

Factsheet 31 January 2023

NIKKO AM NZ BOND STRATEGY

Assets are held in the Nikko AM Wholesale NZ Bond Fund. The Nikko AM NZ Bond Fund (retail) invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- NZ bonds had a strong positive month due to falls in interest rates.
- The NZ swap yield curve remains inverted with further cash rate hikes and a slowing in the economy priced in.
- There has been a lack of supply of credit after the holidays which has been supportive.

Fund Highlights

- The new year started well for NZ bonds with strong positive returns.
- The fund duration has varied around benchmark to modestly longer than benchmark.
- Credit outperformed lower yielding government bonds with some contraction in swap margins.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	2.46%	2.71%	-3.43%	-1.51%	1.73%	3.52%
Benchmark ²	1.98%	1.57%	-4.48%	-2.67%	0.63%	2.27%
Retail ³	2.40%	2.54%	-4.04%	-2.16%	1.03%	2.74%

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Composite 0+ Yr 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}



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.

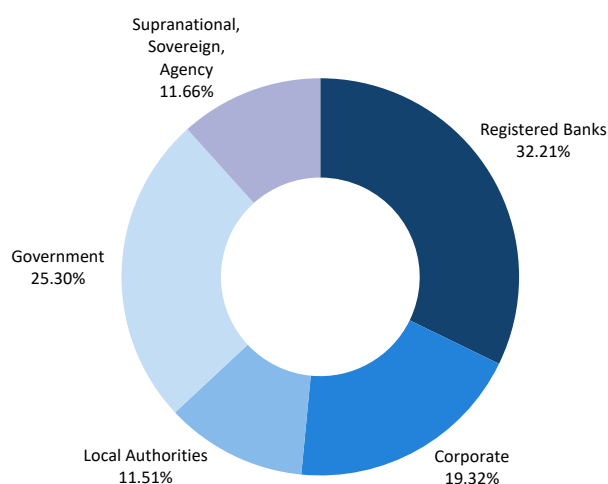
Overview

The fund aims to provide investors with regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

Asset Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Duration
Westpac New Zealand Ltd	8.42	AAA	52.2	Fund 4.67 years vs Benchmark 4.42 years
ASB Bank Ltd	7.89	AA	27.1	Yield to Maturity
Housing New Zealand Ltd	7.78	A	17.1	Fund (gross) 4.76% vs Benchmark 4.60%
Kiwibank Ltd	6.99	BBB	2.3	Green, sustainability and social bonds
New Zealand Local Govt Funding Agency	5.72	BB	1.2	19.78% of the fund

*excludes NZ central government

Market Commentary

It was a strong start to 2023 for NZ bonds with positive returns as yields moved lower. In fairness yields finished 2022 close to their highs so there was some catch up in the new year as investors re-priced prospects for a slowing in inflation, the economy and RBNZ tightening.

The move lower in interest rates was the main driver of returns. From a sector perspective swap performed better than government bonds, particularly the longer maturities. Credit margins were stable to slightly lower as there were monies to be invested after the holiday period and a shortage of supply. Inflation linked bonds didn't move lower to the same extent as other bonds but while inflation remains at elevated levels they are very high yielding in comparison to other high credit quality bonds. We remain overweight quality credit versus government bonds and prefer bonds that appeal to retail investors.

NZ government bond yields all finished lower except the 2023 maturity. Changes in interest rates for the month were; the 1-year government bond yield finished 29 basis points lower, the 2-year 36 bps, the 5-year finished 40 bps, the 10-year bond 29 bps and the 2041 and 2051 government bond were 19 bps and 11 bps lower in yield respectively. In comparison the 5 and 10-year swap were approximately 50bps lower.

We should be close to the end of this tightening cycle, confidence surveys are very weak and economic data has shown signs of softening, but there is still reasonable uncertainty in terms of how "sticky" inflation will be and how tighter monetary conditions will impact the economy. This will determine how long rates need to stay at restrictive levels. The steeply inverted yield curve complicates the decision on yield curve positioning as there is no term premium and we give up yield going longer in duration. Generally, we look to overweight the most consistent ways to add value and prefer a higher yield. We have modestly reduced the fund's duration but will add/subtract duration as opportunities emerge.

Fund Commentary

NZ bond markets had a strong positive return, and the fund outperformed the Bloomberg NZ Bond Composite benchmark. The longer duration was the main contributor to outperformance.

On sector allocation credit holdings which retail investors like were the better performers with a higher yield accruing to the portfolio. We continue to sell bonds that look expensive relative to their credit rating and replace with bonds that we believe will likely perform better over the medium term.

The fund continues to maintain a higher yield from holding credit issues and inflation linked government bonds in preference to lower yielding nominal government bonds. We continue to look to add value within the interest rate range; and reducing risk where bonds look expensive and adding bonds that we believe will have a higher likelihood of adding value.

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:	0.65%, refer PDS for more detail
Hedging		Buy / Sell spread	Strategy size
All investments will be in New Zealand dollars		Click to view	\$441.3m
Strategy Launch			
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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