

# Nikko AM NZ Bond Strategy

Monthly Update 30 June 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

- NZ bonds had a mixed quarter as yields moved quite a lot higher in April and then lower in both May and June.
- A shortage of supply continues to support credit performance.
- Looking forward we remain optimistic that bond returns will be supported by cash rate cuts later this year and longer rates moving lower.

## Fund Highlights

- The funds had a positive quarter, but returns were reduced by rising interest rates.
- We have increased duration when bonds have been higher in yield and believe locking in higher rates for longer will benefit returns over the medium term.
- We like the higher yield of quality credit and expect the demand/supply dynamics to remain supportive.

## Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
<b>Wholesale<sup>1</sup></b>	1.35%	1.18%	6.57%	0.00%	1.05%	3.74%
<b>Benchmark<sup>2</sup></b>	0.98%	0.80%	5.39%	-1.08%	-0.22%	2.68%
<b>Retail<sup>3</sup></b>	1.25%	1.00%	5.87%	-0.64%	0.37%	2.98%

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).

## 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, Senior Fixed Income Manager and Matthew Johnson, Senior Fixed Income Manager.

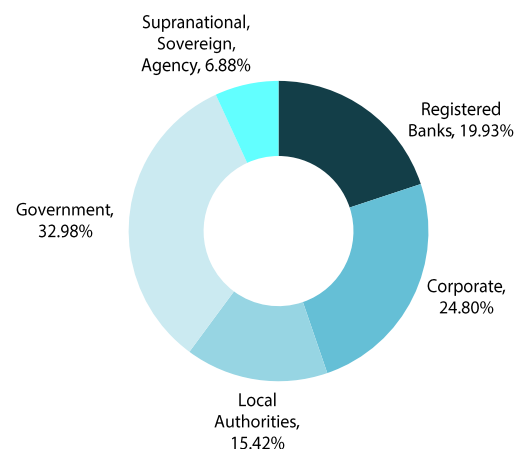
## Overview

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.

## Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
New Zealand Local Govt Funding Agency	9.80	AAA	58.61	22.77% of the fund
Housing New Zealand	6.89	AA	11.51	<b>Duration</b>
Kiwibank	5.29	A	25.85	Fund 6.24 years vs Benchmark 4.82 years
Auckland International Airport	4.21	BBB	4.03	<b>Yield to Maturity*</b>
Westpac Banking Corp	3.55			Fund (gross) 5.19% vs Benchmark 4.9%

\* Excludes NZ central government

\* Excluding the inflation component of government inflation linked bonds

## Market Commentary

Despite NZ interest rates finishing the quarter higher, bonds still had a positive return due to the monthly income accrual outweighing the impact of rising interest rates. In terms of monthly returns, positive returns in May and June (with rates moving lower) outweighed a negative performance in April when rates moved higher. Credit holdings continue to perform well benefiting the fund through a higher yield and some margin contraction as demand outweighs supply. Issuance of NZ corporate bonds so far this year is a lot lower than at the same time last year, and there doesn't appear to be much issuance in the pipeline. Given the above we think it makes sense to lock in higher rates for longer with the extra yield of quality credit rather than government bonds.

At quarter end government yields finished as follows; 2yr +28bp, 5yr +16bps and 10yr +8bps. For comparison swap maturities were 2yr +17bps, 5yr +16bps and 10yr +14bps.

NZ interest rates have been very reactionary to data releases, and it is perhaps surprising there is so much uncertainty this late in the cycle around inflation and cash rate settings. A positive is that this has provided opportunities to build a longer duration position at better levels by buying bonds when higher in yield. We do expect better returns from bonds over the medium term, but ultimately, we will need to see the data support a believable lower inflation story for bonds to outperform from here.

Given the lagged impacts of monetary policy on the consumer and economy we expect the Reserve Bank may have already done enough to achieve lower inflation outcomes. We acknowledge the timing of inflection points can be hard to predict. Our plan remains to build a higher yield through quality credit and participate in further capital gains as rates move lower over the coming months. Going forward, local data outcomes (in terms of inflation) will be the key drivers of short-term rates, and offshore bond moves will weigh more heavily on the direction of longer-term rates.

## Fund Commentary

The fund had a positive return for the quarter and outperformed the Bloomberg NZ Composite benchmark. The move higher in interest rates over April was unhelpful. Fortunately, the monthly income accrual and some moves lower in rates in May and June mitigated the impact of rising rates over the quarter.

We have continued to add longer maturity bonds when yields were high to extend our relative position. The fund is positioned with a long duration with a view that the ultimate direction of rates is lower over the next 12-18 months. Our preference is to hold higher yielding quality credit, but we have added NZ government bonds when they look cheap relative to swap. NZ government bonds are approximately 2/3rds of the benchmark.

## Key Fund Facts

<b>Distributions</b>		<b>Hedging:</b>	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%	<b>Strategy Launch:</b>	October 2007
<b>Wholesale:</b>	Calendar quarter	<b>Exclusions:</b>	Controversial weapons	<b>Strategy size:</b>	\$550.8m
<b>Retail:</b>	Calendar quarter	<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) on our website <a href="https://www.nikkoam.co.nz/invest/retail">https://www.nikkoam.co.nz/invest/retail</a> .	<b>Buy / Sell spread:</b>	<a href="#">Click to view</a>
<b>Estimated annual fund changes (incl. GST)</b>					
<b>Wholesale:</b>	Negotiated outside of unit price				
<b>Retail:</b>	0.65%, refer PDS for more details				

## Compliance

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

## Contact Us

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