

Nikko AM NZ Cash Strategy

Monthly Update 31 July 2024

Assets are held in the Nikko AM Wholesale NZ Cash Fund. The Nikko AM NZ Cash Fund (retail) and Nikko AM KiwiSaver Scheme NZ Cash Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- The Reserve Bank surprised with an intentional change in tone in their May MPR moving towards an easing bias.
- In response to the RB's perceived pivot interest rates sharply fell - 90-day bills ended the month down 17.5bps to 5.455% whilst 1-year swap was down an impressive 58.5bps to 4.795%.
- Second quarter CPI came in at +0.4% for the quarter bringing annual inflation down to 3.3%, tantalizing close to the RB's target reinforcing the markets repricing of future OCR levels.

Fund Highlights

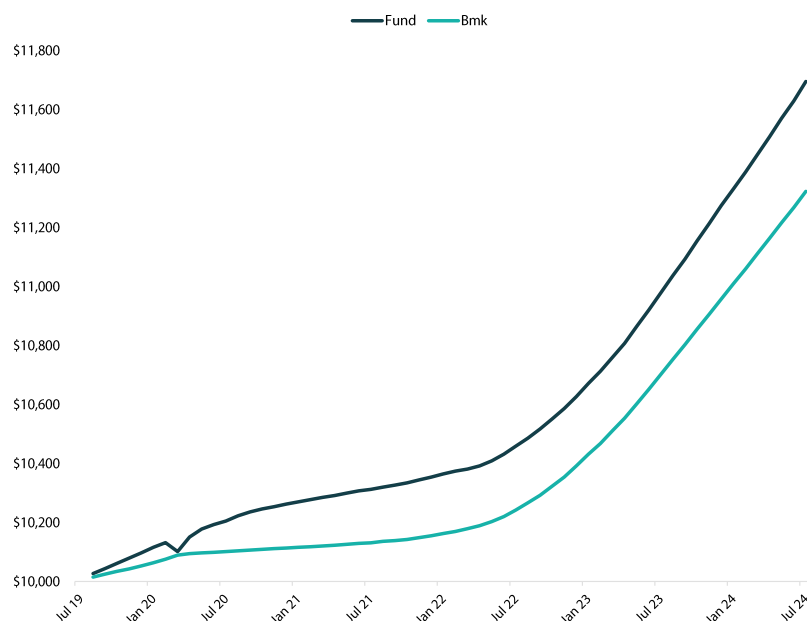
- The fund holds a longer than benchmark duration position reflecting a view that the RB's hiking cycle is complete.
- We are looking to maintain a long duration position, however this may be tempered should markets price cuts at a too rapid pace.
- Credit quality remains high and is expected to perform well in the face of a recession.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	0.57%	1.63%	6.53%	4.28%	3.18%	3.27%
Benchmark²	0.49%	1.43%	5.80%	3.78%	2.52%	2.51%
Retail³	0.59%	1.56%	6.23%	3.99%	2.87%	2.94%
KiwiSaver³	0.58%	1.54%	6.20%	3.88%	2.77%	

1. Returns are before tax and before the deduction of fees and including tax credits (if any).
2. Benchmark: Bloomberg NZBond Bank Bill 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.

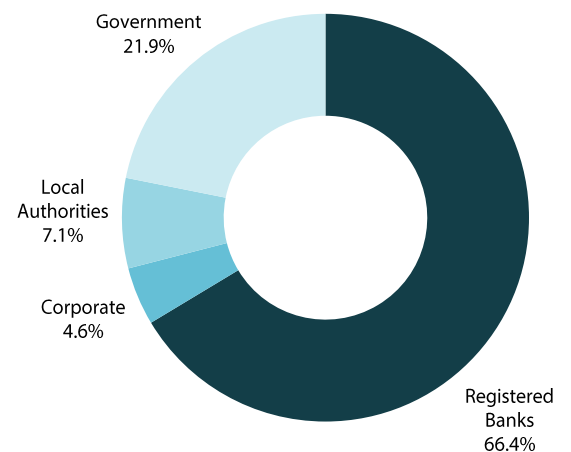
Overview

The strategy aims to generate income by constructing an actively managed investment portfolio of short-term deposits and bonds whilst preserving capital value.

Objective

The fund aims to outperform the benchmark return by 0.20% per annum before fees, expenses and taxes over a rolling three-year period.

Sector Allocation



Top 5 Issuers	(%)	Credit Rating	(%)	Duration
NZ Tax Trading Co	11.90	AAA	25.36	Fund 84 days vs Benchmark 45 days
Westpac New Zealand	11.26	AA	29.45	Portfolio Yield (YTM with FRN yield to next reset date) Fund (gross) 6.15% vs Benchmark 5.50%
Tax Management NZ	9.96	A	45.20	
Kiwibank	9.19			
Cooperatieve Rabo U.A.	9.12			

Market Commentary

July was an eventful month for fixed interest with a strong rally occurring in response to the Reserve Bank's perceived pivot at their Monetary Policy Review. Over the month 90-day bills fell 17.5bps to 5.455%, 6-month bills fell 35bps to 5.27% whilst 1-year swap fell a remarkable 58.5bps to 4.795%.

Prior to the MPR release, market expectations were firmly for a 'no change' decision with perhaps an element of softening in stance from May's hawkish MPS given on-going weakness in data. The former was delivered upon as expected, however, rather than a mild softening in stance the RB surprised markets with statements that suggest it now has a clear easing bias.

There were four key items in the MPR and its minutes:

1. Unlike in May, hikes were not discussed.
2. The RB explicitly observed that monetary policy was "reducing domestic demand and consumer price inflation".
3. The minutes expressed "confidence" that inflation would return to "its 1-3 percent target range over the second half of 2024".
4. The RB stated that policy settings "will" need to "be tempered over time consistent with the expected decline in inflation pressures". This is perhaps the most interesting statement in its use of the affirmative "will" and the conditional proviso "with the expected".

In aggregate these items clearly show the RB has moved to a data dependent easing bias – or in other words, should inflation continue to fall, monetary policy settings will be loosened.

Second quarter CPI came out later in the month, post the RB's MPR, at +0.4% for the quarter taking headline annual inflation to 3.3%, tantalizing close to the RB's target. Conversely, non-tradable inflation continues to be elevated, printing at +0.9% for the quarter resulting in an annual number of 5.4%. The RB has been very focused on non-tradables, however we should note that (1) it is declining, albeit at a slower pace than desired, (2) part of the reason for its elevated level relates to items the RB has little influence over such as "insurance", "property rates and related services" and "rents" and (3) the RB's mandate is headline CPI, not non tradables. Despite this sticky and high non-tradables number we expect the RB is comfortable with how CPI inflation is developing with a downward trajectory. This likely lays the foundation for a continued data dependent softening in its stance with OCR cuts to likely commence in October or November this year.

Fund Commentary

The fund performed well in July returning 0.57% outperforming its benchmark the 90-day Bank Bill Index which returned 0.49%. Over the month, in response to the Reserve Bank's perceived pivot at their MPR 90-day bills fell 17.5bps to 5.455%, 6-month bills fell 35bps to 5.27% whilst 1-year swap fell a remarkable 58.5bps to 4.795%.

The fund's duration position ended the month at 84 days, 39 days longer than benchmark. This long duration position positively contributed to performance over July - most notably for the 16% of positions with maturities of 6-months or longer. As we look forward, we have a market with high expectations for deep and rapid cuts. Market pricing implies an expectation of a remarkable 175 points in cuts over the coming year or 25 points at each of the RB's seven meetings over this period. We do not disagree with the sentiment that the RB will soon begin easing, however the pace at which cuts are being assumed reads a lot into the RB's short format MPR. The RB's next OCR review takes the format of a detailed monetary policy statement on the 14th of August. This will allow them to clarify and expand on their position and shift to an easing bias.

We will continue to look for opportunities to maintain and add duration positions on any backups in yield however remain cautious given markets high expectations for OCR cuts. The pending MPS will provide clarity for market pricing, risks exist that cuts could be slower than implied by pricing.

Key Fund Facts

Distributions Wholesale: Calendar quarter Retail: Calendar quarter KiwiSaver: Does not distribute Estimated annual fund changes (incl. GST) Wholesale: Negotiated outside of unit price Retail: 0.30%, refer PDS for more details KiwiSaver: 0.30%, refer PDS for more details	Hedging: All investments will be in New Zealand dollars 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: October 2007 Strategy size: \$1,092m Buy / Sell spread: 0.00% / 0.00%
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Compliance

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

Contact Us

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