Factsheet 31 January 2022

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The Income Fund fell in value over January as both equity and bond markets delivered negative returns. The NZX 50 Index fell 8.78% over the month as equity markets around the globe started the new year poorly as they pondered the impact of rising inflation.
- Omicron brings with it uncertainty in its impact on the economy. Previous outbreaks have seen temporary reductions in economic activity followed by a quick rebound. With government withdrawing wage subsidies under the red setting and any lockdown derived from a healthcare system overload potentially taking a different format than past lockdowns a period of subdued economic activity could occur.

Fund Highlights

- Current inflation numbers affirm the Reserve Bank's recent OCR increases and support a continuation of their approach to incrementally increase the OCR. Markets are currently pricing 0.25% OCR increases at each of the Reserve Bank's seven meetings in 2022. With market pricing reflecting an OCR move to 2.5% by year end the financial impact is already well and truly with us.

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 2022 is 3.5% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2022.

Performance

	One mth	Three mths	One yr	Three yrs (pa)	Five yrs (pa)	Ten yrs (pa)
Retail[1]	-2.37%	-1.19%	-2.18%	1.27%	2.97%	4.55%
Benchmark[2]	0.31%	0.92%	3.38%	4.58%	4.94%	6.78%
Market Index[3]	-3.15%	-2.85%	-5.30%			

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.

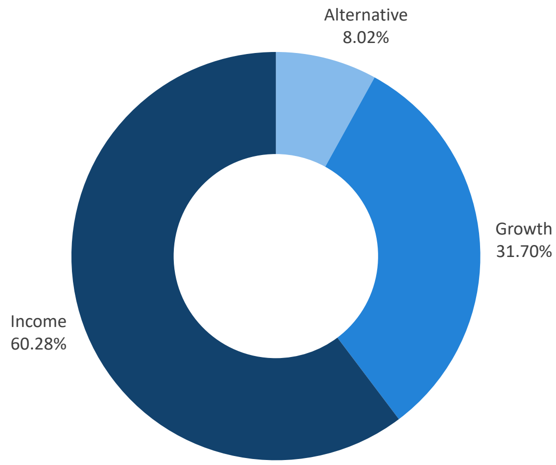
Overview

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	5.15
Westpac Banking Corp	4.83
Bank of New Zealand	4.51
Kiwibank Ltd	3.67
GMT Bond Issuer Ltd	3.28

*Includes cash holdings.

Duration*
Fund 4.18 years
Yield to Maturity
Fund (gross) 3.02%

Top 10 Equities	(%)		(%)
Heartland Group	3.40	Works Finance NZ	2.02
Skellerup Ltd	3.04	Argosy Property Ltd	1.77
Stride Stapled Group	2.80	Scales Corp	1.72
Spark Ltd	2.57	Chorus	1.59
Contact Energy Ltd	2.16	Mercury	1.55

Fund Commentary

The Income Fund fell in value over January as both equity and bond markets delivered negative returns. The NZX 50 Index fell 8.78% over the month as equity markets around the globe started the new year poorly as they pondered the impact of rising inflation and the impact of Central Banks reducing stimulatory economic settings. Bonds also lost value but to a much lesser extent. The Bloomberg NZ Bond Composite Index declined by 0.86%. The performance of the bond and equity sectors meant there were very few assets which held their values over January.

The new year started off thematically in much the same way as 2020 played out - the arrival of Omicron resulted in the country moving to the “red” management setting, meanwhile inflation has continued to accelerate driven by the cocktail of loose monetary policy, strong government stimulus and COVID derived restrictions. Omicron brings with it uncertainty in its impact on the economy. Previous outbreaks have seen temporary reductions in economic activity followed by a quick rebound. With government withdrawing wage subsidies under the red setting and any lockdown derived from a healthcare system overload potentially taking a different format than past lockdowns a period of subdued economic activity could occur. Whilst Omicron plays out the Reserve Bank will need to grapple with the building inflation risks. Fourth quarter inflation printed a robust 5.9% y/y a level not seen since 1990. What’s more, inflation is becoming increasingly broad based in its composition. This will be of concern to the Reserve Bank and is one reason interest rates have risen.

Current inflation numbers affirm the Reserve Bank’s recent OCR increases and support a continuation of their approach to incrementally increase the OCR. Markets are currently pricing 0.25% OCR increases at each of the Reserve Bank’s seven meetings in 2022. With market pricing reflecting an OCR move to 2.5% by year end the financial impact is already well and truly with us. The full effect of the contraction to consumption and consumer spending patterns will emerge over time as mortgages rates rise and incomes struggle to keep pace with inflation. There are positives in our economic outlook. The export sector, especially the dairy industry is doing well, the government is spending large sums of money and the data centre building boom has only just got started however the contractionary impact of monetary policy will eventually cool demand and hopefully the housing market has a soft rather hard landing. Significant falls in asset prices is a risk to the economy and if they occur will likely bring forward the timing of interest rate falls.

We continue to believe investors should seek income from diverse sources. 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 will rise, much of the anticipated increases are already reflected in market pricing and the OCR peak is likely to be low compared to previous tightening cycles.

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

All investments will be in New Zealand dollars

Buy / Sell spread:	Strategy size	Strategy Launch
Click to view	$5.2m	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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