

Factsheet 31 August 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

- Good times for bonds keep getting postponed. NZ interest rates finished modestly higher in yield after a volatile month.
- The Reserve Bank of New Zealand (RBNZ) have likely finished hiking rates but there is still uncertainty around inflation and the economy.
- NZ credit continues to benefit with margins supported by supply demand dynamics.

Fund Highlights

- Shorter maturity bonds generally performed better than longer maturities.
- The fund's duration was moved modestly longer when rates were higher during the month.
- We are moving toward barbell yield curve positioning to construct 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	-0.17%	-0.90%	1.62%	-3.50%	1.06%	3.54%
Benchmark ²	-0.21%	-1.27%	0.33%	-4.30%	-0.18%	2.47%
Retail ³	-0.22%	-1.06%	0.97%	-4.11%	0.37%	2.77%

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, Senior Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

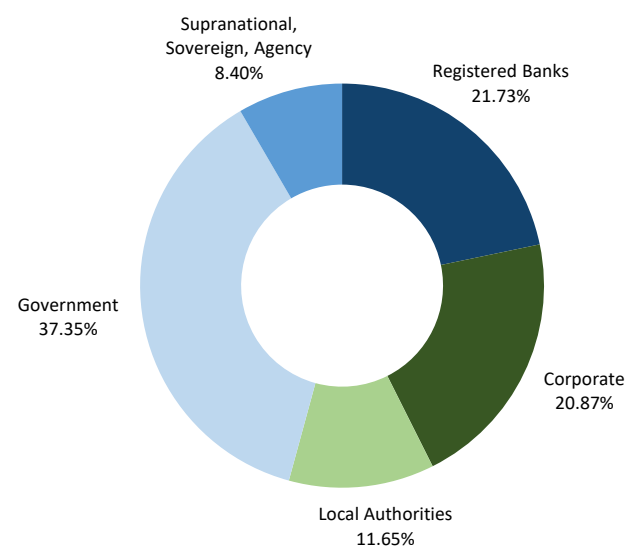
Overview

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	7.65	AAA	62.64	22.60% of the fund
New Zealand Local Govt Funding	6.38	AA	19.09	Duration
Westpac New Zealand	6.05	A	15.35	Fund 5.44 years vs Benchmark 4.53 years
Kiwibank	5.04	BBB	2.91	Yield to Maturity*
Kommunalbanken AS	3.83			Fund (gross) 5.37% vs Benchmark 5.23%
*Excludes NZ central government				* Excluding the inflation component of government inflation linked bonds

Market Commentary

August was a tough month for bonds with interest rates marching higher. Fortunately, an ugly month was avoided with some respite lower into month end as buyers saw value with rates at multi-year highs. Interest rate moves were the main influence on fund returns with shorter bonds less impacted by capital movements than longer maturities.

In terms of sectors, NZ government bonds suffered on the prospect of increased issuance and underperformed swap rates, rising more in yield. Shorter maturity governments were the poorer performers relative to swap. Movements in government bond yields were the; 2yr + 5bps, 5 yr + 14bps and 10 yr + 15bps. The fund generally holds an underweight position in governments as over the medium term we prefer the additional yield of quality credit. Note, after their underperformance the past few months government bonds are starting to look cheap, and the risk to much higher yields has narrowed. NZ credit continues to do a good job, supported by strong demand versus new issuance and secondary supply.

The good times for bonds (in terms of lower rates) seems to keep getting pushed further out. The economy appears to be softening however there seems to be a disconnect or lag in inflation data softening, additionally the prospect of increased government bond issuance is unhelpful. There is now a lot priced in terms of higher rates for longer with markets delivering de-facto tightening without the RBNZ having to do anything. Unless things change the RBNZ have likely tightened enough given the lag of monetary policy, however they won't want rates lower until they are confident inflation is under control. If the inflation continues to remain sticky this will likely result in rates needing to be higher for longer and may exacerbate volatility.

We stick with the plan building a higher yield at the front of the yield curve, which will likely be the highest yielding point for the longest. Balanced against this we also want to participate in capital gains at some stage and have been adding some longer maturities on opportunities higher in yield.

Fund Commentary

The fund return was a small negative for the month, but slightly ahead of the Bloomberg NZ Composite benchmark. The move higher in interest rates was the main driver of absolute returns. The fund had a modest long duration position which was unhelpful as interest rates finished higher.

Relative outperformance was largely the result of the underweight position in NZ government bonds which underperformed versus swap. Credit holdings have continued to perform well providing additional yield and gradual margin contraction.

We purchased some of the new BNZ 5-year bonds which received strong demand at a margin of 1%. Additionally, we added some longer maturity bonds to the funds when yields were higher which was a positive.

The fund has been moving towards a barbell yield curve position, holding higher yielding short maturity bonds, less mid curve and adding longer maturity bonds opportunistically on moves higher in yield. Conversely, we would take profit and trim some longer positions if we saw a reasonable move lower in yields.

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	\$442.8m	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.

Contact Us

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