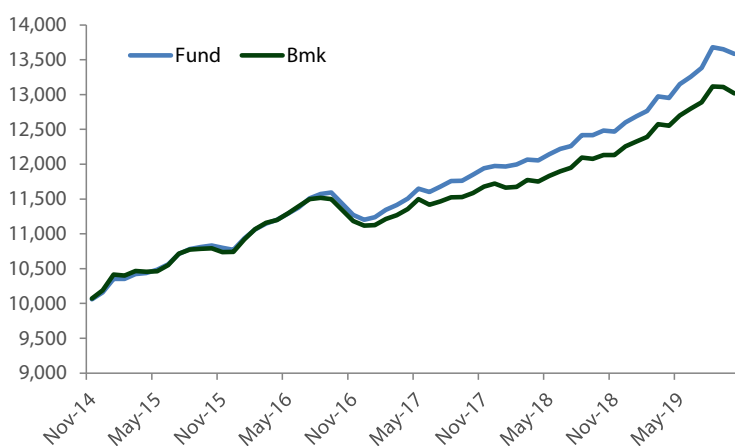
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-0.48%	1.50%	8.81%	5.92%	6.32%	6.91%
Benchmark ²	-0.71%	1.00%	7.32%	4.70%	5.42%	5.62%
Retail ³	-0.56%	1.31%	8.01%	5.14%	5.48%	

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.

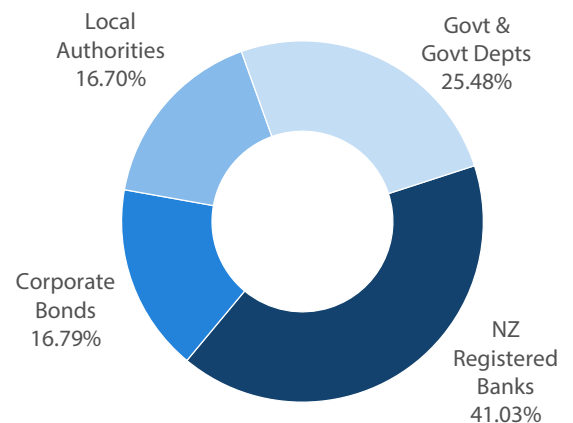
Overview

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
NZ Local Govt. Fund Agency	11.18%	AAA	12.38	Fund 5.07 years vs Benchmark 4.50 years
Bank Of New Zealand	7.94%	AA	63.81	
Westpac New Zealand Ltd	5.89%	A	19.43	Yield Fund (gross) 1.74% vs Benchmark 1.34%
Fonterra Cooperative Group	5.61%	BBB	4.38	
ANZ Bank New Zealand Ltd	5.18%			

*excludes central government

Market Commentary

The returns from NZ bonds were generally negative over October as interest rates moved higher in yield following an improvement in market sentiment. With optimism that US/China trade negotiations may be improving and improved economic data there was some unwind of the negatives that were priced into bond yield curves for slower growth and further interest rates cuts. There has been quite a change in sentiment from market concern around the possibility of very low or negative cash rates in NZ to now only pricing one further interest rate cut of 25 basis points.

Certainly there have been some reasonably large moves in interest rates over the past couple of months, with more volatility in longer maturity bonds as they have followed offshore rates higher, while short maturities have remained more anchored by low cash rates. Over the month medium to longer maturity bonds performed worse than short maturities. The 2021 NZ Government bond finished the month 7 basis points higher in yield, whereas the 2025 maturity increased by 13 basis points, and maturities 10 years and longer were up to 25 basis points higher in yield by month end. Funds with longer duration positions underperformed those with less exposure to rising interest rates.

On a sector basis NZ Government bonds performed poorly as buyers have been absent as yields moved higher. Shorter swap maturities narrowed in spread relative to similar maturities of government bonds and the longer maturities widened slightly. Credit performed reasonably well as the supply overhang of secondary bonds seems to have been readily absorbed by the market. If supply remains limited we would expect credit spreads to unwind the widening seen in the previous month.

With the move higher in yields we have opportunistically added some bonds to the fund. While growth is below potential and inflation low, it seems likely shorter term NZ interest rates will remain low for some time. With little slope or yield pickup along the government and swap yield curve we still like investing in credit to achieve a higher portfolio yield.

Fund Commentary

The fund outperformed the Bloomberg NZ Bond Composite benchmark over the month. Positive contributions to performance came from holdings of inflation linked NZ government bonds which significantly outperformed nominal NZ government bonds, and higher yield from credit. Detractors of value were the longer duration positioning and some of the funds longer maturity bonds as the yield curve steepened. We will focus 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

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter

Estimated annual fund charges (incl GST)

Wholesale: Negotiated outside of unit price
Retail: 0.74%, refer PDS for more detail

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread

0.00% / 0.00%

Strategy size

\$353.8m

Strategy Launch

October 2007

Compliance

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

Contact Us

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