

Factsheet 31 October 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

- It was a very volatile month for interest rates with some large moves higher before retreating into month end.
- The NZ swap yield curve is inverted from 2 to 10 years, and the government curve is slightly positive at the long end.
- The NZ credit sector continues to perform well with margins stable.

Fund Highlights

- NZ bond fund returns finished October little changed after wild swings in value over the month.
- The fund's duration is modestly longer than benchmark.
- NZ government bonds strongly outperformed other sectors.

Performance

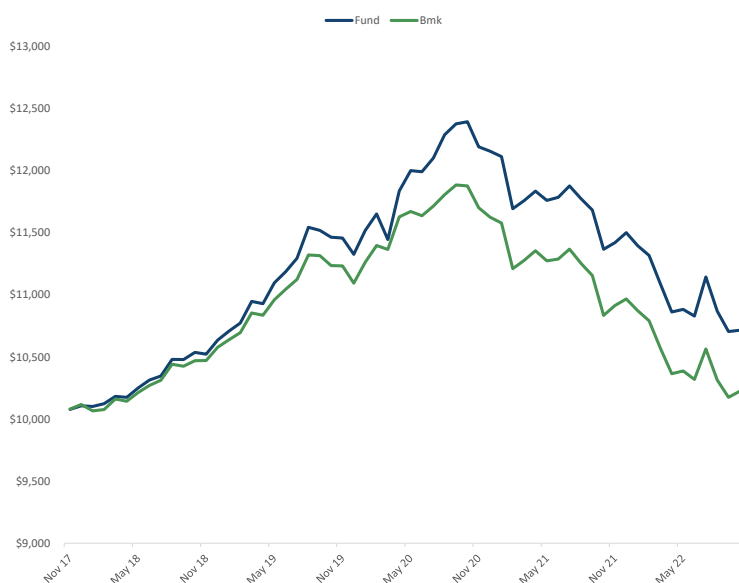
| | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|------------------------|-----------|--------------|----------|-------------------|------------------|-----------------|
| Wholesale ¹ | 0.09% | -3.85% | -5.74% | -2.23% | 1.39% | 3.35% |
| Benchmark ² | 0.49% | -3.22% | -5.63% | -3.10% | 0.45% | 2.09% |
| Retail ³ | 0.03% | -3.98% | -6.31% | -2.88% | 0.69% | 2.57% |

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^{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.

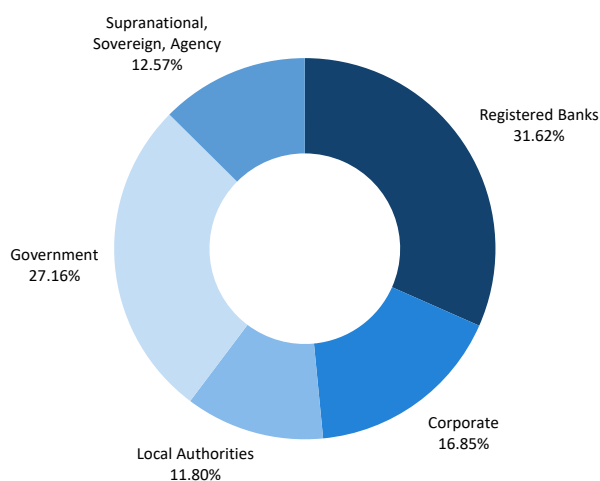
Overview

The 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 | 9.57 | AAA | 53.3 | Fund 4.92 years vs Benchmark 4.49 years |
| Housing New Zealand Ltd | 7.61 | AA | 25.2 | Yield to Maturity |
| Kiwibank Ltd | 6.21 | A | 17.5 | Fund (gross) 4.87% vs Benchmark 4.58% |
| NZ Local Government Agency | 5.71 | BBB | 2.6 | Green, sustainability and social bonds |
| ASB Bank Ltd | 5.14 | BB | 1.4 | 16.00% of the fund |

*excludes NZ central government

Market Commentary

NZ bond returns were a mix of negative and positive, and it was very volatile intra month with bond valuations in negative territory as interest rates surged higher late October. This move was reversed into month end with terminal OCR expectations reversing back close to 5% after peaking around 6%. Moves higher in US bonds and the surprisingly strong NZ CPI print were the key drivers of higher rates, and this was exacerbated by thin liquidity with the market all looking to sell rather than buy.

The fund has a modest longer duration position which had mixed outcomes depending on bond holdings as the yield curve flattened a reasonable amount over the month. We had added some duration during the month and reduced at month end on as rates declined. Changes in interest rates were: the 1- year government bond yield finished 16 basis points higher, the 2-year 10, bps higher, the 5-year unchanged, and the 10-year bond and 2051 government bond were 15 bps, and 27 bps lower in yield respectively.

There was a notable difference in performance across bond sectors with NZ government bonds strongly outperforming swap and credit. NZ Government bonds performed strongly through the month with their 31 October inclusion in the WGBI bond index seeing some strong buy-side support from locals and offshore managers. The outperformance of governments was generally unhelpful for our funds as we tend to underweight low yielding government bonds versus investing in quality credit which is higher yielding and more likely to outperform over the medium term. NZ credit margins have remained stable and with year-end fast approaching there will likely be a shortage of new issuance which should be supportive until supply resumes in the new year.

A higher terminal cash rate around 5% is looking more likely as there has been little improvement in inflation, the labour market, and the things the RBNZ is most concerned about. 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. Volatility is likely to remain high in the near term until we get more certainty from economic data. On the positive side, we may be close to a plateau in peak cash rate expectations. However, 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

The fund had a small positive return but was behind benchmark. The modest long duration position relative to the Bloomberg NZ Bond Composite benchmark helped as we hold more longer maturity bonds which fell in yield. On sector allocation government bonds strongly outperformed other sectors which was unhelpful and the key contributor to benchmark underperformance over the month. Credit holdings continue to perform well with a higher yield accruing to the portfolio and margins stable. We continue to sell bonds that look expensive and replace with those that we believe will likely perform better over the medium term. We marginally extended the fund's duration on a view that the market pricing of interest rate increases was looking overdone, and then reduced duration at month end when rates were lower. 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

| | | | |
|--|------------------|--|----------------------------------|
| Distributions | | Estimated annual fund charges (incl. GST) | |
| Wholesale fund: | Calendar quarter | Wholesale: | Negotiated outside of unit price |
| Retail fund: | Calendar quarter | Retail: | 0.65%, refer PDS for more detail |
| Hedging | | Buy / Sell spread | Strategy size |
| All investments will be in New Zealand dollars | | Click to view | \$387m |
| Strategy Launch | | | |
| 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. | | | |

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

Contact Us

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