

Factsheet 31 May 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

- Interest rates were somewhat volatile with uncertainty approaching the US debt ceiling and the RBNZ May MPS update.
- The Reserve Bank (RB) gave guidance they have likely finished hiking rates but there is still uncertainty around inflation and the economy.
- NZ credit margins remain supported with little new supply.

## Fund Highlights

- Fund returns were around flat to negative due to moves higher in interest rates.
- The fund started the month slightly short duration and extended longer at better levels during May.
- We want to maintain a higher yield and participate in gains if rates move lower.

## Performance

|                        | One month | Three months | One year | Three years (p.a) | Five years (p.a) | Ten years (p.a) |
|------------------------|-----------|--------------|----------|-------------------|------------------|-----------------|
| Wholesale <sup>1</sup> | -0.27%    | 2.91%        | 2.42%    | -2.44%            | 1.69%            | 3.41%           |
| Benchmark <sup>2</sup> | -0.46%    | 2.41%        | 0.89%    | -3.53%            | 0.52%            | 2.24%           |
| Retail <sup>3</sup>    | -0.30%    | 2.75%        | 1.79%    | -3.06%            | 1.00%            | 2.64%           |

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.

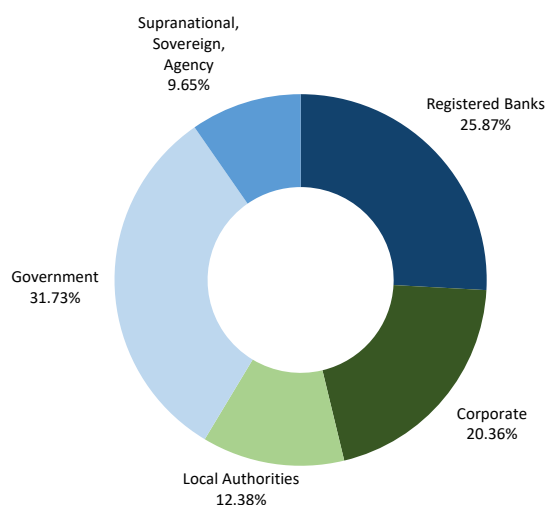
## Overview

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 | (%)  | Green, sustainable and social bonds    |
|---------------------------------------|------|----------------|------|--|
| Housing New Zealand Ltd               | 7.88 | AAA            | 58.4 | 22.19% of the fund                     |
| New Zealand Local Govt Funding Agency | 6.63 | AA             | 21.9 | <b>Duration</b>                        |
| Kiwibank Ltd                          | 6.12 | A              | 16.7 | Fund 5.22years vs Benchmark 4.74 years |
| ASB Bank Ltd                          | 6.08 | BBB            | 3.0  | <b>Yield to Maturity*</b>              |
| Westpac New Zealand Ltd               | 5.25 |                |      | Fund (gross) 4.94% vs Benchmark 4.78%  |

\*excludes NZ central government

\* Excluding the inflation component of government inflation linked bonds

## Market Commentary

NZ bond returns were flat to negative for May as interest rates moved higher. In terms of sectors, the budget announced there will be more supply of NZ government bonds in future years, and as a result they underperformed relative to swaps and credit. The move higher in government bonds was reasonably consistent across maturities with yields up by 21 to 27 bps at month end. Swaps performed better with yields only 13 to 16 bps higher. Credit margins remained little changed, although in our view currently slightly expensive supported by a lack of supply.

We think the front of the yield curve will be the highest yielding part of the curve for the longest period of time. The RBNZ provided guidance in their MPS update that they have likely finished the hiking cycle, but they won't want rates lower until they are confident inflation is under control. Inflation and growth are slowing, albeit at a slower pace than they would like, and its likely short rates may need to be held at current levels for longer. There is a risk this may drag the mid curve higher, unless the RBNZ cuts rates more quickly than they currently expect. Longer term bond yields are lower than the cash rate, pricing in a slowing in activity and will likely follow data outcomes. The long end is complicated as we give up yield investing longer, but there is the potential for greater capital gains from longer maturity bonds if rates move lower.

It has been a market where more value is added through patience and awaiting opportunities to be active in duration rather than a long-term macro 'set and forget' view. In uncertain times we generally keep positioning modest relative to benchmark. We have added value through adding/subtracting duration when interest rates looked mispriced relative to our expectations. In the meantime, we will look for the most consistent ways to add value and prefer a high portfolio yield through holding more high-quality credit and less government bonds. We will add/subtract duration as opportunities arise.

## Fund Commentary

The fund return was slightly negative but with reasonable outperformance versus the Bloomberg NZ Composite benchmark for the month. The move higher in interest rates was the main driver of absolute returns.

The fund duration position was slightly short relative to benchmark at the beginning of May. With the move higher in yields over the month we extended the fund's duration to a modest long position at better levels. We want to maintain a higher yield and participate in gains if rates move lower.

On sector allocation, the key positive contributor (on a relative basis) was the underweight position in government bonds. NZ government bonds underperformed both swap and credit following news of increased supply. NZ credit margins were stable over the month and helped with a higher yield as did inflation linked bonds.

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 has been moving towards a "barbell" curve position, holding higher yielding short maturity bonds, less mid curve and adding longer maturity bonds opportunistically on moves higher in yield.

## 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>                    | \$437.5m                         |
| <b>Exclusions:</b> Controversial weapons.  |                  | <b>Strategy Launch</b>                           |                                  |
| <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> . |                  | October 2007                                     |                                  |

## Compliance

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

## Contact Us

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