

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

- Credit performed well as margins narrowed with NZ bond supply remaining limited.
- NZ interest rates continued to make new record lows, up until a late reversal higher in yields at month end left rates little changed over May.
- 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

- NZ Bond fund returns were positive for the month with interest rates little changed.
- Credit holdings in general have recovered their lost value plus some, post the expansion in credit margins experienced through March.
- The fund has benefited from buying cheaper assets at distressed prices and extending duration through late March and April.

Performance

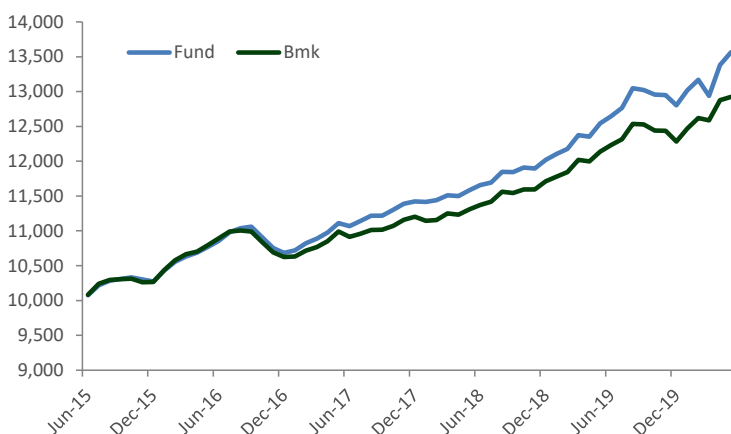
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	1.39%	3.00%	8.15%	6.88%	6.29%	6.83%
Benchmark ²	0.37%	2.40%	6.49%	5.55%	5.26%	5.49%
Retail ³	1.56%	2.79%	7.33%	6.09%	5.47%	

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.

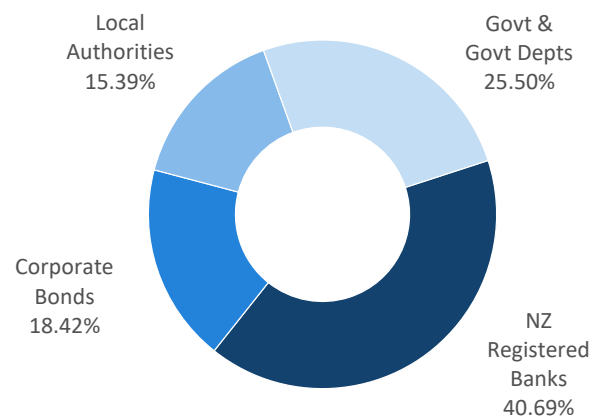
Overview

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	10.54%	AAA	11.05%	Fund 5.23 years vs Benchmark 5.05 years
Bank Of New Zealand	7.03%	AA	64.69%	
Westpac New Zealand	6.03%	A	20.01%	Yield Fund (gross) 1.13% vs Benchmark 0.68%
Fonterra Cooperative Group	5.48%	BBB	2.67%	
Housing New Zealand	5.35%	BB	1.58%	

*excludes central government

Market Commentary

Over the month NZ interest rates finished little changed, and credit continued to perform strongly, as NZ bond supply remained limited and confidence returned to financial markets. The language and actions from Central banks and Governments remain very supportive and financial market asset values have rebounded strongly as buyers have been active in the market. The main driver of returns was the strong performance from credit holdings. NZ interest rates did make new record lows in May, however this was largely reversed by month end as interest rates rebounded higher in yield by 20 to 30 basis points (bps) to finish little changed.

In general credit margins are now narrower than pre-COVID levels as demand has been strong to buy bonds with falling interest rates and investors seeking yield. At the same time that demand has been strong, supply in the NZ bond market has been very limited, and at this stage the supply pipeline of NZ issuers remains negligible.

NZ government bond rates were little changed over the month, the 1-year government bond fell by 3 bps, the 5-year increased 7 bps, and 10-year finished 4 bps lower. Performance across the different sectors of the NZ bond market was more evenly balanced between governments and swaps, with swap spreads contracting slightly and subsequently the better performer. As mentioned above credit was the star performer, for example 5-year senior bank debt in NZ was marked at a credit margin of around 85 bps pre-COVID and traded in excess of 200 bps during March, at the end of April margins were back around 110 bps, and by the end of May margins were 80 bps. The long maturity LGFA and Housing NZ bonds have continued to perform well as their credit spreads compressed to “expensive” levels relative to NZ government bonds. The system remains awash with short-term liquidity with the RBNZ buying bonds back from the market, and demand for new lending is likely to remain slow, which will limit bond issuance from banks.

Financial markets have shown substantial improvement, but we remain cautious and believe that the best strategy is to focus on positioning the funds to outperform over the medium to long term.

Fund Commentary

The fund outperformed the Bloomberg NZ Bond Composite benchmark over the month. The main driver of returns was the strong performance from credit holdings. In general credit margins have fully recovered, and in some cases are now tighter than pre-COVID levels. The longer maturity LGFA, and Housing NZ bonds have continued to perform well. When interest rates were higher and margins wide we added quality credit names at cheaper levels and extended duration which benefited returns. 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 further improvement in credit margins over the medium to long term.

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: 0.70%, refer PDS for more detail

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread

[Click to view](#)

Strategy size

\$359.56m

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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