

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The bond market fared better rising 0.2% as measured by the Bloomberg Composite Bond Index over May however it is down 5.3% on a year-to-date basis. The NZX 50 Index decreased by 4.85% over the month and 13.2% lower since the start of 2022.

Fund Highlights

- The Income Fund declined over May as equity markets fell.
- The Option Fund fell over the month. Meridian Energy, Spark, Chorus and Skellerup were the better performing equity holdings. They all outperformed the return of the NZX50 however all posted negative returns.
- Stride Property Group, Mercury and Contact Energy were this month's laggards being buffeted by changing investor sentiment.

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 2022 is 3.5%. This income will be distributed in four equal amounts each calendar quarter, based on the price at 1 January 2022.

Performance

	One mth	Three mths	One yr	Three yrs (pa)	Five yrs (pa)	Ten yrs (pa)
Retail ¹	-1.65%	-4.22%	-4.25%	-0.93%	1.35%	3.82%
Benchmark ²	0.38%	1.07%	3.68%	4.20%	4.61%	6.58%
Market Index ³	-1.36%	-3.31%	-6.01%			

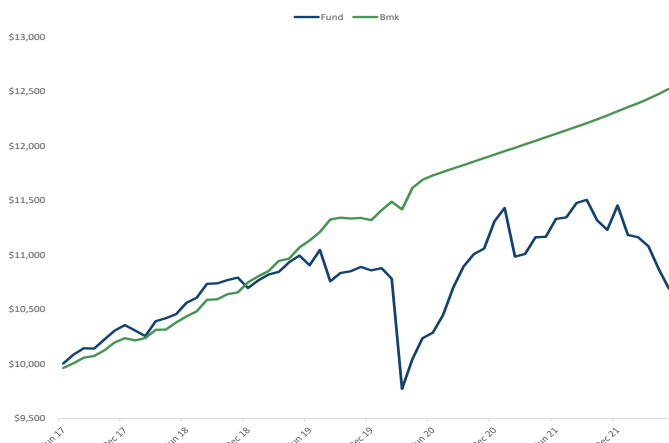
1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

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.



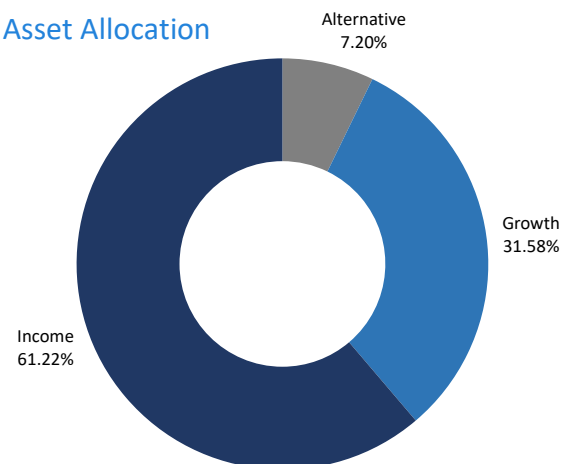
Overview

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 2020 these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)	Duration*	Top 10 Equities	(%)	(%)	
Westpac New Zealand Ltd	5.70	Fund 4.51 years	Spark New Zealand Ltd	3.19	Contact Energy Limited	2.25
New Zealand Local Govt Funding	4.96	Yield to Maturity	Skellerup Ltd	3.05	Works Finance NZ Ltd	2.15
Bank of New Zealand	4.60	Fund (gross) 4.41%	Infratil Limited	2.78	Chorus Limited	1.79
GMT Bond Issuer Ltd	4.00		Stride Stapled	2.61	Scales Corp Ltd	1.76
Infratil Ltd	3.14		Heartland Group	2.48	EBOS Ltd	1.67

*Includes cash holdings.

Fund Commentary

The Income Fund declined over May as equity markets fell. The bond market fared better rising 0.2% as measured by the Bloomberg Composite Bond Index over May however it is down 5.3% on a year-to-date basis. The NZX 50 Index decreased by 4.85% over the month and 13.2% lower since the start of 2022. The fund holds around 29% of its assets in NZ equities with an additional 2% in preference shares. Approximately 61% of the fund is invested in bonds and cash with the remainder invested in the Nikko Option Fund. The Option Fund returns were negative over the month as bond yields spiked to 3.2% before retreating again. These sharp movements saw yields move through option strike levels creating losses for the fund. Meridian Energy, Spark, Chorus and Skellerup were the better performing equity holdings. They all outperformed the return of the NZX50 however all posted negative returns. Stride Property Group, Mercury and Contact Energy were this month's laggards being buffeted by changing investor sentiment. Mid-term bonds with 4 to 7-year maturity dates performed best, being long enough to be somewhat insulated from rising cash rates but not long enough to be significantly impacted by inflation concerns that tend to show up most in 10-year bonds.

As we know interest rates have been rising quickly as the RBNZ and other Central Banks around the globe battle high inflation however we are mindful that the cash rate could peak below the level of RBNZ projections should the economy falter as stimulus is reduced. Governor Orr is reported as saying that it is a very plausible outcome were inflation to return back to the 1% to 3% target range. Likewise, it is possible there is more work for the bank to do should inflation expectations remain elevated. The RBNZ's central projection is one where inflation falls back into the range with interest rates being modestly above neutral and rates holding at that level before falling back again. It is hard to put a precise number on what level of interest rates constitutes neutral as often the level changes over time however at present neutral is probably in the 2% to 2.5% range. Uncertainty surrounding how far and how fast the RBNZ will increase the cash rate has led the market to price in a cash rate as high as 4% to 4.25%. Only time will tell if this expectation is too high and bond yields have increased too much.

We continue to believe investors should seek income from diverse sources. Even though some equity prices have fallen we believe the environment remains acceptable 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 a consistent 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 Official Cash Rate will rise further however much of the anticipated increases are already reflected in market pricing. The OCR peak is likely to be around 3.5% which is low compared to previous tightening cycles and lower than levels priced into bond markets. Most of the recent corporate and bank bond issues have been sold with yields between 4% and 5%, we feel investing at these levels is looking attractive compared to the likely peak in the OCR, even if there is the risk markets overshoot for a while.

Key Fund Facts

Distributions	Estimated annual fund charges (incl. GST)		
Distributions for this fund are defined annually and are effective for the calendar year. The defined rate is 0.80%, refer PDS for more details is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.			
Hedging	Buy / Sell spread:	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	Click to view	\$5m	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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