

Nikko AM NZ Corporate Bond Strategy

Monthly Update 31 December 2023

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

Market Overview

- The final quarter of 2023 was very strong for bond returns.
- Yields kept falling through November and December as the market aggressively priced interest rate cuts in 2024.
- NZ credit continues to help returns with a higher yield and stable margins supported by supply/demand dynamics.

Fund Highlights

- The funds delivered very 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 the final quarter of 2023.
- We continue to prefer quality credit over lower yielding government bonds with the supply dynamics more supportive of credit than governments which will have ample supply in the new year.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	2.71%	5.75%	8.51%	0.12%	2.70%	4.59%
Benchmark²	2.04%	4.64%	7.59%	0.04%	2.05%	3.68%
Retail³	2.62%	5.56%	7.75%	-0.59%	1.95%	3.77%
KiwiSaver³	2.53%	5.36%	7.55%	-0.66%	2.01%	

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.

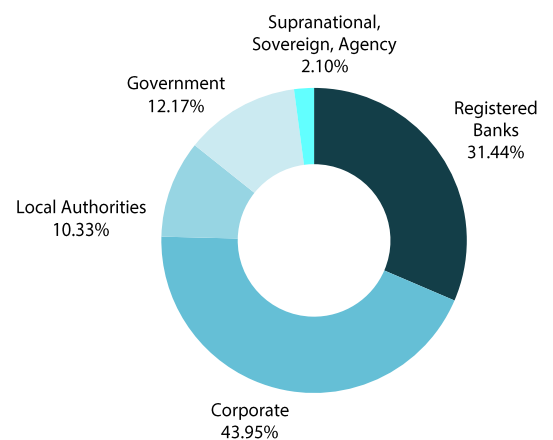
Objective

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}



Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
Housing New Zealand	9.84	AAA	33.64	16.59% of the fund
Westpac New Zealand	7.87	AA	22.62	Duration
Kiwibank	7.20	A	16.47	Fund 4 years vs Benchmark 2.91 years
New Zealand Local Govt Funding Agency	5.84	BBB	27.25	Yield to Maturity*
Bank of New Zealand	5.17			Fund (gross) 5.41% vs Benchmark 5.15%

*Include cash held by custodian

* Excluding the inflation component of government inflation linked bonds

Market Commentary

The final quarter was very strong for NZ bonds with rates falling significantly from November through to year end as the market aggressively priced rate cuts in 2024. The move lower in interest rates was the key driver of absolute and relative returns with capital gains boosting bond returns to very respectable levels for 2023. Longer maturity bonds were the best performers as they have a higher price sensitivity to falls in rates.

It is very pleasing that the longer duration positioning has benefited the fund this year and bonds have delivered a strong return. It has been an abrupt move lower in rates with the fear of ever higher rates flipping to fear of missing out on falling rates and was exacerbated by market positioning. We agree the ultimate direction in rates is lower but doubt the pace of slowing in growth and inflation are sufficient for the RBNZ to deliver rate cuts earlier in 2024. 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 for the quarter were 2yr -111 bps, 5 yr -112 bps and 10 yr -99 bps. For comparison swap maturities were 2yr -108 bps, 5 yr -114 bps and 10 yr -104 bps. NZ credit has added value through a higher yield versus holding governments.

We think the RBNZ maintains a “hawkish hold” and conditions are likely restrictive enough to slow the economy and inflation, however we expect returning inflation to low levels will take time which may make market pricing look presumptuous. 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 are important so we remain patient for opportunities. We marginally reduced the fund’s long duration late December. In terms of sector allocation we prefer quality credit over governments while government bonds face supply issues in the new year.

Fund Commentary

The fund had a very strong final quarter for 2023 and outperformed the Bloomberg NZ Corporate Bond benchmark. The month of October was unhelpful as yields went higher but was followed by very strong returns in November and December as yields fell. The large move lower in interest rates was the main driver of absolute returns and relative returns. The fund had a moderate long duration position (peaking at approx. 1.4 years long). We did trim the long duration position late December.

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. We prefer quality credit which is higher yielding than governments and currently has more supportive demand /supply dynamics too. 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 in terms of duration positioning on opportunities within the range.

Key Fund Facts

Distributions		Hedging:	Any foreign currency exposures are hedged to NZD within operational range of 95%-105%	Strategy Launch:	July 2009
Wholesale:	Calendar quarter	Exclusions:	Controversial weapons	Strategy size:	\$444.1m
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
KiwiSaver:	Does not distribute				
Estimated annual fund changes (incl. GST)					
Wholesale:	Negotiated outside of unit price				
Retail:	0.70%, refer PDS for more details				
KiwiSaver:	0.70%, refer PDS for more details				

Compliance

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

Contact Us

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

This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme. This information is for the use of researchers, financial advisers and wholesale clients. This material has been prepared without taking into account a potential investor’s objectives, financial situation or needs and is not intended to constitute financial advice, and must not be relied on as such. Recipients of this document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult a Financial Advice Provider and the relevant Product Disclosure Statement. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party. For full details on the fund, please refer to our Product Disclosure Statement on nikkoam.co.nz.