Factsheet 28 February 2023

NIKKO AM NZ CASH STRATEGY

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

Market Overview

- As widely expected, the RBNZ lifted the Official Cash Rate (OCR) by 0.50% to 4.75%.
- Inflation remains the RBNZ's primary concern, they looked through the near-term impacts to growth and inflation from cyclone Gabrielle.
- The RBNZ's maintained its hawkish stand with its peak OCR forecast retained at 5.5%.

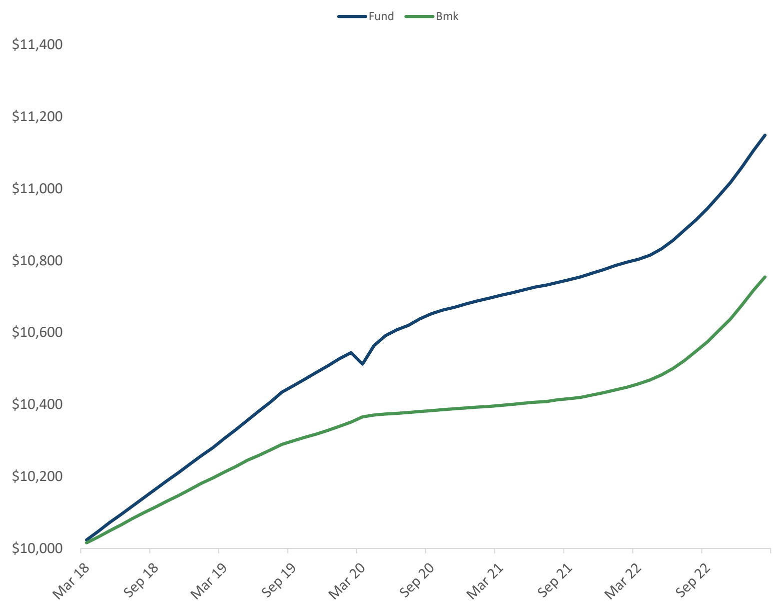
Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that cash rates will peak in 2023.
- The RBNZ's hiking cycle is well progressed and likely entering its latter stages. We are looking for opportunities to add to fund duration reflecting the lateness of the cycle.
- The fund's shorter duration positions are targeted around the nearest two OCR meeting dates, allowing for rapid reinvestment on decisions and any potential pivots.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.39%	1.19%	3.27%	1.88%	2.20%	2.94%
Benchmark[2]	0.35%	1.10%	2.93%	1.28%	1.47%	2.11%
Retail[3]	0.36%	1.12%	2.96%	1.58%	1.87%	
KiwiSaver[3]	0.35%	1.08%	2.81%	1.44%		

1. Returns are before tax and before the deduction of fees.
2. Benchmark: Bloomberg NZBond Bank Bill Index. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).



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.

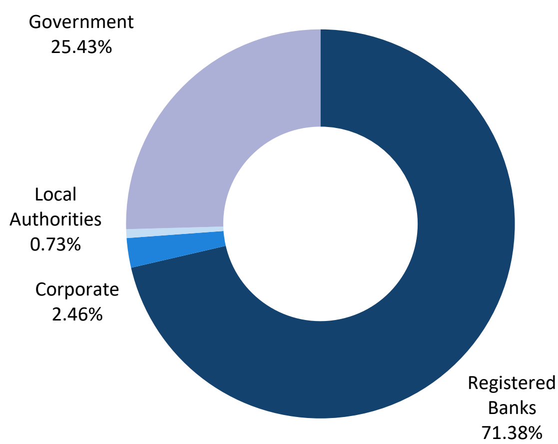
Overview

The strategy aims to generate income by constructing an actively managed investment portfolio of short-term deposits and bonds whilst preserving capital value.

Objective

The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three year period.

Asset Allocation



Top 5 Issuers	(%)
NZ Tax Trading Co	13.36
Tax Management NZ Limited	12.08
ANZ Bank New Zealand	10.82
Cooperatieve Rabo U.A.	10.64
Industrial and Commercial Bank of	8.36

Credit Quality	(%)
AAA	25.4
AA	31.4
A	43.1

Duration
Fund 115 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 5.47% vs Benchmark 4.93%

Market Commentary

The RBNZ meets seven times each year with meetings typically 6 to 7 weeks apart, however the gap between their last meeting of 2022 and their first meeting of the new year is typically twice this interval. For 2023 this resulted in a monetary policy review hiatus of circa 13 weeks. This longer than usual break between reviewing monetary policy settings requires a level of nuance, particularly when monetary policy settings have been rapidly tightened over the past year. For February 2023 this decision was further complicated by the impacts of the Auckland floods then Cyclone Gabrielle. It is through this lens of an extended review period, past rapid OCR changes and significant weather events that one should review the RBNZ's February Monetary Policy Statement and decision to increase the OCR by 50bps to 4.75%.

Going into the February meeting markets had pared back OCR expectations in terms of both the expected move in February and the terminal OCR level. Views were the RBNZ would not need to go to 5.5% as indicated in their November statement and would perhaps slow their pace of hiking as the impact of hikes thus far would continue to build simply through the passage of time. The advent of the Auckland floods then Cyclone Gabrielle further cemented this theme, with some commentators suggesting parallels with the RBNZ's actions post the Christchurch earthquake of 2011 where monetary policy relief was given. This however is a flawed argument as the backdrop of macro-economic conditions is vastly different in 2023 vis-à-vis 2011, most notably inflation is at its highest level in decades and the labour market is tight and beyond capacity. On top of this one should consider that in aggregate the rebuild will likely be inflationary in the short term. Whilst the RBNZ will look through this, the upwards pressure the rebuild places on near term inflation and inflation expectations is challenging. Another point of consideration contributing to the RBNZ's decision to continue to hike at pace and maintain a hawkish terminal OCR forecast was the potential impact any hint of a policy pivot would have on swap markets and ultimately mortgage rates. Had the RBNZ blinked in February and slowed it would have risked losing control of its narrative on the future path of interest rates. Any perceived dovishness would have likely seen markets bring forward both the peak of the hiking cycle and the time at which a pivot to cutting would occur. This would immediately see 1, 2 and 3 year swap rates fall and consequently mortgages rates begin to reduce at these terms. This would not be consistent with the RBNZ's target and the transmission of past decisions given the tightening impact on mortgage rates is still to fully play out – we note the average interest rate on outstanding residential mortgages remains a relatively low 4.35% at the RBNZ's most recent estimate (December 2022). None of the above however impacts our view that the end of the hiking cycle is near. Probability of a slowing in hiking pace will only build, albeit with a very fine line to walk in terms of maintaining a credible hawkish stance and not hinting at pause or pivot until it is clearer inflation has been tamed.

Fund Commentary

The fund performed well in February returning 0.39% outperforming its benchmark the 90-day bank bill index which returned 0.35%. Leading into the RBNZ's late February decision the fund faded its duration position as in our view we were not sufficiently compensated for a 50bp hike or an appropriately high terminal OCR level. With a 50bps hike delivered along with an appropriately high terminal OCR forecast (5.5%) this proved to be a sound decision for the fund. Post the MPS both 90-day bills and 1-year swap rates increased to month highs. The fund used this increase in rates to add back duration with positions at the 1-year term favoured. Our investment thesis remains that we are nearing the end of the hiking cycle. As such looking to the coming month, we will continue to opportunistically add duration when compensated for a terminal OCR in the range of 5.5%.

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:	0.30%, refer PDS for more details
KiwiSaver fund:	Does not distribute	KiwiSaver:	0.45%, refer PDS for more details

Hedging	**Buy / Sell spread**	**Strategy size**	**Strategy Launch**
All investments will be in New Zealand dollars	0.00% / 0.00	$814.6m	October 2007

Exclusions: Controversial weapons.

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.

Compliance

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

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