

Nikko AM NZ Bond Strategy

Monthly Update 30 November 2023

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

Market Overview

- November was a very strong month for bonds with large falls in interest rates.
- In an abrupt turnaround the market unwound the previous quarter's move higher in yields and is again pricing rate cuts in 2024.
- NZ credit continues to help with a higher yield and stable margins supported by supply/demand dynamics.

Fund Highlights

- The fund delivered strong positive returns benefiting from capital gains as rates moved lower.
- We have been incrementally moving the fund's duration longer and this was the main contributor to absolute and relative returns in November.
- We continue to prefer quality credit over lower yielding government bonds with the supply dynamics more supportive of credit than governments.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	4.11%	1.74%	3.53%	-2.68%	1.32%	3.60%
Benchmark²	3.25%	1.61%	2.15%	-3.51%	0.08%	2.63%
Retail³	4.04%	1.61%	2.91%	-3.29%	0.64%	2.84%

1. Returns are before tax and before the deduction of fees.
2. Current benchmark: Bloomberg NZBond Composite 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 fund aims to provide investors with regular 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.

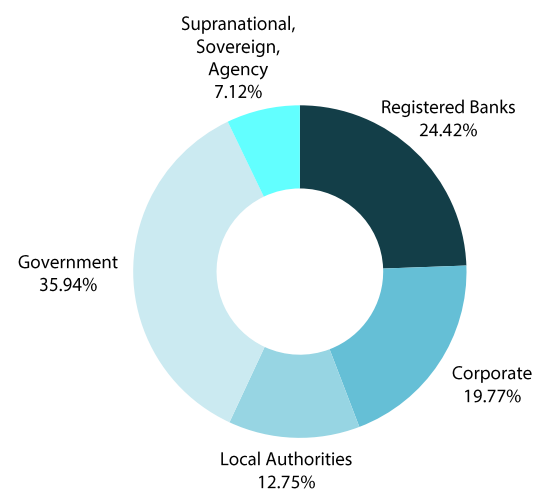
Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

Five Year Cumulative Performance, \$10,000 invested^{1,2}



Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
New Zealand Local Govt Funding Agency	8.76	AAA	60.84	23.22% of the fund
Housing New Zealand	6.92	AA	18.80	Duration
Kiwibank	5.61	A	17.49	Fund 5.4 years vs Benchmark 4.44 years
Westpac New Zealand	5.29	BBB	2.86	Yield to Maturity*
Bank of New Zealand	4.34			Fund (gross) 5.37% vs Benchmark 5.13%

* Excludes NZ central government

* Excluding the inflation component of government inflation linked bonds

Market Commentary

November was a strong month for NZ bonds as yields fell following some softer economic data and large moves lower in US rates. The move lower in interest rates was the key driver of absolute and relative returns with capital gains boosting bond returns to respectable levels year-to-date. Longer maturity bonds were the best performers as they have a higher price sensitivity to falls in rates and the shift lower in rates was relatively consistent along the yield curve.

It is very pleasing that the longer duration positioning has benefited the fund this year and bonds have delivered a respectable return. Although we remain unsure that the pace of slowing in growth and inflation are sufficient for the RBNZ to deliver rate cuts earlier in 2024 the market has swung to price this. Ultimately economic developments and the data will inform the way forward and markets may remain volatile. In terms of performance NZ bond sectors experienced similar moves lower in yield. Movements in government bond yields were 2-year -36 bps, 5-year -63 bps, and 10-year -69 bps. For comparison swap maturities were 2-year -43 bps, 5-year -63 bps and 10-year -70 bps. NZ credit has added value through a higher yield with margins stable as the demand supply dynamics continue to provide support.

We think the RBNZ maintains a “hawkish hold” and conditions are likely restrictive enough to slow the economy and inflation, however given the lag of policy we expect meaningful improvement in data will take time which may test the RBNZ’s patience. On a medium term view we think it makes sense locking in higher rates for longer, but rates have fallen a lot in short order and entry levels and positioning size remain important so remain patient for opportunities. We prefer quality credit over governments while government bonds still face supply issues. We are approaching an issuing hiatus for bonds over the holiday period and expect good demand for credit into the new year as monies need to be invested.

Fund Commentary

The fund returned a strong positive month both absolute and in relative terms versus the Bloomberg NZ Composite benchmark. The move lower in interest rates was the main driver of both absolute and relative returns. The fund has incrementally moved to a moderate long duration position (approximately one year long) which was most helpful as interest rates moved a lot lower in November.

Government bonds and swap had similar performances with the move lower in rates consistent along the yield curve for both sectors. Credit holdings have helped in terms of providing a higher yield while margins have been relatively stable. Our preference remains to invest in new issuance of quality credit. We don’t necessarily expect rate cuts as early as the market is pricing but given the balance of risk, we are happy to lock in higher rates for longer when this makes sense. Again, we will remain patient and look to add value on opportunities within the range.

Key Fund Facts

Distributions		Hedging:	All investments will be in New Zealand dollars	Strategy Launch:	October 2007
Wholesale:	Calendar quarter	Exclusions:	Controversial weapons	Strategy size:	\$528m
Retail:	Calendar quarter	Restrictions:	Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information, please refer to the Statement of Investment Policy and Objectives (SIPO) on our website https://www.nikkoam.co.nz/invest/retail .	Buy / Sell spread:	Click to view
Estimated annual fund changes (incl. GST)					
Wholesale:	Negotiated outside of unit price				
Retail:	0.65%, refer PDS for more details				

Compliance

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

Contact Us

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