

Nikko AM NZ Bond Strategy

Monthly Update 31 January 2024

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

- A weaker start for bonds in January as yields rebounded higher following the very strong rally in rates in November and December 2023.
- Looking forward for 2024 we expect bond returns will be supported by cash rate cuts later this year and rates moving lower.
- Secondary market inventory of NZ credit is higher to start the year and plenty of supply expected early this year.

Fund Highlights

- The funds had negative returns for the month with longer maturity bonds underperforming shorter maturities as rates moved higher.
- We reduced the fund's duration when rates were lower in December, but rates moving higher in January were the main negative contributor to absolute and relative returns.
- Starting 2024 we continue to prefer quality credit over lower yielding government bonds with the supply dynamics more supportive of credit than governments which will have ample supply in the New Year.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	-0.80%	6.77%	4.71%	-1.65%	1.48%	3.76%
Benchmark²	-0.60%	5.54%	3.49%	-2.45%	0.20%	2.71%
Retail³	-0.83%	6.58%	4.08%	-2.26%	0.81%	3.00%

1. Returns are before tax and before the deduction of fees and including tax credits (if any).
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).

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, Senior 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.

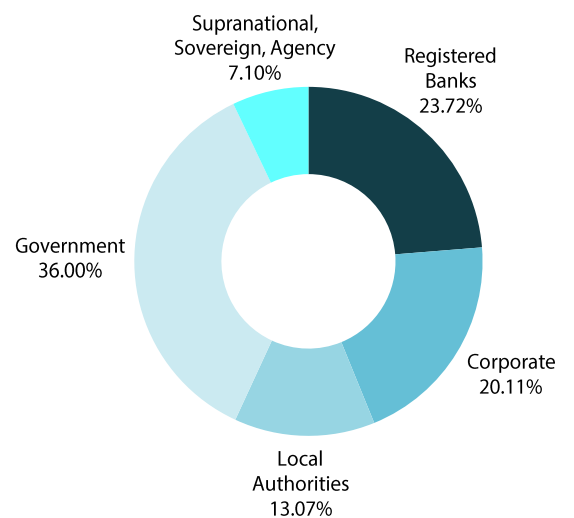
Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

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



Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
New Zealand Local Govt Funding Agency	9.09	AAA	60.92	23.23% of the fund
Housing New Zealand	6.91	AA	18.92	Duration
Kiwibank	5.59	A	16.55	Fund 5.24 years vs Benchmark 4.39 years
Westpac New Zealand	5.17	BBB	3.62	Yield to Maturity*
Bank of New Zealand	4.53			Fund (gross) 5.04% vs Benchmark 4.85%

* Excludes NZ central government

* Excluding the inflation component of government inflation linked bonds

Market Commentary

January suffered a weak start for bonds as yields rebounded higher unwinding some of the large falls from late 2023. The aggressive market pricing for rate cuts was probably overdone into year-end so some correction is not surprising. We had reduced the fund's longer duration position late December, but the move higher in rates was unhelpful and hurt absolute and relative returns.

Bond sector performance was reasonably consistent across governments and swaps in terms of yield moves higher. Credit holdings remained helpful providing a higher fund yield and margins stable. Movements in government bond yields for the month were 2yr +21 bps, 5yr +23 bps and 10yr +23 bps. For comparison swap maturities were 2yr +11 bps, 5yr +17 bps and 10yr +20 bps. We believe the RBNZ maintains a "hawkish hold" and conditions are likely restrictive enough to slow the economy and inflation, however the path of how rates get to lower levels may still be challenging. We are positive for the bond outlook for 2024, and over the next 12 to 18 months we have a high conviction that the ultimate direction in rates is lower. But we doubt the pace of slowing in growth and inflation are sufficient for the RBNZ to deliver rate cuts earlier in 2024 which may result in some disappointment in terms of what is currently priced. Ultimately economic developments and the data will inform the way forward and markets may remain volatile.

On a medium-term outlook, we think it makes sense locking in higher rates for longer. Our preference is to have a modest long duration, (as we want to participate in capital gains when rates fall) and higher fund yield through quality credit. Entry level is always important, and we expect there will be opportunities to add value through duration when bonds are cheaper/expensive in the range. The inventory of secondary bonds is currently quite high and there may be some credit margin cheapening, although we prefer to buy bonds at new issuance. Expectations are for plenty of government supply and NZ credit issuance in the next few months.

Fund Commentary

The fund had a negative absolute return and underperformed versus the Bloomberg NZ Composite benchmark. The fund had a very strong finish to 2023, but the rebound higher in yields in January was unhelpful and the main contributor to absolute and relative performance. We had reduced duration late last year.

Government bonds and swaps had similar performances with the move higher in rates reasonably consistent along the yield curve for both sectors. Credit holdings have helped in terms of providing a higher yield while margins have been relatively stable. In terms of sectors, we continue to favour quality credit in new issuance.

We don't necessarily expect rate cuts as early as the market is pricing but given the balance of risk, we are happy to lock in higher rates for longer when this makes sense. Again, we will remain patient and look to add value in terms of duration positioning on opportunities within the range.

Key Fund Facts

Distributions		Hedging:	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%	Strategy Launch:	October 2007
Wholesale:	Calendar quarter	Exclusions:	Controversial weapons	Strategy size:	\$543m
Retail:	Calendar quarter	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 .	Buy / Sell spread:	Click to view
Estimated annual fund changes (incl. GST)					
Wholesale:	Negotiated outside of unit price				
Retail:	0.65%, refer PDS for more details				

Compliance

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

Contact Us

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