

Factsheet 30 November 2019

# NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

## Market Overview

- Volatility of the US 10-year bond declined from its recent highs and financial markets remained relatively stable through the latter half of November.
- NZ short-term interest rates moved higher in yield and long-term rates were lower. The pricing in of further cuts to the cash rate has been reduced.

## Fund Highlights

- The Fund outperformed its benchmark in November.
- The Option Fund had another strong monthly return as the US 10-year bond remained in a moderate range and no options were exercised during the month. Volatility has declined from its recent highs, but the income the fund receives from selling short dated options still remains supportive of generating good returns.
- The Corporate Bond Fund returns have been muted due to the move higher in interest rates. Credit margin dynamics look supportive with a shortage of supply. A higher running yield through holding quality credit should continue to benefit the fund.

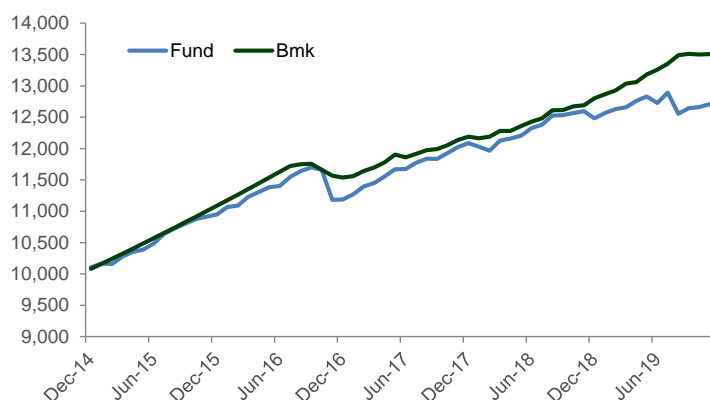
## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail <sup>1</sup>	0.37%	1.23%	0.91%	4.35%	4.91%	6.06%
Benchmark <sup>2</sup>	0.06%	0.14%	6.44%	5.30%	6.20%	8.08%

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.

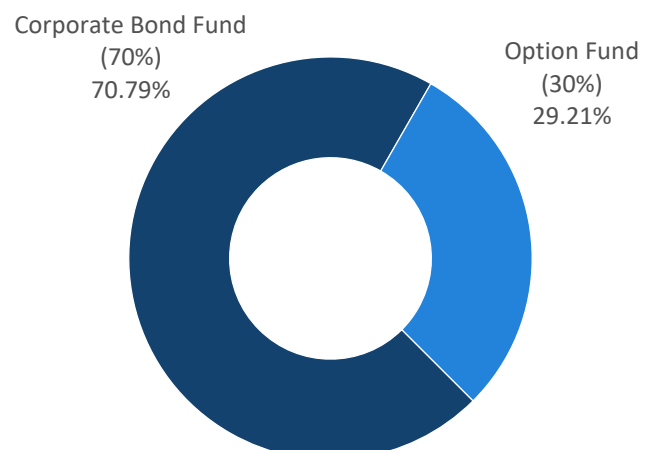
## Overview

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 Issuers*	(%)	Credit Quality*	(%)	Yield – Corporate Bond Fund
Westpac New Zealand	13.53	AAA	1.25	Fund (gross) 2.30% vs Benchmark 1.89%
ASB New Zealand	11.17	AA	50.68	
Kiwibank	8.01	A	25.44	
Bank of New Zealand	7.12	BBB	17.82	
ANZ Bank New Zealand	4.48	Collateral & options & NR	4.80	

\*Aggregation of Option and Corporate Bond Funds

## Option Fund Commentary

The Option fund performed well over the month as the volatility of the US 10 year bond declined from its recent highs and financial markets remained relatively stable through the latter half of November. The US 10 year bond traded in a more constrained 25 basis point band, ranging between a high point of 1.94% and a low of 1.69% before closing the month at 1.78%.

With the US Federal Reserve indicating they are on hold and will be taking their direction from future developments it seems likely that the US 10 year bond could remain more constrained inside its recent trading range of 1.50 to 2% into year-end. At the last rate cut in October Powell said he thinks monetary policy is “somewhat accommodative” which helps explain why Fed officials see themselves as in a holding pattern for the foreseeable future. Even if the Fed is finished easing for now Powell stressed they are nowhere near contemplating rate hikes again suggesting the Fed would need to see rising and persistent inflation before considering raising rates again. A more moderate trading range in the US 10 year bond should be supportive of returns for the Option fund while income levels for selling the options still remain higher than the average level received over the past year.

Over the past couple of months market sentiment has improved on the hope that US/China trade relations are thawing, however we remain mindful that it is unlikely in the near term that we will see a comprehensive agreement that results in a complete roll back of tariffs and a sustained improvement in US/China relations. Risk still remains that there may be some market disappointment. While uncertainty remains we expect that the pricing competition will remain robust between the buyers of the options we sell, and the income received should remain at a reasonable level supporting returns.

The Fund has produced quite strong returns over the past 3 months and option income levels have been good, however the past year has been a difficult one for the fund following a poor month in August when there were large moves in the US 10-year bond. The one year range in US rates 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 before increasing to current levels, around 1.78% as market sentiment improved.

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Income levels generated from selling options has increased and remains above its medium term average 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, however the speed and magnitude of yield changes in the US 10-year Treasury bond will continue to determine the total return of the Fund in the months ahead.

## Corporate Bond Fund Commentary

Fund performance was close to the Bloomberg NZ Bond Credit benchmark over the month. The longer duration positioning, and yield curve positioning detracted value.

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

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

\$12.8m

### Strategy Launch

October 2007

## Compliance

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

## Contact Us

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