

Nikko AM NZ Corporate Bond Strategy

Monthly Update 31 May 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 positive month as yields finished slightly lower.
- Credit continues to perform well with issuance volumes down approximately 45% (relative to last year) supporting margin performance.
- 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 good month receiving income accrual plus some capital gain as interest rates moved lower.
- 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.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	1.02%	1.46%	6.10%	1.04%	2.10%	4.32%
Benchmark²	0.75%	1.28%	5.54%	0.82%	1.62%	3.47%
Retail³	0.95%	1.27%	5.36%	0.34%	1.36%	3.51%
KiwiSaver³	0.94%	1.26%	5.27%	0.29%	1.37%	

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).

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.

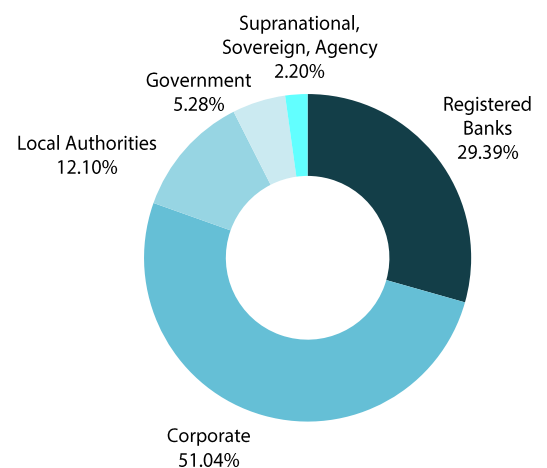
Overview

The strategy aims to 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.

Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
Housing New Zealand Ltd	10.09	AAA	27.46	17.71% of the fund
Kiwibank Ltd	6.44	AA	14.64	Duration
New Zealand Local Govt Funding Agency	6.09	A	29.70	Fund 4.4 years vs Benchmark 2.77 years
Bank of New Zealand	5.90	BBB	28.20	Yield to Maturity*
Westpac New Zealand Ltd	4.69			Fund (gross) 5.81% vs Benchmark 5.5%

*Include cash held by custodian

* Excluding the inflation component of government inflation linked bonds

Market Commentary

It was pleasing to deliver a strong positive month for NZ bonds due to lower interest rates. Interest rates closed last year at low levels (pricing earlier rate cuts in 2024), and this set a difficult starting point to achieve further near-term capital gains from bonds in the first quarter. In terms of attribution, credit holdings continue to perform well benefiting the funds through a higher yield and some margin contraction as demand outweighs supply. Issuance of NZ corporate bonds so far this year is a lot lower than at the same time last year, and there doesn't appear to be much issuance in the pipeline so it makes sense to lock in higher rates for longer with the extra yield of quality credit. Mid-May bond yields were around 20 basis points lower, but they had a steep rise into month end as US rates climbed higher. At month end government yields finished as follows; 2yr -1bp, 5yr -7bps and 10yr -8bps. For comparison swap maturities were 2yr +1bps, 5yr -8bps and 10yr -11bps.

NZ interest rates have been volatile month-on-month, albeit in a moderate range (around +/- 40-50 basis points). A positive is that this has provided opportunities to build a longer duration position at better levels by buying bonds when higher in yield. We do expect better returns from bonds over the medium term, but ultimately, we will need to see the data support a believable lower inflation story for bonds to hold at lower levels. Our plan remains to build a higher yield through quality credit and hopefully participate in further capital gains as rates move lower over the next year. Going forward local data outcomes (in terms of inflation) and offshore bond moves will be the main drivers for the direction of rates. The NZ budget's impact on the market was very muted, with the increase in government borrowing requirements largely expected. The tax rate cuts may be slightly stimulatory in the near term, but they will be funded out of reduced government spend in other areas, and fiscal flexibility remains very limited in terms of achieving targets.

Fund Commentary

The fund had a positive return for May and outperformed the Bloomberg NZ Corporate Bond benchmark.

The move lower in interest rates was the main driver of absolute and relative returns. We continue to extend our duration position on spikes higher in yield. The fund has a moderate long duration with a view that the ultimate direction of rates is lower over the next 12-18 months.

With a supply shortage credit holdings have helped in terms of providing a higher yield while margins have contracted some. We prefer quality credit which is higher yielding than governments and currently has more supportive demand/supply dynamics too. We expect the market pricing/timing of rate cuts to bounce around but given the balance of risk we are happy to lock in higher rates for longer on opportunities.

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:	\$422.7m
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 month.

Contact Us

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