

Factsheet 31 July 2022

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The S&P/NZX 50 Gross Index increased by 5.77% over the month however it is approximately 11.5% lower since the start of 2022. Even though the Reserve Bank is likely to increase the Official Cash Rate to between 3.5% and 4.0% by the end of 2022 there are signs that longer term interest rates are peaking or have peaked already.

Fund Highlights

- The Income Fund had a strong month over July as equity and bond markets rebounded after a period of weakness. The bond market sector as measured by the Bloomberg Composite Bond Index increased 2.37% over July reducing its year-to-date return to -3.67%.
- The fund holds around 29% of its assets in NZ equities with an additional 2% in preference shares. Chorus, Heartland and Infratil returned over 9% for the month with only Scales Corporation falling in price amongst the 14 names in the equity portfolio. Nine of the fourteen names outperformed the NZX50.

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	2.90%	0.18%	-4.00%	-0.47%	1.55%	3.84%
Benchmark ²	0.44%	1.23%	4.00%	4.05%	4.77%	6.50%
Market Index ³	3.06%	0.35%	-5.12%	-	-	-

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.

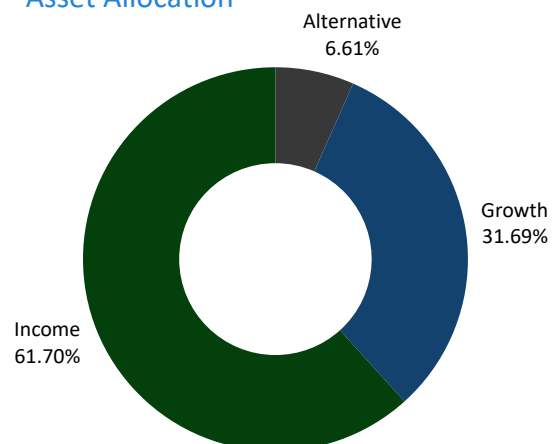
Overview

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	5.90	Fund 4.05 years	Spark New Zealand Ltd	3.25	Contact Energy Limited	2.24
Bank of New Zealand	4.57	Yield to Maturity	Skellerup Ltd	3.03	Works Finance NZ Ltd	2.11
ASB Bank Ltd	4.21	Fund (gross) 4.60%	Infratil Ltd	2.92	Chorus Limited	1.95
NZ Local Govt Funding Agency	4.04		Stride Stapled	2.60	Argosy Property Ltd	1.64
Christchurch Intl. Airport Ltd	3.04		Heartland Group	2.38	Scales Corp Ltd	1.61

*Includes cash holdings.

Fund Commentary

The Income Fund had a strong month over July as equity and bond markets rebounded after a period of weakness. The bond market sector as measured by the Bloomberg Composite Bond Index increased 2.37% over July reducing its year-to-date return to -3.67%. In a similar fashion the S&P/NZX 50 Gross Index increased by 5.77% over the month however it is approximately 11.5% lower since the start of 2022. Even though the Reserve Bank is likely to increase the Official Cash Rate to between 3% and 3.5% by the end of 2022 there are signs that longer term interest rates are peaking or have peaked already. If this is the case the outlook for investment markets may improve, however how company earnings hold up in an economic slowdown may be the next challenge.

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 down over the month. Chorus, Heartland and Infratil returned over 9% for the month with only Scales Corporation falling in price amongst the 14 names in the equity portfolio. Nine of the fourteen names outperformed the NZX50. Bonds with longer term maturity dates outperformed shorter term bonds with the long dated 2050 Auckland City Council bond generating the highest return. The Reserve Bank delivered a third consecutive 50bps hike taking the OCR to 2.5%. The Bank confirmed it was comfortable with their OCR track outlined in their May MPS. The Reserve Bank believes it remains appropriate to “continue to tighten monetary conditions at pace” further reinforcing the case for continued hikes. The Bank is forecasting the OCR peaking at around 4% by mid 2023.

Second quarter CPI inflation came in stronger than expected at 1.7% taking annual inflation to 7.3% its highest level in more than 30 years. This level of inflation will concern the Reserve Bank and affirm their strategy of continuing to tighten at pace. We believe the peak in inflation may have already occurred. When third quarter CPI comes out the dataset will be dropping off 3Q21’s 2.2% quarterly print, a pace of inflation that hasn’t been seen since. This does not mean that CPI inflation will be back to the RB’s target band of 1-3% anytime soon but the pace of growth should start to slow. This means we will possibly see a peak OCR in late 22 or early 23 and possibly below the RB’s forecast level.

We remain cautious on fund positioning in terms of interest rate risk while a fair degree of uncertainty remains, but there have been more opportunities to add value with interest rates moving in both directions, rather than just trending higher. We are happy to continue to add quality mid-curve bonds at yields around 4.5% and higher as we believe they will perform well over the medium term. And although the cash rate will go higher in the near-term growth concerns are increasing and this will likely weigh on how high bond yields will go. We continue to believe investors should seek income from diverse sources. Even though some equity prices have fallen over the past year we believe the environment remains acceptable for equities even though catalysts for new growth remain elusive and an economic slowdown looks inevitable. 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.

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 All investments will be in New Zealand dollars	Buy / Sell spread: Click to view	Strategy size \$5m	Strategy Launch 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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