

Factsheet 29 February 2020

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- A 'flight to safety' saw significant falls in global bond yield with the US 10-year bonds falling.
- Markets are already pricing in a fall in economic growth mainly resulting from lower service sector activity and also from lower trade and tourism numbers, however this pricing could be reversed if the worst fears of the spread of the virus do not materialise.
- In New Zealand, general economic data has been reasonable but activity will take a major hit in the first quarter.

Fund Highlights

- The Fund underperformed its benchmark this month.
- The Option Fund posted a negative return over the month as bond yields dropped significantly as the implications of the corona virus became more apparent.
- The Corporate Bond fund outperformed its benchmark over the month. A higher yield through holding quality credit should continue to benefit the fund.

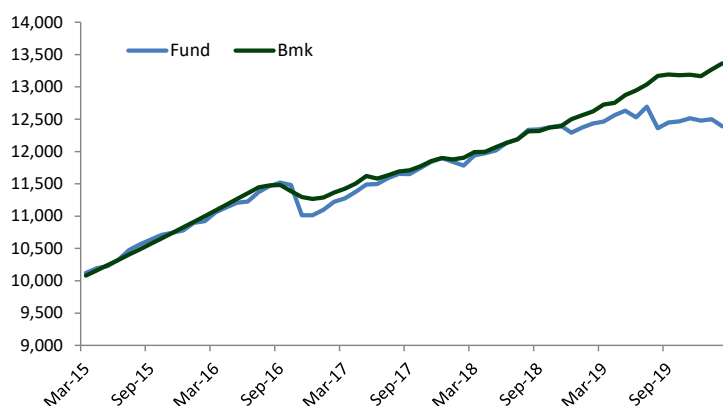
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail ¹	-0.89%	-0.99%	-0.36%	3.36%	4.38%	5.65%
Benchmark ²	0.69%	1.31%	5.87%	5.54%	5.97%	7.97%

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}



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.

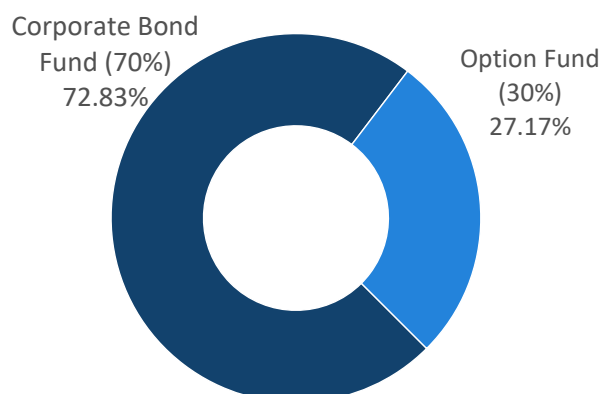
Overview

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

Objective

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	11.75	AAA	1.24	Fund (gross) 2.02% vs Benchmark 1.62%
ASB New Zealand	11.43	AA	51.10	
Kiwibank	7.97	A	25.39	
ANZ Bank New Zealand	6.44	BBB	18.34	
Bank of New Zealand	6.13	Collateral & options & NR	3.93	

*Aggregation of Option and Corporate Bond Funds

Option Fund Commentary

A ‘flight to safety’ saw significant falls in global bond yields with the US 10-year bonds falling from a high point of 1.68% before closing at the monthly low of 1.15%.

The lasting impact the coronavirus will have on economic activity is unknown and this uncertainty is reflected in lower global interest rates and share markets. Markets are pricing in a fall in economic growth mainly resulting from lower service sector activity, lower trade and tourism numbers and dislocation of manufacturing supply chains.

The Federal Reserve has pointed to evolving risks facing the US economy and the central bank’s readiness to deploy tools and act as appropriate to support the economy. To be most effective and bolster confidence any central bank response should be globally co-ordinated. It has to be said though that countering a sudden economic stoppage such as the one caused by the coronavirus is a lot harder for central banks than resolving a financial sudden stop.

To turn the corner, the global economy needs evidence of success in containing the spread of the virus and success in illness recovery and avoidance, best done via the creation of a new vaccine. As for financial markets, expect to see significant price and liquidity swings as investors digest the deepening economic and corporate damage on the one hand and central bank liquidity injections, and policy and health announcements on the other.

The fund posted a negative return over the month as bond yields dropped significantly as the implications of the coronavirus became more apparent. The large fall in 10-year US Treasury bond yield pushed the fund returns into negative territory over the month as bond yields traded through a number of call option strikes and volatility increased. Income levels generated from selling options increased over the past month and year. It remains above its medium term average as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets. We expect income levels and volatility to be elevated in the months ahead. The speed and magnitude of yield changes in the US 10-year Treasury bond combined with the income received from selling options determines the total return of the Fund.

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 also determine the total return of the fund. Unfortunately, in recent times, the cost of options being struck has exceeded the income generated by the fund.

Corporate Bond Fund Commentary

The fund outperformed its benchmark by 25bps over the month. The longer duration positioning and yield curve positioning were the main contributors to outperformance. Credit in general underperformed similar maturities of government bonds and swap rates as margins widened slightly. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government bond issues. Medium term we expect credit to remain well supported with a shortage of supply to market.

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

\$12.7m

Strategy Launch

October 2007

Compliance

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

Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com

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