

# NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

## Market Overview

- The interest rate on the US 10-year Treasury bond was relatively stable over the month.
- NZ interest rates moved much higher in yield over the quarter.
- Market sentiment has become less negative with some positives emerging. The pricing in of cuts to the cash rate has been reduced.

## Fund Highlights

- The Fund underperformed its benchmark in December.
- The Option Fund had a steady month returning 1.11% as the US 10-year bond remained in a moderate range and no options were exercised during the month.
- The Corporate Bond fund underperformed its benchmark over the month. The longer duration positioning and yield curve positioning detracted value.

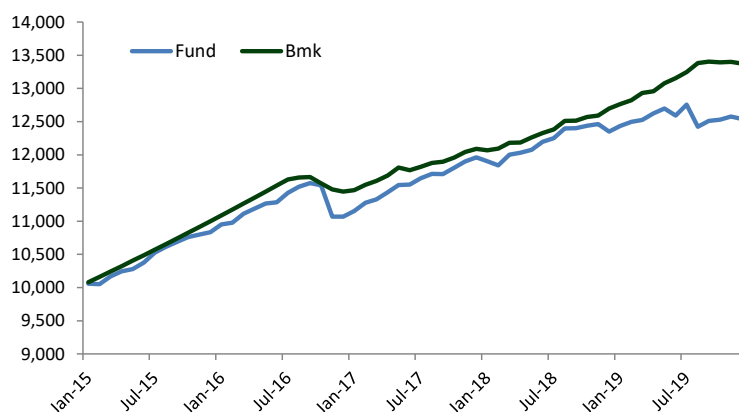
## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail <sup>1</sup>	-0.29%	0.22%	1.52%	4.25%	4.63%	6.05%
Benchmark <sup>2</sup>	-0.18%	-0.20%	5.34%	5.33%	5.99%	7.98%

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

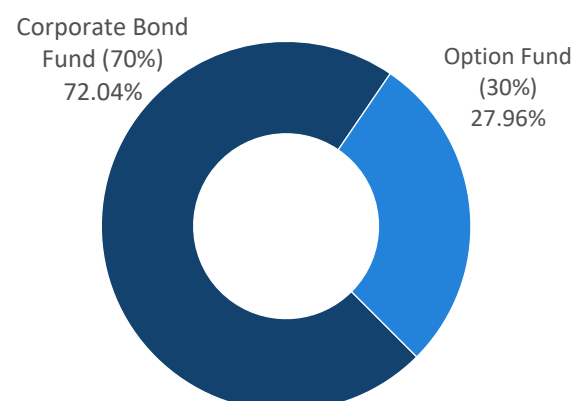
The strategy aims to provide investors with regular income from an actively managed investment portfolio while protecting the capital value of investors' funds.

## 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.

From 01 January 2020 the objective of this fund is to outperform the RBNZ Official Cash Rate by 2.50% p.a. 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	13.04	AAA	1.27	Fund (gross) 2.46% vs Benchmark 2.05%
ASB New Zealand	10.85	AA	53.94	
Kiwibank	7.81	A	22.12	
Bank of New Zealand	7.06	BBB	18.45	
NZ Local Govt. Fund Agency	5.42	Collateral & options & NR	4.22	

\*Aggregation of Option and Corporate Bond Funds

## Option Fund Commentary

Over the month volatility of the US 10-year bond declined from recent highs and financial markets remained relatively stable. The US 10-year bond traded in a constrained 26 basis point band, ranging between a high point of 1.95% and a low of 1.69% before closing the month at 1.92%.

With the US Federal Reserve indicating they are on hold and will be taking their direction from future economic and market developments it seems likely the US 10-year bond could remain more constrained inside its recent trading range of 1.50% to 2% well into the first quarter of 2020.

Federal Reserve Chairman Jerome Powell has left no doubt that US cash rates are on hold for a prolonged period. He said on December 11 that the current level will likely remain appropriate unless the Fed's favourable outlook for the economy sees a material reassessment. He spoke after policy makers kept rates steady in a 1.5% to 1.75% target range following three consecutive cuts. The Fed also published forecasts showing 13 of 17 officials projecting no changes in rates over 2020. If correct that would keep them on hold during the presidential election year.

Global risks remain elevated, yet the past few months has seen a partial thawing of trade tensions between China and the US. The prospects of improving global growth look more promising than in the recent past however new flash points in the geopolitical environment are never too far away. The ebbs and flow of market and investor sentiment should ensure competition remains robust between the buyers of the options we sell, and the income received should remain at a reasonable level supporting returns.

The stable outlook for short term interest rates is likely to limit any sustained movement in longer term interest rates. The speed and magnitude of yield changes in the US 10-year Treasury bond will continue to determine returns in the months ahead.

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 large movements in the US 10-year bond occurred. The range in US rates has been significant with US 10-year Treasury bonds falling from a high point of 3.25% in November 2018 to a low of 1.43% in September 2019 before increasing to current levels, around 1.9%, as market sentiment improved.

Income levels generated from selling options has increased over the past year 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 frequency and cost of options being struck will also determine the total return of the fund.

## Corporate Bond Fund Commentary

The fund underperformed 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

<b>Distributions</b>	<b>Estimated annual fund charges (incl. GST)</b>		
Retail fund: Calendar quarter	Retail fund: 1.07%, refer PDS for more details		
<b>Hedging</b>	<b>Buy / Sell spread:</b>	<b>Strategy size</b>	<b>Strategy Launch</b>
All investments will be in New Zealand dollars	0.0% / 0.0%	\$12.8m	October 2007

## Compliance

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

## Contact Us

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