nikko am
Nikko Asset Management

Factsheet 31 March 2023

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

- On the back of Silicon Valley Bank's failure, global risk sentiment took a turn south and interest rates fell as markets reassessed the impact of central bank rate rises and the need to continue to hike.
- New Zealand's balance of payments deficit blew out to its highest level in 34 years, implying the country is living beyond its means and funding consumption from borrowings.
- Fourth quarter GDP came in at -0.6% well below market consensus of -0.2% suggesting impacts from the RBNZ's rapid tightening are beginning to build momentum.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that cash rates will peak in 2023.
- The RBNZ's hiking cycle is well progressed and likely entering its latter stages. We are looking for opportunities to add to fund duration reflecting the lateness of the tightening cycle.
- The fund's shorter duration positions are targeted around the nearest two OCR meeting dates, allowing for rapid reinvestment on decisions and any potential pivots.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.44%	1.25%	3.65%	2.13%	2.24%	2.95%
Benchmark[2]	0.41%	1.15%	3.26%	1.37%	1.52%	2.13%
Retail[3]	0.43%	1.19%	3.35%	1.83%	1.91%	
KiwiSaver[3]	0.41%	1.15%	3.20%	1.69%	1.90%	

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.

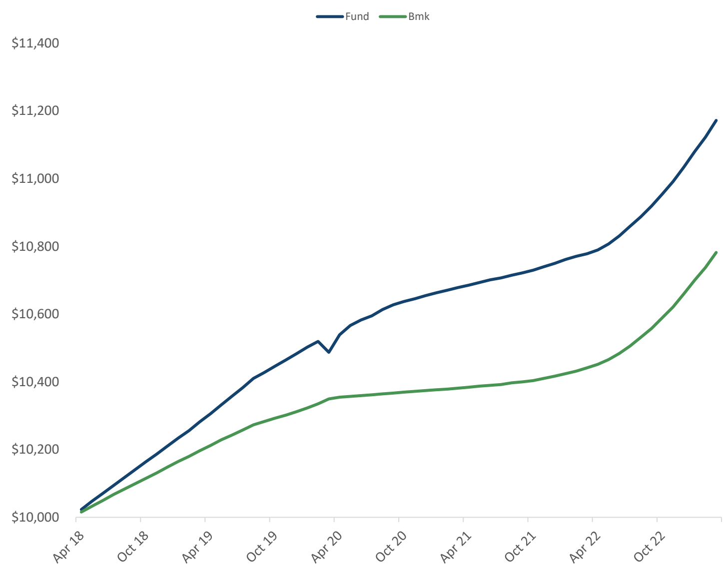
Overview

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

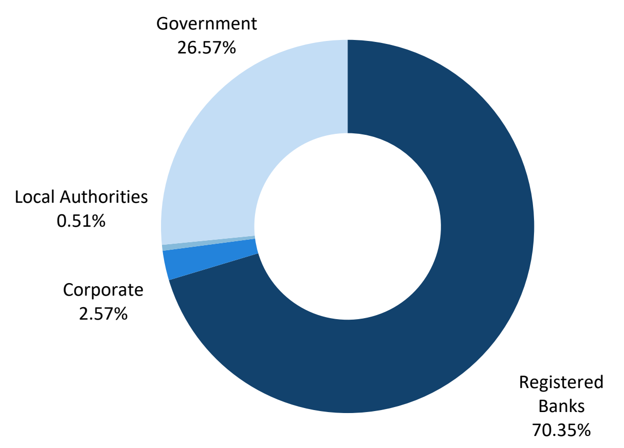
Objective

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	13.96
ANZ Bank New Zealand	12.68
Tax Management NZ Limited	12.61
Industrial & Commercial Bank of China	7.42
Bank of China NZ	7.22

Credit Quality	(%)
AAA	26.6
AA	31.6
A	41.8

Duration
Fund 97 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 5.42% vs Benchmark 5.08%

Market Commentary

Over the past year, the pricing of short-term interest rates has focused on both the pace and magnitude of hikes required to tame inflation. As time progressed a construct of monetary policy lag built in prevalence, yet despite this growing force any downward movements in rates have been rather fleeting as inflation's persistence and consumer and economic resilience continued to surprise to the upside. As is often the case in directional markets changes in key data or unexpected events can lead to inflection in pricing paths – these both presented themselves during March in the form of US regional bank, Silicon Valley Banks (SVB) failure along with some surprisingly poor New Zealand based domestic data in both falling GDP and a large balance of payments deficit.

As we started the month, markets were pricing a high probability the RBNZ would continue to deliver rapid hikes, along with a robust belief that a peak OCR in the vicinity of 5.5% as guided by the RBNZ would eventuate. This all changed on the 10th of March, when US regional bank, Silicon Valley bank failed after a bank run. SVB's failure stemmed from a multitude of issues, however, key among these was poor risk management in relation to how it managed its interest rate risk. SVB's failure was triggered by company specific factors rather than endemic issues across the banking sector. This notwithstanding, we view this event as a sign central bank rate rises are beginning to create stress in the wider economy and the lagged effect of rapid rate rises over the past year are starting to have a meaningful impact. This view is likely shared in the wider market as post SVB's failure, markets have questioned the need for central banks to continue to hike - viewing the lagged effect as increasingly sufficient to eventually tame inflation. On the domestic front global banking concerns in combination with surprisingly weak economic data in negative GDP growth (-0.6% QoQ) and the largest balance of payment deficit in 34 years led to a rapid reassessment of RBNZ action. Pricing of April's OCR hike fell from a peak of +45pts to a low of +17pts intra month before slowly climbing end the month at ~+25pts. At the same time 6-month forward pricing of OCR levels fell from a peak of 5.6% to 5.15% at month end. In sympathy with this reassessment over the month, 90-day bank bills increased 7.5bps to end at 5.225% their lowest rate of monthly increase since 2021; whilst 1- year swap declined by circa 20bps to end at 5.335%. These data have set the scene for the RBNZ to consider a pivot to a more nuanced "watch, wait and worry" stance. This pivot is not without challenges, inflation remains extremely elevated and will likely face some upward pressure as a result of cyclone Gabrielle, whilst the labour market, although showing some signs of softening is still typified by low unemployment. The RBNZ faces a challenging communication tightrope to walk - on one hand it can arguably look to pause or slow down, whilst on the other hand it will not want markets to undo its hikes by pricing in cuts and lowering mortgage rates before a sufficient portion of policy lag has taken hold. The RBNZ's coming OCR review at the start of April takes the form of a briefer "Monetary policy review" where only a one-page press release is made. It seems logical in order to fully communicate any change in approach the RBNZ will need the fullness of a Monetary policy statement (MPS) to finesse its position. As such we expect April to be a continuation of tightening, whilst Mays MPS presents a data dependent opportunity to change course.

Fund Commentary

The fund performed well in Q1, returning 1.25% and outperforming its benchmark the 90-day bank bill index which returned 1.15%. The fund's tactical investment strategy over the month primarily consisted of seeking to add duration when compensated for the risk of a 5.5% peak OCR. Our logic here centred around our long-held view that we are nearing the end of the hiking cycle, that the lagged impact of hikes thus far would continue to build and that a peak OCR in the range of 5.25% to 5.5% would prove sufficient to supress demand and slow inflation. With some degree of patience this presented opportunities over the latter part of February and the early part of March. Market dynamics around peak OCR levels changed mid-March - kicked off by SVB's collapse and followed up by weak domestic data with 4Q22 GDP declining more than expected (-0.6%, vs consensus -0.2%) and NZ seeing its largest balance of payments deficit in 34 years. In response 6-month forward OCR pricing fell from a peak of around 5.6% in early March to 5.15% at the close of the month. This positively supported performance as some 18% of the fund's holdings have tenors 6-months or longer. With the fall in rates we believed the fund was no longer being fully compensated for the risk of the RBNZ continuing to hike at pace, resulting in the fund fading duration in the latter part of March by targeting maturities around the RBNZ's April and May meetings.

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	$782.4	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 wholesale fund complied with its investment mandate and trust deed during the quarter.

Contact Us
www.nikkoam.co.nz | nzenquiries@nikkoam.com