

# Nikko AM NZ Bond Strategy

Monthly Update 31 August 2024

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

## Market Overview

- NZ bonds had a strong month with returns a combination of the monthly accrual plus some capital gains.
- Credit and NZ government bonds remain opposed in terms of supply/demand dynamics with a shortage of credit and increased supply of government bonds.
- There is now a lot priced in terms of rate cut expectations, and there is some risk the market could be disappointed in the near term, but we expect rates could move lower over the medium term.

## Fund Highlights

- The fund had a strong month and performed close to its benchmark.
- We have maintained a longer duration position as the yield curve has become more positive in shape and rates may fall further as the RBNZ cuts.
- Credit margins remain tight, but we don't expect a catalyst for change in the near term and like the higher yield of quality credit.

## Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
<b>Wholesale<sup>1</sup></b>	0.86%	5.10%	10.65%	1.25%	1.14%	3.93%
<b>Benchmark<sup>2</sup></b>	0.91%	4.25%	9.02%	0.08%	-0.07%	2.83%
<b>Retail<sup>3</sup></b>	0.80%	4.93%	9.96%	0.61%	0.48%	3.17%

1. Returns are before tax and before the deduction of fees and including tax credits (if any).
2. Current benchmark: Bloomberg NZBond Composite 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<sup>1,2</sup>



## 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.

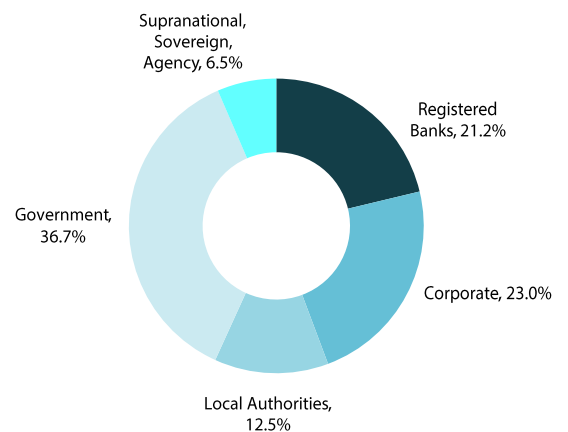
## Overview

The fund aims to provide investors with regular 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 0.60% 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
New Zealand Local Govt Funding Agency	7.22	AAA	58.64	21.45% of the fund
Housing New Zealand	6.49	AA	11.12	<b>Duration</b>
Kiwibank	4.92	A	26.50	Fund 6.17 years vs Benchmark 4.79 years
Auckland International Airport	3.94	BBB	3.73	<b>Yield to Maturity*</b>
Bank of New Zealand	3.47			Fund (gross) 4.63% vs Benchmark 4.25%

\* Excludes NZ central government

\* Excluding the inflation component of government inflation linked bonds

## Market Commentary

The NZ bond funds had a positive month as the monthly income was bolstered by a moderate fall in interest rates. All bond sectors performed well. Credit holdings continue to benefit returns through a higher yield. NZ government bonds and swap moved lower in yield, with governments performing slightly better for longer maturities. At month end government yields finished as follows; 2yr -24bps, 5yr -16bps, 10yr -8bps and 30yr -8bps. For comparison swap maturities were 2yr -29bps, 5yr -14bps, 10yr -6bps and 30yr -1bps.

The big news locally was the RBNZ providing a more negative outlook on the economy with reduced inflation expectations, and finally cutting interest rates. Subsequently the yield curve has continued to become more positive shaped with larger falls in shorter maturity bonds. Bond returns have been strong with rates declining over the past months and there is a lot priced in terms of expectations for cuts, particularly in the front of the yield curve. For example, the 5-year swap rate has fallen since the end of May from approximately 4.7% to 3.75%. If a major NZ bank was to issue a new 5-year bond, we expect the credit margin would be around 80-90 bps which would give a total yield around 4.60%.

We think the NZ economy has slowed significantly and there is the possibility of a 50 bps rate cut, rather than the RBNZ forecast 25bp increments, but the magnitude and timing of cuts will remain tied to the inflation and economic data going forward.

The good news is we think there is the potential for further moderate moves lower in longer maturity bonds as investors search for yield in a lower rate environment, but we expect this could take some time to play out. Credit should remain supported with very limited supply available, and NZ Government bonds are looking more attractive with their margins wide above swap rates and a steep curve for longer maturities. The fund remains positioned longer duration than benchmark, and we have been investing to maintain a higher yield and hopefully participate in further capital gains.

## Fund Commentary

The fund had a strong absolute return for August and performed close to the Bloomberg NZ Composite benchmark. The return was a combination of the monthly yield accrual plus some moderate capital gains as rates moved lower. Credit holdings continue to provide benefit through a higher yield and the longer duration position also helped.

We continue to position the fund to maintain a higher yield and long duration versus the benchmark with the expectation that longer maturity bonds will look more attractive as the RBNZ cuts rates and investors seek yield.

## Key Fund Facts

<b>Distributions</b>		<b>Hedging:</b>	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%	<b>Strategy Launch:</b>	October 2007
<b>Wholesale:</b>	Calendar quarter	<b>Exclusions:</b>	Controversial weapons	<b>Strategy size:</b>	\$608.5m
<b>Retail:</b>	Calendar quarter	<b>Restrictions:</b>	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 <a href="https://www.nikkoam.co.nz/invest/retail">https://www.nikkoam.co.nz/invest/retail</a> .	<b>Buy / Sell spread:</b>	<a href="#">Click to view</a>
<b>Estimated annual fund changes (incl. GST)</b>					
<b>Wholesale:</b>	Negotiated outside of unit price				
<b>Retail:</b>	0.65%, refer PDS for more details				

## Compliance

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

## Contact Us

[www.nikkoam.co.nz](http://www.nikkoam.co.nz) | [nzenquiries@nikkoam.com](mailto:nzenquiries@nikkoam.com)

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