Nikko Asset Management

Factsheet 31 July 2023

NIKKO AM GLOBAL BOND STRATEGY

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

Market Overview (source: GSAM)

- July was a mixed month for fixed income assets. Risk assets continued their strong performance while sovereign bonds underperformed.
- Robust US data and lower-than-expected inflation renewed market optimism around the US Federal Reserve's (Fed) ability to cool price rises without triggering a recession.
- Both the Fed and European Central Bank (ECB) raised policy rates by 25bps over July to 5.25-5.5% and 3.75%, respectively, and cited incoming data would determine upcoming policy actions.

Fund Highlights

- The portfolio outperformed its benchmark over July. This was driven by our Cross Sector and Corporate selection strategies. Elsewhere, our EMD strategy underperformed.
- Underperformance of our EMD selection strategy was driven by our preference to hold local China rate exposure via interest rate swaps versus cash bonds.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	0.31%	-0.08%	-1.65%	-3.26%	1.55%	3.58%
Benchmark[2]	0.05%	-0.40%	-2.69%	-3.44%	0.61%	2.99%
Retail[3]	0.39%	0.27%	-2.18%	-4.02%	0.75%	

1. Returns are before tax and before the deduction of fees. Based on actual calendar periods.
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any). Based on change in unit price.

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

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. The Goldman Sachs Asset Management Global Fixed Income Team managed over US$690 billion of global fixed income and currency assets (as at 30th September 2022).

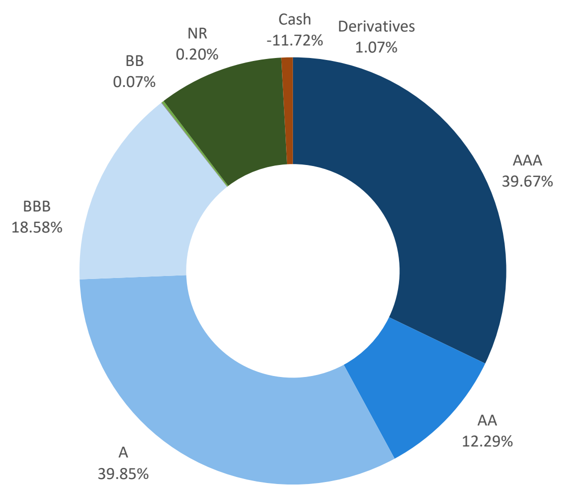
Overview

The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

Objective

The Strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three-year period.

Credit Quality



Sector Allocation (% of fund)	Fund	Index
Governments	35.71%	44.51%
Agency	1.53%	7.86%
Collateralised & MBS	39.86%	11.88%
Credit	29.16%	20.21%
Emerging market debt	4.38%	15.55%
Cash, derivatives, other*	-10.65%	0.00%

*includes deferred settlements

Duration
Fund 6.48 years vs Benchmark 6.67 years

Yield to Maturity
Fund (gross) 5.75 % vs Benchmark 5.42%

Market Commentary

July was a mixed month for fixed income assets. Risk assets continued their strong performance while sovereign bonds underperformed amid continued developed market (DM) central bank tightening. Robust US data and lower-than-expected inflation renewed market optimism around the US Federal Reserve's (Fed) ability to cool price rises without triggering a recession, or in other words, orchestrating a soft-landing. US high yield (HY) bond spreads tightened by 23bps whilst US investment grade (IG) index spreads moved to their tightest levels year-to-date (YTD).

Both the Fed and European Central Bank (ECB) raised policy rates by 25bps over July to 5.25-5.5% and 3.75%, respectively, and cited incoming data would determine upcoming policy actions. Elsewhere, downside surprises in UK labour market and core inflation data led the Bank of England (BoE) to downshift from a 50bps rate rise in June to 25bps at their early August meeting. Notably, the Bank of Japan (BoJ) effectively relaxed its yield curve control (YCC) policy by raising the rate for fixed-rate purchase operations from 0.5% to 1.0%. As such, on a relative-basis, US Treasuries underperformed, followed by German Bunds while UK Gilts relatively outperformed.

Big picture, investors are currently contending with a lingering late-cycle macro backdrop with latent recession risks for the US economy and most DMs. The timeframe for a monetary policy pivot and the duration of the late-cycle phase remains uncertain. As such, we stay up-in-quality, with a preference for investment grade (IG) corporate bonds, as well as agency mortgage-backed securities (MBS). We also believe a restored allocation to core fixed income can help to improve the resilience of portfolios to episodes of bearish sentiment given higher yields have significantly strengthened the protective power and income benefits of high-quality bonds.

We also acknowledge that as cycles turn, investment opportunities shift. Looking ahead, we expect diversification opportunities through staggered hiking cycles and the next phase of policymaking to be more mixed than the coordinated tightening campaign. More broadly, tighter financial conditions, changing correlations, increased economic and geopolitical uncertainty, and increased return dispersion may offer greater opportunities to generate alpha. What we consider a new macroeconomic reality requires a stronger tilt toward active management with the potential to deliver alpha through nimble portfolio management, an active approach to asset allocation and security selection as well as extensive and specialized bottom-up research.

Fund Commentary

The portfolio outperformed its benchmark over July. This was driven by our Cross Sector and Corporate selection strategies. Elsewhere, our EMD strategy underperformed.

Underperformance of our EMD selection strategy was driven by our preference to hold local China rate exposure via interest rate swaps versus cash bonds. China government bonds outperformed over the month as yields moved lower across the curve. News of slower- and lower-than-expected growth and inflation led investors to anticipate additional economic stimulus.

Performance from our Securitized selection strategy was driven by our specific selection among mortgage-backed security (MBS) passthrough securities, particularly among Ginnie versus Fannie Mae MBS. We maintain preference to Ginnie versus Fannie Mae MBS given historically attractive valuations and our outlook on technical dynamics.

Key Fund Facts

Distributions:

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter

Estimated annual fund charges (incl. GST)

Wholesale: Negotiated outside of unit price
Retail: 0.80%, refer PDS for more details

Hedging: All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.

Buy / Sell spread	Strategy size	Strategy Launch
0.00% / 0.00%	$494.8m	October 2008

Exclusions: Controversial weapons.

Restrictions: Thermal coal mining and extraction, oil tar sands extraction, tobacco stocks and fossil fuels. For more information, please refer to the Statement of Investment Policy and Objectives (SIPO) on our website https://www.nikkoam.co.nz/invest/retail.

Compliance

The fund complied with its investment mandate and trust deed during the month.

Contact Us

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