Factsheet 31 December 2022

NIKKO AM GLOBAL BOND STRATEGY

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

Market Overview (source: GSAM)

- 2022 was a tumultuous year for financial markets amid soaring inflation and aggressive monetary tightening. The outlook in 2023 will likely remain dependent on one key datapoint: the rate of inflation.
- Developed market rates sold off into year-end even as central banks in the US, UK and Euro area stepped down the pace of rate hikes from 75bps to 50bps at their December meetings. Nonetheless, policymakers emphasised that they are not stepping back from the task of taming inflation.

Fund Highlights

- The portfolio outperformed its benchmark by 100bps over the December quarter. This was driven by our Cross Sector and Government/Swaps selection strategies, respectively. By contrast, our Securitized selection strategy detracted from excess returns.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	-1.23%	1.80%	-12.79%	-2.11%	0.99%	3.28%
Benchmark[2]	-1.20%	0.80%	-11.75%	-2.78%	0.11%	2.76%
Retail[3]	-0.89%	1.67%	-13.47%	-2.90%	0.14%	-

1. Returns are before tax and before the deduction of fees. Based on actual calendar periods.
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any). Based on change in unit price.

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. The Goldman Sachs Asset Management Global Fixed Income Team managed over US$690 billion of global fixed income and currency assets (as at 30th September 2022).

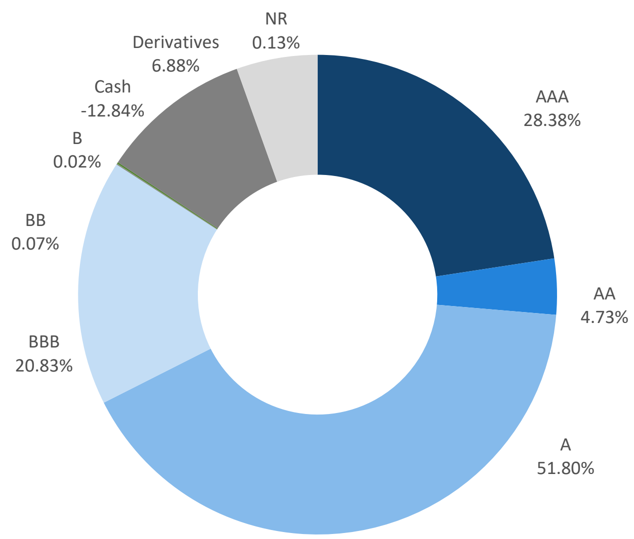
Overview

The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

Objective

The Strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three-year period.

Credit Quality



Sector Allocation (% of fund)	Fund	Index
Governments	46.26%	45.10%
Agency	1.57%	7.71%
Collateralised & MBS	28.48%	12.30%
Credit	26.18%	19.72%
Emerging market debt	3.49%	15.04%
Cash, derivatives, other*	-5.98%	0.14%

*includes deferred settlements

Duration
Fund 6.79 years vs Benchmark 6.72 years

Yield to Maturity
Fund (gross) 5.73% vs Benchmark 4.94%

Market Commentary (source: GSAM)

2022 was a tumultuous year for financial markets amid soaring inflation and aggressive monetary tightening. The outlook in 2023 will likely remain dependent on one key datapoint: the rate of inflation. Following front-loaded rate hikes in 2022, we think policymakers will step down the pace of tightening this year. But with inflation still well above its target, we don't expect central banks, including the US Federal Reserve (Fed), to step back from the fight against inflation. Ultimately, a slower pace of tightening will likely be accompanied by a longer hiking cycle to a higher terminal rate.

Developed market rates sold off into year-end even as central banks in the US, UK and Euro area stepped down the pace of rate hikes from 75bps to 50bps at their December meetings. Nonetheless, policymakers emphasised that they are not stepping back from the task of taming inflation. The Fed's median policymaker projection signalled a higher peak funds rate of 5% - 5.25%. The European Central Bank (ECB) was the most hawkish major central bank —stating that interest rates would need to rise significantly at a steady pace to reach levels sufficiently restrictive to return inflation to its 2% target. Surprisingly, having been an outlier for much of 2022, the Bank of Japan (BoJ) appeared to take a step towards convergence with other central banks in December. The 10-year Japanese government bond yield target was widened from 0% +/- 25bps to +/-50bps. In response, Japan's 10-year government bond yield rose to an almost two-decade high, close to 0.5%. Benchmark 10-year government bond yields in the US, UK and Europe followed the moves, rising to end the year at 3.9%, 3.7% and 2.6%, respectively.
Credit spreads tightened over the fourth quarter on improved risk sentiment; China departing from its stringent zero-Covid policy, downside surprises in inflation across developed economies and a downshift in the pace of central bank tightening. Although strong performance tempered slightly into year-end, US and European investment grade and high yield credit generated positive returns and outperformed government bonds over the quarter. Amid high uncertainty and mixed signals from economic data one thing is clear: it is time to bring on bonds. In the near term, we favour high-quality fixed income assets like investment grade credit and agency mortgage-backed securities (MBS). As evidence of normalizing inflation and growth improvements becomes clearer, we think there will be an opportunity to add exposure to cyclical assets such as high yield credit and emerging market (EM) debt.

Fund Commentary (source: GSAM)

The portfolio outperformed its benchmark by 100bps over the December quarter. This was driven by our Cross Sector and Government/Swaps selection strategies, respectively. By contrast, our Securitized selection strategy detracted from excess returns. Performance of our Cross Sector strategy was driven by our sector overweight to investment grade (IG) corporate credit and collateralized loan obligations (CLO). Broadly, risk assets performed positively over the fourth quarter on increased investor risk appetite. Into the quarter, performance was supported by moderating rate volatility and as markets anticipated a slowdown in the pace of central bank tightening following downside surprises in October and November CPI readings. To follow, easing of stringent zero-COVID measures in China raised hopes of an exit, providing positive implications for the global growth outlook. US and European IG spreads tightening by 29bps and 55bps, respectively over the review period, while AAA-rated CLO spreads tightened by 34bps. Our Government/Swaps selection strategy also contributed to excess returns. This was primarily driven by our selection amongst US and Japanese government bonds. As part of our target trades, performance was driven by our US swap spread curve steepener position in addition to our US butterfly position, whereby we are overweight the belly and underweight short- and longer-dated parts of the curve. From a relative standpoint, short and longer-dated US bonds underperformed the intermediate portion as market participants expected further rate hikes from the Fed. In addition, though headline US inflation slowed over the quarter, core prices remained robust, suggesting prolonged price pressures. Lastly, our Securitized selection strategy detracted over the quarter. This was driven by our selection among agency mortgage-backed securities (MBS) passthrough securities. Our bias remains towards Ginnie Mae versus Fannie Mae MBS and production coupons versus discount coupons.

Key Fund Facts

Distributions:

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter

Estimated annual fund charges (incl. GST)

Wholesale: Negotiated outside of unit price
Retail: 0.80%, refer PDS for more details

Hedging: All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.

Buy / Sell spread	Strategy size	Strategy Launch
0.00% / 0.00%	$452m	October 2008

Restrictions: Thermal coal mining and extraction, oil tar sands extraction, 'controversial weapons', tobacco stocks and fossil fuels. For more information, please refer to the Statement of Investment Policy and Objectives (SIPO) on our website https://www.nikkoam.co.nz/invest/retail.

Compliance

The fund complied with its investment mandate and trust deed during the quarter.

Contact Us

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