

# 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

- Following the positive swing in sentiment longer term interest rates were much higher in yield by month end and overall it was a poor quarter for NZ bond markets.
- Interest rate markets have remained reasonably volatile over the past quarter, although as expected short bond maturities have remained more anchored by expectations for low cash rates.
- On a positive note the market has now priced in a reasonable amount of good news and bonds offer better value at higher yields.

## Fund Highlights

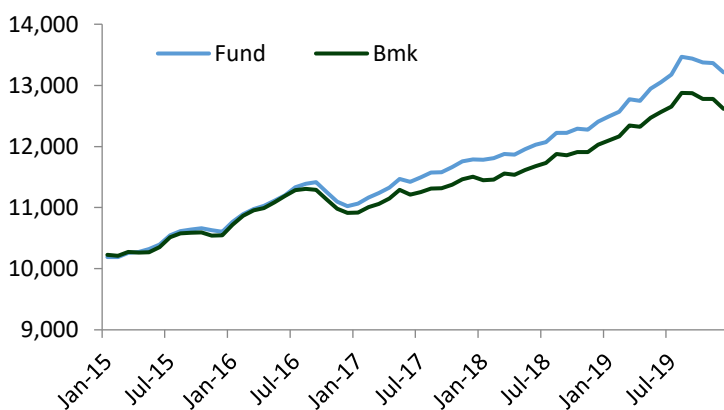
- The fund outperformed its benchmark over the month.
- We will focus on maintaining a higher portfolio yield through buying non-government bond issues.
- We believe there are still some good opportunities to pick up yield through selling short to maturity bonds and investing longer in maturity along the credit curve.

## Performance

|                        | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|------------------------|-----------|--------------|----------|-------------------|------------------|-----------------|
| Wholesale <sup>1</sup> | -1.14%    | -1.68%       | 6.51%    | 6.22%             | 5.73%            | 6.67%           |
| Benchmark <sup>2</sup> | -1.24%    | -1.96%       | 4.89%    | 4.96%             | 4.76%            | 5.41%           |
| Retail <sup>3</sup>    | -1.20%    | -1.87%       | 5.72%    | 5.44%             | 4.90%            |                 |

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<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.

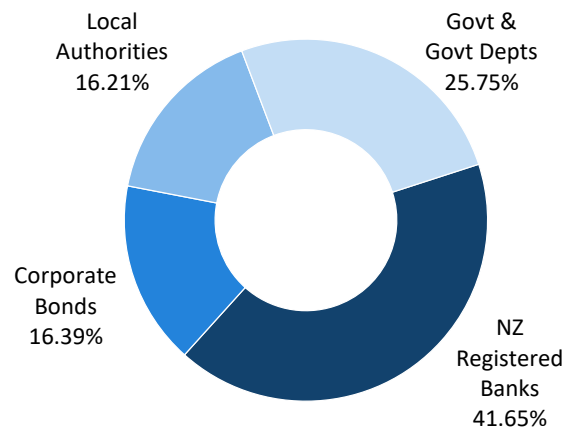
## Overview

The 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 | 11.14% | AAA            | 12.80% | Fund 4.98 years vs Benchmark 4.35 years |
| Bank Of New Zealand        | 7.03%  | AA             | 60.73% |   |
| Westpac New Zealand Ltd    | 7.03%  | A              | 21.97% | <b>Yield</b>                            |
| Fonterra Cooperative Group | 5.73%  | BBB            | 4.50%  | Fund (gross) 1.98% vs Benchmark 1.63%   |
| ANZ Bank New Zealand Ltd   | 5.33%  |                |        |   |

\*excludes central government

## Market Commentary

The returns from NZ bonds were generally negative over the month as interest rates moved much higher in yield and the negative contribution from duration negated the positive contribution from yield. Market sentiment and data has generally improved. Locally, NZ GDP for Q3 was stronger than both the markets and RBNZ’s expectations, (0.7 for the quarter and 2.3% year-on-year), business and consumer confidence has improved, and the government announced a large increase in infrastructure spend of \$12 billion to be spread over the next several years. Global bond yields also moved higher after the US and China made progress on a phase 1 trade deal and the UK Conservative party stormed to victory in the UK elections reducing some uncertainty.

Following the positive swing in sentiment longer term interest rates were much higher in yield by month end and overall it was a poor quarter for NZ bond markets. Over the month the NZ 10-year government bond increased by 34 basis points to 1.65% and the longer maturity 2037 bond by 44 basis points to 2.10%, in comparison the US 10-year bond finished 14 basis points higher at 1.92%. Shorter bonds performed better than longer maturity bonds as they had smaller moves higher in yield and the impact of rising yields is also less for shorter duration assets. The 2021 NZ government bond moved 15 basis points higher, and the 2025 maturity 25 basis points higher to finish the year at 1.12% and 1.35% respectively. On a sector basis NZ Government inflation linked bonds performed well versus nominal Government bonds. The swap yield curve moved steeper in shape with the spread between 2 and 10 year rates increasing from 34 to 52 basis points. Overall swap rates outperformed similar maturities of government bonds as swap spreads narrowed slightly. Corporate bonds continued to perform well as margins remain supported by a lack of supply and monies continue to come into bond markets to be invested. From a duration perspective funds with longer duration positions and more exposure to the direction of interest rates have had a tough time with rising rates over the past quarter.

Interest rate markets have remained reasonably volatile over the past quarter, although as expected short bond maturities have remained more anchored by expectations for low cash rates. Longer term bond rates will likely continue to be more influenced by the direction of offshore bonds. In a low yield environment the direction of interest rates and subsequent gain or loss from duration tends to more heavily dominate the return in comparison to other return drivers such as yield. On a positive note the market has now priced in a reasonable amount of good news and bonds offer better value at higher yields.

## Fund Commentary

The fund outperformed its benchmark over the month. Positives were the holdings of Inflation linked NZ government bonds which significantly outperformed nominal NZ government bonds, also higher yield from credit benefited the portfolio. Detractors of value were the longer duration positioning and yield curve positioning. We will focus on maintaining a higher portfolio yield through buying quality non-government bond issues. We believe 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> |                                  |
| Wholesale fund:                                | Calendar quarter | Wholesale:                                       | Negotiated outside of unit price |
| Retail fund:                                   | Calendar quarter | Retail:  | 0.74%, refer PDS for more detail |
| <b>Hedging</b>                                 |                  | <b>Buy / Sell spread</b>                         | <b>Strategy size</b>             |
| All investments will be in New Zealand dollars |                  | 0.00% / 0.00%                                    | \$339.6m                         |
|  |                  |  | <b>Strategy Launch</b>           |
|  |                  |  | October 2007                     |

## Compliance

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

## Contact Us

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