

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- Equity markets globally were strong on news that COVID-19 vaccines trials were showing high success rates and were starting to be administered.
- The United States S&P 500 index rose 11.7%, the Japanese Nikkei 225 index gained 18.4%, the UK FTSE 100 index increased 10.1%, the Australian ASX 200 index added 13.7% and the MSCI World index ended the quarter up 12.8%.
- The S&P/NZX 50 index had a strong quarter, ending the period up 11.5%.
- With interest rates rising, short and medium term bonds were the best performers in the fixed income sector. After long term bonds out performing shorter term bonds for most of the year, long bonds performed poorly this month.

Fund Highlights

- The fund posted a strong December return driven by exceptional performance from some of the equity holdings.

Distributions

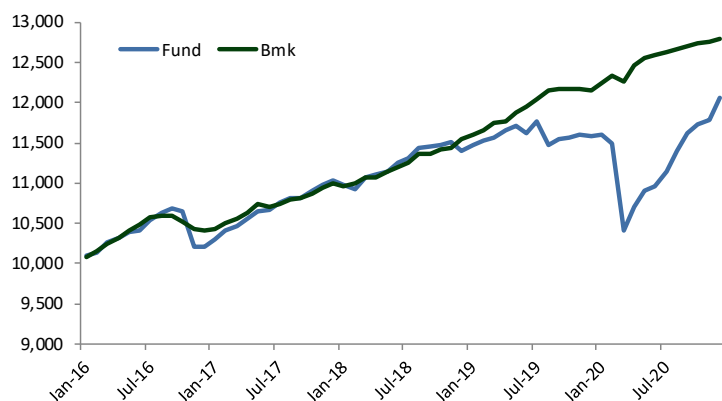
- The defined income rate for 2021 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2021.
- The defined income rate (which is used to calculate the distribution you receive from the fund) will be set at the start of each calendar year, based on 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	2.27%	3.81%	4.15%	2.98%	3.81%	5.44%
Benchmark ²	0.27%	0.81%	5.31%	5.21%	5.06%	7.50%

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.

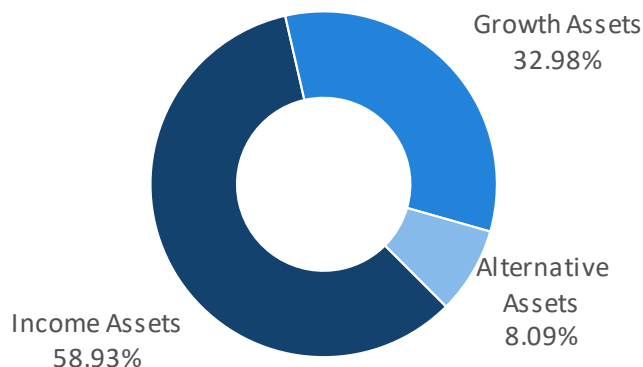
Overview

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
Nikko AM Option Fund	8.09	Stride Property Ltd	4.07	Mercury Energy	2.22
NZ Local Govt. Funding	8.07	Heartland Group	2.77	Contact Energy	2.22
Kiwibank	4.69	Meridian Energy	2.44	Argosy Property	2.21
Infratil	3.67	Skellerup Holdings	2.30	Scales Corporation	2.17
Auckland City Council	3.64	Spark	2.27	Chorus Limited	2.17

*Aggregation of directly held assets and Option Fund

Yield
Fund (gross) 2.13%

(applies to Fixed Income only)

Fund Commentary

The fund had a strong return over December driven by exceptional returns from some of the equity holdings. Five of the companies' share prices increased by more than 12% - Meridian increased by 15.4% followed by Skellerup 14.8%, Heartland 14.5%, Contact 14.2% and Genesis Energy at 12.2%. Chorus performed at the tail of the field with a negative 3.5% return.

The energy sector of the equity allocation performed strongly towards month end as significant buy orders were placed by large global funds interested in New Zealand's sustainable energy operators. Price movements may have been magnified by the thin trading volumes around the Christmas and New Year holiday season.

The fund has an exposure of approximately 30% in equities in 13 names with a small additional holding in preference shares. The balance of the fund is held in fixed income securities including an 8% weighting to the Nikko Option Fund. Interest rates increased over the month with the largest movements occurring in longer maturities. This resulted in the fixed income sector posting a small negative return, the Option Fund gained close to 1.2%.

With interest rates rising, short and medium term bonds were the best performers in the fixed income sector. After long term bonds out performing shorter term bonds for most of the year, long bonds performed poorly this month. The Reserve Bank seems less convinced of the need to lower the Official Cash Rate into negative territory as the economic recovery is stronger than anticipated and many of the stimulatory programmes remain in place. The Funding for Lending Programme (FLP) which started in December provides banks with low cost funding which could push lending rates lower. With the Government and Reserve Bank focused upon reviving the economy we think stimulatory monetary policy settings and low cash rates will be with us until at least 2023, however longer term bond rates will be more influenced by global trends. Banks have cut their term deposit rates and are unlikely to increase them again while cash rates remain low. As mentioned above the banks will become less reliant on retail deposit funding over 2021 as they are able to borrow cheaply from the Reserve Bank. In return the Reserve Bank will want to see some of this interest cost savings that the banks enjoy being passed on to borrowers and in particular borrowers who want to invest in employment related activities.

With these dynamics at play we believe it is appropriate for investors to seek income from more diverse sources than just interest rates alone. 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 fund is fully invested and the manager will continue to look for opportunities to add value and income to the fund. Low and stable short term interest rates represent 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 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.

The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.

Hedging

All investments will be in New Zealand dollars

Estimated annual fund charges (incl. GST)

0.81%, refer PDS for more details

Buy / Sell spread: [Click to view](#) Strategy size: \$4.23m Strategy Launch: October 2007

Compliance

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

Contact Us

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