

# NIKKO AM NZ CASH STRATEGY

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

## Market Overview

- CPI inflation came roaring in at 2.2% for the quarter taking annual inflation to 4.9%, well ahead of market expectations of 1.5% for the quarter and 4.2% for the year.
- The RBNZ raised the OCR to 0.50%, formally starting a widely expected tightening cycle. Markets reacted to these CPI numbers by quickly pushing short term interest rates up anticipating the RBNZ would need to respond.

## Fund Highlights

- The fund holds a longer than benchmark duration position to benefit from slope in the credit and bank bill curves.
- Duration is actively managed with fund positions reflecting the likely path of the OCR over the coming months along with what is priced into security yields.
- The fund holds a range of securities including floating rate notes which provide some protection against a rising cash rate.

## Performance

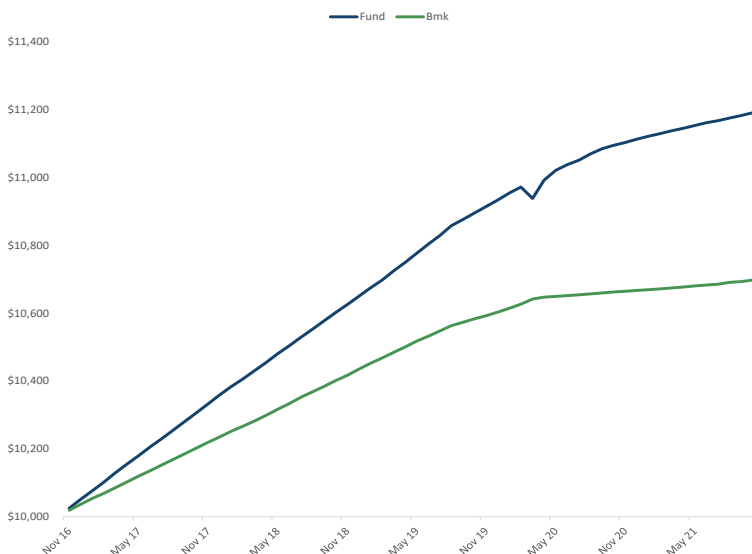
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	0.07%	0.21%	0.86%	1.82%	2.28%	3.12%
Benchmark <sup>2</sup>	0.04%	0.11%	0.33%	0.94%	1.36%	2.15%
Retail <sup>3</sup>	0.05%	0.14%	0.57%	1.49%	1.93%	
KiwiSaver <sup>3</sup>	0.03%	0.10%	0.43%	1.50%		

1. Returns are before tax and before the deduction of fees.

2. Benchmark: Bloomberg NZBond Bank Bill Index. No tax or fees.

3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

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



## 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.

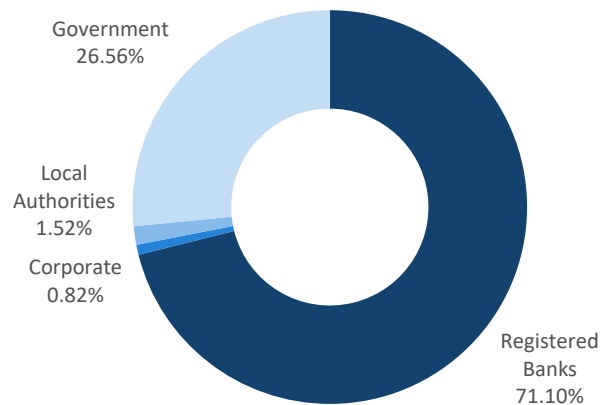
## Overview

The strategy aims to generate income by constructing an actively managed investment portfolio of short-term deposits and bonds whilst preserving capital value.

## Objective

The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three year period.

## Asset Allocation



Top 5 Issuers	(%)	Credit Quality	(%)	Duration
Westpac New Zealand Ltd	15.74	AAA	26.56	Fund 119 days vs Benchmark 45 days
Tax Management NZ Ltd (Govt IRD)	13.20	AA	38.64	
NZ Tax Trading Co (Govt IRD)	12.97	A	34.80	
Kiwibank Ltd	11.50			<b>Yield to Maturity</b>
ASB Bank Ltd	10.29			Fund (gross) 1.24% vs Benchmark 0.65%

## Market Commentary

October's short term interest rate market centred around inflation - its strength, consistency, and persistence along with possible reactions it may engender from the Reserve Bank all needing due consideration. CPI inflation came roaring in at 2.2% for the quarter taking annual inflation to 4.9%, well ahead of market expectations of 1.5% for the quarter and 4.2% for the year. To put the size of this print into context, over the past 30 years there has been only one quarter with a higher inflation rate, this being when GST was increased back in October 2010. Looking in more detail at the composition of these price increases shows a picture of consistency with consumer purchasing power eroded from all directions. Out of the 11 CPI groups measured all but one showed quarterly price increases with the decrease being in the 'communications' group which accounts for a miniscule 3.1% of the CPI basket. In addition to this some of the larger group increases came from categories that not only represent less avoidable consumption but are also meaningful in size including 'transportation' +4.2% QoQ (11.9% of basket), 'Food' +2.7% QoQ (18.7% of basket) and 'Housing' +2.6% QoQ (28% of basket).

The RBNZ has been arguing a reasonable proportion of inflation currently experienced is driven by transitory factors including supply chain disruptions and energy prices. However, when considering New Zealand's situation, we have record low unemployment and closed borders preventing efficient sourcing of additional labour, along with significant government stimulus and being at the end of global supply chains. The former of these factors puts more power into employee's hands which is arguably already leading to upwards pressure in wage demands - absent the counterbalancing of imported labour, whilst being at the end of global supply chains may see constraints remain longer for New Zealand than other countries. On top of this we note that in general the longer inflation persists and the more widely it is experienced the more likely it will be seen in wage demands. For the RBNZ this inflation data will confirm their decision to increase the OCR from 0.25% to 0.50% at the start of the month. The challenge now becomes the journey of the OCR tightening cycle from here. As we previously mentioned in our September commentary the RBNZ's assistant governor recently gave a speech detailing their 'least regrets approach' to monetary policy which stipulated when there is uncertainty, they will take slow and measured steps. Arguably this uncertainty currently exists suggesting the RBNZ should take measured steps of 0.25% OCR increases. This has not stopped the market pricing in the potential for 0.50% moves on the back of this inflation data. Here one must remember that credibility is a key component of monetary policy effectiveness, implementing larger OCR increases at a single meeting would require an adjustment to the RBNZ's narrative. This seems unnecessary when the RBNZ can manage forward expectations through comments keeping their credibility intact and whilst not necessitating a change in the narrative.

## Fund Commentary

The fund performed well in October returning 0.07% outperforming the 90-day bank bill index which returned 0.04%. The fund's duration position ended the month longer as we implemented a barbel strategy across the fund. The market is pricing near a 50% probability of a 50 basis point move at the RBNZ's November meeting whilst around 2% of rate rises are priced in one year out. If one takes the view the RBNZ will implement a measured approach to tightening consistent with their speech on their 'least regrets approach' to monetary policy market pricing looks attractive targeting the RBNZ's November and February meeting dates combined with some positions towards one year in tenor. We will continue to take an active view on what is priced into security yields as these OCR review meetings eventuate over the coming months.

## Key Fund Facts

<b>Distributions</b>	<b>Estimated annual fund charges (incl. GST)</b>		
Wholesale fund: Calendar quarter	Wholesale:	Negotiated outside of unit price	
Retail fund: Calendar quarter	Retail:	0.30%, refer PDS for more details	
KiwiSaver fund: Does not distribute	KiwiSaver:	0.45%, refer PDS for more details	
<b>Hedging</b>	<b>Buy / Sell spread</b>	<b>Strategy size</b>	<b>Strategy Launch</b>
All investments will be in New Zealand dollars	0.00% / 0.00	\$779.4m	October 2007
<b>Restrictions</b>			
Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information please refer to the Statement of Investment Policy and Objectives (SIPO) which can be found on our website <a href="https://www.nikkoam.co.nz/invest/retail">https://www.nikkoam.co.nz/invest/retail</a> .			
<b>Exclusions</b>			
Securities that conduct activities listed on the Schedule to Cluster Munitions Prohibition Act 2009.			

## Compliance

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

## Contact Us [www.nikkoam.co.nz](http://www.nikkoam.co.nz) | [nzenquiries@nikkoam.com](mailto:nzenquiries@nikkoam.com)

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