nikko am
Nikko Asset Management

Factsheet 30 November 2021

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The Reserve Bank implemented a 0.25% cash rate rise accompanied with commentary that significantly raised the bar for 0.50% increments to occur.
- This move and accompanying statements proved a reality check for the aggressive rate hike pricing we had seen, sending interest rates across the yield curve down between 0.10% and 0.15% post meeting.
- Equity markets performed poorly relative to the bond market

Fund Highlights

- The Income Fund fell in value over November as equity markets struggled. Some of the Income Fund's equity holdings delivered positive returns as did the Option Fund exposure, bonds performed well but this was not enough to drag the fund into positive territory.
- Only two of the thirteen equity holdings increased in value, however only one of these had a great month - Chorus bucked the downward trend and increased by around 5%. Spark was the only other holding in positive territory. The combined return from all sectors was negative, however considering the equity market's negative returns it is pleasing bond markets moderated the downturn.

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.

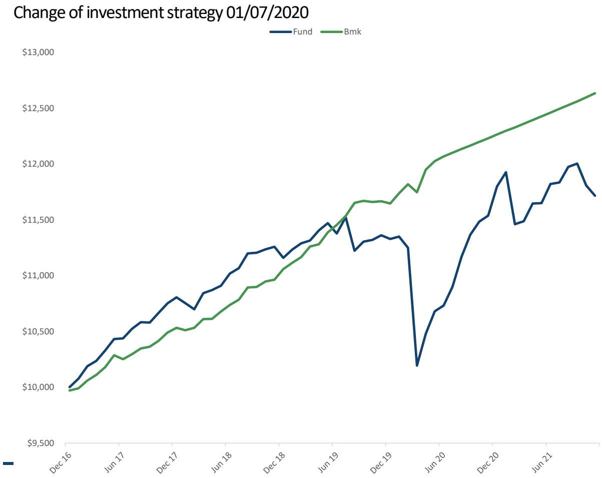
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	-0.78%	-2.15%	1.55%	1.34%	3.22%	4.84%
Benchmark[2]	0.29%	0.84%	3.29%	4.84%	4.79%	6.88%
Market Index[3]	-0.75%	-2.59%	-2.47%			

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.

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

Change of investment strategy 01/07/2020



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.

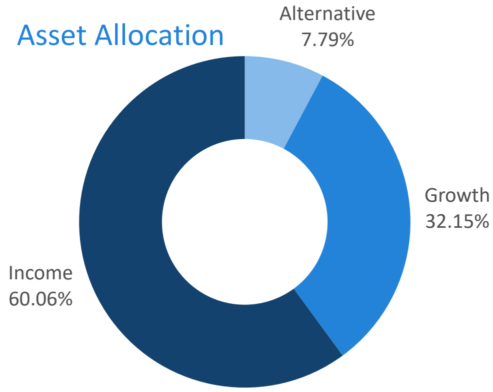
Overview

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.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)
NZ Local Govt Funding Agency	5.44
Bank of New Zealand	4.77
Kiwibank Ltd	3.87
Westpac New Zealand Ltd	3.35
Infratil Ltd	3.14

Duration*
Fund 4.75 years
Yield to Maturity
Fund (gross) 2.94%

Top 10 Equities	(%)		(%)
Heartland Group	3.36	Contact Energy Ltd	2.28
Skellerup Ltd	3.31	Works Finance NZ	2.12
Spark Ltd	2.88	Scales Corp Ltd	2.00
Infratil Ltd	2.74	Argosy Property Ltd	1.84
Stride Stapled Group	2.65	Mercury Energy Ltd	1.77

*Includes cash holdings.

Fund Commentary

The Income Fund fell in value over November as equity markets struggled. Some of the Income Fund's equity holdings delivered positive returns as did the Option Fund exposure, bonds performed well but this was not enough to drag the fund into positive territory. Only two of the thirteen equity holdings increased in value, however only one of these had a great month - Chorus bucked the downward trend and increased by around 5%. Spark was the only other holding in positive territory. The combined return from all sectors was negative, however considering the equity market's negative returns it is pleasing bond markets moderated the downturn. Once again, this month demonstrated that investing in a diversified portfolio of income focused assets provides some protection from the down-turn in individual asset classes. The main focus of the month was the Reserve Bank's November 24 Monetary policy statement with bets finely balanced between two camps, those expecting a 0.25% OCR rise and those that viewed a 0.50% rise as more appropriate. With pricing so finely balanced the one certainty from a markets perspective was a post meeting pricing reaction with one of these two groups disappointed. In the end the Reserve Bank implemented a 0.25% cash rate rise accompanied with commentary that significantly raised the bar for a 0.50% rise to occur stating "considered steps… were most appropriate". This move and accompanying statements proved a reality check for the aggressive rate hike pricing we had seen sending interest rates across the yield curve down between 0.10% and 0.15% post meeting. Looking to the detail of the Reserve Bank's statement there were a couple more points worth highlighting. First, the Reserve Bank confirmed it would progressively raise the cash rate until monetary conditions were on the tighter side of neutral which they assess as being around 2%. Second, they provided an updated OCR path with a peak OCR at 2.6%, suggesting a further 7 to 8 0.25% OCR rises to the end of 2023. Finally, with regard to CPI inflation the Reserve Bank sees inflation remaining elevated in the near term with 1.2% pencilled in for Q4 and 0.9% for Q1 along with inflation remaining above the midpoint of the Reserve Bank's target band for an extended time.

Even though we believe longer term bond rates are near their peak, to help mitigate the impact of rising interest rates, over the past few months the fund has held higher levels of cash than it would normally do so. The fund's exposure to the alternative investment sector via the Option Fund has also provided a source of returns and diversity as investment outcomes and characteristics from this sector are not highly correlated with traditional equity and bond assets. The fund is also holding close to the upper limit of shares as we continue to believe shares have a good chance of outperforming bonds over the next three years. As noted in previous commentaries, the market is pricing in around a further 2% of Official Cash Rate rises by the Reserve Bank. With this in mind we think we need to see further unexpected rises in inflation or economic growth rates for interest rates to push much higher as current pricing already reflects increased inflation uncertainty and central banks removal of economic stimulus. 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 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 balanced out with a higher than usual allocation to cash assets. We are happy to have exposure to longer term assets as even though the Official Cash Rate looks likely to rise, much of the anticipated rise is already reflected in market pricing and the OCR is likely to be low compared to previous tightening cycles from the Reserve Bank.

We continue to look for opportunities to add value and income. Low short term interest rates represent both a threat and an opportunity. High levels of liquidity in the banking system have seen deposit rates remain low for an extended period of time. This has 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.

Key Fund Facts

Distributions	**Estimated annual fund charges (incl. GST)**		
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.	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	$4.9m	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 month.

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