

Nikko AM Income Strategy

Monthly Update 31 May 2024

Applies to the Nikko AM Income Fund.

Market Overview

- The RBNZ's forecasts have inflation holding up higher for longer, with inflation not back to 2% until 2026.
- The RBNZ estimates it will need to hold the OCR higher for slightly longer with cuts not implied until around August 2025, about 3 months later than the RBNZ's February forecasts.
- The Budget was delivered against a weaker economic backdrop which translated into a softer fiscal outlook, with a delay to the return to surpluses until 2027/28 and a higher debt profile for Crown Debt.

Fund Highlights

- The Income Fund marked time over May with the New Zealand bond market performing well but the equity market falling.
- 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.
- 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	0.00%	0.39%	3.52%	0.05%	0.34%	2.95%
Benchmark²	0.70%	2.08%	8.52%	6.30%	5.56%	6.12%
Market Index³	0.23%	1.30%	4.13%	0.49%		

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, Senior 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	8.59	Fund 4.32 years	Contact Energy	3.68	Chorus	3.14
Powerco	5.23	Yield to Maturity	Meridian Energy	3.59	Spark New Zealand	2.74
Kiwi Property	4.37	Fund (gross) 6.28%	Bank Of New Zealand	3.50	Heartland	2.53
Auckland International Airport	3.76		Works Finance NZ	3.36	Kiwibank	2.21
Kiwibank	3.43		Infratil	3.34	Scales Corp	2.15

*Includes cash holdings.

Fund Commentary

The Income Fund marked time over May with the New Zealand bond market performing well but the equity market falling.

The local bond and equity markets continue to struggle in 2024 with both sectors registering zero to modest gains over the year-to-date.

From a domestic perspective the Reserve Bank's Monetary Policy Statement on May 22 and the delivery of the Government's Budget on May 30 were the two main points of interest.

The RBNZ delivered a warning that it is still considering raising the Official Cash Rate. We do not think this will happen, however the MPS was clearly a shot across the bow of market participants' expectations of an early pivot in the RBNZ's interest rate policy. The RBNZ's forecasts have inflation holding up higher for longer, with inflation not back to 2% until 2026. Consequently, the RBNZ estimates it will need to hold the OCR higher for slightly longer with cuts not implied until around August 2025, about 3 months later than the RBNZ's February forecasts.

The Budget was delivered against a weaker economic backdrop which translated into a softer fiscal outlook, with a delay to the return to surpluses until 2027/28 and a higher debt profile for Crown Debt. The Budget contained a pivot towards tax cuts and discussion around to what extent tax cuts have been paid for by reductions in Government expenditure. The RBNZ will be reviewing the numbers in an attempt to determine the inflationary impacts, if any, of the new Government spending initiatives. Any increase in inflationary pressure will be viewed unfavorably by the RBNZ and could be another reason for the caution on the timing of interest rate cuts.

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. In the short term the direction of the NZ bond and equity markets are likely to be influenced by trends and sentiments in the large offshore markets.

The S&P/NZX 50 Gross (with imputation credits) Index fell by 0.75% over May and is up 0.82% over the year-to-date. There continued to be a wide variance in stock returns over the month with energy companies such as Meridian, Contact and Mercury all benefiting from the renegotiation of the Tiwai point smelter contract on favourable terms. Skellerup, Spark and Investore underperformed as their results disappointed investors.

The bond sector as measured by the Bloomberg NZ Bond Composite Index increased 0.86% and is up a modest 0.07% so far in 2024. Cash and short-term bonds held their value as the Official Cash Rate remained unchanged however longer-term bonds performed well as there are signs that inflation globally is falling, and it is only a matter of when not if central banks start their rate cutting cycle.

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:	\$3m
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

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

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