Nikko Asset Management

Factsheet 31 July 2022

NIKKO AM NZ CASH STRATEGY

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

- The Reserve Bank (RB) delivered its third consecutive 50bps hike taking the OCR to 2.5%.
- The RB affirmed its actions were consistent with their May Monetary Policy Statement (MPS) OCR track and they would “continue to tighten monetary conditions at pace”.
- 2Q22 CPI came in stronger than expected at 1.7% taking annual inflation to 7.3% its highest level in more than 30 years.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that cash rates will peak towards the end of 2022 or early 2023.
- Duration is actively managed with fund positions reflecting the likely path of the OCR over the coming months along with what is already priced into security yields.
- The fund holds a range of securities including floating rate notes which provide some protection against a rising cash rate.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.26%	0.65%	1.42%	1.51%	2.06%	2.93%
Benchmark[2]	0.21%	0.52%	1.10%	0.80%	1.25%	2.04%
Retail[3]	0.22%	0.55%	1.12%	1.19%	1.71%	-
KiwiSaver[3]	0.22%	0.53%	0.99%	1.09%	-	-

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, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

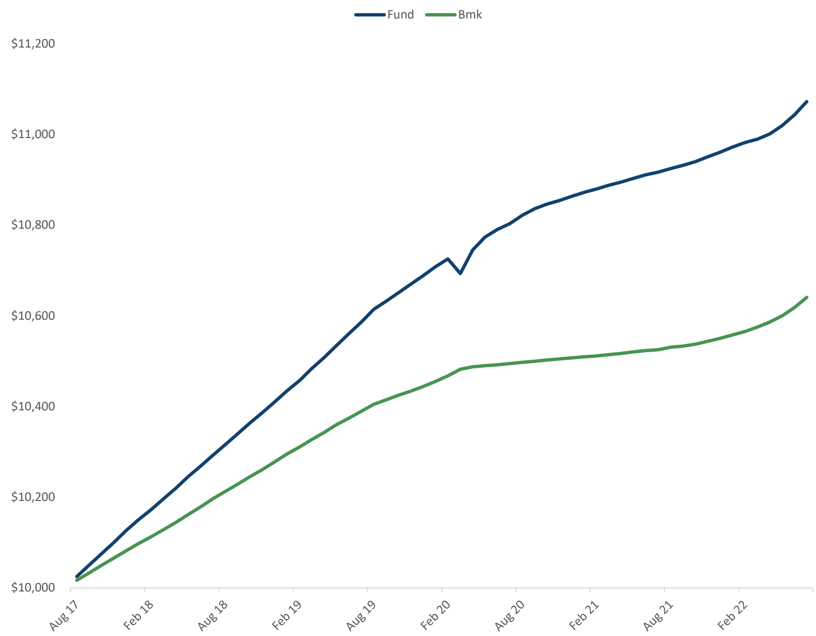
Overview

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

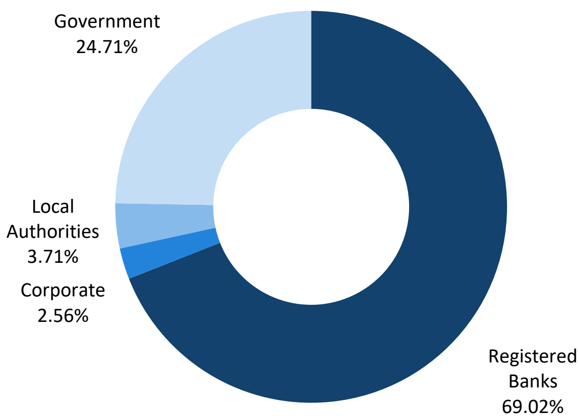
Objective

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]



Asset Allocation



Top 5 Issuers	(%)
NZ Tax Trading Co	13.59
Tax Management NZ Limited	11.12
Bank of New Zealand	10.62
Westpac New Zealand Ltd	9.85
Cooperatieve Rabo U.A.	9.17

Credit Quality	(%)
AAA	27.7
AA	33.8
A	38.5

Duration
Fund 97 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 3.50% vs Benchmark 2.88%

Market Commentary

The RBNZ stuck to its script in its July Monetary Policy Review (MPR) delivering a third consecutive 50bps hike taking the OCR to 2.5%. The market priced for this outcome and analysts anticipated the hike, as such, reactions were reasonably muted. With July's OCR review a MPR meeting vis-a-vie a more detailed Monetary Policy Statement (MPS) no updated forecasts were provided however the statement did affirm that the bank was comfortable with their OCR track outlined in their May MPS. The statement also highlighted that the Reserve Bank believed it remained appropriate to "continue to tighten monetary conditions at pace" further reinforcing the case for continued hikes consistent with the May OCR track.

In a small change the July MPR did acknowledge there were downside risks to growth, a departure from the language in their May MPS where they noted that "underlying strength remains in the economy". This change aside the statement continues to firmly hold a hawkish tone, with the RB noting "household spending has remained resilient despite a decline in consumer confidence" and that "labour shortages continue to be a major constraint". In addition, unsurprisingly, inflation was called out with the committee noting there were "near-term upside risks to consumer price inflation" and that it would continue "briskly lifting" until monetary conditions were "sufficient to constrain inflation".

Other economic data of note in July included second quarter CPI inflation, which came in stronger than expected at 1.7% taking annual inflation to 7.3% its highest level in more than 30 years. This level of inflation will be concerning the Reserve Bank and will affirm their strategy of continuing to tighten at pace. Looking to future CPI levels we increasingly believe the peak may have already occurred. When third quarter CPI comes out in mid-October the dataset will be dropping off 3Q21s 2.2% quarterly print, a pace of inflation that hasn't been seen since.

This does not mean that CPI inflation will be back to the RB's target band of 1-3% anytime soon but the pace of growth should start to slow. Should this occur, it would take some pressure off the RB and allow them to back off continued hikes and observe the impacts of a higher OCR on inflation, noting here that it typically takes 1-2 years for monetary policy changes to reach their maximum impact. This likely means we will see peak OCR in late 2022 or early 2023 and one should expect this peak level to be sustained for most of 2023.

Fund Commentary

The fund performed well in July returning 0.26% outperforming its benchmark the 90-day bank bill index which returned 0.21%. With the Reserve Bank sticking to its script and tightening "at pace" interest rates for 90-day bank bills continued to climb ending the month at 3.14% up 0.29% from the end of June. The progression in longer interest rates has been less upwardly linear. One year swap rates increased from their start of month level of 3.785% to an intra month peak of 4.085% on 20 July before rapidly falling back to end the month at 3.76%. This is the first month on month decrease in 1-year rates we have seen in 2022 a sign that concerns around growth are building. This slowing growth does not mean the Reserve Bank will pivot to cutting rates as inflation is likely to remain stubbornly above their 1-3% target, however, it will provide some breathing room to observe the impact of OCR hikes made far. With monetary policy typically taking 1-2 years to reach its maximum impact this likely means we will see peak OCR in late 2022 or early 2023 and should expect this peak level to be sustained for most of 2023. In this environment it will be increasingly appropriate to run a long duration position.

Key Fund Facts

Distributions

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter
KiwiSaver fund: Does not distribute

Estimated annual fund charges (incl. GST)

Wholesale: Negotiated outside of unit price
Retail: 0.30%, refer PDS for more details
KiwiSaver: 0.45%, refer PDS for more details

Hedging	Buy / Sell spread	Strategy size	Strategy Launch
All investments will be in New Zealand dollars	0.00% / 0.00	$974m	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.

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

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