Factsheet 30 September 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

- All major bank economic teams revised their terminal OCR forecasts upwards from 4% to between 4.25% and 4.75%.
- The move upward in terminal OCR estimates looks to be related to a stronger than expected Q2 GDP which came in at +1.7% vs consensus of +1.0%.
- The theme of rising cash rates and hawkish rhetoric from key global central banks continued – the Fed, ECB & the Bank of Canada all increased 0.75%, whilst the RBA and the Bank of England increased 0.50%.

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.
- The RBNZ's hiking cycle is well progressed and likely entering its latter stages, the fund is looking for opportunities to add duration reflecting the lateness of the cycle.
- The market is currently pricing in a peak OCR higher than the Reserve Bank's most recent forecast and the fund is seeking to capitalize on this divergence.

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

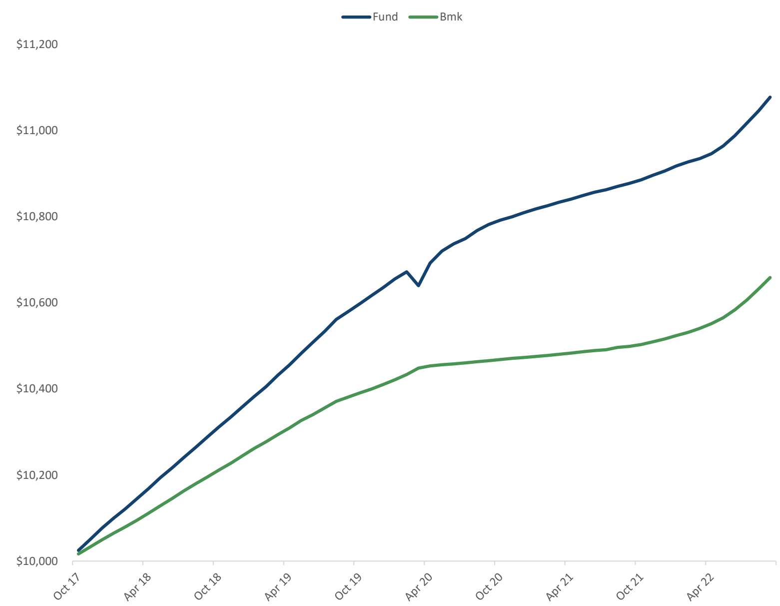
The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three year period.

Performance

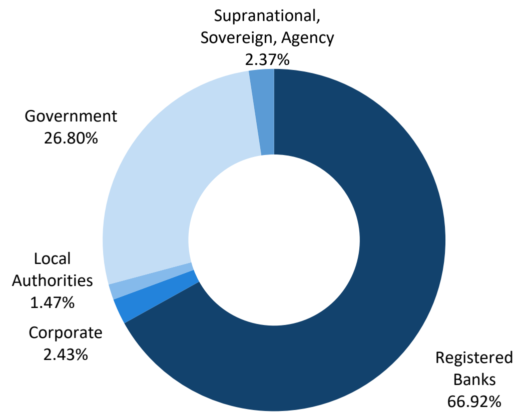
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.29%	0.81%	1.84%	1.55%	2.07%	2.92%
Benchmark[2]	0.25%	0.71%	1.52%	0.88%	1.28%	2.05%
Retail[3]	0.27%	0.74%	1.55%	1.24%	1.73%	-
KiwiSaver[3]	0.25%	0.70%	1.41%	1.10%	-	-

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).

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



Asset Allocation



Top 5 Issuers	(%)
NZ Tax Trading Co (IRD Deposit)	13.67
Tax Management NZ (IRD Deposit)	13.13
ANZ Bank New Zealand	10.34
Bank of New Zealand	9.82
Cooperatieve Rabo U.A. (Rabobank)	9.63

Credit Quality	(%)
AAA	32.7
AA	29.9
A	37.4

Duration
Fund 103 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 4.16% vs Benchmark 3.54%

Market Commentary

Domestic rates took a step change upwards in September as all major banks increased their terminal OCR forecasts on the back of a surprisingly strong second quarter GDP print. At the same time in global markets aggressive action continued from key global central banks further reinforcing this hawkish central bank theme and providing additional impetus to the upward movement in domestic rates.

Second quarter GDP appeared a key domestic pivot point with growth coming in at a robust +1.7% - well above market consensus of +1% and a shade above the most optimistic major bank economic team at +1.6%. The strength of this print precipitated a slew of peak OCR call revisions with ASB moving to 4.25% on the day of this release and ANZ following the day after with a remarkable 4.75% call. Other key banks also revised up their estimates towards the latter part of the month with BNZ calling 4.25%, Westpac 4.5% and TD 4.5% well and truly cementing this theme. The NZ OCR is 3.5% after a 50bps hike on 5 October.

At the same time these domestic OCR calls were being digested markets observed a continuation of aggressive global central bank hiking action and rhetoric. The Fed, ECB & the Bank of Canada all increased 75 basis points (bps), whilst the RBA and the Bank of England increased 50bps. Looking to the Rhetoric accompanying these actions once again this was best summed up by the Fed with Powell highlighting that the Fed remains firmly committed to bringing inflation back down to levels in line with its inflation target of 2%, even though this will likely cause "some pain" in the economy.

With this confluence of hawkish signals, it is perhaps unsurprising that markets aggressively moved up peak OCR pricing over the month (from ~4.25% to more than 4.75%). We can understand the logic here however view the magnitude of the reaction as overdone. Here we would like to highlight that monetary policy has a lag of one to two years to its maximal impact and that the slowing impetus from OCR hikes to date continues to build most notably as consumers refix their mortgages. Governor Orr has recently made comments that are sympathetic to our view stating as the RBNZ has “done so much already” the current cycle is “very mature”. This is not to say that inflation and continued escalation of wages are not of concern but rather that OCR decisions should be more balanced, or data driven. It is with this lens that one should review inflation and employment outturns from here looking for signs of directional impact beginning to show through in the numbers rather than the absolute level of these statistics.

Fund Commentary

The fund performed well in the 3Q22 returning 0.29% outperforming its benchmark the 90-day bank bill index which returned 0.25%. Over the quarter the fund’s strategy has increasingly moved from managing front end risk of OCR hikes through holding a portion of very short tenor securities to positioning for the conclusion of the hiking cycle. We note the RBNZ hiking cycle is well progressed and arguably entering its latter stages. Additionally, although inflation has remained stubbornly high and the labour market tight there are reasons to believe pressure is abating. House prices have come off the boil, there is anecdotal evidence that activity in the building sector is rapidly softening, spot freight rates and oil prices are significantly down from their peaks and mortgage rates continue to increase further diminishing consumers spending power. As we move into the final quarter of 2022, we expect to implement a continuation of this strategy albeit with a more data driven review of key economic outturns looking for signs of directional impact beginning to show through in the numbers rather than the absolute level of these statistics.

Key Fund Facts

Distributions		**Estimated annual fund charges (incl. GST)**	
Wholesale fund:	Calendar quarter	Wholesale:	Negotiated outside of unit price
Retail fund:	Calendar quarter	Retail:	0.30%, refer PDS for more details
KiwiSaver fund:	Does not distribute	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	$826.7m	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 quarter.

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