

Nikko AM Global Bond Strategy

Monthly Update 31 July 2024

Assets are held in the Nikko AM NZ Wholesale Global Bond Fund. Nikko AM Global Bond Fund (retail) invests in units in the wholesale fund, which this commentary refers to.

Market Overview

- In the US, benign CPI and PCE inflation data reaffirmed the disinflation trend and the labour market continued to rebalance, while Q2 GDP growth proved resilient.
- The BoC became the first major central bank to implement consecutive rate reductions and signalled more cuts to come.
- Despite the volatility in US politics, including President Biden's withdrawal from the race and his endorsement of Vice President Kamala Harris as the Democrat nominee, market movements in July were mainly influenced by economic and corporate fundamentals as the second-quarter earnings season began.

Fund Highlights

- The fund posted a positive return for the month, outperforming its benchmark.
- Outperformance was driven by our Duration and Cross-Sector strategies, while our Securitized selection strategy detracted from excess returns.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	2.27%	4.54%	7.43%	-1.32%	1.24%	3.41%
Benchmark²	1.97%	3.75%	5.81%	-1.67%	0.20%	2.79%
Retail³	1.75%	3.71%	6.34%	-2.12%	0.41%	2.45%

1. Returns are before tax and before the deduction of fees and including tax credits (if any). Based on actual calendar periods.
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any). Based on change in unit price.

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. The Goldman Sachs Asset Management Global Fixed Income Team managed over US\$690 billion of global fixed income and currency assets (as at 30th September 2022).

Overview

The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

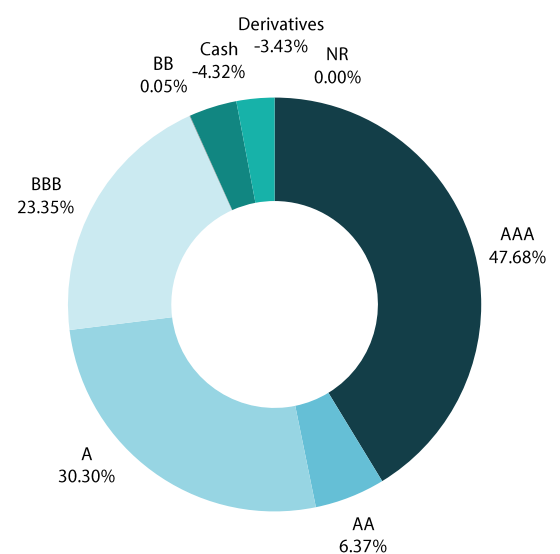
Objective

The strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three-year period.

Five Year Cumulative Performance, \$10,000 invested^{1,2}



Credit Quality



Sector Allocation (% of fund)	Fund	Index	Duration
Governments	21.90%	44.48%	Fund 5.38 years vs Benchmark 6.54 years
Agency	4.80%	7.80%	Yield to Maturity Fund (gross) 5.15% vs Benchmark 5.07%
Collateralised & MBS	48.20%	11.46%	
Credit	28.64%	20.37%	
Emerging market debt	4.21%	15.89%	
Cash, derivatives, other	-7.75%	0.00%	

*Includes deferred settlements

Market Commentary

Macro: Normalizing to a New Normal. In the US, benign CPI and PCE inflation data reaffirmed the disinflation trend and the labour market continued to rebalance, while Q2 GDP growth proved resilient. Collectively, these indicators point towards a normalization from the high inflation, employment, and growth rates seen in the post-pandemic period. However, due to structural changes in the economy, such as a heightened emphasis on supply chain security and sectoral innovation, in part driven by generative AI, we may be entering a 'new normal.' In this new phase, interest rates and inflation are expected to stabilize at higher levels than in the previous cycle, while uncertainty may linger.

Note: Early August data including a downside surprise in the ISM manufacturing survey, upside surprise in initial jobless claims and weaker-than-expected July labour market report illustrates the path to normalization may be bumpy.

Policy: More Cuts, More to Come. The BoC became the first major central bank to implement consecutive rate reductions and signalled more cuts to come. We expect rate reductions at all remaining meetings this year. On the other hand, the ECB maintained its policy but hinted at a potential second reduction in its current easing cycle in September if inflation continues to improve. For investors, the growing trend of central bank rate cuts enhances the attractiveness of fixed income, including sovereign bonds. Indeed, raised prospects of rate cuts saw US Treasuries and European sovereign bonds experience their strongest month of the year in terms of total return. The BoJ is a notable outlier, with prospects of policy normalization resulting in a 7.3% gain in the Japanese yen versus the US dollar in July, the strongest showing in almost two years.

Markets: Focused on Fundamentals. Despite the volatility in US politics, including President Biden's withdrawal from the race and his endorsement of Vice President Kamala Harris as the Democrat nominee, market movements in July were mainly influenced by economic and corporate fundamentals as the second-quarter earnings season began. We anticipate that the potential effects of the US election on credit markets will be specific to individual companies, highlighting the significance of active security selection. The risk premium associated with French assets due to election uncertainty has diminished, although the new Prime Minister's announcement is not expected until after the Olympics end on August 11. While we observe strong fundamentals like low unemployment and robust private sector balance sheets, we remain vigilant for signs of economic slowdown and changes in consumer spending, as well as the potential effects of policy uncertainty as the third quarter progresses.

Fund Commentary

The fund outperformed its benchmark over the month.

Outperformance was driven by our Duration and Cross-Sector strategies, while our Securitized selection strategy detracted from excess returns. Contributions from our Duration strategy were driven by our bias towards US curve steepening. This was driven by the rally at the front end, causing the US yield curve to steepen, with the 2 yr and 10yr maturities spread narrowing by 9bps, its tightest level since January 2024. Our overweight to front-end European rates also contributed, supported by market expectations for a European Central Bank (ECB) rate cut in September alongside the global rates rally. Likewise, our European curve steeper contributed.

Our Cross-Sector strategy also contributed to excess returns. This was driven by our overweight beta to mortgage-backed securities (MBS) and commercial mortgage-backed securities (CMBS). US MBS spreads tightening by 4bps and yields fell by 34bps considering the rates rallied in response to downside surprises to growth and inflation data, supporting fixed income risk asset outperformance as the market began to price in a US policy rate cut by September. Elsewhere, our marginal overweight beta to investment grade (IG) corporate credit also contributed, driven by a similar macro backdrop, as global IG spreads tightened by 2bps.

Lastly, our Securitized selection strategy underperformed. This was driven by our specific selection among non-agency MBS.

Key Fund Facts

Estimated annual fund charges (incl. GST)		Hedging:	All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.	Strategy Launch:	October 2008
Wholesale:	Negotiated outside of the unit price.	Exclusions:	Controversial weapons.	Strategy size:	\$598.9m
Retail:	0.80%, refer to PDS for more details.	Restrictions:	Thermal coal mining and extraction, oil tar sands extraction, tobacco stocks and fossil fuels. 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:	0.00%/0.00%
Distributions:					
Wholesale:	Calendar quarter				
Retail:	Calendar quarter				

Compliance

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

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