

NIKKO AM NZ CASH STRATEGY

Assets are held in the Nikko AM Wholesale NZ Cash Fund. The Nikko AM NZ Cash Fund (retail) and Nikko AM KiwiSaver Scheme NZ Cash Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- Short-term interest rates started the month with strong upward momentum as the market increasingly viewed an OCR increase as a certainty, with debate primarily around if this increase would be 25 or 50 basis points.
- This momentum abruptly reversed the day prior to the RBNZ's meeting date, as it became apparent New Zealand once again had community transmission of COVID-19 and would enter a level 4 lockdown.
- In light of this COVID outbreak the RBNZ made an eleventh-hour decision to hold fire and keep the OCR unchanged at 25 basis points.

Fund Highlights

- The fund holds a longer than benchmark duration position to benefit from slope in the credit and bank bill curves.
- Duration is actively managed and may reduce as we approach the time where the RBNZ has indicated potential OCR hikes may occur.
- The fund holds a range of securities including floating rate notes which provide some protection against a rising cash rate.

Performance

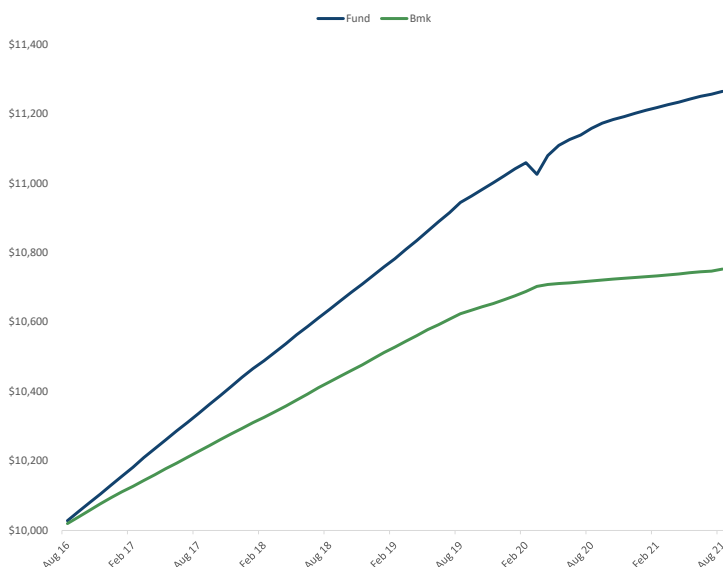
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	0.07%	0.20%	0.95%	1.93%	2.35%	3.16%
Benchmark ²	0.05%	0.10%	0.32%	1.03%	1.42%	2.19%
Retail ³	0.05%	0.12%	0.66%	1.59%	2.00%	
KiwiSaver ³	0.04%	0.09%	0.52%	1.64%		

1. Returns are before tax and before the deduction of fees.

2. Benchmark: Bloomberg NZBond Bank Bill 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^{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.

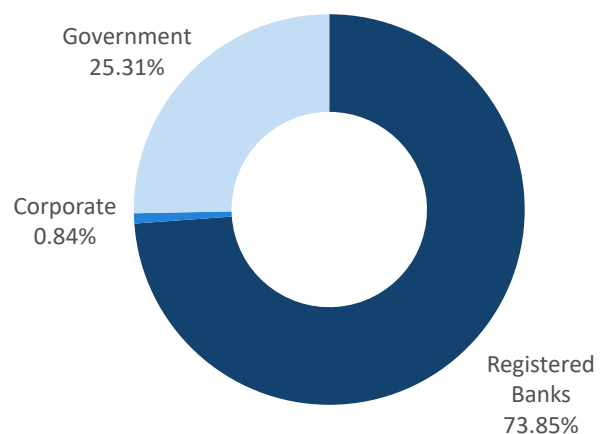
Overview

The strategy aims to generate income by constructing an actively managed investment portfolio of short-term deposits and bonds whilst preserving capital value.

Objective

The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three year period.

Asset Allocation



Top 5 Issuers	(%)	Credit Quality	(%)	Duration
Westpac New Zealand Ltd	17.36	AAA	25.31	Fund 97 days vs Benchmark 45 days
Kiwibank Ltd	13.12	AA	33.43	
Inland Revenue NZ	12.81	A	41.26	
NZ Tax Trading Co	12.49			Yield to Maturity
Cooperatieve Rabo U.A.	11.08			Fund (gross) 0.90% vs Benchmark 0.34%

Market Commentary

The month of August was always going to be about the RBNZ’s first potential rate rise since cutting the OCR to emergency levels in March 2020, in response to the first COVID-19 outbreak. Speculation built through the month that the RBNZ’s August 18 meeting would see a rate rise as inflation continued to accelerate, unemployment remained low and capacity pressures became evident. However, much like in a Hercule Poirot mystery, new information emerged in the eleventh hour with an outbreak of the delta variant and resulting lockdown revealed as the murderer of these OCR rises.

The RBNZ’s decision to keep the OCR on hold was a finely balanced decision and not without consequences in the short-term interest rate market. In the first half of the month prior to the COVID-19 outbreak, 90-day bank bill rates moved up from 0.48% to a peak of 0.685% a substantial move in a short period of time when one considers the low overall level of absolute rates. These gains in rates were fully reversed post the OCR decision date, with 90-day bank bill rates falling as low as 0.39% before recovering back towards their start of month levels ending August at 0.46%. It’s notable that in the first half of the month, returns out of a passive portfolio of 90-day bank bills would have produced a negative return – this is mathematically expected with current low interest rates providing very little protection in the form of accrued interest (accrual of a coupon or discount rate) against increases in rates over a short period of time.

In the RBNZ’s various press engagements in the days following their on-hold OCR decision it became apparent their primary reason for their no change decision was around messaging. The RBNZ viewed increasing the OCR on the first day of a national lockdown with uncertainty of the severity of the outbreak as highly dissonant. This viewpoint is understandable, none the less the no change move is somewhat inconsistent with their overall messaging. Feathers were ruffled across interest rate trading desks with views expressed along the lines of, if the RBNZ were so set on reducing stimulus as their post MPS speeches suggested, why didn’t they move with caution rather than not moving at all? We sympathise with this sentiment, however ultimately note the RBNZ’s mandate is not concerned with reactions of interest rate markets and trading desks. Key among their goals are price stability and full employment. Reducing monetary support has the potential to negatively impact employment, whilst inflation albeit higher than the RBNZ’s target band of 1-3% is not imminently concerning. The RBNZ shares a similar stance as many other central banks that inflation is likely transitory and should this not prove the case they are confident in their ability to quickly move to bring it into line by increasing interest rates.

Fund Commentary

The fund performed well in August returning 0.07% outperforming the 90-day bank bill index which returned 0.05%. The fund’s overall duration position ended the month much unchanged, however this hides tactical calls. Exposures to securities that would have been impacted on a mark-to-market basis by what was a widely expected OCR increase were reduced. At the same time the fund opportunistically added duration positions in accrual type securities that are not valued on a mark-to-market basis and where they were already pricing in a series of cash rate increases. This strategy enhances current returns whilst reducing volatility and providing some mitigating protection against mark-to-market losses from rising interest rates. We expect to continue to reduce duration exposure at the margin whilst opportunistically adding longer duration positions in accrual securities should they price in sufficient rate rises.

Key Fund Facts			
Distributions		Estimated annual fund charges (incl. GST)	
Wholesale fund:	Calendar quarter	Wholesale:	Negotiated outside of unit price
Retail fund:	Calendar quarter	Retail:	0.30%, refer PDS for more details
KiwiSaver fund:	Does not distribute	KiwiSaver:	0.45%, refer PDS for more details
Hedging		Buy / Sell spread	Strategy size
All investments will be in New Zealand dollars		0.00% / 0.00	\$764.6m
Restrictions			
Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information please refer to the Statement of Investment Policy and Objectives (SIPO) which can be found on our website https://www.nikkoam.co.nz/invest/retail .			
Exclusions			
Securities that conduct activities listed on the Schedule to Cluster Munitions Prohibition Act 2009. Tobacco manufacturers.			

Compliance

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

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