

Factsheet 30 April 2022

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The NZX 50 Index decreased by 1.86% over the month, reversing the gain from March. The NZ bond market didn't fare any better falling 1.95% as measured by the Bloomberg Composite Bond Index.
- In the NZ fixed income sector government bonds have been the better performers with inflation linked bonds a standout on a relative basis. NZ credit margins have had a modest widening but performed much better than credit issues in offshore markets. There has been strong demand for new issues of mid curve bonds as this is viewed as a "safer/better" place to invest with rising rates and a flat curve.

Fund Highlights

- The Income Fund declined over April as both equity and bond markets fell.
- Spark was the star performer within the fund's equity holdings, advancing 7.4%. EBOS, Mercury Energy and Infratil all gained in price while Meridian, Scales and Argosy Property were the laggards.
- Longer term bonds underperformed as interest rates pushed higher as inflation concerns intensified.

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 2022 is 3.5% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price at 1 January 2022.

Performance

	One mth	Three mths	One yr	Three yrs (pa)	Five yrs (pa)	Ten yrs (pa)
Retail ¹	-1.89%	-2.79%	-2.62%	-0.19%	1.89%	4.05%
Benchmark ²	0.35%	0.97%	3.57%	4.40%	4.74%	6.63%
Market Index ³	-1.45%	-2.12%	-5.94%			

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.

3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 30% S&P/NZX 50 Gross Index, 7.5% Alternatives exempt.

Five Year Cumulative Performance, \$10,000 invested^{1,2}

Change of investment strategy 01/07/2020



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.

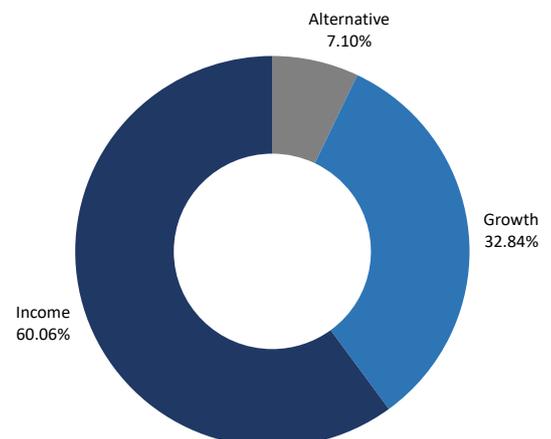
Overview

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 2020 these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)	Duration*	Top 10 Equities	(%)	(%)	
GMT Bond Issuer Ltd	5.33	Fund 4.18 years	Spark New Zealand Ltd	3.18	Contact Energy Limited	2.42
Westpac New Zealand Ltd	5.11	Yield to Maturity	Skellerup Ltd	3.12	Works Finance NZ Ltd	2.09
New Zealand Local Gov Agency	4.88	Fund (gross) 4.43%	Infratil Limited	2.96	Scales Corp Ltd	1.83
Bank of New Zealand	4.57		Stride Stapled	2.93	Chorus Limited	1.82
Infratil Ltd	3.07		Heartland Group	2.67	EBOS Ltd	1.71

*Includes cash holdings.

Fund Commentary

The Income Fund declined over April as both equity and bond markets fell. The NZX 50 Index decreased by 1.86% over the month, reversing the gain from March. The equity market has now declined by 8.8% since the beginning of the year. The NZ bond market didn't fare any better falling 1.95% as measured by the Bloomberg Composite Bond Index, over April and 5.5% year-to-date. The Option Fund fell over the month.

Spark was the star performer within the fund's equity holdings, advancing 7.4%. EBOS, Mercury Energy and Infratil all gained in price while Meridian, Scales and Argosy Property were the laggards. Longer term bonds underperformed as interest rates pushed higher as inflation concerns intensified. Uncertainty surrounding how far and how fast the Reserve Bank will increase the cash rate has led the market to price in a cash rate as high as 4% - 4.25%. Only time will tell if this expectation is too high and bond yields have increased too much. April was a poor month for bonds - financial markets remained volatile and experienced outsized moves as Central banks signaled intentions to move cash rates higher and faster to combat inflation. The moves in global bonds yields have weighed heavily on NZ and lack of local buy-side interest has exacerbated the pace and quantum of moves higher in NZ rates. Over the month the NZ 2-year government bond finished 42 basis points (bps) higher, the 5-year finished 43 bps higher, and the 10-year bond and 2051 government bond were 42 bps, and 43 bps higher in yield respectively. The yield curve has become very flat over recent months with short term bonds rising more in yield than longer bonds in what is termed a "bear flattening", resulting in a difficult environment for bond returns.

In the NZ fixed income sector government bonds have been the better performers, with inflation linked bonds a standout on a relative basis. Swap margins have expanded relative to similar maturities of governments. NZ credit margins have had a modest widening but performed much better than credit issues in offshore markets. There has been strong demand for new issues of mid curve bonds as this is viewed as a "safer/better" place to invest with rising rates and a flat curve. Over history flat or inverted yields curves have been viewed as a potential harbinger of slower economic growth often resulting from a policy mistake with cash rates going too high too fast. Dare we say it, interest rates have to move a lot higher to fight inflation, will this be at the cost of growth? We continue to believe investors should seek income from diverse sources. Even though some equity prices have fallen we believe the environment remains attractive for equities even though catalysts for new growth remain elusive. This means the Income Fund will remain invested in a range of NZ companies listed on the NZX that pay an acceptable level of dividends or who have the likelihood of doing so in the future. In addition to the fund receiving a steady stream of dividend income, we expect that over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price. The Official Cash Rate will rise further however much of the anticipated increases are already reflected in market pricing. The OCR peak is likely to be around 3.5% which is low compared to previous tightening cycles and lower than levels priced into bond markets. Most of the recent corporate and bank bond issues have been sold with yields between 4% and 5%. We feel investing at these levels is looking attractive compared to the likely peak in the OCR, even if there is the risk markets overshoot for a while.

Key Fund Facts

Distributions	Estimated annual fund charges (incl. GST)		
Distributions for this fund are defined annually and are effective for 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.	0.80%, refer PDS for more details		
Hedging	Buy / Sell spread:	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	Click to view	\$5m	October 2007
Restrictions	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 https://www.nikkoam.co.nz/invest/retail .		
Exclusions	Securities that conduct activities listed on the Schedule to Cluster Munitions Prohibition Act 2009. Tobacco manufacturers.		

Compliance

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

Contact Us

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