Factsheet 31 May 2022

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

- The Reserve Bank delivered a second consecutive 0.50% OCR hike taking the cash rate to 2%.
- Rhetoric was decidedly hawkish with the RB stating it was "resolute" in its commitment to "confidently" bring down inflation and that it would "briskly" lift the OCR until it was "convinced" inflation was constrained.
- An updated OCR track was released implying roughly a 3.5% OCR by year end and a peak OCR of 3.95%. This suggests two of the remaining four meetings of 2022 will see 0.50% rises.

Fund Highlights

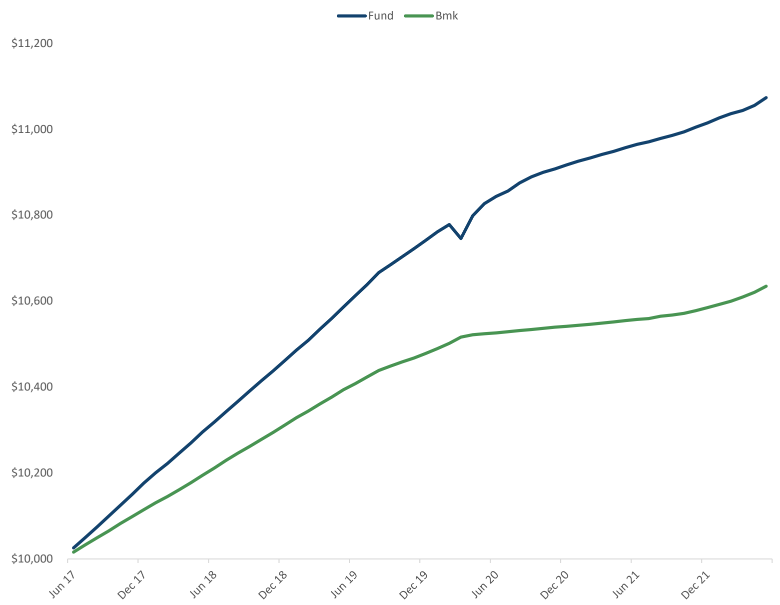
- The fund is using a barbel strategy to benefit from higher future expected rates today while short positions are concentrated around upcoming Reserve Bank OCR review dates to reduce risk.
- Duration is actively managed with fund positions reflecting the likely path of the OCR over the coming months along with what is priced into security yields.
- 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]	0.16%	0.34%	1.06%	1.51%	2.06%	2.94%
Benchmark[2]	0.13%	0.33%	0.76%	0.77%	1.24%	2.05%
Retail[3]	0.14%	0.26%	0.77%	1.19%	1.72%	
KiwiSaver[3]	0.13%	0.23%	0.64%	1.11%		

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.

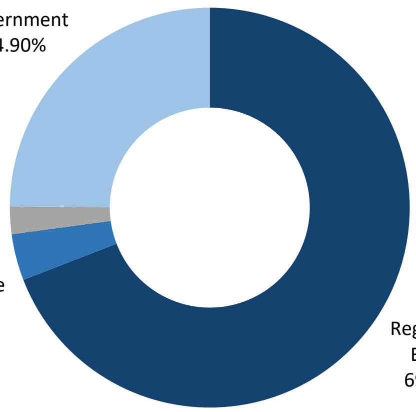
Overview

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	(%)
NZ Tax Trading Co	12.66
Westpac New Zealand Ltd	12.10
Tax Management NZ Limited	11.82
Bank of New Zealand	10.00
ANZ Bank New Zealand	7.87

Credit Quality	(%)
AAA	24.9
AA	38.6
A	36.5

Duration
Fund 95 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 2.96% vs Benchmark 2.19%

Market Commentary

The Reserve Bank (RB) came out fighting in its May Monetary Policy Statement delivering a decidedly hawkish 0.50% OCR increase. This increase was universally expected however the Bank's heightened concern around inflation and its willingness to aggressively act to bring it under control was less so. The RB's focus is now firmly on inflation rather than near term growth risks. With CPI inflation near 7% and wage growth picking up the RB has sent a clear message that it is "resolute" in its commitment to "confidently" bring down inflation even if this brings elevated risks to growth and potential for an outright hard landing. The Monetary Policy statement brought with it a slew of updated projections key among these a revised OCR track. When the RB last reviewed the OCR in its April meeting it used a "Stitch in time" analogy and described its actions as consistent with their OCR track released in February. February's track included a year end OCR level at 2.4% and a peak OCR of 3.35% - leaving the market to expect another 0.50% increase for May followed by more muted 0.25% increases. May's OCR track departed from this guidance with OCR projections raised substantially and further frontloaded to imply roughly a 3.5% OCR by year end and a peak level of 3.95%. This suggests we should see OCR rises at each of the RB's four remaining meetings in 2022 and that two of these increases will be of 0.50%. The level of consistency of these forecasts with the RB's "Stitch in time" analogy is arguably weak. This aside the RB has now made very clear its concern and focus on inflation along with its willingness to aggressively wield the OCR hammer with any risk to growth seen as collateral damage of a necessary action. Finally, we note the RB has framed its actions under its least regrets approach stating it was more concerned by tightening policy "too little, too late" vis-à-vis "too much, too soon". We have been highlighting for some time that should the RB pursue too aggressive a hiking cycle risks to growth will increasingly build and the probability of shorter hiking cycle and return to an easing bias at an earlier date will increase. Since the OCR was introduced in 1999 there have been five hiking cycles the most aggressive of which was the pre GFC cycle from 2004-2007 where the OCR was raised by 3.25%. This presents an interesting reference point for the RB's current projections; where, should they deliver on their forecast OCR track, they will not only have implemented a new most aggressive hiking cycle (increasing rates by some 3.7%) but also done this at an extremely rapid pace. As the old investor mantra goes one should not "fight the fed" or in our case "the RB" this is certainly apparent in current market pricing with cash investors near fully compensated for OCR increases at near term meeting dates and more than fully compensated for positions out towards 1-year in term. This being said, the road to ruin is often paved with notions of fair value, keeping this in mind we will continue to take a nimble active approach to positioning the portfolio and whilst we see strong value out towards 1-year we expected to balance these positions with corresponding short positions reflecting the RB's demonstrated aggression.

Fund Commentary

The fund outperformed in May returning 0.16% versus its 90-day bank bill index which returned 0.13%. The fund has been implementing a barbel investment strategy, with short positions concentrated around the upcoming Reserve Bank meeting dates complemented with some longer positions to take advantage of higher rates offered for tenor. Going into the May RB meeting date the fund had over one third of its securities due to mature inside one month including circa 6.5% in cash. These positions have or will shortly be reinvested at higher prevailing rates. At the same time the fund's longer positions have added value primarily through the accrual of their yield advantage. As mentioned in our market commentary, current pricing is such that investors are well compensated for taking bank bill positions out towards 1-year in term. To put some numbers around this, at our time of writing an investment of 1-year in term would offer a return gain of some 0.32% over a strategy of sitting in call cash should the RB implement a hiking profile consistent with its forecast OCR track. (This being two further 0.50% increases followed by three 0.25% increases). Credit spreads further enhance this prospective advantage to the tune of 0.20-0.40%. We continue to remain comfortable with our strategy of taking short positions around upcoming RB meeting dates combined with longer positions when we see fair value versus our expected OCR track.

Key Fund Facts

Distributions

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter
KiwiSaver fund: Does not distribute

Estimated annual fund charges (incl. GST)

Wholesale: Negotiated outside of unit price
Retail: 0.30%, refer PDS for more details
KiwiSaver: 0.45%, refer PDS for more details

Hedging	Buy / Sell spread	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	0.00% / 0.00	$948m	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.

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

Contact Us
www.nikkoam.co.nz | nzenquiries@nikkoam.com