

Nikko AM Income Strategy

Monthly Update 31 December 2023

Applies to the Nikko AM Income Fund.

Market Overview

- The S&P/NZX 50 Gross (with imputation credits) Index returned 4.2% over the quarter and 3.89% in December alone, making up for negative returns in October.
- The bond sector as measured by the Bloomberg NZ Bond Composite Index also had a strong quarter and month, up 4.64% and 2.04% respectively as interest rates continued to move lower.

Fund Highlights

- The Income Fund performed strongly over the final quarter of 2023 with November and December returns being elevated by strong equity and bond market performance.
- 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.
- The fund benefited from a long duration position as interest rates declined.

Distributions

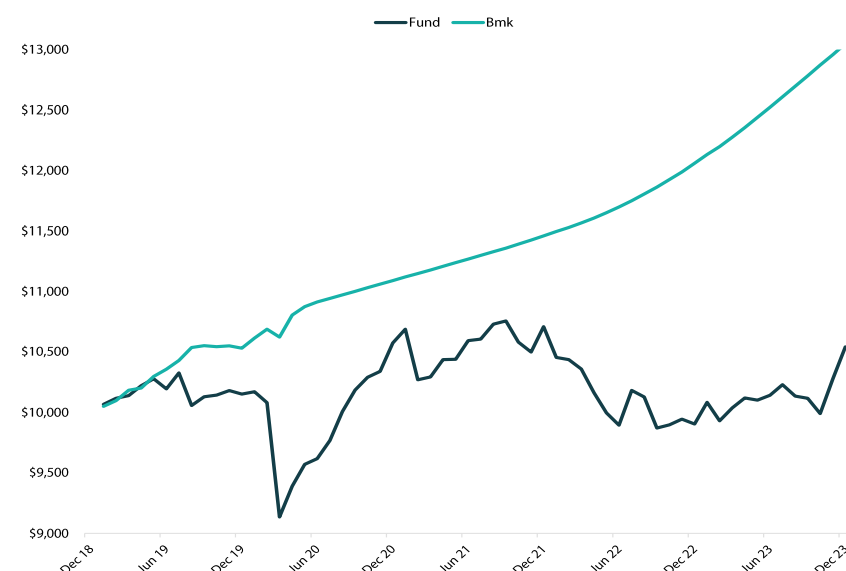
- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point. The defined distribution rate for 2024 is 6.5%. This income will be distributed in four equal amounts each calendar quarter, based on the price on 1 January 2024.

Performance

	One month	Three months	One year	Three years (pa)	Five years (pa)	Ten years (pa)
Retail¹	2.56%	4.21%	6.44%	-0.10%	1.06%	3.40%
Benchmark²	0.70%	2.08%	8.20%	5.57%	5.47%	6.18%
Market Index³	2.71%	4.57%	6.23%	-0.77%		

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%.

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



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.

Asset Allocation



Top 5 Income Issuers*	(%)	Duration	Top 10 Equities	(%)	(%)	
ANZ Bank New Zealand	10.26	Fund 3.75 years	Bank Of New Zealand	3.20	Contact Energy	2.88
Westpac New Zealand	7.87	Yield to Maturity	Works Finance NZ	3.15	Meridian Energy	2.66
Kiwibank	5.13	Fund (gross) 6.07%	Spark New Zealand	3.11	Skellerup	2.65
Powerco	4.92		Chorus	3.05	Heartland Group	2.53
TR Group	4.21		Infratil	2.89	Kiwibank	2.04

Fund Commentary

The Income Fund performed strongly over the final quarter of 2023 with November and December returns being elevated by strong equity and bond market performance.

The S&P/NZX 50 Gross (with imputation credits) Index returned 4.2% over the quarter and 3.89% in December alone, making up for negative returns in October. The bond sector as measured by the Bloomberg NZ Bond Composite Index also had a strong quarter and month, up 4.64% and 2.04% respectively as interest rates continued to move lower. Interest rates fell as inflation continued to trend lower in most international markets. Investor attention turned from anticipating more central bank rate rises to speculating on when and by how much interest rates may fall. This change of sentiment in the fixed interest market increased the buying interest in bonds of all maturities resulting in rate falls and increased bond prices. Lower interest rates and the possibility of more to come as 2024 progresses also encouraged a strong year-end rally in equity markets.

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. The December quarter gains in the bond market was enough to push bond returns above cash returns over 2023 but cash returns still outperformed the equity market as the NZX 50 did not significantly participate in the strong performance of the 'tech sector' that is more highly represented in some offshore markets such as the US.

The fund benefited from a long duration position as interest rates declined. Although we believe interest rates will be lower than present by the end of 2024 it is possible that markets have got too optimistic about the positive interest rate outlook. A short term upward bounce in interest rates is likely early in 2024. However, we believe a move higher in rates represents a buying opportunity as the general trend in rates is down, however the timing of this occurring is uncertain and we remain patient for investment opportunities. Ultimately economic developments and the data will dictate the way forward and markets may remain volatile for some time.

With interest rates falling for two months in a row it was not surprising to see interest rate sensitive stocks perform well. The property names in the fund's equity portfolio performed strongly after being under pressure for most of the year. The electricity sector also performed well with Meridian, Mercury and Genesis all increasing by over 5% over December. Heartland Group share price fell after they announced a lower 2024 earnings outlook after a slow start to the year.

We continue to believe investors should seek income from a diverse range of sources. Looking ahead over the medium term a lower rate environment should be supportive for both bond and equity returns. 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

Estimated annual fund charges (incl. GST)	0.80%, refer PDS for more details.	Hedging:	All investments will be in New Zealand dollars.	Strategy Launch:	October 2017
Exclusions:	Controversial weapons.	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.	Strategy size:	\$3.2m
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

Compliance

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

Contact Us

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