

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- March was a volatile month for financial markets especially in the performance of some New Zealand equity names.
- Long term bonds provided positive returns after a number of months of being under pressure from rising interest rates, shorter term bonds continued to generate steady albeit low returns.
- Global markets were mixed with positive returns from equity markets however global bonds generated negative returns and underperformed the NZ fixed income market.

Fund Highlights

- More than half of the Income Fund's equity names increased in value over March, however a close to 9% fall in the share price of Chorus and smaller falls from Heartland Group and Meridian meant the return from the equity sector in total was slightly negative.

Distributions

- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point.
- The defined distribution 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.

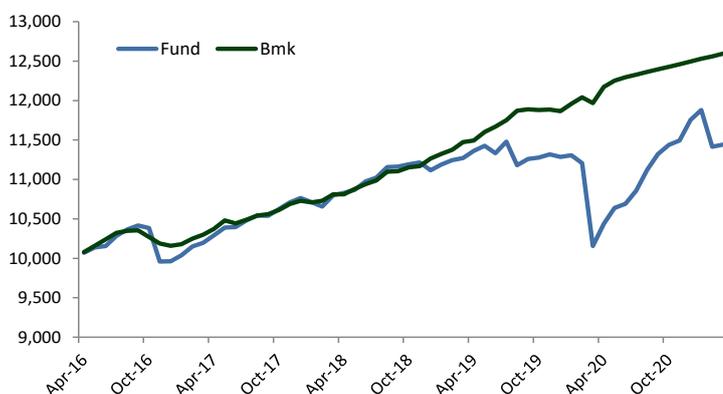
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail ¹	0.23%	-2.65%	12.68%	1.94%	2.73%	4.73%
Benchmark ²	0.27%	0.79%	5.23%	5.22%	4.72%	7.33%

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.

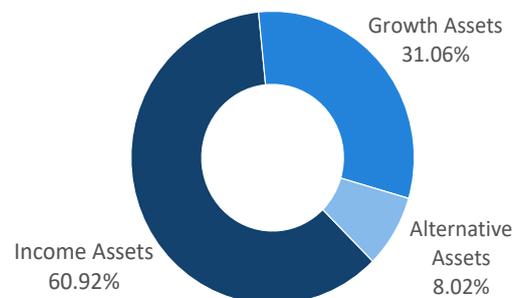
Overview

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	8.02%	Heartland Group	3.14	Scales Corp Ltd	2.13
NZ Local Govt. Funding Agency	7.66%	Stride Property Ltd	3.10	Argosy Property Limited	2.13
Kiwibank Ltd	4.89%	Skellerup Holdings	2.82	Chorus Limited Ordinary	2.04
Infratil Ltd	3.86%	Mercury NZ Limited	2.33	Genesis Energy Ltd	1.96
Liberty Finance	3.68%	Spark New Zealand Limited	2.28	Investore Property Ltd	1.88
					Yield
					Fund (gross) 2.55%
					(applies to fixed income only)

*Aggregation of directly held assets and Option Fund

Fund Commentary

March was a volatile month for financial markets especially in the performance of some New Zealand equity names. Long term bonds provided positive returns after a number of months of being under pressure from rising interest rates. Shorter term bonds continued to generate steady albeit low returns. Global markets were mixed with positive returns from equity markets however, global bonds generated negative returns and underperformed the NZ fixed income market.

More than half of the Income Fund's equity names increased in value over March however, a close to 9% fall in the share price of Chorus and smaller falls from Heartland Group and Meridian meant the return from the equity sector in total was slightly negative. Meridian continues to be the smallest equity exposure at 1.2% of the fund's assets. Dividend income received from the selected portfolio of equities continues to be attractive compared to interest income from the fixed interest sector.

The fund has an exposure of close to 28% in equities in 13 names with a small additional holding in preference shares. The balance of the fund is held in fixed income securities and an 8% weighting to the Nikko Option Fund. Interest rates were more settled over the month with longer term rates slightly lower and some issues contracting in credit margin resulting a strong performance, an example is the 2037 LGFA bond which posted a monthly return of 1.8%.

A lower than expected December GDP number of negative 1%, and uncertainty about the economic impact of Government changes imposed upon residential property investors has seen the market push out the time line of when the RBNZ is expected start to increase the OCR.

Even though lending demand, especially via mortgages has been high the banking system seems to be well funded with little upward pressure on deposit rates. The Reserve Bank's Funding for Lending Programme (FLP) also provides banks with the opportunity to borrow at low cost which should help keep lending rates low. With the Government and Reserve Bank focused upon reviving the economy to a robust state before thinking of removing stimulatory monetary policy settings we believe low cash rates will be with us well into 2022 or 2023 however, longer term bond rates will be more influenced by global trends.

With these dynamics likely to remain, we believe it is appropriate for investors to seek income from more diverse sources than just interest rates alone. Even though some equity prices have fallen this month we continue to believe the environment remains attractive for the equity market. The Income Fund has exposure to shares in companies that pay dividends likely to be higher than the interest rate that would be available if the companies issued fixed interest securities. In addition, it is expected that over time the industry sector and business models adopted by these companies should see a steady or rising share price.

The bond sector of the fund is invested primarily in medium to longer duration assets. At present we are happy to have exposure to longer term assets as the Official Cash Rate looks increasingly likely to remain low over the next two years at least. The prospect of low cash rates and the RBNZ keeping downward pressure on longer term rates by buying bonds in the secondary market will likely keep a lid on the size of any future interest rate rises.

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 their money that gives them an opportunity to earn more than 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)

0.80%, refer PDS for more details

Buy / Sell spread: **Strategy size** **Strategy Launch**
[Click to view](#) \$4.1m October 2007

Compliance

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

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

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