

Factsheet 31 October 2022

NIKKO AM NZ CORPORATE BOND STRATEGY

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

Market Overview

- It was a very volatile month for interest rates with some large moves higher before retreating into month end.
- The NZ swap yield curve is inverted from 2 to 10 years, the government curve is slightly positive at the long end.
- The NZ credit sector continues to perform well with margins stable.

Fund Highlights

- NZ Corporate Bond fund returns finished October down slightly after wild swings in value over the month.
- The fund duration is modestly longer than benchmark.
- NZ government bonds strongly outperformed other sectors.

Performance

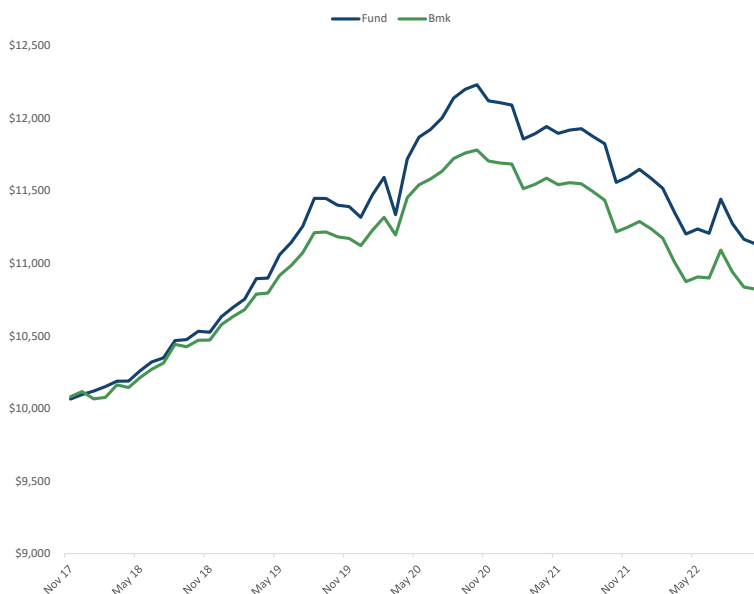
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-0.29%	-2.70%	-3.68%	-0.79%	2.17%	4.14%
Benchmark ²	-0.13%	-2.43%	-3.53%	-1.09%	1.59%	2.67%
Retail ³	-0.35%	-2.87%	-4.33%	-1.52%	1.40%	3.31%
KiwiSaver ³	-0.32%	-2.77%	-4.29%	-1.55%	-	-

1. Returns are before tax and before the deduction of fees.

2. Current benchmark: Bloomberg NZBond Credit 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.

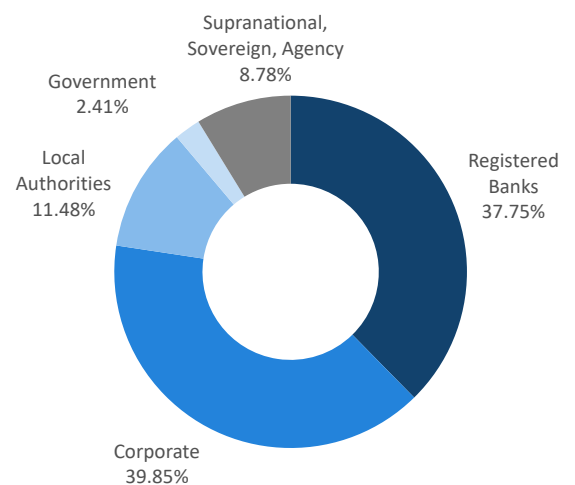
Overview

The strategy aims to generate 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 0.70% per annum before fees, expenses and taxes over a rolling three-year period.

Asset Allocation



Top 5 Corporate Issuers	%	Credit Quality (% of fund)	%	Duration
Westpac New Zealand Ltd*	9.9	AAA	19.5	Fund 3.58 years vs Benchmark 2.92 years
ASB Bank Ltd	8.7	AA	37.6	Yield to Maturity
Kiwibank Ltd	7.4	A	16.1	Fund (gross) 5.57% vs Benchmark 5.33%
Housing New Zealand Ltd	6.9	BBB	26.3	Green, sustainability and social bonds
Dunedin City Treasury	5.2	BB	0.8	21.63% of the fund

*Includes cash held by custodian

Market Commentary

NZ bond returns were a mix of negative and positive over October. It was very volatile intra month with bond valuations in negative territory as interest rates surged higher late October. This move was reversed into month end with terminal OCR expectations reversing back close to 5% after peaking around 6%. Moves higher in US bonds and the surprisingly strong NZ CPI print were the key drivers of higher rates, and this was exacerbated by thin liquidity with the market looking to sell rather than buy. The fund has a modest longer duration position which had mixed outcomes depending on bond holdings as the yield curve flattened a reasonable amount over the month. We added some duration during the month but reduced it again at month end as rates fell. Changes in interest rates were: 1- year government bond yields finished 16 basis points higher, the 2-year 10, bps higher, the 5-year unchanged, and the 10-year bond and 2051 government bond were 15 bps, and 27 bps lower in yield respectively.

There was a notable difference in performance across bond sectors with NZ government bonds strongly outperforming swap and credit. NZ Government bonds performed strongly through the month with their 31 October inclusion in the WGBI bond index seeing some strong buy-side support from locals and offshore managers. The outperformance of governments was generally unhelpful for our funds as we tend to underweight low yielding government bonds versus investing in quality credit which is higher yielding and more likely to outperform over the medium term. NZ credit margins have remained stable and with year-end fast approaching there will likely be a shortage of new issuance which should be supportive until supply resumes in the new year. A higher terminal cash rate around 5% is looking more likely as there has been little improvement in inflation, the labour market, and the things the RBNZ is most concerned about. What will dominate the direction of bond markets in the short term remains difficult to forecast. Investor focus continues to swing from being concerned about high inflation to concern about the negative impact tightening monetary conditions may have on growth. Volatility is likely to remain high in the near term until we get more certainty from economic data.

We may be close to a plateau in peak cash rate expectations. How long short rates remain elevated is uncertain, and the fate of longer-term bond rates remain much more heavily influenced by offshore direction than local considerations. 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, reducing risk when bonds look expensive and adding bonds that we believe will have a high likelihood of adding value.

Fund Commentary

The fund had a negative return as short-term yields finished the month higher and long term yields lower. Performance was marginally behind the benchmark. Longer maturity bond holdings performed well and shorter maturity bonds and the inflation linked government bond were unhelpful as yields moved higher. Credit holdings continued to perform well with a higher yield accruing to the portfolio and credit margins stable. We marginally extended the fund’s duration on a view that the market pricing of interest rate increases was looking overdone, and then reduced duration at month end when rates were lower. The fund continues to maintain a higher yield from holding credit issues and inflation linked government bonds in preference to lower yielding nominal government bonds, and we continue to believe this should benefit returns over the medium term.

Key Fund Facts

Distributions	Estimated annual fund charges (incl. GST)		
Wholesale fund: calendar quarter	Wholesale fund: negotiated outside of unit price		
Retail fund: calendar quarter	Retail fund: 0.70%, refer PDS for more details		
KiwiSaver fund: does not distribute	KiwiSaver fund: 0.80%, refer PDS for more details		
Hedging	Buy / Sell spread:	Strategy size	Strategy Launch
Any foreign currency exposure to be hedged to NZD within operational range of 97.5%-102.5%	Click to view	\$544.7m	July 2009
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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