

Nikko AM Income Strategy

Monthly Update 29 February 2024

Applies to the Nikko AM Income Fund.

Market Overview

- The S&P/NZX 50 Gross (with imputation credits) Index fell 1.1% over February.
- The bond sector as measured by the Bloomberg NZ Bond Composite Index fell 0.24% with longer-term bonds providing the weakest returns.
- The RBNZ gave a clear message that it is holding the Official Cash Rate at 5.5% for some time.

Fund Highlights

- The Income Fund fell over February. It has been a tough start to the year for the New Zealand bond and equity markets with both markets lower than the close of 2023.
- There was a wide variance in stock returns with Meridian being the highest and Heartland Group trailing the field.
- Cash and short-term bonds were the best performing parts of the fixed income market as they held their value as the Official Cash Rate remained unchanged.

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 | -1.03% | 1.34% | 4.89% | 0.47% | 0.59% | 3.14% |
| Benchmark² | 0.65% | 2.05% | 8.42% | 5.86% | 5.55% | 6.16% |
| Market Index³ | -0.40% | 2.48% | 4.19% | 0.22% | | |

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 | (%) | (%) | |
|--------------------------------|------|--------------------------|---------------------|------|-----------------|------|
| Westpac New Zealand | 8.41 | Fund 3.65 years | Works Finance NZ | 3.15 | Contact Energy | 2.94 |
| Auckland International Airport | 7.11 | Yield to Maturity | Bank Of New Zealand | 3.15 | Meridian Energy | 2.92 |
| Kiwibank | 5.18 | Fund (gross) 6.20% | Chorus | 3.13 | Skellerup | 2.29 |
| Powerco | 4.79 | | Spark New Zealand | 3.09 | Heartland | 2.13 |
| ANZ Bank New Zealand | 4.65 | | Infratil | 3.02 | Kiwibank | 2.04 |

*Includes cash holdings.

Fund Commentary

The Income Fund fell over February. It has been a tough start to the year for the New Zealand bond and equity markets with both markets lower than the close of 2023. After strong equity and bond market performance over the final months of last year, perhaps a period of consolidation was required to reflect upon what's to come over the year ahead.

Central Bank activity, or lack of it, has been top of mind for many investors. Central Banks pushing back on market expectations of near-term rate cuts has been a global theme. Investors seem to have abandoned the idea of late last year that the US Federal Reserve would cut rates much more aggressively than the Fed's own projections.

Equally the Reserve Bank (RB) of NZ has been pushing back on market expectations of a quick pivot to start rate cuts, however the RB has acknowledged the economy is weaker than they previously thought and there has been progress on inflation, although not quickly enough. The RB gave a clear message that it is holding the Official Cash Rate at 5.5% for some time. The RB's projections show some rate reductions can start next year with the OCR at 3.5% by the end of 2026, as always, the projections are dependent upon data points continuing in the right direction to deliver sustainably lower inflation.

If cash rates move significantly lower over the next year or two, we would expect bond rates to follow and deliver strong returns to the portfolio.

The S&P/NZX 50 Gross (with imputation credits) Index fell 1.1% over February. There was a wide variance in stock returns with Meridian being the highest and Heartland Group trailing the field. The bond sector as measured by the Bloomberg NZ Bond Composite Index fell 0.24% with longer-term bonds providing the weakest returns. Cash and short-term bonds were the best performing parts of the fixed income market as they held their value as the Official Cash Rate remained unchanged.

Longer-term interest rates continued to follow trends in international markets. NZ 10-year rates followed US Treasury yields higher as like many other central banks, the US Federal Reserve seems to be in no rush to reduce rates. They noted in a recent statement that it does not expect it will be appropriate to reduce rates until it has gained greater confidence that inflation is moving toward 2%. The Fed is unlikely to reach that level of confidence by the time of their March meeting. Even though US inflation has fallen dramatically Governor Powell is of the opinion more data confirming the sustainability of the downward move is required.

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 month.

Contact Us

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