Factsheet 30 June 2020

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- US 10-year bonds traded in a narrow range over the month. June saw yields hit a high of 0.96% and a low of 0.62%. 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. The impacts have been greater than anticipated as has the governmental and central bank response.
- The actions and language of central banks and governments continues to have a strong influence on bond markets.

Fund Highlights

- The fund returned 5.3% over the quarter, 254 basis points (bps) ahead of its benchmark.
- The Option Fund posted a positive return over the quarter after a string of disappointing returns earlier in the year. 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 quarter. Credit holdings of NZ issuers have continued to perform well with supply limited.

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

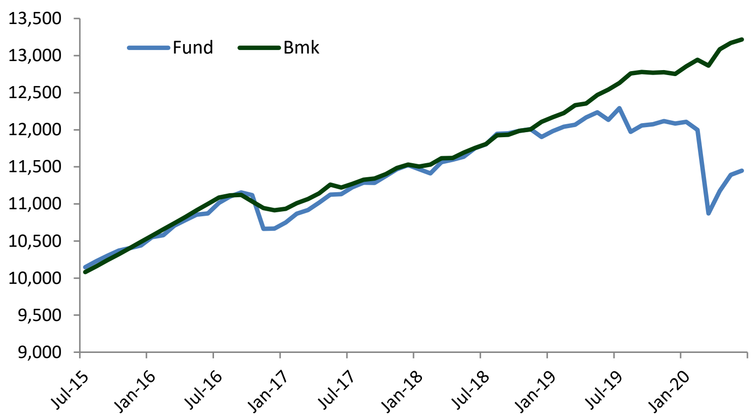
From 01 January 2020 the objective of this fund is to outperform the RBNZ Official Cash Rate by 2.50% p.a. over a rolling three year period before fees, expenses and taxes.

Performance

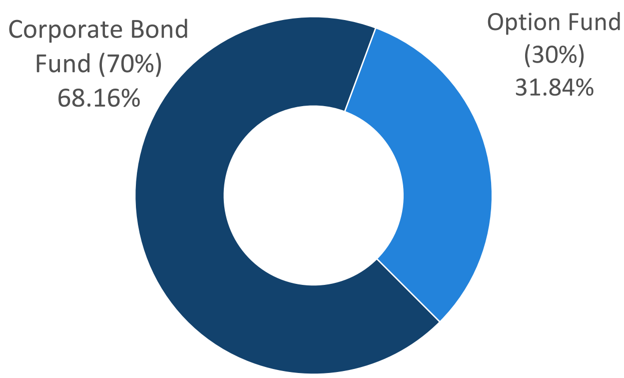
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	0.49%	5.28%	-5.67%	0.93%	2.74%	5.03%
Benchmark[2]	0.35%	2.74%	5.39%	5.61%	5.74%	7.85%

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	39.68
ASB New Zealand	17.67
Kiwibank	14.42
ANZ New Zealand	12.81
China Construction Bank	10.25

Credit Quality*	(%)
AAA	2.09
AA	43.05
A	28.83
BB	0.91
BBB	16.49
Collateral & options; NR	8.63

Yield – Corporate Bond Fund
Fund (gross) 1.34% vs Benchmark 1.00%

*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. Increases in yields have been viewed as a buying opportunity as infection rates continue to climb.

June saw yields hit a high of 0.96% before closing on their monthly low of 0.62%. The historical low point in 10-year Treasury bonds was recorded in March this year when bonds traded at a yield of 0.31%.

The US bond market seems to be holding firm to its view that the revival of the American economy from the damage of the pandemic will be slow and fragmented. Ten-year US Treasury bond yields are barely changed from the end of March. Investors have pounced on any sell-off as a buying opportunity, keeping yields in check after they fell 125 basis points (bps) in the first quarter of 2020.

The grim outlook among bond investors is starkly contrasted with the positive outlook from equity investors. Share prices rose strongly on expectations for a rebound in business activity however optimism faded somewhat amid a surge of infections and moves by some states to delay re-openings. The end result is that Treasuries will likely remain a haven for investors seeking protection from the risk of another drop off in economic growth and another dose of central bank monetary accommodation.

The US labour market remains the area of most concern. June payrolls are expected to show an improvement on the rebound in hiring seen in May, however, the deep damage done to the labour market is likely to see the jobless rate at around 12.3%, down from the April peak but still highly elevated from the 3.5% seen in February. The Federal Reserve is likely to continue pumping stimulus into the US economy until jobs recover. In an interview Fed Chairman Powell said “we’re not even thinking about raising rates” and followed up by saying “we are strongly committed to using our tools to do whatever we can for as long as it takes”. Taking these comments at face value, unless an efficient vaccine is discovered over the next few months, we are not expecting a sustained rise in US interest rates any time soon.

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.

Corporate Bond Fund Commentary

The fund outperformed its benchmark by 173 basis points over the quarter. The ongoing strong performance of credit margins and higher yield was the main contributor to outperformance. Credit in general outperformed similar maturities of governments and swap as margins contracted further. 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

Retail fund: Calendar quarter

Estimated annual fund charges (incl. GST)

Retail fund: 1.06%, refer PDS for more details

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread:

Click to view

Strategy size

$3.4m

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