Factsheet 31 May 2020

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- US 10-year bonds traded in a less volatile manner as the initial reaction to the economic shock caused by COVID-19 continued to subside. Within the month yields hit a high of 0.74% and a low of 0.58%. The historical low point in 10-year Treasury bonds was recorded in March this year when bonds traded at a yield of 0.31%.
- Markets continue to be focused on the economic and financial market impact of COVID-19 which have been greater than anticipated
- Central banks and governments have taken unprecedented actions to try and reduce the negative economic impacts of lock-downs, and confidence has recovered, however there remains considerable uncertainty about the extent of the recovery.

Fund Highlights

- The fund returned 1.9% in May, 133 basis points (bps) ahead of its benchmark.
- The Option Fund posted a positive return over May after some months of disappointing returns. Bond yields dropped to record lows in March however financial markets have subsequently been calmed by significant central bank and governmental support.
- The Corporate Bond Fund returns were positive for the month with interest rates little changed.

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

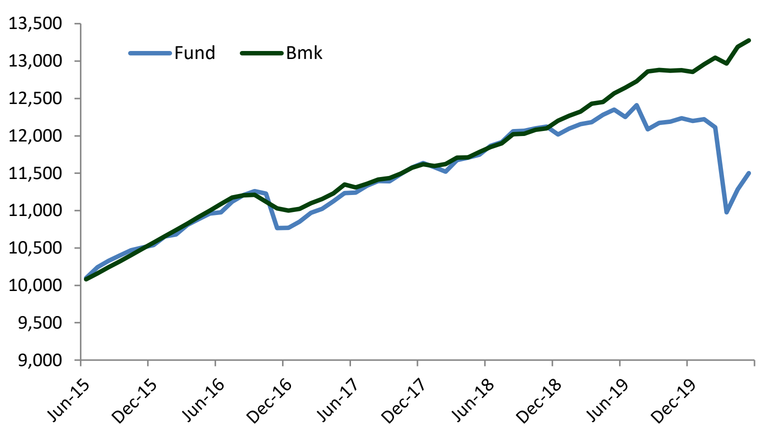
From 01 January 2020 the objective of this fund is to outperform the RBNZ Official Cash Rate by 2.50% p.a. over a rolling three year period before fees, expenses and taxes.

Performance

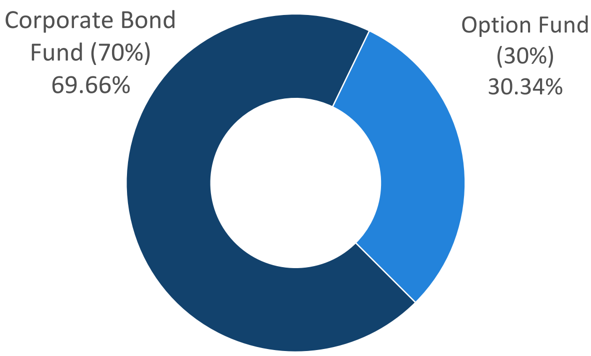
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	1.92%	-5.06%	-6.89%	0.79%	2.84%	5.14%
Benchmark[2]	0.65%	1.76%	5.63%	5.37%	5.83%	7.90%

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]



Asset Allocation



Top 5 Issuers*	(%)
Westpac New Zealand	18.05
Kiwibank	6.89
ASB New Zealand	6.83
ANZ New Zealand	5.86
China Construction Bank	5.05

Credit Quality*	(%)
AAA	1.12
AA	41.47
A	30.17
BB	0.96
BBB	17.08
Collateral & options; NR	9.20

Yield – Corporate Bond Fund
Fund (gross) 1.35% vs Benchmark 1.09%

*Aggregation of Option and Corporate Bond Funds

Option Fund Commentary

Interest rates on US 10-year Treasury bonds traded in a modest range over the month as the initial reaction to the economic shock caused by COVID-19 continued to subside. US bonds traded in a less volatile manner than seen over recent months with yields hitting a high of 0.74% and a low of 0.58% during May. The historical low point in 10-year Treasury bonds was recorded in March this year when bonds traded at a yield of 0.31%.

Federal Reserve Chairman, Jerome Powell stated that the US economy faces unprecedented risks from the coronavirus if fiscal and monetary policy makers don't rise to the challenge. Powell and his colleagues at the Fed have taken dramatic measures to shelter the US economy during the virus pandemic. They have cut their benchmark cash rate to close to zero, engaged in open ended bond buying and begun rolling out emergency lending programmes as US unemployment soars to levels not seen since the 1930s Great Depression. The US unemployment rate is likely to be significantly higher than 20%, more than double the GFC peak of 10% in 2009. With the labour market hurting this badly it is difficult to see a time when the Fed will start to reverse their low interest rate stance.

Amid such a gloomy outlook, some investors are of the view that the Fed may follow other central banks and take rates into negative territory in an attempt to spur spending and investment. Powell acknowledged the speculation but said such a move was not being considered, although he stopped short of completely ruling out negative rates as a policy option in the future. With large scale fiscal and monetary policy stimulus required to support US economic activity and jobs for the foreseeable future interest rates are likely to remain low across all maturities and volatility in interest rate markets will moderate after the dislocation we have seen so far in 2020.

The fund posted a positive return over May after some months of disappointing returns. Bond yields dropped to record lows in March however financial markets have subsequently been calmed by significant central bank and governmental support.
The precise impact COVID-19 will have on economic activity is unknown however what we do know is the impact will be large and unfavourable. Earlier than anticipated opening up of economies from stringent lock downs is causing optimism to rise. Time will tell if this is the correct response.
Volatility has reduced as central bank and government spending programmes continue to support economies and financial markets. As a consequence of lower volatility, the income the fund receives from selling short dated options has decreased over the month but still remains elevated compared to pre-COVID levels.
If volatility remains at current levels the income generating potential of the fund looks attractive however the frequency and cost of options being struck will also determine the total return.

Corporate Bond Fund Commentary

The fund outperformed its benchmark over the month. The recovery of credit margins, longer duration positioning, and yield curve positioning were all contributors to outperformance as yields fell to record lows. Credit in general outperformed similar maturities of governments and swap as margins contracted significantly. We contributed to returns by adding quality credit at cheaper levels and extending duration. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government bond issues. The credit quality of the fund remains strong. Over the medium term it is likely returns will be supported by a higher yield, and some further improvement in credit margins.

Key Fund Facts

Distributions	**Estimated annual fund charges (incl. GST)**		
Retail fund: Calendar quarter	Retail fund: 1.06%, refer PDS for more details		
Hedging	**Buy / Sell spread:**	**Strategy size**	**Strategy Launch**
All investments will be in New Zealand dollars	Click to view	$3.59m	October 2007

Compliance

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

Contact Us

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