

Factsheet 30 November 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

- NZ short term interest rates finished higher in yield following the RBNZ 75bps rate hike.
- The NZ swap yield curve has become more steeply inverted from 2 to 10 years signalling recession.
- NZ longer term rates followed the US lower in yield as the market has generally been caught shorter duration.

Fund Highlights

- The fund has a modest long duration position which was of benefit where rates moved lower.
- Swaps and credit played some catchup from last month and outperformed government bonds.
- Holding Kainga Ora (Housing NZ) bonds benefited from a contraction in margins.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	1.30%	-0.14%	-4.97%	-1.79%	1.50%	3.40%
Benchmark ²	0.67%	-0.20%	-5.69%	-2.87%	0.42%	2.15%
Retail ³	1.24%	-0.31%	-5.57%	-2.44%	0.79%	2.62%

- Returns are before tax and before the deduction of fees.
- Current benchmark: Bloomberg NZBond Composite 0+ Yr Index. No tax or fees.
- 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.

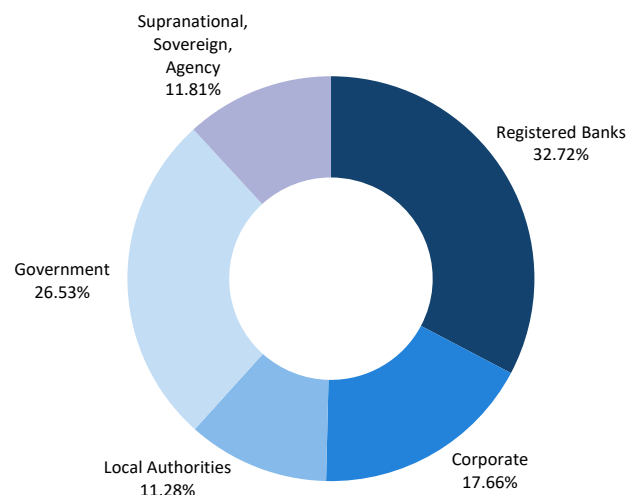
Overview

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
Westpac New Zealand Ltd	8.58	AAA	52.2	Fund 4.90 years vs Benchmark 4.46 years
Housing New Zealand Ltd	7.89	AA	26.7	Yield to Maturity
ASB Bank Ltd	7.69	A	17.4	Fund (gross) 4.84% vs Benchmark 4.64%
Kiwibank Ltd	7.07	BBB	2.4	Green, sustainability and social bonds
New Zealand Local Govt Funding Agency	5.78	BB	1.3	20.10% of the fund

*excludes NZ central government

Market Commentary

NZ bond returns were positive for the month. Longer maturity bonds performed better than shorter maturities. Swap was the best performing sector, and this flowed through to a better performance from credit, making up for some underperformance versus government bonds from the previous month.

In terms of positioning, the fund has a modest long duration position which was helpful as the yield curve continued to invert as short-term yields moved higher after a hawkish RBNZ, while longer term rates moved lower pricing in an increased likelihood of recession. Changes in interest rates were: the 1- year government bond yield finished 31 basis points higher, the 2-year 40 bps higher, the 5-year 5 bps higher and the 10-year bond and 2051 government bond were 10 bps, and 16 bps lower in yield respectively.

Across sectors we continue to hold more high-quality credit bonds and less government bonds as we believe the additional yield will continue to benefit performance over the medium term. (For example, AAA rated LGFA 2027 bonds yield approximately 1% higher and AA rated NZ bank 1.5% above 5-year government bonds). NZ credit margins have remained relatively 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. Of note in credit, Kainga Ora (Housing NZ) bonds had a strong performance as margins contracted following the government taking over their debt program.

A higher terminal cash rate around 5.0-5.5% looks likely as there has been little improvement in inflation, the labour market, and the things the RBNZ is most concerned about. The front end of the yield curve is pricing a higher OCR and the longer end is pricing recession. How long short rates need to remain elevated is uncertain, and the fate of longer-term bond rates are likely to remain much more heavily influenced by offshore direction.

Fund Commentary

The fund had a positive return outperforming benchmark. The modest long duration position relative to the Bloomberg NZ Bond Composite benchmark helped as we hold more longer maturity bonds which fell in yield. On sector allocation, swap and credit holdings outperformed government bonds which suited the fund. We continue to sell bonds that look expensive and replace with those that we believe will likely perform better over the medium term. We held an overweight position in Kainga Ora (Housing NZ bonds) which had a strong performance. 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.

With investors concerned about both high inflation and the negative impact tightening monetary conditions may have on growth it looks likely volatility is likely to remain until we get more certainty from economic data. We remain patient awaiting opportunities to add duration when yields are higher in the range and would also consider selling bonds if the curve became too steeply inverted.

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
All investments will be in New Zealand dollars		Click to view	\$430m
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

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