Nikko AM Global Bond Strategy

Monthly Update 31 January 2024

Assets are held in the Nikko AM NZ Wholesale Global Bond Fund. Nikko AM Global Bond Fund (retail) invests in units in the wholesale fund, which this commentary refers to.

Market Overview

- Central banks indicated that rate cuts are unlikely in the first quarter or 2024 but removed their hiking biases from policy statements and signalled that they expect policy rates to end the year lower.
- Solid US GDP, ongoing strength in the US labour market, and rising US consumer sentiment as reflected by the University of Michigan consumer index rising to its highest level since July 2021, reinforced expectations for a US soft-landing and boosted risk assets.
- Elsewhere, concerns such as geopolitical instability in the Middle East and China's weak economic recovery have had limited impact on markets beyond the affected regions.

Fund Highlights

- The fund outperformed its benchmark for the month by 17 basis points.
- Outperformance was driven by Securitized selection and Cross-sector strategies.
- Meanwhile, the fund's Country strategy detracted from excess returns.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	-0.05%	7.25%	5.33%	-2.25%	1.88%	3.62%
Benchmark[2]	-0.22%	6.23%	4.05%	-2.31%	0.79%	3.00%
Retail[3]	-0.85%	6.53%	4.20%	-3.22%	1.02%	2.66%

1. Returns are before tax and before the deduction of fees and including tax credits (if any). Based on actual calendar periods.
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any). Based on change in unit price.

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. The Goldman Sachs Asset Management Global Fixed Income Team managed over US$690 billion of global fixed income and currency assets (as at 30th September 2022).

Overview

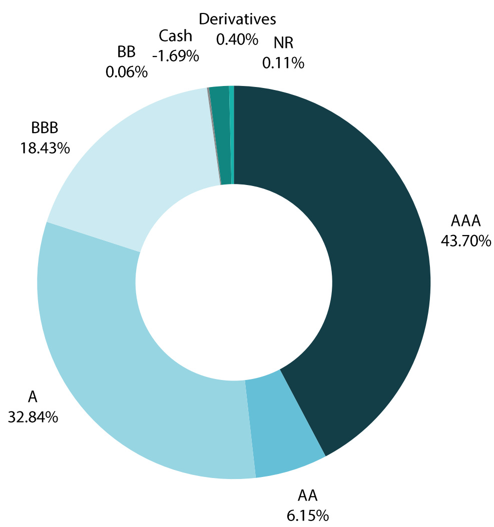
The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

Objective

The strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three-year period.

Five Year Cumulative Performance, $10,000 invested[1,2]

Credit Quality



Sector Allocation (% of fund)	Fund	Index
Governments	23.60%	44.39%
Agency	5.84%	7.89%
Collateralised & MBS	40.68%	11.69%
Credit	26.64%	20.45%
Emerging market debt	4.51%	15.57%
Cash, derivatives, other	-1.29%	0.00%

*Includes deferred settlements

Duration
Fund 6.29 years vs Benchmark 6.58 years

Yield to Maturity
Fund (gross) 5.28% vs Benchmark 5.06%

Market Commentary

Central banks maintained their policy stance at their first gatherings of 2024. They indicated that rate cuts are unlikely in the first quarter but removed their hiking biases from policy statements and signalled that they expect policy rates to end the year lower. The US Federal Reserve (Fed) maintained the federal funds rate at 5.25%-5.5% and shifted its stance from a hiking bias to a data-dependent approach. The European Central Bank (ECB) also kept policy unchanged but acknowledged evidence of disinflation as supply shocks dissipate and financial conditions tighten. Elsewhere, the Bank of England (BoE) kept the Bank Rate at 5.25% and upgraded its growth and inflation projections. Lastly, the Bank of Japan (BoJ) kept all policy parameters on hold including yield curve control (YCC), asset purchase programs and forward guidance. Sovereign bond yields fluctuated and market expectations for the start of rate-cutting cycles shifted beyond March. However, policy rates are still anticipated to end the year lower.

Furthermore, solid US GDP, ongoing strength in the US labour market, and rising US consumer sentiment as reflected by the University of Michigan consumer index rising to its highest level since July 2021, reinforced expectations for a US soft-landing and boosted risk assets. The US dollar (+1.9%) steadily increased over the month while global investment grade (IG) credit spreads narrowed by 5bps.

Elsewhere, concerns such as geopolitical instability in the Middle East and China's weak economic recovery have had limited impact on markets beyond the affected regions. We think the recent surge in shipping costs from disruptions in the Red Sea presents only moderate upside risks to inflation. However, we remain vigilant about the potential dark side of higher rates, especially for over-indebted borrowers facing a rapid transition to higher rates. Additionally, we are mindful of potential economic and market risks arising from increased political uncertainties.

With attractive yields and central bank rate cuts on the horizon, we see value in balanced portfolios that draw income from high-quality assets like investment grade credit and securitized sectors, and protection from government bonds. Our bond selection balances cyclical dynamics with underlying structural trends such as shifting work patterns and consumption habits. This holistic perspective helps us pinpoint promising avenues for return while avoiding paths to financial distress.

Fund Commentary

The portfolio outperformed its benchmark over January by 17 basis points.

This was driven by our Securitized selection and Cross-sector strategies. Meanwhile, our Country strategy detracted from excess returns.

Our Securitized selection strategy contributed to excess returns. This was driven by our specific selection among mortgage-backed security (MBS) passthroughs, particularly selection among our overweight to Ginnie Mae versus Fannie Mae MBS. This was in part supported by technical dynamics such as strong demand.

Positive contributions from our Cross-sector strategy were driven by our marginal sector overweight to commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLO). Risk assets were in part supported by soft-landing optimism given robust US data. CMBS for instance, was also supported by positive technical dynamics (supply remained low while demand grew stronger amidst less bearish sentiment in the sector) with AAA-rated and BBB-rated CMBS spreads tightening by 22bps and 129bps, respectively.

Elsewhere, our Country strategy detracted. This was driven by our relative-value overweight positions to US and UK versus Japanese rates. Hawkish Fed commentary and soft-landing optimism drove global bond yields higher and led financial markets to reassess the timing of the first Fed cut. Meanwhile, slower than expected inflation data and the Bank of Japan (BoJ) leaving policy unchanged on all parameters at its January meeting, challenged the underweight component of our position.

Key Fund Facts

Estimated annual fund charges (incl. GST)	
Wholesale: **Retail:**	Negotiated outside of the unit price. 0.80%, refer to PDS for more details.
Distributions:	
Wholesale: **Retail:**	Calendar quarter Calendar quarter

Hedging:	All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.
Exclusions:	Controversial weapons.
Restrictions:	Thermal coal mining and extraction, oil tar sands extraction, tobacco stocks and fossil fuels. 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 2008
Strategy size:	$557.6m
Buy / Sell spread:	0.00%/0.00%

Compliance

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

Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com