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Nikko Asset Management

YOUR GOALS,
OUR COMMITMENT.

Nikko AM NZ Corporate Bond Strategy

Monthly Update 30 April 2024

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

- NZ bonds had a poor month as yields moved higher delivering flat to negative returns.
- There has been an increase in corporate issuance and deals have been well supported with underlying rates elevated.
- Looking forward we remain optimistic that bond returns will be supported by cash rate cuts later this year and longer rates moving lower.

Fund Highlights

- The fund had a negative return for the month as interest rates moved higher. Shorter maturity bonds performed better than longer maturities.
- We have increased duration when bonds have been higher in yield and believe locking in higher rates for longer will benefit returns.
- We like the higher yield of quality credit and expect the demand/supply dynamics to remain supportive.

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.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	-0.81%	0.30%	5.12%	0.57%	2.20%	4.35%
Benchmark[2]	-0.46%	0.48%	4.78%	0.44%	1.69%	3.50%
Retail[3]	-0.83%	0.13%	4.42%	-0.13%	1.45%	3.54%
KiwiSaver[3]	-0.81%	0.14%	4.34%	-0.17%	1.48%	

1. Returns are before tax and before the deduction of fees and including tax credits (if any).
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).

Overview

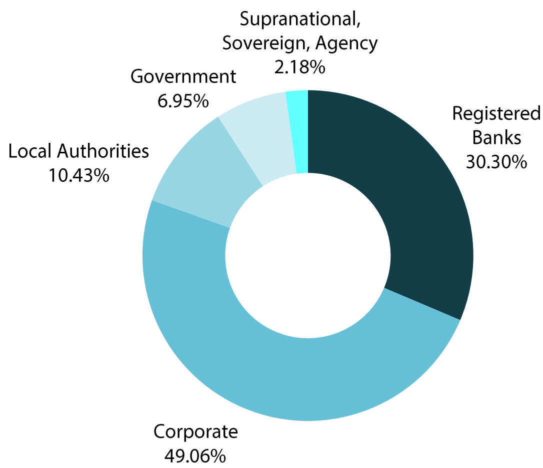
The strategy aims to generate income by constructing an actively managed investment portfolio of New Zealand bonds, deposits, and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

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*	(%)
Housing New Zealand	9.92
Kiwibank	7.55
New Zealand Local Govt Funding Agency	5.99
Bank of New Zealand	5.33
Westpac New Zealand	5.26

*Include cash held by custodian

Credit Quality	(%)
AAA	28.98
AA	19.21
A	23.29
BBB	28.52

Green, sustainable and social bonds
17.13% of the fund
Duration
Fund 4.11 years vs Benchmark 2.79 years
Yield to Maturity*
Fund (gross) 5.9% vs Benchmark 5.59%

* Excluding the inflation component of government inflation linked bonds

Market Commentary

NZ bonds had flat to negative returns with interest rates moving higher as the market re-priced high cash rates for longer. Markets remain highly data reactive, and April was volatile as the jump in the US 10-year bond pressured our bonds higher. Fortunately, NZ bonds did regain some lost ground into month end after briefly making new 2024 highs. In terms of returns the move up in interest rates was the key driver of absolute and relative returns. At month end government yields finished as follows; 2yr +33 bps, 5yr +36 bps and 10yr +31 bps. For comparison swap maturities were 2yr +31 bps, 5yr +40 bps and 10yr +40 bps.

Looking at sectors NZ government bonds compressed in spread relative to swap rates after The Debt Management Office (DMO) successfully completed a reasonable amount of issuance in the first quarter. The star performer remains NZ credit which continued to perform well with margins stable and strong demand supported by underlying rates at attractive levels. Like other investors we have been happy to lock in higher yields for longer through quality credit on the view that rates will revisit lower levels over the medium term. In general, we see increases in rates at this late stage in the cycle as an opportunity rather than a threat. We do expect that inflation will decline back towards the RBNZ's target later this year which will likely see the market take rates lower again.

On a positive note, the RBNZ have been more conciliatory/less hawkish in their comments acknowledging they are making good progress toward achieving inflation objectives. This is important as the risk for further increases in the cash rate appears greatly diminished, however higher cash rates for longer could stall a sustainable move lower in rates.

We think it makes sense locking in higher rates for longer, but "keep some powder dry". We don't want to miss capital gains when rates fall, but keep in mind we need inflation lower for rate cuts to occur. Also, longer maturity NZ bonds are highly correlated with moves in the US. We expect there will be opportunities to add value through duration when bonds are cheaper or expensive in the range and we remain patient adding on cheapening moves.

Fund Commentary

The fund had a negative return for April and underperformed the Bloomberg NZ Corporate Bond benchmark. Moves higher in interest rates were the main driver of absolute and relative returns. We have participated in new deals extending credit duration, and market demand has been strong with underlying rates higher. The fund has a moderate long duration with a view that the ultimate direction of rates is lower over the next 12-18 months.

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.

Key Fund Facts

Distributions	
Wholesale: **Retail:** **KiwiSaver:**	Calendar quarter Calendar quarter Does not distribute
Estimated annual fund changes (incl. GST)	
Wholesale: **Retail:** **KiwiSaver:**	Negotiated outside of unit price 0.70%, refer PDS for more details 0.70%, refer PDS for more details

Hedging:	Any foreign currency exposures are hedged to NZD within operational range of 95%-105%
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) on our website https://www.nikkoam.co.nz/invest/retail.

Strategy Launch:	July 2009
Strategy size:	$424.1m
Buy / Sell spread:	Click to view

Compliance

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

Contact Us

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