

Nikko AM Income Strategy

Monthly Update 31 July 2024

Applies to the Nikko AM Income Fund.

Market Overview

- Over the month the NZX50 (gross with imputation credits) increased 5.87% while the NZ Composite Bond Index advanced 2.31%.
- The NZ economy remains weak and inflation pressures are falling. The June quarter CPI came in slightly below expectations at 0.4%, giving an annual increase of 3.3%.
- The Federal Reserve is also turning more dovish as Governor Powell all but told markets that rate cuts are on the table as early as September if inflation data continues to cool.

Fund Highlights

- The Income Fund surged 2.8% over July as both bond and equity markets performed well as markets anticipated an early start to the RBNZ's rate-cutting cycle.
- There continues to be a wide variance in stock returns with Skellerup, being the standout in the portfolio with a monthly return in excess of 18%. The interest rate sensitive property sector also had a strong boost with Investore Property, Stride advancing and EBOS and Heartland performing strongly.

Distributions

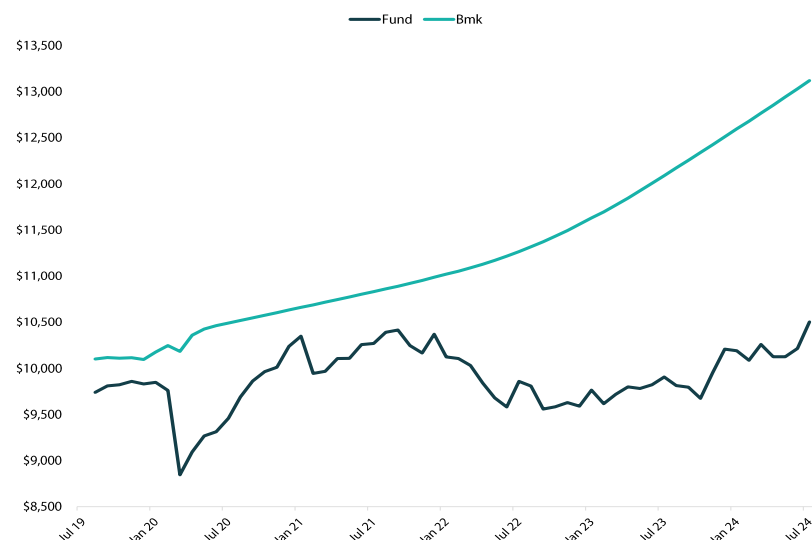
- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point. The defined distribution rate for 2024 is 6.5%. This income will be distributed in four equal amounts each calendar 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	2.81%	3.73%	6.03%	0.75%	0.99%	3.23%
Benchmark²	0.70%	2.08%	8.52%	6.60%	5.58%	6.10%
Market Index³	3.45%	3.86%	6.97%	1.42%		

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: 65% Bloomberg NZBond Credit 0+ Yr Index, 35% S&P/NZX 50 Gross Index.

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.



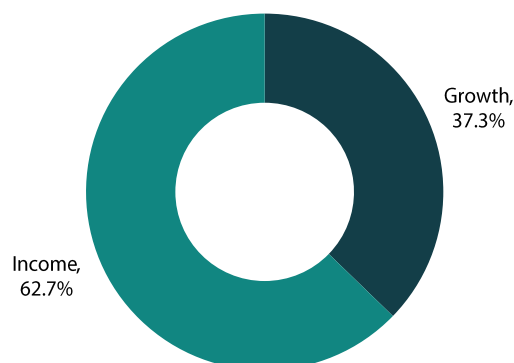
Overview

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	8.07	Fund 3.87 years	Infratil	3.59	Meridian Energy	2.70
ANZ Bank New Zealand	6.89	Yield to Maturity	Bank Of New Zealand	3.23	Spark New Zealand	2.61
Powerco	5.03	Fund (gross) 5.46%	Works Finance NZ	3.12	Heartland	2.44
Kiwi Property	4.14		Chorus	3.08	Skellerup	2.35
Auckland International Airport	3.59		Contact Energy	2.70	Kiwibank	2.06

*Includes cash holdings.

Fund Commentary

The Income Fund surged 2.8% over July as both bond and equity markets performed well as markets anticipated an early start to the RBNZ's rate-cutting cycle. Over the month the NZX50 (gross with imputation credits) increased 5.87% while the NZ Composite Bond Index advanced 2.31%. Cash provided a steady return of around 0.5%.

Markets continue to focus on the words and actions of the Reserve Bank of NZ and other central banks such as the influential US Federal Reserve for signs of when and by how much cash rates will cut.

The NZ economy remains weak and inflation pressures are falling. The June quarter CPI came in slightly below expectations at 0.4%, giving an annual increase of 3.3%. When the large 1.8% September 2023 increase is replaced by a much more modest number later this year, CPI inflation should be within the RBNZ's speed limit of between 1% and 3% before quickly heading to the 2% mid-point.

The RBNZ is releasing their next Monetary Policy Statement on the 14th of August. We expect this statement and the analysis accompanying it will set the scene for rate cuts to occur much earlier than the previous MPS indicated back in May. Market's expectations are high that the RBNZ will have a dovish pivot and all future RBNZ meeting dates can be considered "live" for rate cuts to occur. By way of example markets are expecting NZ's cash rate to be around 2% lower than current levels in a year's time.

The Federal Reserve is also turning more dovish as Governor Powell all but told markets that rate cuts are on the table as early as September if inflation data continues to cool. If the Fed does move it probably increases the likelihood of the RBNZ moving soon after. Equity markets also seem to be taking the lead from interest rate markets with a downward trajectory of interest rates lifting the spirits of equity investors.

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 however, the direction of the NZ bond and equity markets are likely to be influenced by trends and sentiments in the large offshore markets. We are also aware that large falls in cash rates are already priced into markets so any disappointment could see some retracement in prices/yields however if this does occur it could represent a good buying opportunity.

The S&P/NZX 50 Gross (with imputation credits) Index increased by 5.87% over July. There continues to be a wide variance in stock returns with Skellerup, being the standout in the portfolio with a monthly return in excess of 18%. The interest rate sensitive property sector also had a strong boost with Investore Property, Stride advancing and EBOS and Heartland performing strongly. On the negative side Contact Energy and Infratil saw their share price fall.

The bond sector as measured by the Bloomberg NZ Bond Composite Index increased 2.31%. Longer term bonds were the best performing part of the fixed income sector. Bonds have performed well recently as signs that inflation pressures globally and locally are decreasing and it is only a matter of "when", not "if", more 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:	\$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

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

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