

Factsheet 31 August 2022

NIKKO AM NZ BOND STRATEGY

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

Market Overview

- Bond market yields pushed higher from mid-August unwinding falls in July.
- The swap curve is inverted from 2 to 10 years, and government curve slightly positive.
- New issuance has been modest supporting credit sector performance.

Fund Highlights

- NZ Bond fund returns were negative as rates moved higher in yield.
- The fund duration is modestly longer than benchmark which was a negative for the month.
- Credit and swap outperformed lower yielding government bonds.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-2.46%	-0.12%	-7.70%	-1.99%	1.84%	3.64%
Benchmark ²	-2.38%	-0.71%	-8.36%	-3.06%	0.73%	2.24%
Retail ³	-2.49%	-0.25%	-8.26%	-2.65%	1.13%	2.85%

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Composite 0+ Yr 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.

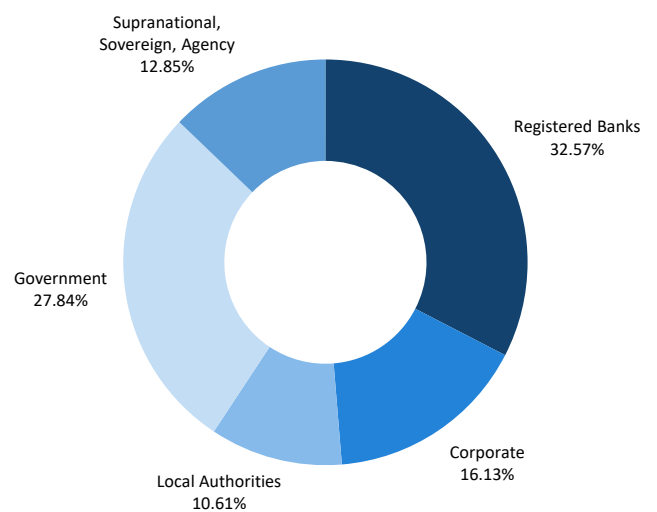
Overview

The fund aims to provide investors with regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Duration
Housing New Zealand Ltd	7.44	AAA	53.1	Fund 4.93 years vs Benchmark 4.64 years
Westpac New Zealand Ltd	7.40	AA	27.3	Yield to Maturity
Bank of New Zealand	6.73	A	15.4	Fund (gross) 4.18% vs Benchmark 4.12%
ASB Bank Ltd	5.23	BBB	2.8	Green, sustainability and social bonds
Kommunalbanken AS	5.12	BB	1.4	15.98% of the fund

*excludes NZ central government

Market Commentary

The month of August was poor for NZ bond returns as interest rates moved quite a lot higher unwinding falls in yield from July. The move higher in interest rates was the key driver of negative returns. Otherwise, the performance difference across government and swap sectors was relatively muted with credit and swaps a modest outperformer versus government bonds. Credit spreads remained stable.

The move higher in NZ rates was consistent along the yield curve. The 1-year government bond yield finished 50 bps (basis points) higher, the 2-year 55 bps higher, the 5-year finished 57 bps higher, and the 10-year bond and 2051 government bond were 52 bps higher, and 55 bps higher in yield respectively. Interest rates have already moved a lot higher this year and it still remains difficult to forecast what is going to dominate the direction of bond markets in the short term. Investor focus continues to swing from being concerned about high inflation to concern about the negative impact tightening monetary conditions may have on growth. And in a stagflation environment both are valid concerns that could push rates either higher or lower in yield. At the same time volatility has remained choppy this year with low trading volumes exacerbating moves in interest rates and this is likely to remain so in the near term.

The RBNZ is one of the most advanced central banks in terms of tightening cycle, and with most major central banks projecting terminal cash rates around 4%, we may be close to peak cash rate expectations already. How long short rates remained elevated is uncertain, and the fate of longer-term bond rates are likely to remain heavily influenced by offshore direction. In this environment it makes sense to not have too much risk to the direction of interest rate moves. NZ bonds can generate reasonable returns over the medium term as there is plenty of yield available through purchasing quality credit rather than going longer on a flat yield curve. We continue to look to add value within the interest rate range; and reducing risk where bonds look expensive and adding bonds that we believe will have a higher likelihood of adding value.

Fund Commentary

The fund had a negative return as yields moved higher in August. Performance was in line the Bloomberg NZ Bond Composite benchmark. Credit holdings continued to perform well with a higher yield accruing to the portfolio and a mild contraction in margins. We trimmed some of our inflation linked bond holding which had a volatile month as the Debt Management Office issued a new 2035 maturity bond and repurchased some 2025 bonds. Swap margins had a small contraction relative to similar maturities of governments and was helpful as the fund generally holds less government bonds due to their lower yield, and more high grade credit which is priced as a margin above swap. The modest long duration position was unhelpful this month as yields moved higher. The fund achieves a high yield from holding credit issues and holding inflation linked government bonds and we continue to believe this should benefit returns over the medium term. A gradual recycle into new deals at higher levels is our plan. We continue to sell bonds that look expensive and switching into bonds that in our view have a good chance of delivering acceptable future returns.

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:	0.65%, refer PDS for more detail
Hedging	Buy / Sell spread	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	Click to view	\$388.3m	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.

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