

Factsheet 31 December 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 into December year-end unwinding falls earlier in the quarter.
- The NZ swap yield curve remains inverted with further cash rate hikes and a slowing in the economy priced in.
- There has been a lack of new issuance into year-end which should be supportive of credit through the holiday period.

## Fund Highlights

- NZ bond fund returns were negative for the month and positive for the quarter.
- The fund duration has varied - around benchmark to modestly longer than benchmark.
- Credit outperformed lower yielding government bonds with the higher yield helpful over the medium term.

## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	-1.04%	0.34%	-6.60%	-1.75%	1.23%	3.24%
Benchmark <sup>2</sup>	-1.06%	0.09%	-7.14%	-2.81%	0.13%	2.04%
Retail <sup>3</sup>	-1.09%	0.17%	-7.19%	-2.41%	0.53%	2.46%

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.

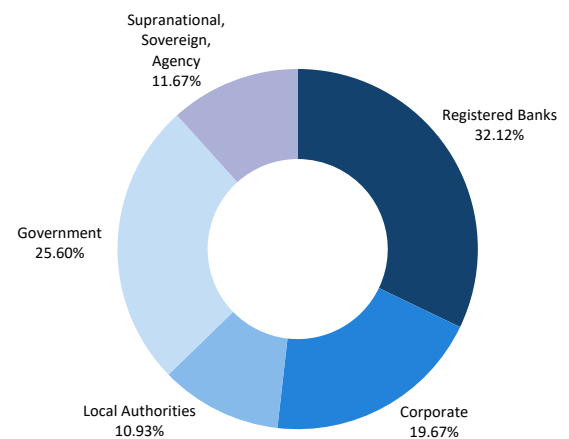
## Overview

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	8.84	AAA	52.6	Fund 4.72 years vs Benchmark 4.37 years
Housing New Zealand Ltd	7.75	AA	26.3	<b>Yield to Maturity</b>
ASB Bank Ltd	7.55	A	17.4	Fund (gross) 5.12% vs Benchmark 4.91%
Kiwibank Ltd	7.10	BBB	2.4	<b>Green, sustainability and social bonds</b>
New Zealand Local Govt Funding Agency	5.61	BB	1.3	19.84% of the fund

\*excludes NZ central government

## Market Commentary

NZ bond yields moved higher into December year-end, finishing close to year-to-date highs following a lack of buying interest and rising offshore bond yields. This subtracted from the quarter’s returns after both October and November were positive months. Over the past quarter and year, movements in interest rates have been the main driver of returns.

Performance differences across sectors have generally equalised out over the past months. Credit margins have widened marginally over the year, but the higher yield has been helpful versus holding lower yielding bonds such as NZ governments. Inflation linked bonds had a good performance over the quarter, and while inflation remains at elevated levels, they are very high yielding in comparison to other high credit quality bonds. NZ government bonds had a strong performance around index inclusion in October, but swap margins subsequently narrowed back regaining performance. In summary, quality higher yielding bonds that retail investors like have generally been the best performers.

Over the quarter interest rates were range bound in terms of yield highs, which makes sense given the already large adjustment higher in interest rates over the year. NZ government bond yields all finished the quarter higher in yield apart from the longest maturity 2051. Changes in interest rates for the month and (quarter) were; the 1-year government bond yield finished 14 (and 61) basis points higher, the 2-year 28, (and 68) bps higher, the 5-year finished 25 (and 33) bps higher, and the 10-year bond and 2051 government bond were 41 (and 17) bps higher, and 27 higher (and 15) bps lower in yield respectively.

There is considerable uncertainty in terms of how “sticky” inflation will be and what impact tightening monetary conditions will have on growth, but with another 3 to 6 months of data we should have a much better idea. It will be interesting to see what the dominant theme that markets focus on for direction in 2023. NZ bonds can likely generate reasonable returns over the year ahead as there is plenty of yield available through purchasing quality credit rather than going longer on an inverted yield curve.

## Fund Commentary

The fund had a negative return for December but managed to have a positive quarter. The fund had a modest long duration position relative to the Bloomberg NZ Bond Composite benchmark which resulted in good outcomes in October and November when rates were stable to lower but was unhelpful at year-end as rates were higher.

On sector allocation, inflation linked bonds and credit holdings which retail investors like were the better performers with a higher yield accruing to the portfolio. We continue to sell bonds that look expensive relative to their credit rating and replace with bonds that we believe will likely perform better over the medium term.

The fund’s duration was longer earlier in the quarter and reduced into year-end on a view that there wasn’t a lot of value in longer maturity bonds at lower yields. 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. 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.

## 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>
All investments will be in New Zealand dollars		<a href="#">Click to view</a>	\$426m
<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.			

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

## Contact Us

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