

Factsheet 30 September 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

- It has been difficult times for bonds with the market pricing rates 'higher for longer' and increased government bond supply.
- The market has taken rates a lot higher since the RBNZ's last move effectively delivering a 'de-facto' tightening, still uncertainty around inflation and the economy remain and we will have to wait to get a better read on conditions.
- NZ credit has performed (ex-underlying rate moves) ok with margins supported by supply/demand dynamics and providing a higher yield.

Fund Highlights

- Shorter maturity bonds generally performed better than longer maturities as interest rates moved higher.
- The fund's duration was moved modestly longer when rates were higher during the quarter, we are mindful of having less risk in uncertain times and have been taking incremental steps.
- We are moving toward barbell yield curve positioning to construct a higher fund yield and participate in capital gains if rates move lower in the future.

Performance

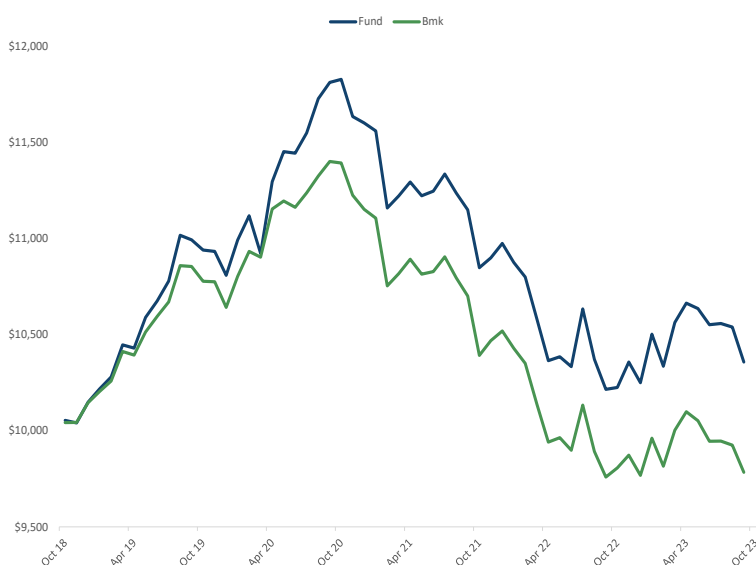
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-1.73%	-1.84%	1.39%	-4.28%	0.71%	3.32%
Benchmark ²	-1.42%	-1.62%	0.25%	-4.97%	-0.44%	2.31%
Retail ³	-1.77%	-1.99%	0.75%	-4.89%	0.03%	2.55%

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.



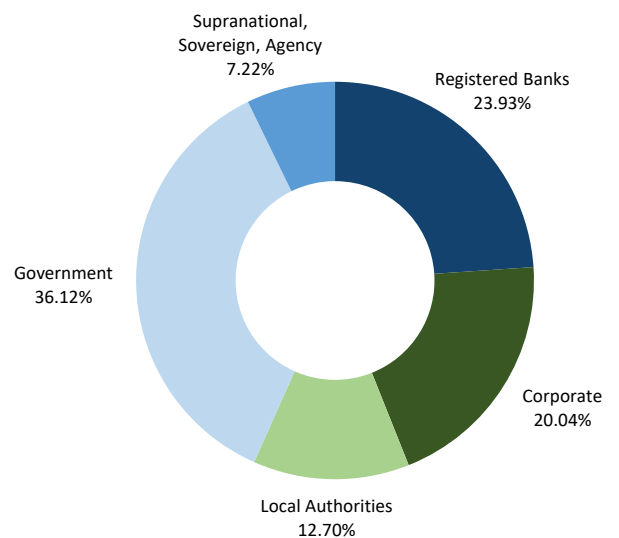
Overview

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
NZ Local Govt Funding Agency	7.65	AAA	60.39	23.69% of the fund
Housing New Zealand	6.98	AA	19.56	Duration
Kiwibank	5.74	A	17.54	Fund 5.24 years vs Benchmark 4.41 years
Westpac New Zealand	4.90	BBB	2.52	Yield to Maturity*
Bank of New Zealand	4.28			Fund (gross) 5.75% vs Benchmark 5.60%

*Excludes NZ central government

*Excluding the inflation component of government inflation linked bonds

Market Commentary

September finished a poor quarter for NZ bond returns with interest rates moving higher in both July and August. Higher Interest rates were the key driver of returns as capital loss from upward moves dominated the fund’s income accrual. Longer maturity bond returns were negative and shorter bonds, which have less price sensitivity to changes in interest rates, were less impacted although returns were still muted.

The theme of higher cash rates for longer and increased supply of government bond issuance weighed heavily on bond markets both here and offshore and yield curves are now a lot higher and flatter in slope. In terms of sectors, swaps performed better than governments for maturities inside 5 years, but both sectors suffered similar moves higher in yields for longer maturities. Over the quarter movements in government bond yields were 2yr + 47bps, 5yr + 67 bps and 10yr + 67 bps. For comparison swap maturities were 2yr +25 bps, 5yr + 53 bps and 10yr + 68bps. NZ credit has fortunately performed ok with margins stable to slightly narrower as the demand supply dynamics continue to provide support.

The good times for bonds (in terms of lower rates) seems to keep getting pushed further out; in fact it was an ugly quarter. The economy appears to be softening and higher rates will add more pressure on consumers and business. The threat to the cash rate remains higher until inflation shows meaningful signs of slowing, but markets have delivered de-facto tightening without the RBNZ having to do anything. Conditions are likely restrictive enough given the lag of monetary policy, however the RBNZ won’t want rates lower until they are confident inflation is under control. If inflation continues to remain sticky this will likely result in rates needing to be higher for longer and may exacerbate volatility.

Fund Commentary

The fund return was negative for the quarter, and slightly underperformed the Bloomberg NZ Composite benchmark. The move higher in interest rates was the main driver of absolute returns, and relative returns. The fund had a moderate long duration position which was unhelpful as interest rates finished higher.

The fund maintains an underweight position in NZ government bonds which was helpful earlier in the quarter. Credit holdings have continued to perform ok providing additional yield and gradual margin contraction.

We added a small weighting of longer maturity bonds to the fund when yields were higher which was a positive early in the quarter, however rates again moved higher in September which hurt.

The fund has been cautiously moving towards a barbell yield curve position, holding higher yielding short maturity bonds, and adding longer maturity bonds opportunistically to lock in higher rates for longer. We have been taking an incremental approach in terms of risk while uncertainty remains elevated, and we will likely need to wait longer to get a better read on inflation and the economy.

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	\$504.6m	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 quarter.

Contact Us

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