

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- Most equity markets globally struggled in October as COVID-19 case numbers increased in Europe and parts of the United States
- The United States S&P 500 index fell 2.8%, the Japanese Nikkei 225 index lost 0.9%, the UK FTSE 100 index declined 4.9% while the Australian ASX 200 index rose 1.9%. The MSCI World index ended the month down 2.5%
- In NZ, equities out performed bonds with short and medium-term bonds being the best performers in the fixed income sector. After a long period of long-term bonds out performing shorter-term bonds, longer duration bonds lagged this month. The Reserve Bank's talk of lowering the Official Cash Rate into negative territory has seen short-term bonds perform well as investors try to lock their money away before any cuts occur.

Fund Highlights

- The fund returned 1.03% for the month - the inclusion of equities in the asset allocation of the fund benefitted returns.

Distributions

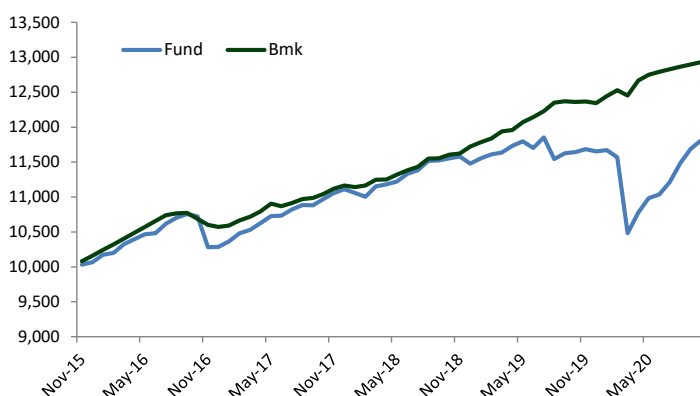
- The defined income rate for 2020 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 July 2020. Remaining distribution in 2020 will be in December.
- The defined income rate (which is used to calculate the distribution you receive from 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	1.03%	5.35%	1.45%	2.49%	3.38%	5.20%
Benchmark ²	0.27%	0.81%	4.62%	5.41%	5.28%	7.61%

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.

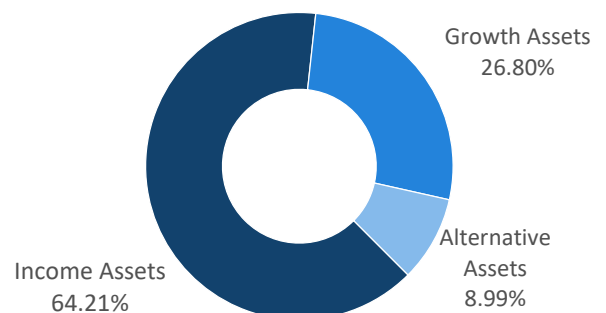
Overview

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
Westpac Banking Corp	10.76	Stride Property Ltd	2.24	Vector Limited	2.09
NZ Local Govt. Funding	9.61	Skellerup Holdings Limited	2.21	Mercury Energy	2.08
Nikko AM Option Fund	8.99	Investore Property Ltd	2.21	Chorus Limited	2.07
Fonterra Co-Op	4.14	Argosy Property Limited	2.18	Heartland Group	2.01
TR Group	3.87	Contact Energy	2.10	Meridian Energy	1.99
					Yield
					Fund 5.77 years
					Fund (gross) 1.45%
					(applies to Fixed Income only)

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

Fund Commentary

The Income Fund returned 1.03% over October. Performance was largely helped by a strong return from the equity sector of the portfolio. Contact Energy was the best performer gaining more than 10% over the month followed by an 8% return from Skellerup and 7% from Meridian Energy. The fund holds 13 equity names of which 10 increased over the month and 3 declined. Spark trailed the field at close to -4.5%

In general, equities outperformed bonds with short and medium-term bonds being the best performers in the fixed income sector. After a long period of long-term bonds outperforming shorter-term bonds, longer duration bonds lagged this month. The Reserve Bank's talk of lowering the Official Cash Rate into negative territory has seen short-term bonds perform well as investors try to lock their money away before any cuts occur. With the Government and Reserve Bank focused on reviving the economy we think stimulatory monetary policy settings and low cash rates will be with us until at least 2023.

Banks have been cutting their term deposit rates and are unlikely to increase them again while cash rates are low. In addition the banks will become less reliant on retail funding as they will soon be able to borrow cheaply from the Reserve Bank as long as these interest cost savings are passed on to the banks' clients.

With these dynamics at play we believe it is appropriate to seek income from more diverse sources. For the Income Fund this means investing in NZ companies listed on the NZX that pay an acceptable level of dividends or who have the likelihood of doing so in the future. The Income Fund has an exposure of approximately 27% to NZ shares. The shares are in companies that pay dividends at a level that is likely to be at a higher level 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. At present we are happy to have exposure to long 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 but is still dependent upon NZ's economic performance. 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 the rate on bank deposits. This search for income is likely to be an enduring theme for the next few years and we believe this environment should create opportunities for the fund to deliver an enhanced level of performance.

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

\$3.8m

Strategy Launch

October 2007

Compliance

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

Contact Us

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