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Nikko Asset Management

YOUR GOALS,
OUR COMMITMENT.

Nikko AM Income Strategy

Monthly Update 31 October 2023

Applies to the Nikko AM Income Fund.

Market Overview

- The S&P/NZX 50 Gross (with imputation credits) Index fell 4.8% over October and declined 11.1 % over the past three months.
- The bond sector as measured by the Bloomberg NZ Bond Composite Index also fell, declining 0.16 % and 1.8 % for the past three months.

Fund Highlights

- The Income Fund fell over the past month and quarter as equity and bond markets both continued to fall.
- The fund owns 14 companies in its equities portfolio, with only Stride Property, Spark and EBOS posting positive returns over the month.

Distributions

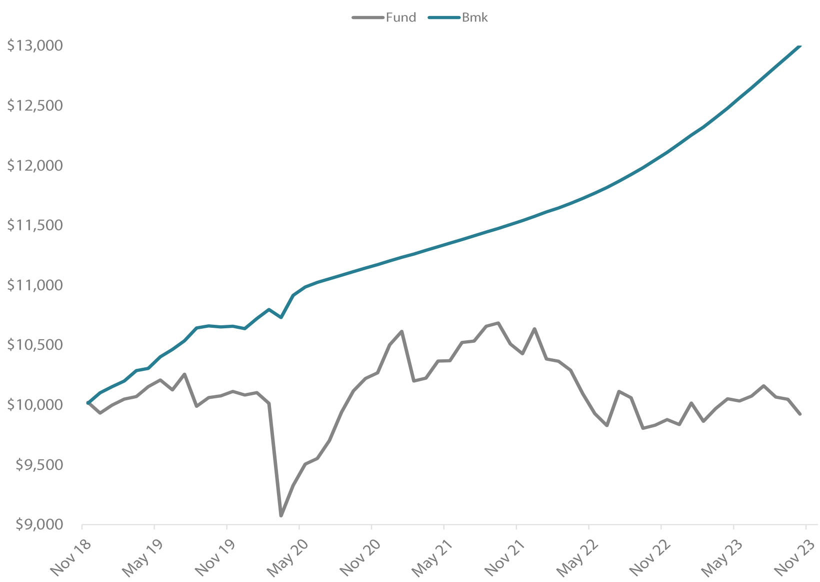
- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point. The defined distribution rate for 2023 is 5.5%. This income will be distributed in four equal amounts each calendar quarter, based on the price on 1 January 2023.

Performance

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail[1]	-1.24%	-2.33%	0.95%	-0.98%	-0.15%	2.90%
Benchmark[2]	0.70%	2.08%	7.94%	5.28%	5.39%	6.21%
Market Index[3]	-1.44%	-3.74%	0.91%	-2.01%		

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).
2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.
3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 30% S&P/NZX 50 Gross Index, 7.5%.

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.

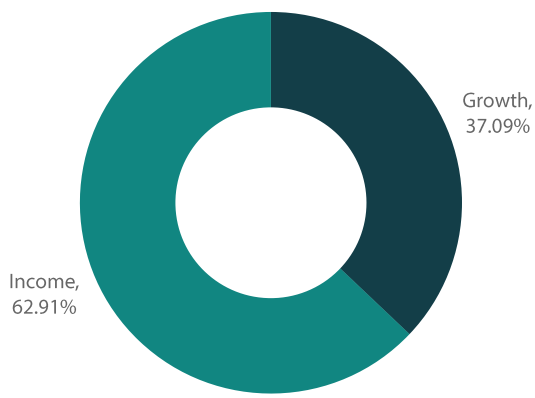
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00% p.a. over a rolling three-year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July 2020 these were amended to include equities.

Asset Allocation



Top 5 Income Issuers*	(%)
Westpac New Zealand	19.29
Kiwibank	5.09
Powerco	4.74
TR Group	4.33
Kiwi Property Group	3.95

Duration
Fund 3.43 years
Yield to Maturity
Fund (gross) 6.68%

Top 10 Equities	(%)		(%)
Bank Of New Zealand	3.27	Chorus	2.90
Works Finance NZ	3.22	Heartland Group	2.72
Spark New Zealand	3.11	Skellerup	2.47
Infratil	2.93	Meridian Energy	2.42
Contact Energy	2.91	Kiwibank	2.05

Fund Commentary

The Income Fund fell over the past month and quarter as equity and bond markets both continued to fall.

The S&P/NZX 50 Gross (with imputation credits) Index fell 4.8% over October and declined 11.1 % over the past three months. The bond sector as measured by the Bloomberg NZ Bond Composite Index also fell, declining 0.16 % and 1.8 % for the past three months. Cash and short-term bonds have continued to be the "safest" assets as yields around the 6% level look attractive.

Interest rates on longer term bonds continue to move higher across international markets. The yield on the influential US 10-year Treasury Bond market saw 10-year bonds trade over the 5% level for a short time before falling back below this level by month end.

Recent US economic data indicates the economy remains in good health however there are areas of weakness, especially in housing activity as interest rates bite affordability. Inflation is remaining stubbornly high, however the NZ September CPI release saw annual inflation fall from 6% to 5.6%. There are a number of areas that remain problematic such as local council rates, rent, insurance and the flow-on effects of past wage rises. However inflation is expected to ease further especially in the retail sector as demand wilts, inventories build and supply chains ease.

The Reserve Bank's latest Monetary Policy Statement indicated they will hold the cash rate at an elevated level of 5.5% until the end of 2024 as they monitor incoming economic data. It is becoming increasingly evident the Bank has done enough to cool consumer demand, inflationary pressures, inflation expectations and that further rate rises will not be required.

In the US the Federal Reserve is of the opinion that the run-up in long-term Treasury bond yields reduces the impetus to raise rates again. The thinking is that the increase in long term rates has done some of the work the Fed has been trying to accomplish in its quest to tighten conditions and bring inflation back to the 2% target. So domestically and internationally the rising interest rate cycle seems to be topping out.

Locking into longer term bonds around current levels will likely outperform cash returns over the next few years. We continue to believe the next significant move is down in rates but we might have to wait for a year or so until this occurs in any meaningful way. An OCR cash rate of around 3.5% to 4% is probable by mid-2026.

The fund owns 14 companies in its equities portfolio, with only Stride Property, Spark and EBOS posting positive returns over the month. Interest rates continue to be top of mind for many investors along with how demand will hold up as the economy weathers a soft patch. Short term bonds and cash outperformed longer-term bonds as bond market weakness was seen internationally and the increasing supply of NZ Government bonds put upward pressure on rates. The Income Fund was holding close to 7% of the portfolio in cash at the end of October, this higher cash weighting helped to stabilise investment returns however in hindsight an even higher weighting would have been desirable.

We continue to believe investors should seek income from a diverse range of sources. Bond rates are looking attractive and even though some equity prices have fallen over the past year we believe the environment remains acceptable for many companies. The Income Fund remains invested in a range of NZ companies listed on the NZX that pay a consistent level of dividends or who have the likelihood of doing so in the future. In addition to dividend income we expect over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price.

Key Fund Facts

Estimated annual fund charges (incl. GST)	0.80%, refer PDS for more details.
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) on our website https://www.nikkoam.co.nz/invest/retail.

Hedging:	All investments will be in New Zealand dollars.
Distributions:	Distributions for this fund are defined annually and are effective for the calendar year. The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.

Strategy Launch:	October 2017
Strategy size:	$3.1m
Buy / Sell spread:	[Click to view]()

Compliance

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

Contact Us

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