Factsheet 30 September 2020

# NIKKO AM NZ CORPORATE BOND STRATEGY

Assets are held in the Nikko AM Wholesale NZ Corporate Bond Fund. The Nikko AM NZ Corporate Bond Fund (retail) and Nikko AM KiwiSaver NZ Corporate Bond Fund invest in units in the wholesale fund, which the commentary refers to.

## Market Overview

- NZ interest rates have continued to track lower over the quarter as expectations for further rate cuts and the possibility of a negative cash rate was priced into markets.
- Credit has continued to perform well with the increase in new issuance readily absorbed.
- The actions and language of central banks and governments continues to have a strong influence on bond markets.

## Fund Highlights

- The fund has continued to deliver strong returns as interest rates grind lower in yield, and has continued to perform well relative to benchmark.
- NZ bank bonds margins have narrowed further with supply limited.

## Performance

| | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|---|---|---|---|---|---|---|
| Wholesale[1] | 0.51% | 2.33% | 6.59% | 7.15% | 6.29% | 6.89% |
| Benchmark[2] | 0.32% | 1.54% | 4.86% | 5.74% | 4.79% | 5.17% |
| Retail[3] | 0.45% | 2.13% | 5.75% | 6.32% | 5.44% | 5.99% |
| KiwiSaver[3] | 0.44% | 2.13% | 5.73% | | | |

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Credit 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).

## 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.

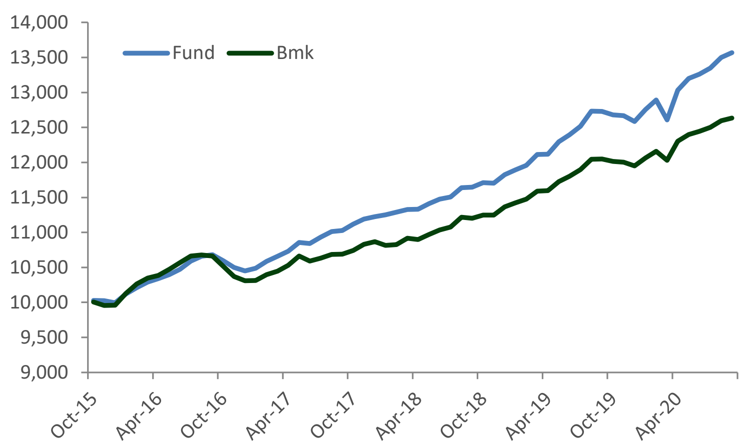
## Overview

The strategy aims to generate 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.

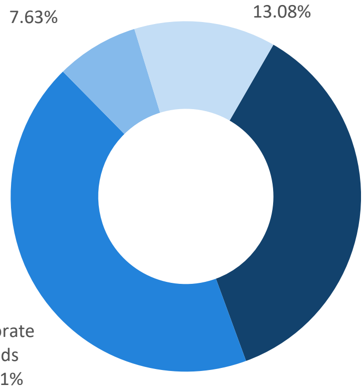
## Objective

The fund aims to outperform the benchmark return by 0.70% per annum before fees, expenses and taxes over a rolling three year period.

## Five Year Cumulative Performance, $10,000 invested[1,2]




## Asset Allocation



| Top 5 Corporate Issuers | % |
|---|---|
| NZ Local Govt Funding Agency | 7.12 |
| Fonterra Cooperative Group | 5.45 |
| ANZ Bank | 4.82 |
| Bank of New Zealand | 4.80 |
| Kiwibank | 4.79 |

| Credit Quality (% of fund) | % |
|---|---|
| AAA | 3.83 |
| AA | 40.59 |
| A | 28.41 |
| BBB | 25.83 |
| BB | 1.34 |

| Duration |
|---|
| Fund 4.22 years vs Benchmark 3.15 years |

| Yield |
|---|
| Fund (gross) 1.16% vs Benchmark 0.64% |

## Market Commentary

NZ bonds performed well over the September quarter. The key drivers of returns were a further move lower in interest rates and continuing strong performance from credit holdings, supported by a higher than benchmark yield.

The events of the past few months have seen NZ interest rates in a general downtrend, and there is now a high likelihood of further cuts to the cash rate priced in - for example, NZ government bonds out to five years have already traded at negative yields.

The latest Reserve Bank update remained consistent - in that their preferred tools for stimulating the economy are further QE bond purchases, and that they are also likely to introduce a new targeted lending programme at very low borrowing rates in the future. Whether or not we see a negative cash rate is likely still five months away if the bank remains consistent in their rhetoric to keep cash rates stable until early 2021. With current pricing there is some risk, particularly to the front of the yield curve if things pan out better than expected and further rate cuts don't eventuate. However it would still seem too early for interest rates to move much higher in yield for some time while economic growth, employment and inflation are substantially underachieving their targets.

On a sector basis NZ government bonds and local authorities were some of the better performers over the month. Auckland City Council issued a very long maturity 2050 bond at 2.97% which was a first for NZ bond markets, and this received strong demand and subsequently performed very well. The 3-year government bond decreased by 9 basis points, the 5-year fell 13 basis points, and 10-year also finished 13 basis points lower. It is however important to note that longer maturity bonds increase more in value than shorter maturities when yields fall due to their longer duration exposure and resultant greater leverage to interest rate movements. For credit the increase in supply of new bond issues has not dented demand thus far and sectors where issuance is expected to remain scarce such as banks have continued to tighten in margin. Conversely some other issuers' credit margins are reasonably consistent with where they were marked pre-COVID. We have been investing where we see value, with a quality and liquidity bias as there still remains a reasonable amount of uncertainty. The yield curve remains steep in slope, however if investors continue to buy longer term bonds, interest rates should continue to fall.

## Fund Commentary

The fund outperformed its benchmark over the quarter. The main positive contributor to returns was the longer duration positioning, and strong performance from credit supported by higher fund yield. We extended duration and added some long maturity bonds when yields were higher with a steep yield curve. Credit margins have performed strongly with supply very limited. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government bond issues. Over the past couple of months we have been selling shorter maturity bonds and buying mid curve and longer maturity bonds where appropriate to try and avoid very low or negative yields. It has been this extension and search for yield further along the curve by NZ bond investors that is principally responsible for further declines in interest rates over the past month. The fund has been positioned longer in duration than benchmark and also has an overweight positioning bias to longer maturity bonds which has supported the ongoing outperformance.

## Key Fund Facts

**Distributions**

Wholesale fund: calendar quarter
Retail fund: calendar quarter
KiwiSaver fund: does not distribute

**Estimated annual fund charges (incl. GST)**

Wholesale fund: negotiated outside of unit price
Retail fund: 0.79%, refer PDS for more details
KiwiSaver fund: 0.80%, refer PDS for more details

**Hedging**

All investments will be in New Zealand dollars

**Buy / Sell spread:**

Click to view

**Strategy size**

$329.5m

**Strategy Launch**

July 2009

### Compliance

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

### Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com