Factsheet 30 September 2021

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- We continue to believe that even though the NZ economy has recovered well and the outlook for a global economic recovery is looking promising, short-term rates will stay low compared to past tightening cycles.
- New Zealand's economic activity will resume its upward trend as we slowly emerge from the latest lockdown. However, other than large levels of Government spending and good commodity prices, we struggle to see what the next catalyst will be to achieve high levels of sustainable growth in the New Zealand economy once economic stimulus is removed.

Fund Highlights

- The Income Fund returned 1.5% for the quarter.
- Long-term bonds fell in value with only very short-term bonds providing a positive return.
- Equity holdings delivered a stronger result pulling the fund into positive territory for September. Seven of the thirteen holdings increased in value with both Skellerup Holdings and Scales Corporation share prices increasing by more than 9.5% over the month. The combined return from all sectors delivered small but positive return illustrating the benefit of holding a diverse portfolio of assets.

Distributions

- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point.
- The defined distribution rate for 2021 is 3.0% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2021.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	0.25%	1.54%	5.61%	2.32%	2.80%	5.37%
Benchmark[2]	0.26%	0.81%	3.25%	4.85%	4.33%	6.99%
Market Index[3]	-0.14%	0.96%	2.46%			

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).
2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.
3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 30% S&P/NZX 50 Gross Index, 7.5% Alternatives exempt.

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 strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

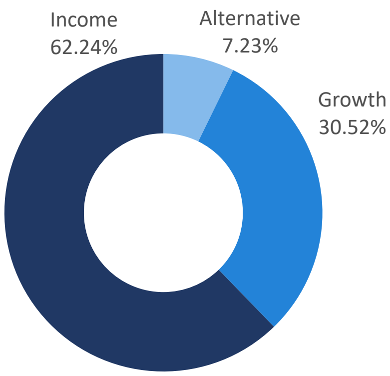
Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00% p.a. over a rolling three-year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July these were amended to include equities.

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

Change of investment strategy 01/07/2020

Asset Allocation



Top 5 Fixed Income Issuers*	(%)
Westpac New Zealand Ltd	7.36
NZ Local Govt Funding	5.53
Bank of New Zealand	4.80
Kiwibank Ltd	3.85
Housing NZ	3.08

Duration*
Fund 4.34 years
Yield to Maturity
Fund (gross) 2.23%

Top 10 Equities	(%)		(%)
Heartland Group	3.39	Contact Energy Ltd	2.36
Skellerup Ltd	3.07	Works Finance NZ	2.05
Spark NZ Ltd	2.81	Scales Corp Ltd	1.99
Infratil Ltd	2.67	Argosy Property Ltd	1.94
Stride Stapled	2.63	Mercury Energy Ltd	1.84

*Applies to the portfolio of directly held fixed income assets only.

Fund Commentary

The Income Fund returned 1.5% over the quarter. Long-term bonds fell with only very short-term bonds holding their values. The Income Fund's equity holdings delivered a stronger result pulling the fund into positive territory for the month and quarter. Seven of the thirteen holdings increased in value with both Skellerup Holdings and Scales Corporation share prices increasing by more than 9.5% over September. The combined return from all sectors delivered a small but positive return illustrating the benefit of holding a diverse portfolio of assets. Longer term bond yields increased by around 25 basis points with one-year rates moving 14 basis points higher. Even though the Reserve Bank didn't increase the cash rate in August due to the timing of the Delta outbreak, they made it clear that a rise is not far away as the economy no longer requires emergency levels of support. The Reserve Bank indicated they are likely to move the cash rate up in 0.25% increments with the first occurring in October and then in November and again in February 2022. These rate rises and a couple more are already priced into the yield curve so if the rate rise path occurs as the market is expecting further rises in longer term bond yields may be limited.

To help mitigate the impact of rising interest rates the fund is currently holding close to 8% of its assets in cash, the cash holding also helps balance the bond sector duration. The fund is also holding close to the upper permitted limit of shares as we continue to believe shares have a good chance of outperforming bonds over the next three years. As mentioned above, the share portfolio of the Income Fund performed well over September. Strong performance from Heartland Group and Skellerup has seen their weighting in the fund increase to 3.4% and 3.1% respectively. Infratil has been introduced into the fund over recent months and its performance over September was pleasing, as it gained around 6%. We like the electricity sector for income and stability of earnings however the sector has been down weighted in the portfolio.

We continue to believe that even though the NZ economy has recovered well and the outlook for a global economic recovery is looking promising, short-term rates will stay low compared to past tightening cycles. New Zealand's economic activity will resume its upward trend as we slowly emerge from the latest lockdown however, other than large levels of Government spending and good commodity prices, we struggle to see what the next catalyst will be to achieve high levels of sustainable growth in the New Zealand economy. The tech sector is one possibility, but it will take a lot to replace international tourism and, the benefit of a strongly growing population base. The interest rate environment will also be a head wind for growth as the economy faces replacing falling interest rates with rising ones. With interest rates likely to remain low relative to historical levels we continue to believe it is appropriate for investors to seek income from more diverse sources than the interest rate market alone. Even though some equity prices have fallen we believe the environment remains attractive for equities even though new catalysts for new growth remain elusive. This means the Income Fund will remain invested in a range of NZ companies listed on the NZX that pay an acceptable level of dividends or who have the likelihood of doing so in the future. In addition to the fund receiving a steady stream of dividend income, we expect that over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price. The bond sector of the fund is invested primarily in medium to longer duration assets. We are happy to have exposure to longer term assets as the Official Cash Rate looks likely to remain relatively low over the next year or two and, longer term rates have already risen significantly in response to the economic recovery that has already occurred.

The managers of the fund continue to look for opportunities to add value and income. Low and stable short term interest rates represent both a threat and an opportunity. High levels of liquidity in the banking system have left many investors looking for a home for their money that gives them an opportunity to earn more than bank deposits. This search for income is likely to be an enduring theme for the next few years, we believe this environment should create opportunities for the fund to deliver an enhanced level of performance.

Key Fund Facts

Distributions

Distributions for this fund are defined annually and are effective for the calendar year. The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.

Estimated annual fund charges (incl. GST)

0.80%, refer PDS for more details

Hedging	Buy / Sell spread:	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	Click to view	$5.1m	October 2007

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.

Exclusions

Securities that conduct activities listed on the Schedule to Cluster Munitions Prohibition Act 2009. Tobacco manufacturers.

Compliance

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

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