Nikko Asset Management

Factsheet 30 September 2023

NIKKO AM NZ CORPORATE BOND STRATEGY

Assets are held in the Nikko AM Wholesale NZ Corporate Bond Fund. The Nikko AM NZ Corporate Bond Fund (retail) and Nikko AM KiwiSaver NZ Corporate Bond Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- It has been difficult times for bonds with the market pricing rates 'higher for longer' and increased government bond supply.
- The market has taken rates a lot higher since the RBNZ's last move effectively delivering a 'de-facto' tightening, still uncertainty around inflation and the economy remain and we will have to wait to get a better read on conditions.
- NZ credit has performed (ex-underlying rate moves) ok with margins supported by supply/demand dynamics and providing a higher yield.

Fund Highlights

- Shorter maturity bonds generally performed better than longer maturities as interest rates moved higher.
- The fund's duration was moved modestly longer when rates were higher during the quarter, we are mindful of having less risk in uncertain times and have been taking incremental steps.
- We are moving toward barbell yield curve positioning to construct a higher fund yield and participate in capital gains if rates move lower in the future.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	-0.93%	-0.42%	2.90%	-1.98%	1.87%	4.10%
Benchmark[2]	-0.65%	-0.08%	3.25%	-1.65%	1.42%	3.26%
Retail[3]	-0.98%	-0.61%	2.18%	-2.68%	1.12%	3.28%
KiwiSaver[3]	-0.96%	-0.55%	2.20%	-2.69%	1.26%	

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Credit 0+ Yr 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, Senior Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

Overview

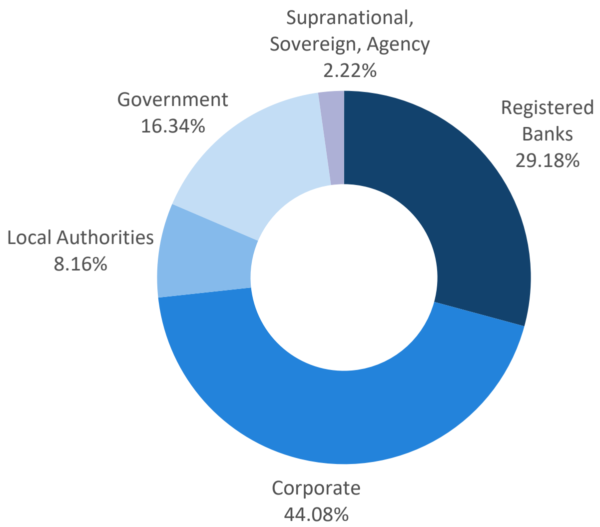
The strategy aims to generate income by constructing an actively managed investment portfolio of New Zealand bonds, deposits, and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

Objective

The fund aims to outperform the benchmark return by 0.70% per annum before fees, expenses and taxes over a rolling three-year period.

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

Asset Allocation



FX contracts value 0.02%

Top 5 Corporate Issuers*	%
Housing New Zealand	9.50
Westpac New Zealand	8.06
Kiwibank	6.25
NZ Tax Trading Co	4.29
TR Group	4.07

*Includes cash held by custodian
*Excludes NZ central government

Credit Quality (% of fund)	%
AAA	35.43
AA	23.39
A	13.91
BBB	27.24

Green, sustainable and social bonds
17.76% of the fund
Duration
Fund 3.99 years vs Benchmark 2.93 years
Yield to Maturity*
Fund (gross) 6.14% vs Benchmark 6.08%

*Excluding the inflation component of government inflation linked bonds

Market Commentary

September finished a poor quarter for NZ bond returns with interest rates moving higher in both July and August. Higher Interest rates were the key driver of returns as capital loss from upward moves dominated the fund's income accrual. Longer maturity bond returns were negative and shorter bonds, which have less price sensitivity to changes in interest rates, were less impacted although returns were still muted.

The theme of higher cash rates for longer and increased supply of government bond issuance weighed heavily on bond markets both here and offshore and yield curves are now a lot higher and flatter in slope. In terms of sectors, swaps performed better than governments for maturities inside 5 years, but both sectors suffered similar moves higher in yields for longer maturities. Over the quarter movements in government bond yields were 2yr + 47bps, 5yr + 67 bps and 10yr + 67 bps. For comparison swap maturities were 2yr +25 bps, 5yr + 53 bps and 10yr + 68bps. NZ credit has fortunately performed ok with margins stable to slightly narrower as the demand supply dynamics continue to provide support.

The good times for bonds (in terms of lower rates) seems to keep getting pushed further out; in fact it was an ugly quarter. The economy appears to be softening and higher rates will add more pressure on consumers and business. The threat to the cash rate remains higher until inflation shows meaningful signs of slowing, but markets have delivered de-facto tightening without the RBNZ having to do anything. Conditions are likely restrictive enough given the lag of monetary policy, however the RBNZ won't want rates lower until they are confident inflation is under control. If inflation continues to remain sticky this will likely result in rates needing to be higher for longer and may exacerbate volatility.

Fund Commentary

The Fund performance was negative for the quarter and slightly underperformed the Bloomberg NZ Credit benchmark. The move higher in interest rates was the main driver of absolute returns and relative returns.

The fund started the month with a moderate long duration position which was unhelpful as interest rates finished higher. We added a small weighting of longer maturity bonds to the fund when yields spiked higher earlier in the quarter which initially helped, but rates went higher again in September which hurt. On sector performance NZ credit has performed ok providing additional yield and a gradual contraction in margins.

We're keeping with our plan of building a higher yield at the front of the yield curve, which will likely be the highest yielding point for the longest. Balanced against this we also want to lock in some higher rates for longer and have been cautiously adding some longer maturities on opportunities higher in yield. Bond yields have gone a lot higher, but we remain mindful that sometimes cheap things get cheaper.

Key Fund Facts

Distributions

Wholesale fund: calendar quarter
Retail fund: calendar quarter
KiwiSaver fund: does not distribute

Estimated annual fund charges (incl. GST)

Wholesale fund: negotiated outside of unit price
Retail fund: 0.70%, refer PDS for more details
KiwiSaver fund: 0.70%, refer PDS for more details

Hedging

Any foreign currency exposure to be hedged to NZD within operational range of 97.5%-102.5%

Buy / Sell spread:	Strategy size	Strategy Launch
Click to view	$427.3m	July 2009

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

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