

Factsheet 28 February 2023

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- The S&P/NZX 50 Gross Index fell by 0.6% over February and the bond sector fell 1.5% as measured by the Bloomberg NZ Bond Index. Interest rate markets continue to be volatile as investors started to anticipate central banks slowing the pace of cash rate rises only to be reminded that inflation continues to be stubbornly high.

Fund Highlights

- Over February, bond and equity markets partially reversed the strong start to the year. The Income Fund posted a negative return as both bond and equity markets fell over the month.
- The fund owns 14 companies in its equities portfolio, over the month nine fell in price and five increased. Mercury Energy carried on their good run, however Scales price was impacted by the weather damage in the Hawkes Bay. February was a poor month for bonds as yields moved higher resulting in mark-to-market losses on the fund's bond holdings.

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 2023 is 5.5%. This income will be distributed in four equal amounts each calendar quarter, based on the price at 1 January 2023.

Performance

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail ¹	-1.52%	-0.14%	-4.84%	-0.50%	0.71%	3.10%
Benchmark ²	0.55%	1.75%	5.81%	4.50%	5.07%	6.31%
Market Index ³	-0.81%	1.22%	-1.10%			

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.

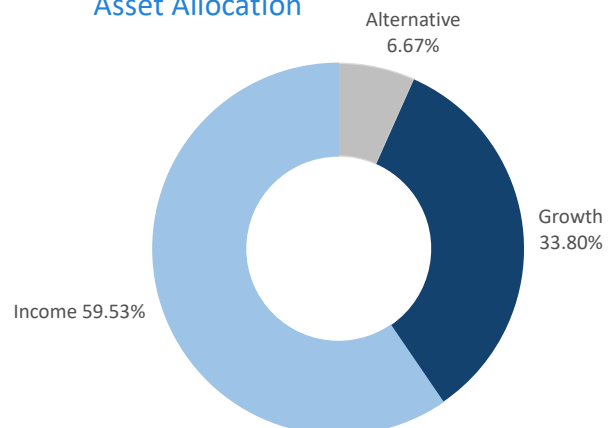
Overview

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 2020 these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)	Duration*	Top 10 Equities	(%)	(%)
Westpac New Zealand Ltd	6.80	Fund 4.18 years	Heartland Group	3.48	Chorus Limited 2.34
ASB Bank Ltd	4.52	Yield to Maturity	Skellerup Holdings Limited	3.16	Works Finance NZ Ltd 2.30
Kiwibank Ltd	3.66	Fund (gross) 6.13%	Spark New Zealand Ltd	3.02	Stride Stapled Grp 2.29
Contact Energy Ltd	3.60		Infratil Limited	2.85	EBOS Group Ltd 2.02
Powerco Ltd	3.37		Contact Energy	2.59	Meridian Energy Ltd 1.79

*Includes cash holdings.

Fund Commentary

Over February, bond and equity markets partially reversed their strong start to the year. The Income Fund posted a negative return as both bond and equity markets fell over the month. The S&P/NZX 50 Gross Index lost 0.6% over February and the bond sector fell 1.5% as measured by the Bloomberg NZ Bond Index. Interest rate markets continue to be volatile as investors started to anticipate central banks slowing the pace of cash rate rises only to be reminded that inflation continues to be stubbornly high. How long cash rates stay high to battle inflation and how much the economy slows before the tightening cycle starts to be partially reversed is the next question to be answered. Equity markets continued to see high levels of volatility in individual company performances from month to month. In general companies and industries that are sensitive to rising interest rates have performed poorly over the past year however as the trend towards higher rates fades these sectors may perform better as the year progresses. The recent storm damage in the North Island had a negative impact on some orchards and associated property owned by Scales Corporation. As a consequence, Scale's share price fell over the second half of the month. The fund owns 14 companies in its equities portfolio, over the month nine fell in price and five increased. Mercury Energy carried on their good run, however as mentioned above, Scales price was impacted by the weather damage in the Hawkes Bay. February was a poor month for bonds as yields moved higher resulting in market-to-market losses on the fund's bond holdings. Credit issues continue to be in demand especially as interest rates push higher and medium-term bonds can be bought at levels higher than the projected peak in the cash rate.

Over the past few months economic data has at times been contradictory resulting in changing expectations for the extent and timing of further central bank tightening. In February the market priced in higher rates for longer, reducing rate cut expectations. With yields close to highs we are positive on the outlook for NZ bonds over the next 24 months. We incrementally extended duration late in February to lock in high rates for longer and with bond yields on high quality issues above the level where we think cash rates will peak, over the medium-term bonds look good value compared to cash. How "sticky" inflation proves to be and how tight monetary conditions impact the economy will determine how long rates need to stay at restrictive levels. The inverted yield curve complicates the decision on yield curve positioning as there is no term premium and the fund generally gives up yield by going longer duration. We do feel however that the correct positioning is to move longer as the next significant move in rates is down, but we might have to wait until 2024 until this occurs in any meaningful way. The Option Fund declined over the month after performing strongly in January. Bond yields moved through a number of option strike levels and income earned by the fund was insufficient to compensate for the losses.

We continue to believe investors should seek income from a diverse range of sources. Bond rates are looking attractive and even though most equity prices have fallen over the past year we believe the environment remains acceptable for many companies. The Income Fund remains invested in a range of NZ companies listed on the NZX that pay a consistent level of dividends or who have the likelihood of doing so in the future. In addition to dividend income we expect over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price.

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	\$4.5m	October 2007
Exclusions: Controversial weapons.			
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 .			

Compliance

The fund complied with its investment mandate and trust deed during the quarter, except that an error has been identified in the Option Fund where the value of specific options were incorrectly accounted for in the net asset value of the fund on certain days. We are working through the details and will advise the affected clients when the impact analysis is complete in March.

Contact Us

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