

Factsheet 30 June 2023

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 interest rates finished the quarter higher in yield as rate cut expectations were pushed further into the future.
- The RBNZ gave guidance they have likely finished hiking rates but there is still uncertainty around inflation and the economy.
- NZ credit has performed well over the quarter - tightening in margin as supply reduced.

Fund Highlights

- Fund return over the quarter was slightly negative due to moves higher in interest rates.
- The fund started April slightly short duration and extended modestly longer when rates were higher during May. We want to maintain a higher fund yield and participate in capital 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	-0.79%	-0.11%	2.11%	-2.67%	1.40%	3.49%
Benchmark ²	-1.07%	-0.58%	0.47%	-3.78%	0.19%	2.36%
Retail ³	-0.84%	-0.27%	1.47%	-3.30%	0.71%	2.72%

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Composite 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.

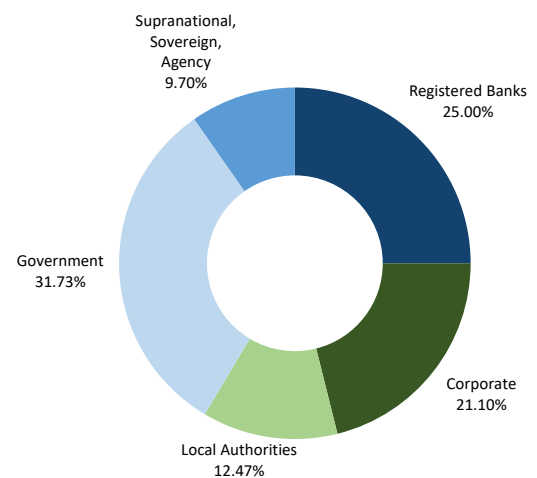
Overview

The 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	(%)	Green, sustainable and social bonds
Housing New Zealand Ltd	7.94	AAA	59.3	22.31% of the fund
New Zealand Local Govt Funding Agency	6.65	AA	20.9	Duration
Kiwibank Ltd	6.23	A	16.8	Fund 5.11 years vs Benchmark 4.64 years
ASB Bank Ltd	5.50	BBB	3.0	Yield to Maturity*
Westpac New Zealand Ltd	5.29			Fund (gross) 5.18% vs Benchmark 5.07%

*excludes NZ central government

* Excluding the inflation component of government inflation linked bonds

Market Commentary

NZ bond returns were flat to negative for the quarter due to moves higher in interest rates. April was a good start with a move lower in rates. Unhelpfully, rates moved higher in both May and June as economic data generally underlined more resilience in the economy with inflation slower to fall and expectations for interest rate cuts pushed further out.

In terms of sectors, NZ government bonds have underperformed on the prospect of more issuance and several government maturities are now higher than swap rates. NZ credit has performed well, supported by strong demand versus new issuance and secondary supply.

Over the quarter movements in government bond yields were 2yr + 34bps, 5 yr + 29 bps and 10 yr + 46 bps. For comparison, swap maturities were 2yr +44 bps, 5 yr + 24 bps and 10 yr + 20bps. Longer maturity swap performed better than governments.

While the RBNZ has paused on rate hikes they won't start lowering rates until they are confident inflation is under control. Therefore, it's likely short-term rates may need to be higher for longer. There is a risk this may drag the mid curve higher. The longer end of the curve is inverted and will likely follow the data, and although we give up yield investing longer, there is the potential for greater capital gains from longer maturity bonds if rates move lower.

Fund Commentary

The absolute fund return was negative for both the June month and the quarter but had reasonable outperformance versus the Bloomberg NZ Composite benchmark. The move higher in interest rates was the main driver of absolute returns. The main driver of relative outperformance was the underweight position in government bonds versus benchmark.

The fund duration position was slightly short relative to benchmark in April. With the move higher in yields over May we extended the fund's duration to a modest long position at better levels, then unhelpfully rates moved higher late June.

On sector allocation, NZ government bonds underperformed both swap and credit following news of increased supply. NZ credit has performed well with a gradual contraction in margins.

In uncertain times we generally keep positioning modest relative to benchmark, however with rates towards recent highs and given the balance of risks we have been moving towards a barbell yield curve positioning. We think the front of the yield curve will be the highest yielding part of the curve for the longest and having a higher yield is a consistent way to add value. We achieve this through overweighting the front of the curve in high-quality credit and less in the mid curve. We also want to participate in gains if rates do move lower and will add some longer maturity bonds opportunistically on moves higher in yield.

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	Strategy Launch
All investments will be in New Zealand dollars	Click to view	\$429.9m	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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