

Nikko AM NZ Cash Strategy

Monthly Update 31 December 2023

Assets are held in the Nikko AM Wholesale NZ Cash Fund. The Nikko AM NZ Cash Fund (retail) and Nikko AM KiwiSaver Scheme NZ Cash Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- New Zealand's economy shrunk by 0.3% in the September quarter - a result well below market expectations of +0.2% growth.
- With weak GDP and dovish comments from global central banks markets rapidly shifted from pricing a higher for longer OCR to over 100bps of cuts in 2024.
- The bank bill curve inverted, at month end 90-day bills were 5.635%, whilst 1-year swap was 5.24%.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that the RBNZ's hiking cycle is complete.
- We are looking to maintain the fund's long duration and add to it reflecting our view the next move in the cash rate is more likely to be down than up.
- Credit quality remains high and is expected to perform well in the face of a recession.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	0.55%	1.64%	6.10%	3.19%	2.77%	3.13%
Benchmark²	0.47%	1.43%	5.45%	2.71%	2.07%	2.35%
Retail³	0.49%	1.55%	5.76%	2.88%	2.45%	
KiwiSaver³	0.49%	1.56%	5.67%	2.75%	2.40%	

1. Returns are before tax and before the deduction of fees.
2. Benchmark: Bloomberg NZBond Bank Bill 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, Senior Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

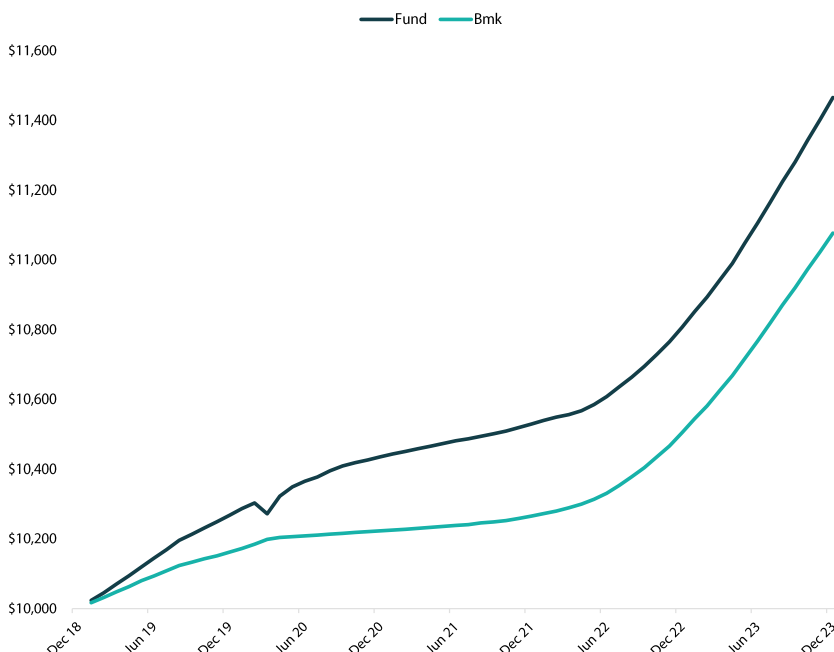
Overview

The strategy aims to generate income by constructing an actively managed investment portfolio of short-term deposits and bonds whilst preserving capital value.

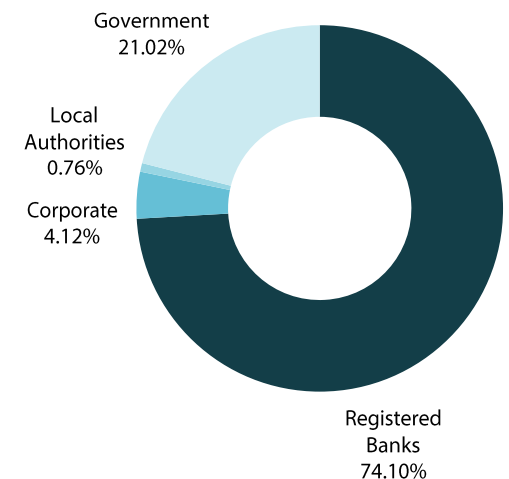
Objective

The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three-year period.

Five year Cumulative Performance, \$10,000 invested^{1,2}



Sector Allocation



Top 5 Issuers	(%)	Credit Rating	(%)	Duration
Tax Management NZ	13.14	AAA	21.02	Fund 108 days vs Benchmark 45 days
Westpac New Zealand	12.13	AA	32.84	Yield to Maturity
Kiwibank	9.13	A	46.14	Fund (gross) 5.82% vs Benchmark 5.59%
NZ Tax Trading Co	7.88			
ANZ Bank New Zealand	7.63			

Market Commentary

The month kicked off with short term interest rates in a holding pattern pending the final domestic tier-one data release of 2023 - third quarter GDP. This turned out to be a pivotal release with the economy shrinking 0.3%, well below market expectations of 0.2% growth. The result was a surprise to all and sundry, more so when one considers New Zealand's population has grown by ~2.7% in the year to September. This construct of weak growth was supported by the Fed's final FOMC meeting of 2023 that occurred the morning prior to New Zealand's third quarter GDP release. Key in their decision were comments suggesting a pivot in their policy stance is increasingly likely, most notably their median dot plot forecast showed some 75bps of cuts in 2024. Sentiment can turn on a dime when data change and this was certainly the case in December.

Markets have taken the Fed's comments along with the poor GDP number as strongly affirming restrictive monetary policy settings are having a meaningful impact on demand, that the Reserve Bank has done enough and may need to consider cuts in 2024.

In response, markets rapidly priced in OCR cuts with the first seen as occurring as early as April 2024 and some 119bps of cuts occurring over the year. This resulted in the bank bill curve inverting at the 90-day point - at month end 90-day bills were 5.635%, 6-month bills 5.56% and 1-year 5.24%.

We now have a market with very strong expectations of cuts, highly in opposition to the RBNZ last statement of 2023 which stated (1) the OCR needs to remain elevated for a "sustained" period, (2) that has "a low tolerance" for any "increase in the time" to return to target and (3) that they are "willing to tighten further". With these competing standpoints short rates will be highly sensitive to domestic data that affirm conditions necessary for the RBNZ to shift its stance. Prior to its first meeting of the year on February 28 the most important data releases are 4Q23 CPI out on 24 January, unemployment out on 7 February and any slowing in net migration release both January 19 and February 15.

Fund Commentary

The fund performed well in December quarter returning 1.64% outperforming its benchmark the 90-day Bank Bill Index which returned 1.43%. Over the quarter 1-year swap fell from a high of 5.92% to 5.24%, 6-month bills fell from 5.81% to 5.56% and 90-day bills from 5.74% to 5.635%. With rates falling the fund's long duration position (which ranged between +63 to +77 days long over the quarter) supported performance. We expect to continue to hold a long duration position as we enter 2024, however with the curve inverted adding duration is more nuanced than previously. Market pricing is now clearly in conflict with the Reserve Bank's November statement as such we need key domestic data to soften to allow the RBNZ to shift its stance and support both the pace (as soon as April 2024) and level (119bps over 2024) of rate cuts priced – most key will be fourth quarter CPI out on January 24. To mitigate risk of resilient data the fund currently holds 38% in floating rate notes, which price at a margin to 90-day bills and provide exposure to the highest yield point of the curve given the inversion profile. At the same time, we remain ever watchful for data that suggest weakness and will be increasingly willing to take on positions that lock in today's rates should a trend of softness continue.

Key Fund Facts

Distributions Wholesale: Calendar quarter Retail: Calendar quarter KiwiSaver: Does not distribute Estimated annual fund changes (incl. GST) Wholesale: Negotiated outside of unit price Retail: 0.30%, refer PDS for more details KiwiSaver: 0.30%, refer PDS for more details	Hedging: All investments will be in New Zealand dollars 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) on our website https://www.nikkoam.co.nz/invest/retail .	Strategy Launch: October 2007 Strategy size: \$866m Buy / Sell spread: 0.00% / 0.00%
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Compliance

The wholesale fund complied with its investment mandate and trust deed during the quarter.

Contact Us

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