Nikko Asset Management

Factsheet 31 October 2021

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The NZ bond market performed poorly as large increases in interest rates were recorded throughout October. Increased concern over inflation was the catalyst for rates to jump higher. Rising interest rates in offshore bond markets and poor liquidity exacerbated the move higher in NZ, with bonds of all maturities except cash losing value.
- Credit issues remained supported over the month with new-issue credit margins setting at the low end of the range and demand far exceeding supply.
- Equity market returns were mixed and not sufficient to offset the impact of bond markets.

Fund Highlights

- The Income Fund fell in value over October as equity and bond markets struggled.
- Strong performance was posted by Skellerup, Infratil and Heartland, Meridian Energy also had a positive month.
- The bond sector of the fund is invested primarily in medium-to-longer duration assets, balanced out with a higher than usual allocation to cash assets.

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.

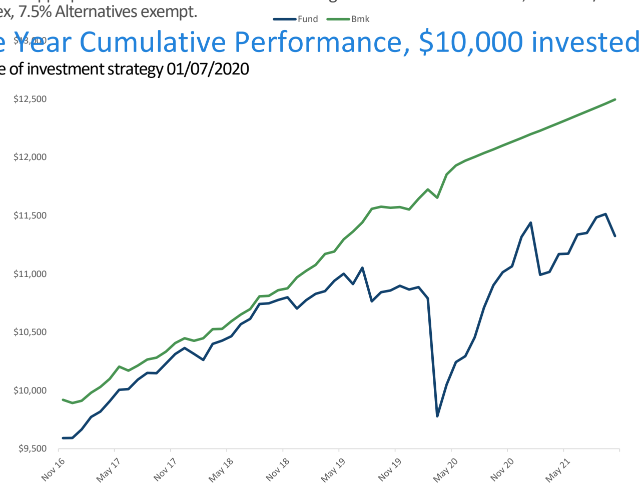
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	-1.63%	-0.23%	2.83%	1.67%	2.52%	5.10%
Benchmark[2]	0.29%	0.83%	3.27%	4.79%	4.56%	6.94%
Market Index[3]	-1.72%	-0.57%	-0.35%			

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, 30% 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.

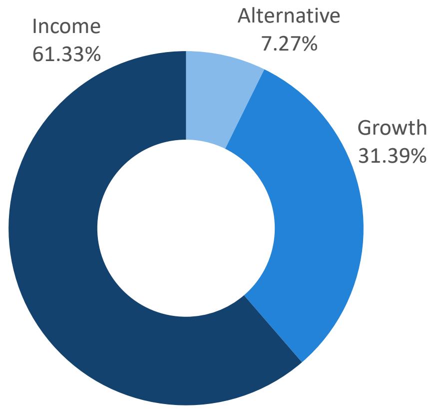
Overview

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*	(%)
Westpac New Zealand Ltd	8.52
NZ Local Govt Funding Agency	5.18
Bank of New Zealand	4.60
Kiwibank Ltd	3.70
Infratil Ltd	3.00

Duration*
Fund 4.09 years
Yield to Maturity
Fund (gross) 2.66%

Top 10 Equities	(%)		(%)
Heartland Group	3.40	Contact Energy Ltd	2.26
Skellerup Ltd	3.23	Works Finance NZ	2.01
Infratil Ltd	2.75	Scales Corp Ltd	1.93
Spark Ltd	2.73	Argosy Property Ltd	1.85
Stride Stapled Group	2.53	Mercury Energy Ltd	1.72

*Includes cash holdings.

Fund Commentary

The Income Fund fell in value over October as equity and bond markets struggled. All bonds fell in value with only very short-term bonds and cash generating positive returns. Some of the Income Fund's equity holdings delivered strong results as did the Option Fund exposure, however this was not enough to pull the fund into positive territory. Only four of the thirteen equity holdings increased in value however two of these had a great month - Skellerup Holdings increased by over 6% and Infratil increased by 4%. The combined return from all sectors was negative, however considering bond markets in general were down between 2% and 3%, investing in a diversified portfolio of income focused assets provided some protection from the worst of the bond sector losses. The NZ bond market performed poorly as large increases in interest rates were recorded throughout October. Increased concern over inflation was the catalyst for rates to jump higher. Rising interest rates in offshore bond markets and poor liquidity exacerbated the move higher in NZ with bonds of all maturities except cash losing value. The 2-year government bond finished 85 basis points (bp) higher, the 5-year finished 79 bps higher in yield, and the 10-year bond and 2051 government bond were 60 bps, and 14 bps higher in yield respectively. Although longer maturity bonds experienced smaller increases in yield it is important to note that longer maturity bonds have larger changes in capital values when yields move. Credit issues remained supported over the month with new-issue credit margins setting at the low end of the range and demand far exceeding supply. High quality 5-year corporate bonds are now yielding over 3% which has been attractive to retail investors. The other sector that performed well on a relative basis was inflation linked bonds which outperformed nominal government bonds by a reasonable margin. To help mitigate the impact of rising interest rates the fund is currently holding close to 8% of its assets in cash to help balance the bond sector duration. The fund is also holding close to the upper permitted limit of shares as we continue to believe shares have a good chance of outperforming bonds over the next three years. We also note that after the large rise in interest rates over October, the market is now pricing in around a further 2% of Official Cash Rate rises by the Reserve Bank. With this in mind we think we need to see further unexpected rises in inflation or economic growth rates for interest rates to push much higher, as current pricing already reflects increased inflation uncertainty and Central Banks removal of economic stimulus.

As mentioned above, there were some star performers in the Income Fund's portfolio of shares. Strong performance was posted by Skellerup, Infratil and Heartland, Meridian Energy also had a positive month. Heartland Group and Skellerup remain the fund's largest equity exposures. Infratil was introduced into the fund over recent months and its performance over September and October is pleasing as it gained around 10% over this time period. We like the electricity sector for income and stability of earnings however the sector has been down-weighted in the portfolio. With interest rates likely to remain low relative to historical levels we continue to believe it is appropriate for investors to seek income from more diverse sources than the interest rate market alone. Even though some equity prices have fallen we believe the environment remains attractive for equities even though catalysts for new growth remain elusive. This means the Income Fund will remain invested in a range of NZ companies listed on the NZX that pay an acceptable level of dividends, or who have the likelihood of doing so in the future. In addition to the fund receiving a steady stream of dividend income, we expect that over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price. The bond sector of the fund is invested primarily in medium to longer duration assets, balanced out with a higher than usual allocation to cash assets. We are happy to have exposure to longer term assets as even though the Official Cash Rate looks likely to rise, much of the anticipated rise is already reflected in market pricing and the OCR is likely to be low compared to previous tightening cycles from the Reserve Bank.

Key Fund Facts

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	Buy / Sell spread:	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	Click to view	$5.2m	October 2007

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

Contact Us

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