

Factsheet 31 October 2020

# 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

- NZ interest rates were stable over the month after steep falls earlier in the year.
- 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 produced modest returns over the month, but still outperformed returns from cash and continues to perform well relative to benchmark.
- NZ bank bonds have narrowed further in margin with supply limited.

## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	0.14%	2.41%	8.12%	7.42%	6.28%	6.74%
Benchmark <sup>2</sup>	-0.07%	1.38%	5.71%	5.91%	4.98%	5.34%
Retail <sup>3</sup>	0.09%	2.25%	7.34%	6.64%	5.49%	

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).

## 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.

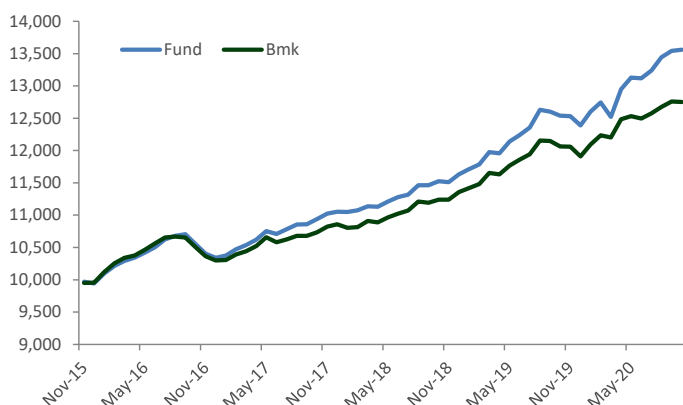
## Overview

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.

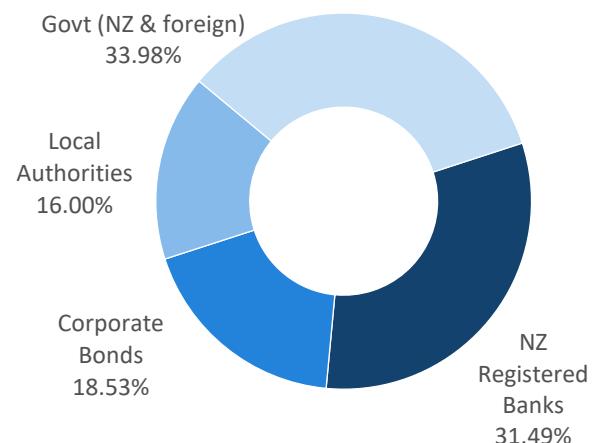
## Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three year period.

## Five Year Cumulative Performance, \$10,000 invested<sup>1&2</sup>



## Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Duration
NZ Local Govt. Funding Agency	11.38	AAA	12.77	Fund 6.37 years vs Benchmark 5.42 years
Kommunalbanken	8.27	AA	60.01	
Housing New Zealand	5.26	A	23.07	Yield Fund (gross) 0.74% vs Benchmark 0.40%
Kiwibank	5.22	BBB	2.73	
Fonterra Cooperative Group	4.93	BB	1.42	

\*excludes central government

## Market Commentary

October produced modest returns from the NZ bond market. Short term bonds outperformed longer term bonds as the Reserve Bank continued to talk up the prospect of a negative Official Cash Rate in 2021. The key drivers of returns over the month were an incremental move lower in interest rates out to five years and continuing strong performance from credit holdings, supported by a higher than benchmark portfolio yield.

New Zealand’s inflation rate unexpectedly slowed in the third quarter of 2020 as fuel prices failed to recover previous falls, adding to signs the Reserve Bank may need to deliver more stimulus. The RBNZ Governor signalled he is prepared to use a suite of monetary policy tools to avoid seeing deflation take hold. Governor Orr said “The failure of monetary policy is deflation”, he went on to say “I’d prefer to be battling with the quality problem of re-containing high inflation than the real challenge of battling deflation.”

Further insights from the Reserve Bank reveal all their economic scenarios include very weak inflation pressures. That has been the motivation for their approach of going hard, going early and risking doing too much rather than too little. They concedes that some data has surprised on the upside, however the economy is still on life support to some extent that will last for some time ahead. There will be a transition period required before a full economic recovery occurs. This transitional period will require continued policy support especially as the global environment has risk to the downside.

On a sector basis, NZ government bonds and longer duration bonds under performed with corporate and bank bonds some of the better performers over the month. It is 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 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 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 around about the economic outlook.

## Fund Commentary

The fund outperformed its benchmark over the month. The main positive contributor was a strong performance from credit issues supported by higher fund yield and exposure to inflation linked bonds. We extended duration by adding May 2028 government bonds which were funded from selling 2021 maturities. Credit margins have continued to perform well with supply very limited. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government issues.

## 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

\$403.9m

### 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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