

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

- Interest rates continued lower in yield over February.
- Market sentiment remains negative, polarised by coronavirus concerns.
- In general economic data has been reasonable but activity will take a major hit in the first quarter.

Fund Highlights

- Returns from bonds have been strong as yields continue to fall.
- Credit margins have widened but should be supported with a shortage of supply.
- A higher running yield through holding quality credit should benefit the fund.

Performance

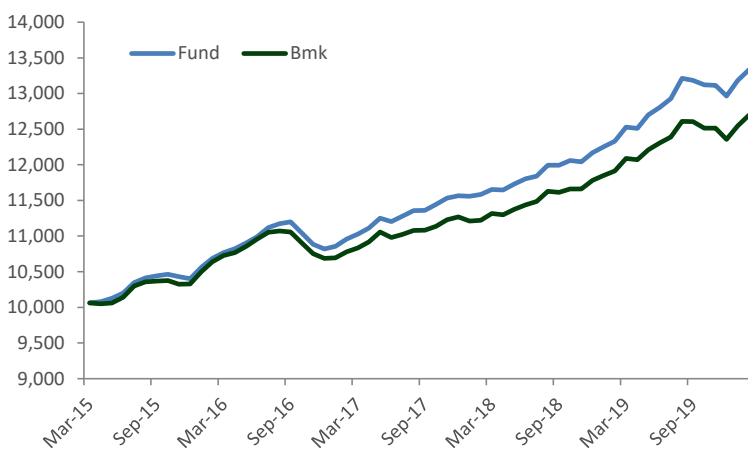
| | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|------------------------|-----------|--------------|----------|-------------------|------------------|-----------------|
| Wholesale ¹ | 1.15% | 1.69% | 8.16% | 6.77% | 5.93% | 6.72% |
| Benchmark ² | 1.20% | 1.47% | 6.57% | 5.61% | 4.89% | 5.42% |
| Retail ³ | 1.09% | 1.50% | 7.35% | 5.98% | 5.10% | |

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.

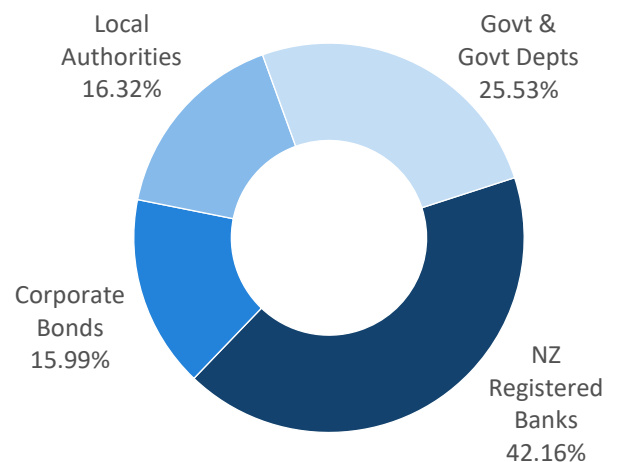
Overview

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 | 11.32% | AAA | 12.35% | Fund 4.83 years vs Benchmark 4.46 years |
| Westpac New Zealand | 7.73% | AA | 61.01% | |
| Bank Of New Zealand | 6.72% | A | 22.25% | Yield |
| Fonterra Cooperative Group | 5.59% | BBB | 4.39% | Fund (gross) 1.60% vs Benchmark 1.18% |
| ANZ Bank New Zealand | 5.21% | | | |

*excludes central government

Market Commentary

The returns from NZ bonds were again strong over the month as interest rates continued to move lower in yield. The positive contribution from duration has been the primary driver of returns as bond yields have fallen significantly since the start of the year. Funds with longer duration positions and more exposure to the direction of interest rates had a surprisingly strong start to the year.

The financial markets sentiment remains negative and has been polarised by concern over the coronavirus and what impact that could have on economic activity and world growth. There is currently a lot of negative news priced into bond markets as sentiment dominates reason. It would however be fair to say there remains considerable uncertainty about what the impact of the virus will be, and in a “risk off” environment investors generally buy bonds pushing yields lower. The NZ 10-year bond is close to records lows, and the US 10-year bond which is generally viewed as “a bellwether of global risk appetite” has plummeted to new record lows in yield. There has also been a major change priced into the front end of yield curves. Previously expectations were that central banks would keep rates on hold and the market has now switched to pricing aggressive interest rate cuts. Although we think there has been some market overreaction and bonds have perhaps become expensive we recognise markets can overshoot. In general we remain positioned longer duration than benchmark across our bond funds.

Over the month the decline in yields along the NZ government bond curve was fairly consistent with both short and longer maturities finishing around 25 basis points (bps) lower. On a sector basis NZ Government bonds were the best performing sector as yields fell in a flight to quality move. The swap curve moved in line with governments. Credit holdings underperformed as credit margins widened marginally in the “risk off” environment. We find it difficult to be overly negative on credit as the supply/demand fundamentals remain supportive with limited supply versus upcoming maturities.

Interest rate markets have had a volatile start to the year and we would expect what happens in our major trading partners to have a significant impact here in NZ. Longer term bond rates will likely continue to be more influenced by the direction of offshore bonds. Short term rates are expected to fall as there is a considerable expectation that the Reserve Bank and/or Government should provide support to the economy and those sectors that are impacted by the virus and cash flow crunch.

Fund Commentary

The fund performed in line with its benchmark over the month. The main positive was the longer duration positioning, and yield curve positioning as interest rate fell in yield. Over the month credit underperformed 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

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

\$353.7m

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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