

Factsheet 31 May 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

- Interest rates were somewhat volatile with uncertainty approaching the US debt ceiling and the RBNZ May MPS update.
- The Reserve Bank (RB) gave guidance they have likely finished hiking rates but there is still uncertainty around inflation and the economy.
- NZ credit margins remain supported with little new supply.

Fund Highlights

- Fund returns were around flat to negative due to moves higher in interest rates.
- The fund started the month slightly short duration and extended longer at better levels during May.
- We want to maintain a higher yield and participate in gains if rates move lower.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	0.09%	2.46%	2.93%	-0.86%	2.43%	4.10%
Benchmark ²	0.03%	2.19%	2.77%	-0.97%	1.88%	2.93%
Retail ³	0.05%	2.27%	2.24%	-1.56%	1.67%	3.28%
KiwiSaver ³	0.05%	2.24%	2.19%	-1.60%	1.87%	

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.

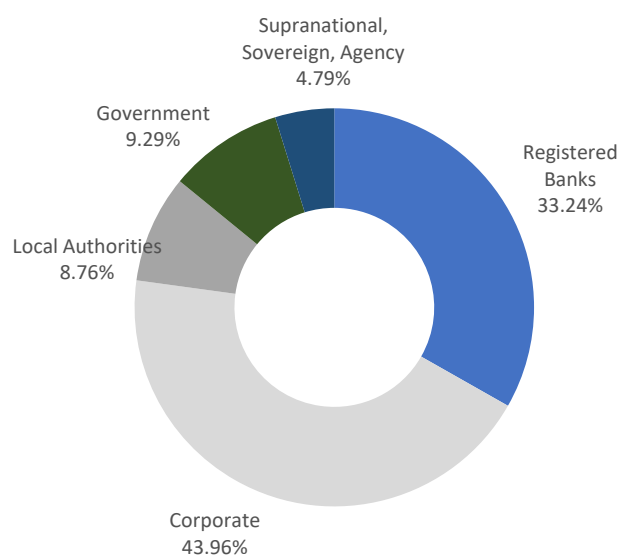
Overview

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)	%	Green, sustainable and social bonds
Housing New Zealand Ltd	9.5	AAA	30.1	17.80% of the fund
Westpac New Zealand Ltd	7.2	AA	26.7	Duration
Kiwibank Ltd	6.4	A	15.9	Fund 3.56 years vs Benchmark 2.92 years
ASB Bank Ltd	6.2	BBB	27.4	Yield to Maturity*
New Zealand Government	5.1			Fund (gross) 5.74% vs Benchmark 5.51%

*Includes cash held by custodian

* Excluding the inflation component of government inflation linked bonds

Market Commentary

NZ bond returns were around flat to negative for May as interest rates moved higher. In terms of sectors, the budget announced there will be more supply of NZ government bonds in future years, and as a result they underperformed relative to swaps and credit. The move higher in government bonds was reasonably consistent across maturities with yields up by 21 to 27 bps at month end. Swaps performed better with yields only 13 to 16 bps higher. Credit margins remained little changed, although in our view currently slightly expensive supported by a lack of supply.

We think the front of the yield curve will be the highest yielding part of the curve for the longest period of time. The RBNZ provided guidance in their MPS update that they have likely finished the hiking cycle, but they won't want rates lower until they are confident inflation is under control. Inflation and growth are slowing, albeit at a slower pace than they would like, and its likely short rates may need to be held at current levels for longer. There is a risk this may drag the mid curve higher, unless the RBNZ cuts rates more quickly than they currently expect. Longer term bond yields are lower than the cash rate, pricing in a slowing in activity and will likely follow data outcomes. The long end is complicated as we give up yield investing longer, but there is the potential for greater capital gains from longer maturity bonds if rates move lower.

It has been a market where more value is added through patience and awaiting opportunities to be active in duration rather than a long-term macro 'set and forget' view. In uncertain times we generally keep positioning modest relative to benchmark. We have added value through adding/subtracting duration when interest rates looked mispriced relative to our expectations. In the meantime, we will look for the most consistent ways to add value and prefer a high portfolio yield through holding more high-quality credit and less government bonds. We will add/subtract duration as opportunities arise.

Fund Commentary

The fund return was positive, and performance was in line with the Bloomberg NZ Corporate Bond benchmark for the month. The move higher in interest rates was the main driver of absolute returns. The fund started the month slightly longer than benchmark, which was unhelpful. We did however modestly extend duration through buying longer maturity bonds at higher rates during the month.

On sector allocation credit margins were stable and helped with a higher yield as did inflation linked bonds. 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.

We have been moving towards a barbell in terms of duration positioning. We want to have a higher yield and participate in gains if interest rates move 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	\$499.2m	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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