

Factsheet 31 August 2022

# NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

## Market Overview

- Bond markets performed poorly as longer-term bond yields moved higher as central banks around the globe indicated they will keep interest rates elevated for an extended period to ensure inflation pressures and inflation expectations fall. Equity markets are also concerned about inflation pressures and how increasing costs may impact trading margins and profits however the recent company reporting season was as expected which saw the S&P/NZX 50 Gross Index advance 0.94% over the month.

## Fund Highlights

- The Income Fund declined over August.  
- Some individual equity names in the fund performed well, Scales Corp advanced 9.5%, Infratil gained 8% and Spark increased close to 6.3%. On the opposite end of the scale Heartland fell approximately 10% after it had a discounted capital raising to support their growth aspirations. Short term bonds and cash were the outperformers in the bond sector.

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

## Performance

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail <sup>1</sup>	-0.52%	1.33%	-5.60%	0.24%	1.33%	3.72%
Benchmark <sup>2</sup>	0.47%	1.32%	4.21%	3.86%	4.76%	6.47%
Market Index <sup>3</sup>	-0.60%	1.12%	-6.91%	-	-	-

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<sup>1,2</sup>

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.

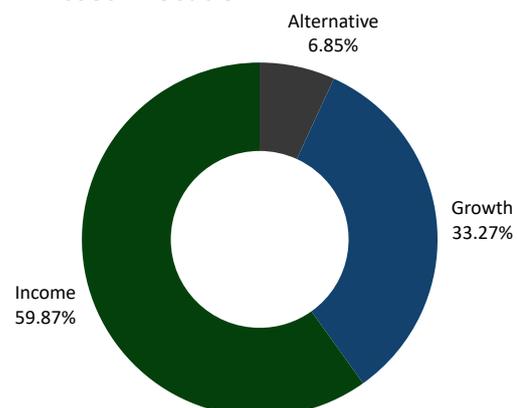
## Overview

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	(%)	(%)
Westpac New Zealand Ltd	4.79	Fund 4.24 years	Spark New Zealand Ltd	3.48	Works Finance NZ Ltd 2.11
Bank of New Zealand	4.53	<b>Yield to Maturity</b>	Infratil Ltd	3.17	Heartland Group Pref 2.09
ASB Bank Ltd	4.16	Fund (gross) 4.87%	Skellerup Ltd	3.01	Chorus Limited 1.97
New Zealand Local Govt Funding	3.90		Stride Stapled	2.65	Scales Corp Ltd 1.78
Infratil Ltd	3.06		Contact Energy Ltd	2.32	Argosy Property Ltd 1.69

\*Includes cash holdings.

## Fund Commentary

The Income Fund declined over August. Bond markets performed poorly as longer-term bond yields moved higher as central banks around the globe indicated they will keep interest rates elevated for an extended period to ensure inflation pressures and inflation expectations fall. Equity markets are also concerned about inflation pressures and how increasing costs may impact trading margins and profits however the recent company reporting season was as expected which saw the S&P/NZX 50 Gross Index advance 0.94% over the month. In contrast the bond sector, as measured by the Bloomberg Composite Bond Index decreased 2.38% almost exactly its gain from the previous month.

The Option Fund returns were up over the month. The Reserve Bank (RBNZ) is likely to increase the Official Cash Rate to around 4% by the end of 2022 or early 2023 and keep rates there until labour market and inflation readings decline. We would expect longer term rates to remain higher than the cash rate until there are clear signs that economic conditions exist that may warrant the RBNZ to start thinking about cutting rates again. We think an easing cycle may start by late 2023 or 2024 however risks remain that inflation may remain stubbornly high. There are signs that longer term interest rates could be peaking soon however how robustly company earnings hold up in an economic slowdown may be the next challenge.

Looking at the performance of some individual equity names in the fund Scales Corp advanced 9.5%, Infratil gained 8% and Spark increased close to 6.3%. On the opposite end of the scale Heartland fell approximately 10% after it had a discounted capital raising to support their growth aspirations. Short-term bonds and cash were the outperformers in the bond sector. The RBNZ is one of the most advanced central banks in terms of their tightening cycle, and with most global central banks projecting terminal cash rates around 4% New Zealand may be close to peak OCR expectations already. How long short-term rates remain elevated is uncertain however an extended period looks likely as inflation remains stubbornly high. The fate of longer-term bond rates will remain much more heavily influenced by offshore direction. We believe NZ bonds can generate reasonable returns over the medium term as there is plenty of yield available through purchasing quality credit.

We are happy to add quality mid-curve bonds at yields around 4.5% and higher as we believe they will outperform cash rates over the medium term. Although the cash rate will go higher in the near term, growth concerns both in NZ and globally are increasing and this will likely limit how high bond yields will go. We continue to believe investors should seek income from a diverse range of sources. Even though interest rates have risen, and some equity prices have fallen over the past year we believe the environment remains acceptable for equities even though catalysts for new growth remain elusive and an economic slowdown looks inevitable. This means the Income Fund will remain invested in a range of NZ companies listed on the NZX that pay a consistent level of dividends or those that 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.

## Key Fund Facts

<b>Distributions</b> 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.	<b>Estimated annual fund charges (incl. GST)</b> 0.80%, refer PDS for more details		
<b>Hedging</b> All investments will be in New Zealand dollars	<b>Buy / Sell spread:</b> <a href="#">Click to view</a>	<b>Strategy size</b> \$5m	<b>Strategy Launch</b> 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. Tobacco manufacturers.			

## Compliance

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

## Contact Us

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