Factsheet 31 August 2023

NIKKO AM INCOME STRATEGY

Applies to the Nikko AM Income Fund

Market Overview

- The S&P/NZX 50 Gross (with imputation credits) Index fell 4.2% over the month while the bond sector gained 0.29% as measured by the Bloomberg NZ Bond Credit Index.
- The Reserve Bank's latest Monetary Policy Statement indicated they will hold the cash rate at an elevated level of 5.5% until the end of 2024 as they monitor incoming economic data.
- With the NZ economy slowing, consumer spending falling and the export sector facing lower demand and lower prices sticky short-term inflation is the only reason stopping rate cuts occurring earlier.

Fund Highlights

- The Fund fell over August with equity and bond markets both down.
- Of the 14 companies in the equities portfolio only Contact Energy and Infratil delivered positive returns over the past month.
- Short-term bonds and cash outperformed longer-term bonds as bond market weakness was seen internationally and supply of NZ Government bonds is increasing.

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 on 1 January 2023.

Performance [1,2,3]

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail[1]	-0.93%	0.33%	0.06%	0.42%	0.20%	3.20%
Benchmark[2]	0.70%	2.08%	7.56%	4.99%	5.21%	6.23%
Market Index[3]	-1.26%	-0.41%	2.10%	-0.91%		

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.

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, Senior 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.

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

Asset Allocation

Top 5 Fixed Income Issuers*	(%)
Westpac New Zealand	10.75
Kiwibank	5.18
Powerco	4.75
TR Group	4.20
Fonterra	4.08

*Includes cash holdings.

Duration*
Fund 3.93 years
Yield to Maturity
Fund (gross) 6.39%

Top 10 Equities	(%)		(%)
Heartland Group	3.84	Spark New Zealand	3.12
Infratil	3.60	Contact Energy	3.00
Bank Of New Zealand	3.23	Skellerup	2.99
Chorus	3.19	Meridian Energy	2.58
Works Finance NZ	3.16	Kiwibank	2.01

Fund Commentary

The Fund fell over August as equity and bond markets were both down.

The S&P/NZX 50 Gross (with imputation credits) Index fell 4.2% over the month while the bond sector gained 0.29%.
as measured by the Bloomberg NZ Bond Credit Index.
Interest rates on longer term bonds continue to move higher as more government bond issuance is likely. Tax revenue is sliding as economic activity weakens due to the rising cost of living and higher mortgage costs. The export sector has performed well but now faces downward pressure on prices as global demand wanes. Short term interest rates have been much more stable as the Reserve Bank pauses and probably stops raising the Official Cash Rate (OCR).

Interest rate volatility remains elevated globally, triggered by ongoing uncertainty surrounding the future strength of economic growth, inflation and central bank actions. Increasingly central banks around the world are looking to pause interest rate increases however uncertainty remains as central banks review data to see if they have raised cash rates enough to tame inflation.
The Reserve Bank's latest Monetary Policy Statement indicated they will hold the cash rate at an elevated level of 5.5% until the end of 2024 as they monitor incoming economic data. They hope they have done enough to cool consumer demand, inflationary pressures and inflation expectations and further rate rises will not be required. It now seems the RBNZ is looking for reasons not to push cash rates higher. With the NZ economy slowing, consumer spending falling and the export sector facing lower demand and lower prices sticky short-term inflation is the only reason stopping rate cuts occurring earlier.

In previous commentaries we have expressed our view that locking into longer term bonds around current levels will likely outperform cash returns over the next few years as the next significant move is likely to be down in rates, but we might have to wait for a year or so until this occurs in any meaningful way. An OCR cash rate of around 3.5% is probable by mid-2026.
Equity markets, like bond markets, continued to see high levels of volatility in individual company performances. In general, companies and industries that are sensitive to rising interest rates and the property sector 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 commercial property sector is also facing the prospect of changes to building depreciation which would be negative for the sector.

The fund owns 14 companies in its equities portfolio with only Contact Energy and Infratil delivering positive returns over the past month. Short-term bonds and cash outperformed longer-term bonds as bond market weakness was seen internationally and supply of NZ Government bonds is increasing. The global push higher in bond rates also pushed longer term NZ rates higher as markets try to determine the extent of weakening economic growth and inflation.

We continue to believe investors should seek income from a diverse range of sources. Bond rates are looking attractive and even though some 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
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.

Estimated annual fund charges (incl. GST)
0.80%, refer PDS for more details

Hedging
All investments will be in New Zealand dollars

Buy /Sell spread: Click to view

Strategy size $3.2m

Strategy Launch 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 month.

Contact Us
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