

Factsheet 28 February 2023

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

- NZ bonds had a poor month unwinding January's gains as interest rates moved higher in yield.
- The NZ swap yield curve moved higher and flattened marginally.
- NZ credit remains in short supply and margins have been tighter.

Fund Highlights

- Fund returns were poor due to the move higher in yields.
- We extended fund duration towards month end when yields were higher.
- The fund's yield to maturity is closer to 6% (with inflation linked bonds included).

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-1.59%	-0.22%	-4.30%	-2.41%	1.36%	3.34%
Benchmark ²	-1.46%	-0.58%	-5.16%	-3.53%	0.31%	2.12%
Retail ³	-1.64%	-0.38%	-4.90%	-3.05%	0.66%	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.

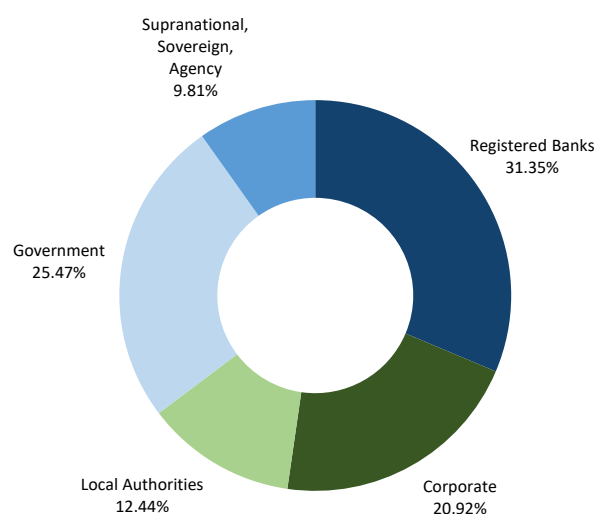
Overview

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
Housing New Zealand Ltd	7.84	AAA	53.5	Fund 5.03 years vs Benchmark 4.3 years
Westpac New Zealand Ltd	7.63	AA	24.0	Yield to Maturity
New Zealand Local Govt Funding Agency	7.61	A	17.9	Fund (gross) 5.17% vs Benchmark 4.99%
ASB Bank Ltd	7.33	BBB	3.4	Green, sustainable and social bonds
Kiwibank Ltd	6.66	BB	1.3	22.36% of the fund

*excludes NZ central government

Market Commentary

February was a poor month for bonds as yields moved higher. The move higher in interest rates was the main driver of negative absolute returns. In relative terms the fund has been positioned around benchmark duration to modestly longer and as a result the impact from rising rates relative to benchmark was muted. From a sector return perspective swap and government bonds were similar, and the credit sector was marginally better due to higher yield and tighter credit margins.

Over the past few months economic data has at times been contradictory resulting in changing expectations for the extent and timing of further central bank tightening. In February the market repriced higher rates for longer reducing rate cut expectations. Looking at market volatility (bond markets have had month-on-month moves up and down of around 50 bps since December last year) there remains considerable uncertainty around inflation and economic outcomes.

With yields close to highs we are reasonably positive on the outlook for NZ bonds over the next 18 months. Our patience has been rewarded as we incrementally extended duration late in February, at better levels than recently available, to lock in higher rates for longer. The fund’s yield to maturity is getting close to 6% (with an adjustment to include the inflation linked bonds). A 6% yield is above the level we believe the cash rate will peak at, so bonds are looking attractive again relative to the likely return on cash type assets.

Changes in interest rates for the month were the 1-year government bond yield finished 34 basis points higher, the 2-year 43 bps, the 5-year finished 50 bps, the 10-year bond 40 bps and the 2041 and 2051 government bond were 32 bps and 28 bps higher in yield respectively. Moves higher in swap rates were similar.

We are close to the end of this tightening cycle but how “sticky” inflation proves to be and how tight monetary conditions impact the economy will determine how long rates need to stay at restrictive levels. The inverted yield curve complicates the decision on yield curve positioning as there is no term premium and the fund generally gives up yield by going longer duration. We do feel however, that the correct positioning is to move longer as the next significant move is down in rates, but we might have to wait until 2024 until this occurs in any meaningful way. In the meantime, we will look to for the most consistent ways to add value and prefer a high portfolio yield but will add/subtract duration as opportunities arise.

Fund Commentary

NZ bond markets had a poor month due to rising yields. The fund return was marginally below the Bloomberg NZ Bond Composite benchmark. The longer duration was the main contributor to underperformance. On sector allocation, inflation linked 2025 bonds performed well, and credit holdings which retail investors like have been in demand. Governments and swap had a similar poor performance as yields moved higher. We added some duration late in the month with yields looking more attractive. 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. We added some 7-year corporate bonds at 6.4% at month end.

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	Strategy Launch
All investments will be in New Zealand dollars	Click to view	\$430.4m	October 2007
Exclusions: Controversial weapons.			
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 .			

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

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