Nikko Asset Management

Factsheet 30 September 2022

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- Economic forecasters revised their views on how high the Reserve Bank would hike the Official Cash Rate. At the same time these domestic OCR calls were being digested markets observed a continuation of aggressive global central bank hiking action and rhetoric. The Fed, ECB and the Bank of Canada all increased 75 basis points, whilst the RBA and the Bank of England increased 50. NZ OCR was raised by 50 bps to 3.5% on 5 October.

Fund Highlights

- The Income Fund declined over September.
- Looking at the performance of some individual equity names in the fund, only Scales Corp and Mercury Energy advanced in price. On the opposite end of the scale the property sector performed poorly as higher longer term interest rates caused investors to question the value of commercial property assets. Short term bonds and cash were the outperformers in the bond sector.

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 month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail[1]	-2.54%	-0.24%	-8.23%	-0.86%	0.81%	3.37%
Benchmark[2]	0.48%	1.40%	4.43%	3.98%	4.83%	6.44%
Market Index[3]	-2.05%	0.34%	-8.69%	-	-	-

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.

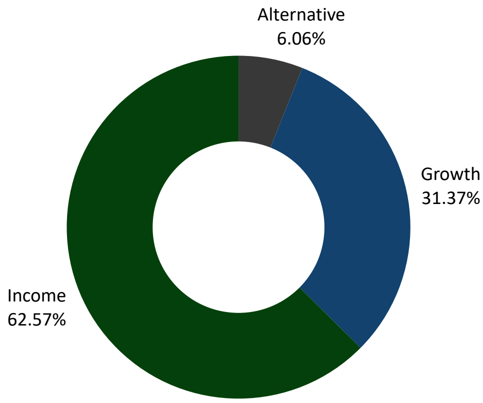
Overview

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



Nikko Asset Management

Top 5 Fixed Income Issuers*	(%)
Westpac New Zealand Ltd	9.12
Bank of New Zealand	4.65
ASB Bank Ltd	4.26
New Zealand Local Govt Funding	3.90
Contact Energy Ltd	3.38

*Includes cash holdings.

Duration*
Fund 4.12 years
Yield to Maturity
Fund (gross) 5.37%

Top 10 Equities	(%)		(%)
Skellerup Ltd	3.03	Contact Energy Ltd	2.35
Heartland Group Pref	2.96	Works Finance NZ Ltd	2.18
Spark New Zealand Ltd	2.81	Chorus Limited	1.94
Infratil Ltd	2.60	Scales Corp Ltd	1.93
Stride Stapled	2.55	EBOS Ltd	1.59

Fund Commentary

The Income Fund declined over September. Bond and equity markets performed poorly as longer-term bond yields moved higher as central banks around the globe indicated they will keep interest rates elevated for an extended period to ensure inflation pressures and inflation expectations fall. Equity markets are also concerned about inflation and how increasing costs may impact trading margins and profits as economic growth slows under the pressure of rising interest rates. The S&P/NZX 50 Gross Index fell by 4.6% over the month. The bond sector, as measured by the Bloomberg Composite Bond Index, also fell but by a more modest 1.35%. The Option Fund returns were also down over the month as bond yields increased significantly and market volatility spiked. Bond yields moved through option strike levels resulting in losses for the fund.

Looking at the performance of some individual equity names in the fund only Scales Corp and Mercury Energy advanced in price. On the opposite end of the scale the property sector performed poorly as higher longer term interest rates caused investors to question the value of commercial property assets. Short term bonds and cash were the outperformers in the bond sector.

Over September we saw many economic forecasters revise their views on how high the Reserve Bank would hike the Official Cash Rate. At the same time these domestic OCR calls were being digested markets observed a continuation of aggressive global central bank hiking action and rhetoric. The Fed, ECB and the Bank of Canada all increased 75 basis points, whilst the RBA and the Bank of England increased 50. Looking to the rhetoric accompanying these actions once again this was best summed up by the US Federal Reserve with Powell highlighting the Fed remains firmly committed to bringing inflation back down to levels in line with its inflation target of 2%, even though this will likely cause "some pain" in the economy.

With this confluence of hawkish signals, it is perhaps unsurprising that markets aggressively moved up peak OCR pricing over the month (from ~4.25% to more than 4.75%). We can understand the logic here however we view the magnitude of the reaction as overdone. Monetary policy often has a lag of one to two years before its maximal impact is felt as the slowing impetus from OCR hikes continues to build most notably as consumers refix their mortgages. Governor Orr has recently made comments that are sympathetic to our view stating as the RBNZ has “done so much already” the current cycle is “very mature”.

We are happy to add quality mid-curve bonds to the portfolio at yields around 5% and higher as we believe they will outperform cash rates over the medium term. Although the cash rate will go higher in the near-term, growth concerns in NZ and globally are increasing which will likely limit how high interest rates go. We continue to believe investors should seek income from a diverse range of sources. Even though interest rates have risen, and most 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. The Income Fund remains 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:	**Strategy size**	**Strategy Launch**
Click to view	$4.7m	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 quarter.

Contact Us

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