FACTSHEET 31 MAY 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

- The Reserve Bank (RB) hiked the OCR by 0.25% to 5.50% and made comments that suggest the hiking cycle is now over.
- The OCR path is now data dependent, the RB's lens is likely one of looking for reasons to cut rather than to resume hiking.
- The RB suggested the OCR will need to remain elevated for an extended period, with cuts likely not occurring until mid-2024.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that the RB's hiking cycle is complete.
- We are looking to opportunistically add duration reflecting a view that the next move is the cash rate is more likely to be down than up.
- Credit quality remains very solid and is expected to perform well in the face of a potential recession.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.53%	1.42%	4.38%	2.20%	2.34%	2.98%
Benchmark[2]	0.46%	1.28%	3.92%	1.64%	1.63%	2.17%
Retail[3]	0.53%	1.35%	4.07%	1.91%	2.01%	
KiwiSaver[3]	0.51%	1.31%	3.92%	1.76%	2.01%	

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.

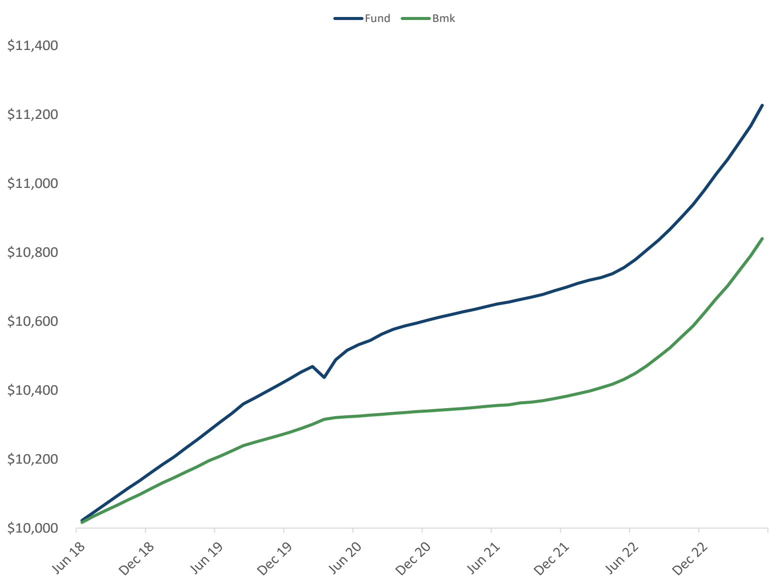
Overview

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

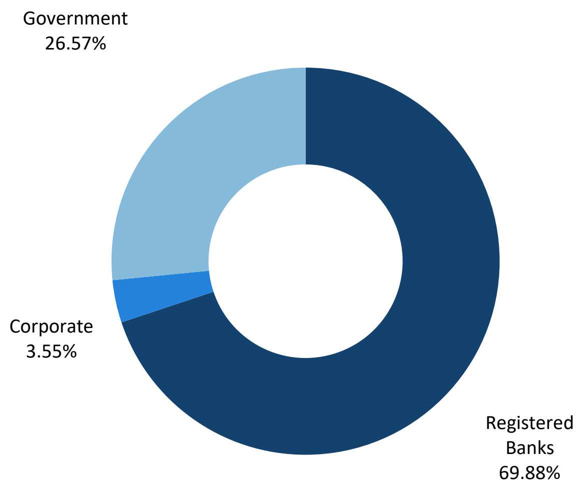
Objective

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	13.91
Tax Management NZ Limited	12.66
ANZ Bank New Zealand	10.40
Westpac New Zealand Ltd	8.05
Bank of New Zealand	7.38

Credit Quality	(%)
AAA	26.6
AA	32.4
A	41.1

Duration
Fund 102 days vs Benchmark 45 days

Yield to Maturity
Fund (gross) 5.85% vs Benchmark 5.62%

Market Commentary

The Reserve Bank hiked the OCR by 0.25% to 5.50% whilst signalling it has now likely done enough to bring inflation under control. The Monetary Policy Committee debated between a pause and a 0.25% hike, the latter confirmed by vote '5 for' and '2 against'- this being the first time an OCR review decision was not unanimous. This notwithstanding, all members of the committee agreed a 5.50% peak OCR level was sufficient, indicating dissension was around the journey rather than destination. This caught markets wrong footed, with pricing going into the meeting suggesting a peak OCR level of near 6% would be pursued and most major bank economists similarly forecasting a peak OCR of 5.75% to 6% along with a continuation of a rapid approach to hikes to get to this peak sooner rather than later.

Markets and economists' missteps in viewing a higher OCR and more rapid approach as likely were in two primary areas; (1) a belief that elevated migration would cause a near-term demand shock increasing inflation and (2) that higher than expected government spending would add further demand-driven fuel to the inflation fire. The Reserve Bank (RB) took different interpretations in both these areas. Regarding elevated migration, the RB viewed the resulting increased supply of labour along with its potential to de-bottleneck labour constraints and lower wage demand pressure as more important than any temporary additional demand these migrants create. Whilst regarding the elevated government spending presented in budget 2023, the RB stated it would add demand in fiscal year 2023/24, then "dampen demand in subsequent years". Consequently, fiscal policy would be contractionary on demand, as government consumption, which is the larger share of government spending was expected to fall as a percentage of GDP from its COVID elevated levels in the coming years.

All in all, the Monetary Policy Statement delivered a confident dovish message with the RB believing it has now done enough to get inflation back under control. However, this does not mean cuts are imminent, with the RB suggesting the OCR will need to remain elevated for an extended period, with cuts likely not occurring until mid-2024. We are now moving to a new phase where transmission lag plays out and the RB applies its data driven "watch, wait and worry" approach. Future decisions for either a recontinuation of hikes or a shift to cuts are data dependentand, in our view, the hurdle for hikes is significantly higher than that for cuts.

Fund Commentary

The fund performed well in May returning 0.53% outperforming its benchmark of the 90-day bank bill index which returned 0.46%. The Reserve Bank's MPS included statements that strongly suggest that by raising the OCR to 5.5% it has now done enough to get inflation under control. This resulted in a roller coaster ride for rates with markets expecting a more hawkish statement and a higher peak cash rate. 90-day bills started the month at 5.56% increasing to a pre-OCR peak of 5.85% then falling back to end the month at 5.69%, whilst 1-year swap unsurprisingly saw a more aggressive rally starting the month at 5.59%, increasing to a pre-OCR peak of 6.045%, then falling back circa 0.33% to end the month at 5.71%. The hurdle for a higher cash rate and a continuation of hikes has risen with RB's MPS rebutting market concerns around the potential inflationary impact of elevated migration and increased fiscal spending. We now expect RB to let monetary policy lag play-out while observing data under a "watch, wait and worry" lens. Under this backdrop adding duration becomes a logical strategy to pursue in the coming months. The fund has begun to implement this strategy in earnest post the MPS.

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	$808.8m	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 month.

Contact Us

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