

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The NZX 50 Equity Index and the NZ Bond market indices all posted negative returns over the month; a fund return close to zero is disappointing however an acceptable return.
- Longer term interest rates increased with only very short-term securities posting a positive return.
- Shorter term bonds continued to generate steady, albeit low returns.

Fund Highlights

- Over May, the share portfolio of the Income Fund increased in value, however it was a mixed bag with eight holdings increasing in value and five falling.
- The star performer was Heartland Group which increased by 6.6%. Other strong performers were Contact Energy up 4.5%, Argosy Property and Spark.

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 2021 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2021.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail ¹	0.03%	1.65%	9.08%	2.21%	2.74%	4.68%
Benchmark ²	0.27%	0.81%	3.34%	5.18%	4.50%	7.22%
Market Index ³	-1.30%	0.49%				

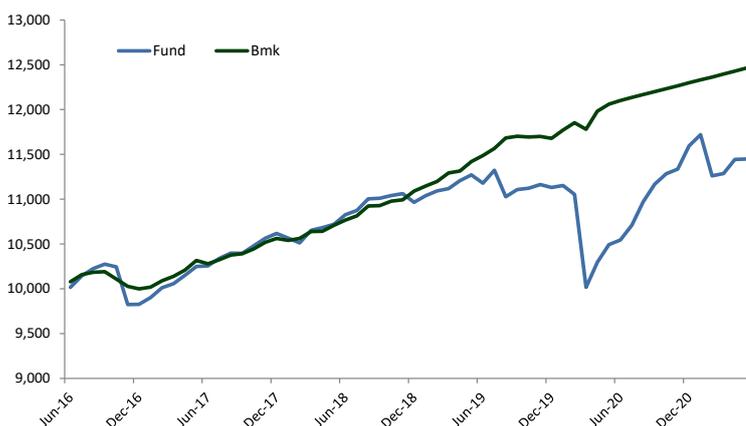
1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.

3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 7.5% S&P/NZX 50 Gross Index, 7.5% Alternatives exempt.

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

Change of investment strategy 01/07/2020



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.

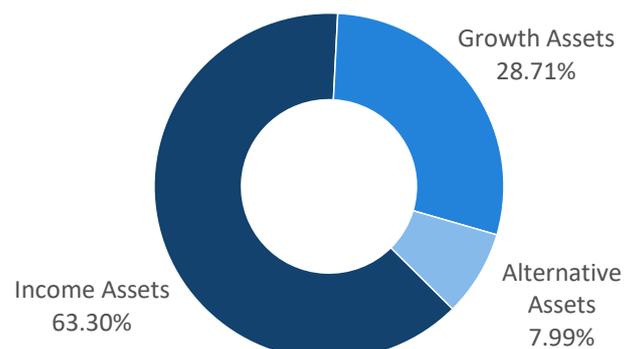
Overview

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 these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)	Top 10 Equities	(%)	(%)	Duration
Nikko AM Wholesale Option	7.99%	Heartland Group	3.31%	Mercury NZ Ltd	2.24%
Kiwibank Ltd	4.68%	Stride Property Ltd	3.08%	Argosy Property Ltd	2.16%
New Zealand Local Government	4.39%	Skellerup Ltd	2.95%	Investore	1.78%
Infratil Ltd	3.72%	Works Finance NZ Ltd	2.46%	Chorus Ltd	1.73%
Liberty Finance	3.54%	Spark New Zealand Ltd	2.26%	Meridian Energy Ltd	1.13%

*Aggregation of directly held assets and Option Fund

Yield to Maturity
Fund (gross) 2.20%
(applies to fixed income only)

Fund Commentary

The NZX 50 Equity Index and the NZ Bond market indices all posted negative returns over the month; a return close to zero is a disappointing however, an acceptable outcome. Longer term interest rates increased with only very short-term securities posting a positive return. Rates increased as the economy continues to perform well. The Reserve Bank now seem likely to bring forward the date for a cash rate rise, the first since the pandemic inspired recession. Shorter term bonds continued to generate steady albeit low returns. The NZ share market as measured by the S&P/NZX 50 Gross Index fell by 3.22%, however the Income Fund’s holdings performed significantly better than the wider market.

Over May the share portfolio of the Income Fund increased in value; however, it was a mixed bag with eight holdings increasing in value and five falling. The star performer was Heartland Group which increased by 6.6%. Heartland is also the largest individual share exposure in the fund at a 3.3% weighting. Other strong performers were Contact Energy up 4.5%, Argosy Property and Spark. Chorus was at the tail of the field. Chorus’s share price has struggled as broadband growth has slowed; however, it offers an attractive dividend yield. Meridian is the fund’s smallest share exposure at around 1.1%.

The Fund’s exposure to shares is close to 26% with a small additional holding in preference shares. The balance of the fund is held in fixed income securities and an 8% weighting to the Nikko Option Fund. The fund is 52% invested in bonds and cash with an average credit rating of A- and 11% is spread across four unrated bond issuers. We believe that even though the NZ economy has recovered well and the outlook for a global economic recovery is looking promising, short term rates will stay low over 2021 and into 2022 before rising. The RBNZ’s messaging continues to be that expansionary monetary policy will be needed for a “considerable time”. They repeated they won’t tighten policy until inflation was up to 2% on a “sustainable basis” and employment was at or above its maximum sustainable level. The global growth outlook continues to improve, inflation expectations are building and, progress is being made to open borders, all of which support economic growth. With this in mind we have seen the low point in interest rates, looking forward short term rates will likely remain stable for the next year however, longer term rates in NZ will likely move around with global trends, as will our local equity market. Even when interest rates rise, we see the peak in the interest rate cycle being much lower than in previous cycles. Our view is that cash rates will peak around 2% in late 2023 or 2024 with longer term rates perhaps moving higher from current levels, but not by much. With the prospect of interest rates remaining low relative to historical levels we continue to believe it is appropriate for investors to seek income from more diverse sources than just interest rates alone.

The bond sector of the fund is invested primarily in medium to longer duration assets. We are happy to have exposure to longer term assets as the Official Cash Rate looks likely to remain low over the next year or two and, longer-term rates have already risen in response to the strong economic recovery. The prospect of low cash rates coupled with the RBNZ continuing to buy bonds in the secondary market and, their desire to see a sustainable recovery in the labour market across all sectors of the community will likely keep a lid on the size of any future interest rate rises. The managers of the fund will continue to look for opportunities to add value and income. This search for income is likely to be an enduring theme for the next few years and we believe this environment should create opportunities for the fund to deliver an enhanced level of performance.

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.

Estimated annual fund charges (incl. GST)

0.80%, refer PDS for more details

Hedging

All investments will be in New Zealand dollars

Buy / Sell spread: Strategy size Strategy Launch

[Click to view](#)

\$4.3m

October 2007

Compliance

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

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