

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- Supported by low interest rates, most equity markets globally performed well during the quarter and somewhat ignored the health and economic impacts from COVID-19.
- Over the quarter, the United States S&P 500 index rose 8.5%, the Japanese Nikkei 225 index was up 4.0% while the UK FTSE 100 index and the Australian ASX 200 index fell 4.9% and 0.4% respectively. The MSCI World index ended up 6.5%. The S&P/NZX 50 index ended up 2.9% and is up 2.8% on a calendar year-to-date basis.
- NZ interest rates have continued lower as expectations for further rate cuts and the possibility of a negative cash rate was priced into markets. Credit has performed strongly, and may find some stability around current levels.

Fund Highlights

- The fund returned 5.91% for the quarter - the inclusion of equities in the asset allocation of the fund benefitting returns.

Distributions

- The defined income rate for 2020 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 July 2020. Remaining distributions in 2020 will be in September and December.
- The defined income rate (which is used to calculate the distribution you receive from the fund) will be set at the start of each calendar year, based the price of the fund at that point.

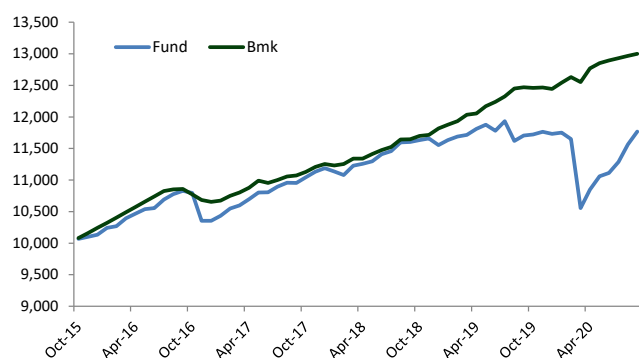
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail ¹	1.79%	5.91%	0.55%	2.42%	3.31%	5.16%
Benchmark ²	0.26%	0.81%	4.25%	5.49%	5.39%	7.67%

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.

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.

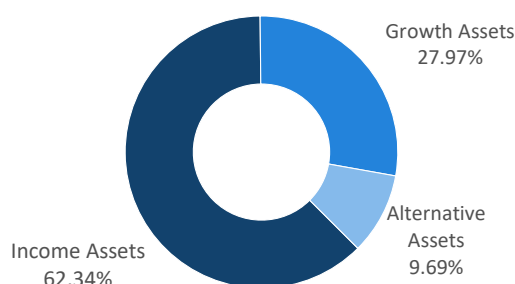
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00 % p.a. over a rolling three year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)	Top 10 Equities	(%)	(%)	Duration
NZ Local Govt. Funding Agency	10.53	Investore Property Ltd	2.36	Chorus Limited	2.27
Nikko AM Option Fund	9.69	Stride Stapled Grp	2.31	Mercury Energy	2.14
Fonterra Co-Op	4.46	Argosy Property Limited	2.31	Spark New Zealand	2.07
Auckland Int. Airport	4.15	Vector Limited	2.31	Contact Energy	2.05
Westpac Banking Corp	4.14	Skellerup Holdings Limited	2.27	Heartland Group	2.02
					Yield
					Fund 5.84 years
					Fund (gross) 1.23%
					(applies to Fixed Income only)

*Aggregation of directly held assets, Option and Corporate Bond Funds

Fund Commentary

The fund returned 5.91% over the quarter. All sectors contributed to returns with NZ shares being the highest performing sector along with long duration bonds - especially the fund's holding of Local Government bonds. In September we added a holding of a long dated 2050 Auckland Council bond to the portfolio. This bond did exceptionally well generating a return in excess of 8% in the short time it has been in the portfolio. Other long dated LGFA bonds returned close to 1.5% over the month as credit margins contracted and the bonds remained in high demand. Longer term government bonds also performed strongly with the 2041 Government bond gaining in excess of 2.7%. Gains of these levels are unlikely to be sustained, however they do give some insight into how gains can be made in the fixed income sector even as we deal with very low levels of interest rates. The fund's exposure to the Option Fund and Corporate Bond Fund also added to returns. The best performing equity holdings in the portfolio over the quarter included Investore, Skellerup, Vector, Chorus and Stride.

The fund has an exposure of approximately 28% to NZ shares. The shares are in companies that pay dividends at a level that is likely to be higher than the interest rate that would be available if the companies issued fixed interest securities to institutional and retail investors. In addition, it is expected that over time the industry sector and business models adopted by the companies should see a steady or rising share price.

The bond sector of the fund is invested primarily in long duration assets. Bond yields fell over the quarter which meant the bond sector performed well. The fund continued to hold some long dated Government and Local Government bonds. Interest rates on most bonds moved lower over the month resulting in a gain in value of the bond sector. At present we are happy to have exposure to long duration assets as cuts to the Official Cash Rate looks increasingly likely to occur in the first half of 2021. The prospect of low cash rates and the RBNZ keeping downward pressure on longer term rates by buying large volumes of bonds in the secondary market will likely keep a lid on any future interest rate rises for many years to come.

The fund is fully invested and the manager will continue to look for opportunities to add value and income to the fund. The possibility of the Reserve Bank cutting the Official Cash Rate into negative territory in 2021 has increased. This represents both a threat and an opportunity for the fund. High levels of liquidity in the banking system has left many investors looking for a home for their money that will give them an opportunity to earn more than is on offer from bank deposits. This search for income is likely to be an enduring theme for the next few years at least.

Key Fund Facts

Distributions

Distributions for this fund are defined annually and are effective for the calendar year. The annual defined income rate for 2020 is effective on a pro rata basis from 1 July 2020 for the balance of the calendar year.

Estimated annual fund charges (incl. GST)

0.81%, refer PDS for more details

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread:

[Click to view](#)

Strategy size

\$3.5m

Strategy Launch

October 2007

Compliance

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

Contact Us

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