

Nikko AM Global Bond Strategy

Monthly Update 31 December 2023

Assets are held in the Nikko AM NZ Wholesale Global Bond Fund. Nikko AM Global Bond Fund (retail) invests in units in the wholesale fund, which this commentary refers to.

Market Overview

- Faster rate cut projections and US Federal Reserve (Fed) Chair Powell entertaining the idea of policy easing led to a rally in rates and bolstered risk assets over December.
- Major central banks kept policy rates on hold in December.
- With the inflation surge in the rear-view, central banks are now balancing the challenge of inflation persisting slightly above target with the risk of weaker growth.

Fund Highlights

- The fund returned 6.53% (gross of fees) for the quarter, which was 86 basis points (bps) better than the benchmark return of 5.67%.
- Outperformance was driven by our Cross-sector and Country strategies, respectively. Meanwhile, our Duration strategy detracted from excess returns.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	3.52%	6.53%	8.33%	-2.46%	2.22%	3.78%
Benchmark²	3.12%	5.67%	6.59%	-2.42%	1.03%	3.20%
Retail³	3.31%	6.86%	7.77%	-3.13%	1.42%	2.85%

1. Returns are before tax and before the deduction of fees. Based on actual calendar periods.
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any). Based on change in unit price.

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. The Goldman Sachs Asset Management Global Fixed Income Team managed over US\$690 billion of global fixed income and currency assets (as at 30th September 2022).

Overview

The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

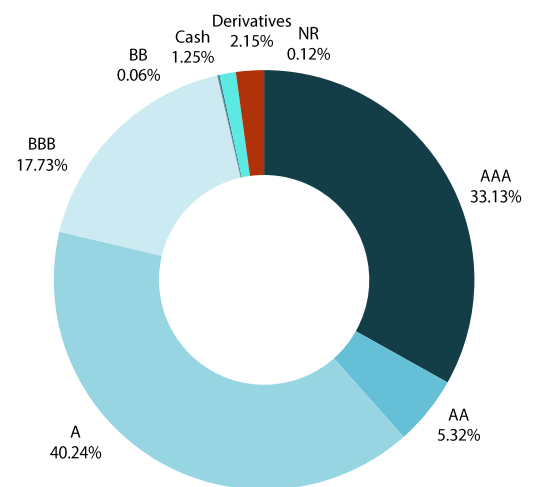
Objective

The strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three-year period.

Five Year Cumulative Performance, \$10,000 invested^{1,2}



Credit Quality



Sector Allocation (% of fund)	Fund	Index	Duration
Governments	31.87%	44.56%	Fund 6.17 years vs Benchmark 6.65 years
Agency	4.24%	7.81%	Yield to Maturity
Collateralised & MBS	31.02%	11.72%	Fund (gross) 4.99% vs Benchmark 4.96%
Credit	25.07%	20.37%	
Emerging market debt	4.40%	15.54%	
Cash, derivatives, other*	3.40%	0.00%	

*Includes deferred settlements

Market Commentary

Faster rate cut projections and US Federal Reserve (Fed) Chair Powell entertaining the idea of policy easing led to a rally in rates and bolstered risk assets over December. Following the Fed meeting, financial conditions eased further, and the 10-year US Treasury yield fell below 4% for the first time since August. In all, the 10-year Treasury yield retreated by around 100bps from October highs. Risk assets outperformed amid this environment. US high yield spreads tightened by 47bps while external emerging market (EM) debt spreads tightened by 21bps. Taken together, the Global Aggregate index returned 5.7% in the final quarter of 2023.

Moreover, major central banks kept policy rates on hold in December. The Fed maintained the federal funds rate at 5.25-5.5%. While keeping their key policy rate at 4%, the European Central Bank (ECB) announced that Pandemic Emergency Purchase Programme (PEPP) reinvestments will reduce in the second half of 2024 and conclude by 2024-end. Despite no outright policy changes, the Bank of England (BoE) struck a slightly hawkish tone with three members opting for a 25bps hike. Elsewhere, the Bank of Japan (BoJ) kept ultra-loose policy unchanged on all parameters citing further developments would need to be made on wage and price pressures.

With the inflation surge in the rear-view, central banks are now balancing the challenge of inflation persisting slightly above target with the risk of weaker growth—a dynamic not experienced in recent years. Against this backdrop, we continue to prefer high-quality assets, including investment grade (IG) credit and agency mortgage-backed securities (MBS).

Fund Commentary

The fund returned 6.53% (gross of fees) for the quarter, which was 86 basis points (bps) better than the benchmark return of 5.67%.

The portfolio outperformed its benchmark over the review period. This was driven by our Cross-sector and Country strategies, respectively. Meanwhile, our Duration strategy detracted from excess returns.

Positive contributions from our Cross-sector strategy were driven by our credit hedge, whereby we balance our sector exposures with an overweight allocation to US Treasuries. Our overweight beta to collateralized loan obligations (CLO) and investment grade (IG) credit also contributed. Fixed income assets rallied into year-end for several reasons including downside surprises in global inflation measures suggesting central banks had reached the end of their respective hiking cycles, soft landing optimism and dovish central bank rhetoric. The 10-year US Treasury yield fell below 4% for the first time since August and in all, retreated by around 100bps from October highs. Elsewhere, US IG spreads tightened by 20bps over the quarter while AAA-rated CLO spreads narrowed by 16bps.

Our Country strategy also contributed to excess returns. This was primarily driven by our cross-market overweight Sweden versus Australia rates position. A dovish Riksbank November meeting (rates were kept on hold) and market anticipation that Swedish rates had reached their peak supported our position. The underweight component of our position was supported by the Reserve Bank of Australia's (RBA) 25bps rate hike at its November meeting and hawkish commentary around the persistence of inflation and robust economy.

Our Duration strategy underperformed. This was driven by our underweight to Japanese rates. First, Japanese government bonds tracked the global rates rally into the latter part of the quarter on prospects of central bank easing. Second, the Bank of Japan (BoJ) kept ultra-easy policy parameters unchanged at its December meeting; both challenging our position.

Key Fund Facts

Estimated annual fund charges (incl. GST)		Hedging:	All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.	Strategy Launch:	October 2008
Wholesale:	Negotiated outside of the unit price. 0.80%, refer to PDS for more details.	Exclusions:	Controversial weapons.	Strategy size:	\$555m
Retail:		Restrictions:	Thermal coal mining and extraction, oil tar sands extraction, tobacco stocks and fossil fuels. For more information, please refer to the Statement of Investment Policy and Objectives (SIPO) on our website https://www.nikkoam.co.nz/invest/retail .	Buy / Sell spread:	0.00%/0.00%
Distributions:					
Wholesale:	Calendar quarter				
Retail:	Calendar quarter				

Compliance

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

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