Factsheet 28 February 2023

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

- NZ bonds had a poor month unwinding January's gains as interest rates moved higher in yield.
- The NZ swap yield curve moved higher and flattened marginally.
- NZ credit remains in short supply and margins have been tighter.

Fund Highlights

- Fund returns were poor due to the move higher in yields.
- We extended fund duration towards month end when yields were higher.
- The fund's yield to maturity is closer to 6% (with inflation linked bonds included).

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	-1.15%	0.39%	-1.98%	-0.88%	2.15%	4.09%
Benchmark[2]	-0.90%	0.35%	-1.84%	-1.04%	1.71%	2.83%
Retail[3]	-1.21%	0.22%	-2.64%	-1.60%	1.39%	3.27%
KiwiSaver[3]	-1.19%	0.21%	-2.61%	-1.63%		

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).

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

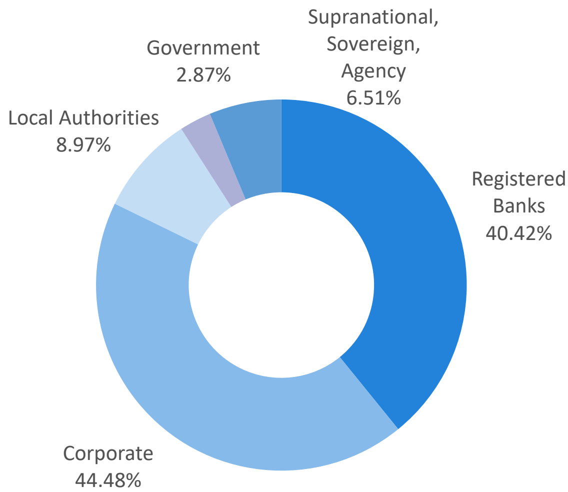
The strategy aims to generate income by constructing an actively managed investment portfolio of New Zealand bonds, deposits, and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

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.

Five Year Cumulative Performance, $10,000 invested[1,2]

Asset Allocation



Top 5 Corporate Issuers*	%	Credit Quality (% of fund)	%	Duration
Westpac New Zealand Ltd	9.1	AAA	24.0	Fund 3.55 years vs Benchmark 2.8 years
ASB Bank Ltd	7.9	AA	33.1	**Yield to Maturity**
Housing New Zealand Ltd	7.6	A	16.5	Fund (gross) 5.91% vs Benchmark 5.61%
Kiwibank Ltd	6.5	BBB	28.9	**Green, sustainable and social bonds**
China Construction Bank NZ Ltd	4.9	BB	0.8	17.75% of the fund

*Includes cash held by custodian

Market Commentary

February was a poor month for bonds as yields moved higher. The move higher in interest rates was the main driver of negative absolute returns. In relative terms the fund has been positioned modestly longer and as a result the impact from rising rates relative to benchmark was muted but negative. From a sector return perspective swap and government bonds were similar, and credit marginally better due to higher yield and tighter credit margins. Over the past few months economic data has at times been contradictory resulting in changing expectations for the extent and timing of further central bank tightening. In February the market repriced higher rates for longer reducing rate cut expectations. Looking at market volatility (bond markets have had month-on-month moves up and down of around 50 bps since December last year) there remains considerable uncertainty around inflation and economic outcomes.

With yields close to highs we are reasonably positive on the outlook for NZ bonds over the next 18 months. Our patience has been rewarded as we incrementally extended duration late in February, at better levels than recently available, to lock in higher rates for longer. The fund's yield to maturity is getting close to 6% (with an adjustment to include the inflation linked bonds). A 6% yield is above the level we believe the cash rate will peak at, so bonds are looking attractive again relative to the likely return on cash type assets. Changes in interest rates for the month were the 1-year government bond yield finished 34 basis points higher, the 2-year 43 bps, the 5-year finished 50 bps, the 10-year bond 40 bps and the 2041 and 2051 government bond were 32 bps and 28 bps higher in yield respectively. Moves higher in swap rates were similar. We are close to the end of this tightening cycle but how "sticky" inflation proves to be and how tight monetary conditions impact the economy will determine how long rates need to stay at restrictive levels. The inverted yield curve complicates the decision on yield curve positioning as there is no term premium and the fund generally gives up yield by going longer duration. We do feel however, that the correct positioning is to move longer as the next significant move is down in rates, but we might have to wait until 2024 until this occurs in any meaningful way. In the meantime, we will look to for the most consistent ways to add value and prefer a high portfolio yield but will add/subtract duration as opportunities arise.

Fund Commentary

The NZ bond markets had a poor month with yields moving higher. The fund return was lower than the Bloomberg NZ Corporate Bond benchmark. The long duration position versus benchmark was the main contributor to underperformance. Credit holdings that retail investors like performed marginally better than governments and swap as yields moved higher. We added some duration late in the month with yields looking more attractive. We continue to sell bonds that look expensive relative to their credit rating and replace with bonds that we believe will likely perform better over the medium term. 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. We added some 7-year corporate bonds at 6.4% at month end.

Key Fund Facts

Distributions

Wholesale fund: calendar quarter
Retail fund: calendar quarter
KiwiSaver fund: does not distribute

Estimated annual fund charges (incl. GST)

Wholesale fund: negotiated outside of unit price
Retail fund: 0.70%, refer PDS for more details
KiwiSaver fund: 0.80%, refer PDS for more details

Hedging

Any foreign currency exposure to be hedged to NZD within operational range of 97.5%-102.5%

Buy / Sell spread:	Strategy size	Strategy Launch
Click to view	$503m	July 2009

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.

Contact Us

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