

Factsheet 30 September 2022

# NIKKO AM NZ BOND STRATEGY

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

## Market Overview

- Bond market yields pushed higher over the quarter.
- The NZ swap yield curve is inverted from 2 to 10 years, and government curve slightly positive.
- The NZ credit sector has performed well relative to offshore.

## Fund Highlights

- NZ Bond fund returns were negative for the month and quarter as rates moved higher in yield.
- The fund duration is modestly longer than benchmark which was a negative.
- Credit outperformed lower yielding government bonds.

## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	-1.51%	-1.14%	-8.37%	-2.42%	1.52%	3.41%
Benchmark <sup>2</sup>	-1.35%	-1.41%	-8.80%	-3.48%	0.45%	2.07%
Retail <sup>3</sup>	-1.56%	-1.29%	-8.93%	-3.07%	0.82%	2.63%

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Composite 0+ Yr 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.

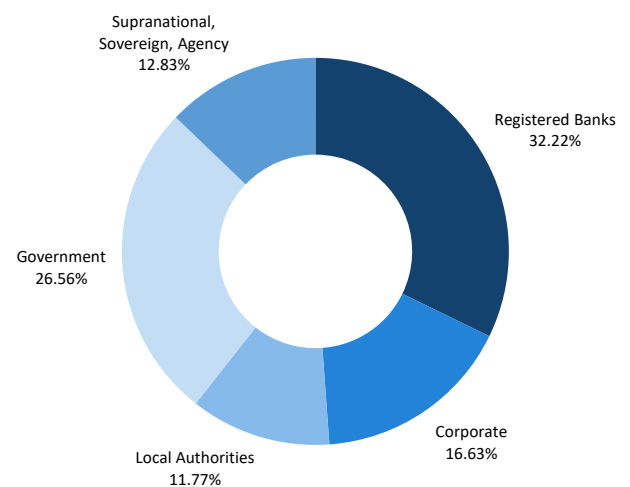
## Overview

The fund aims to provide investors with regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

## Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

## Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Duration
Westpac New Zealand Ltd	9.86	AAA	53.4	Fund 5.08 years vs Benchmark 4.49 years
Housing New Zealand Ltd	7.85	AA	26.9	<b>Yield to Maturity</b>
NZ Local Government Agency	5.90	A	15.6	Fund (gross) 4.68% vs Benchmark 4.5%
ASB Bank Ltd	5.25	BBB	2.7	<b>Green, sustainability and social bonds</b>
Kommunalbanken AS	5.10	BB	1.4	16.35% of the fund

\*excludes NZ central government

## Market Commentary

The September month added woe to a poor quarter for NZ bond returns as interest rates moved quite a lot higher. The move higher in interest rates was the key driver of negative returns. It was a volatile quarter. NZ bond yields moved lower in July but rose to new year-to-date highs in yield late September with large moves in offshore bonds impacting our markets. To put the volatility in context the UK 10-year bond rate traded in a 170 basis point range over the month, the US 10-year 80 basis points, and the NZ 10-year a more subdued 35 basis points. The relative performance across different sectors of the bond market - government, swaps and credit has been muted compared to the impact from rising rates. On a positive note, the fund has maintained a higher weighting to NZ credit which has performed well with spreads narrowing slightly and high demand for new issuance remaining supportive.

In terms of higher rates there is a lot priced in, however what will dominate the direction of bond markets in the short term remains difficult to forecast. Investor focus continues to swing from being concerned about high inflation to concern about the negative impact tightening monetary conditions may have on growth. And in a stagflation environment both are valid concerns that could push rates either higher or lower in yield. At the same time volatility has remained choppy this year with low trading volumes exacerbating moves in interest rates and this is likely to remain so in the near term. Changes in interest rates for the month and (quarter) were: the 1- year government bond yield finished 28 (and 73) basis points higher, the 2-year 37, (and 72) bps higher, the 5-year finished 38 (and 56) bps higher, and the 10-year bond and 2051 government bond were 29 (and 37) bps higher, and 36 (and 52) bps higher in yield respectively. The RBNZ is one of the most advanced central banks in terms of the tightening cycle, and with most major central banks projecting terminal cash rates around 4% we may be close to a plateau in peak cash rate expectations. How long short rates remain elevated is uncertain, and the fate of longer-term bond rates are likely to remain much more heavily influenced by offshore direction. In this environment it still makes sense to not have too much risk to the direction of interest rate moves. NZ bonds can generate reasonable returns over the medium term as there is plenty of yield available through purchasing quality credit rather than going longer on a flat yield curve. We continue to look to add value within the interest rate range; and reducing risk where bonds look expensive and adding bonds that we believe will have a higher likelihood of adding value.

## Fund Commentary

NZ bond markets had a negative return as yields moved higher in September and August, and a positive return in July as rates fell. The fund had a modest long duration position relative to the Bloomberg NZ Bond Composite benchmark which resulted in an underperformance as rates moved higher. On sector allocation Inflation linked bonds had a poor month as inflation expectation reduced even though rates were rising. A positive was credit holdings which continued to perform well (over the month and quarter) with a higher yield accruing to the portfolio and a mild contraction in margins. Offshore credit has been under some pressure, and we continue to sell bonds that look expensive and replace those that we believe will likely perform better over the medium term. We marginally extended the fund's duration on spikes higher in yield late September on a view that the market pricing of interest rate increases was looking overdone. The fund continues to maintain a higher yield from holding credit issues and inflation linked government bonds in preference to lower yielding nominal government bonds, and we continue to believe this should benefit returns over the medium term.

## 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: 0.65%, refer PDS for more detail		
<b>Hedging</b>	<b>Buy / Sell spread</b>	<b>Strategy size</b>	<b>Strategy Launch</b>
All investments will be in New Zealand dollars	<a href="#">Click to view</a>	\$380.9m	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 quarter.

## Contact Us

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

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