Nikko Asset Management

Factsheet 31 March 2020

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

- The global spread of the COVID-19 has resulted in a series of extraordinary events.
- There have been large price movements in financial markets which have been dysfunctional at times as liquidity has been severely reduced and volatility spiked.
- Central banks and Governments have taken unprecedented actions to try and reduce the negative economic impacts of lock-downs which have been implemented to reduce the spread of the virus and save lives.

Fund Highlights

- NZ Bond fund returns were negative for the month, but remained positive over the quarter as quality bonds fulfilled their role as a safe haven compared to other financial assets.
- Credit margins have widened significantly, but the credit quality of the funds remains strong.
- The fund has not had to sell assets at distressed prices and we expect credit margins to return to "more normal" levels over the medium term which should help support returns.

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

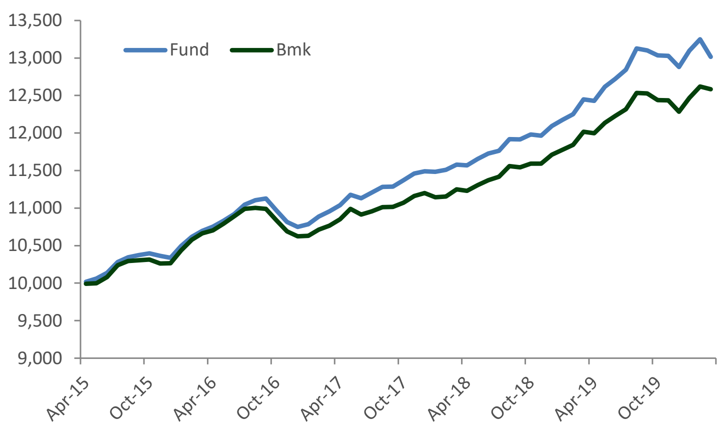
The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three year period.

Performance

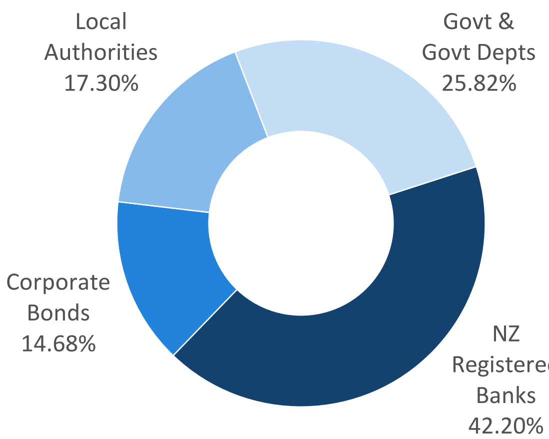
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	-1.77%	1.05%	4.55%	5.91%	5.41%	6.53%
Benchmark[2]	-0.27%	2.46%	4.72%	5.34%	4.71%	5.42%
Retail[3]	-1.83%	0.86%	3.79%	5.13%	4.59%	

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]



Asset Allocation



Top 5 Corporate Issuers*	(%)
NZ Local Govt. Fund Agency	12.39%
Bank Of New Zealand	7.12%
Westpac New Zealand	5.76%
Fonterra Cooperative Group	5.34%
ANZ Bank New Zealand	5.23%

*excludes central government

Credit Quality	(%)
AAA	12.64%
AA	59.94%
A	23.15%
BBB	4.27%

Duration
Fund 5.19 years vs Benchmark 4.40 years

Yield
Fund (gross) 1.93% vs Benchmark 1.14%

Market Commentary

The returns from NZ bonds were negative over March, but still positive over the quarter and a safe haven compared to other financial assets. Over the month volatility in financial markets was at times extreme, exacerbated by a lack of liquidity and falling investor confidence. Even in the NZ bond market sellers requiring liquidity far outweighed buyers, fortunately we have not had to sell assets from the bond funds at distressed levels. With wide pricing we have introduced buy/sell spreads on some funds to ensure equitable treatment across investors.

In explanation of performance outcomes both in absolute terms and relative to benchmark it is important to note there was a large difference in performance across the different sectors of the NZ bond market through March and at month end. NZ swap rates performed strongly as their yields fell, the 1-year swap fell by 38 basis points and the 10-year finished 28 bps lower as swap levels were not impacted by the widening in credit margins. In comparison all other sectors of the NZ bond market underperformed.

The main reason for underperformance was that credit margins expanded significantly. With a lack of liquidity and dysfunctional markets credit performed poorly, for example 5-year senior bank debt in NZ was previously marked at a credit margin of around 85 bps and closed the month much higher at margins of 160-170bps. We don’t have any solvency concerns around the fund’s holdings, however even high grade issuers close to government such as LGFA and housing NZ were marked much higher in margin over the month resulting in mark-to-market losses. Unusual in a “risk-off” environment NZ government bonds underperformed significantly in comparison to swap. Longer government bonds had large swings in yield as the market became concerned about the large increase in debt issuance required to fund the government’s support package. The sell-off higher in yield began to reverse with the NZ Reserve Bank announcing Quantitative easing (QE) and buying of NZ government bonds. The 2021 NZ government bond finished the month 55 bps lower in yield as the RBNZ slashed the Cash Rate to 0.25% and the front end of the yield curve moved much lower, the 2029 maturity was little changed. The 2037 long maturity bond finished the month 25 bps higher in yield after trading in a very wide 1.5% range over the month.

From a yield curve perspective shorter bonds performed better than longer maturities as yield curves steepened.

Fund Commentary

The fund underperformed its benchmark over the quarter. The main negative contribution was due to the expansion in credit margins, and to a lesser extent the longer duration positioning, and yield curve positioning as yield curves steepened. Over the month credit underperformed as margins widened significantly, Inflation Index linked government bonds also underperformed nominal governments and swap. The credit quality of the fund remains strong. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government bond issues. It is likely future returns will be supported by a higher yield, and some improvement in credit margins over the medium to long term. Interest rate positioning wasn’t a major detractor of value as the fund was generally positioned only slightly longer than benchmark duration earlier in the month. We have subsequently moderately extended duration.

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

Click to view

Strategy size

$343.9m

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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