

Nikko AM Global Bond Strategy

Monthly Update 30 September 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

- Monetary easing gained traction in September as the long-awaited US Federal Reserve (Fed) joined six other developed market (DM) peers in easing monetary policy with a 0.5% rate cut.
- The People's Bank of China and regulators announced a comprehensive policy stimulus package.

Fund Highlights

- The portfolio outperformed its benchmark over the third quarter.
- Outperformance was driven by our Duration and Cross-Sector strategies, while our Emerging Market Debt (EMD) 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	1.24%	4.65%	12.06%	-0.23%	1.32%	3.52%
Benchmark²	1.14%	4.22%	10.20%	-0.57%	0.29%	2.86%
Retail³	1.18%	4.45%	11.68%	-0.94%	0.56%	2.62%

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.

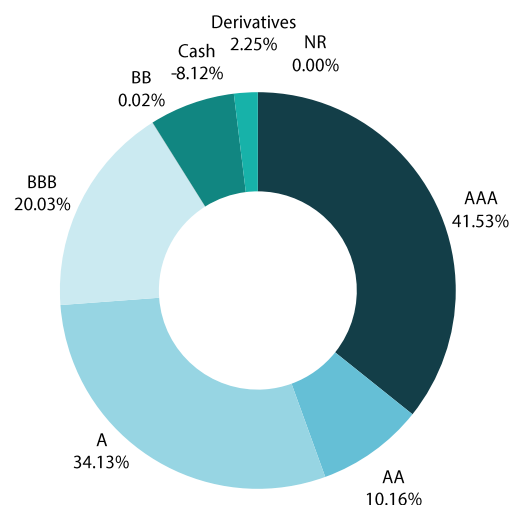
Objective

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
Governments	30.56%	44.59%
Agency	4.04%	7.82%
Collateralised & MBS	42.61%	11.23%
Credit	24.60%	20.33%
Emerging market debt	4.07%	16.03%
Cash, derivatives, other	-5.88%	0.00%

*Includes deferred settlements

Duration
Fund 6.18 years vs Benchmark 6.55 years
Yield to Maturity
Fund (gross) 5.00% vs Benchmark 4.65%

Market Commentary

Monetary easing gained traction in September as the long-awaited US Federal Reserve (Fed) joined six other developed market (DM) peers in easing monetary policy with a 0.5% rate cut. The move signalled their responsiveness to labour market weaknesses and aim to secure a soft landing for the economy. Similarly citing progress on disinflation, the European Central Bank (ECB) cut its deposit rate by 25bps. The Bank of England (BoE), however, maintained the Bank Rate at 5%, signalling a gradual approach to removing policy restraint, absent a significant shift in the macro backdrop. The Bank of Japan also maintained its policy rate at 0.25% and kept its assessment of economic activity and prices largely unchanged from the July Outlook Report. Central banks in Sweden and Switzerland took cues from the Fed, also lowering policy rates over September.

There is no one-size-fits-all approach to current central bank cycles, which creates relative value interest rate opportunities. We are overweight in markets where central banks are easing or expected to ease more than currently priced based on inflation dynamics. This includes the US, Canada, and the UK. Conversely, we are underweight interest rates from economies where central banks are unlikely to ease this year, such as Australia, or where the central bank is raising rates, such as Japan.

Moreover, the People's Bank of China and regulators announced a comprehensive policy stimulus package. This included a 0.5% reduction in mortgage rates, lower downpayment requirements for second home purchases, and increased liquidity provision to support lending. The measures aim to stabilize the equity market and the property sector. In addition, the Politburo, comprised of principal policymakers, convened for an unscheduled meeting and pledged forthcoming fiscal and additional monetary support to further stabilize the property market.

Central bank easing and stimulus announcements in China supported risk assets across the board. Broadly, sound economic and corporate fundamentals, coupled with a Fed that is committed to extending the economic expansion, allows investors to earn attractive income across fixed income spread sectors like corporate and securitized credit. We are particularly constructive on securitized credit given attractive valuations and firm underlying fundamentals. Indeed, the return of yield allows bonds to fulfil their strategic role as a source of income but also diversification and protection against downside growth risks. With downside growth risks dominating upside inflation risks, and fixed income spreads being tight, we believe it is prudent to balance a portion of our spread exposure with interest rates to cushion any potential spread widening on weak growth or labour market data.

Fund Commentary

The portfolio outperformed its benchmark over the third quarter. This was driven by our Duration and Cross-Sector strategies, while our Emerging Market Debt (EMD) selection strategy detracted from excess returns.

Contributions from our Duration strategy were driven by our US and European curve steepener positions. Front-end US rates fell by over 100bps over the period, driven by market expectations for Fed rate cuts throughout the quarter. The US rates rally was exacerbated at the beginning of August following a weaker-than-expected US labour market data, raising fears of a US recession and prompting investors to anticipate a faster pace of Fed rate cuts. In addition to the ECB's rate cut, weaker data over the quarter led markets to increasingly price a faster pace of ECB rate cuts, also supporting our position. Our Cross-Sector strategy also contributed to returns. This was driven by our sector overweight to mortgage-backed securities (MBS) and commercial mortgage-backed securities (CMBS). Sound economic data (indicating the US economy was poised for a soft landing), market anticipation for US Federal Reserve easing, and solid credit fundamentals supported spread sectors over the quarter. US MBS spreads tightened by 11bps. Our overweight beta to corporate credit also contributed, with US investment grade (IG) spreads narrowing to their seventh percentile (all time tight) over the period, supported by a benign macro backdrop, strong fundamentals and firm investor demand.

Underperformance of our EMD selection strategy was driven by our position on local China rates. Specially, this was due to our underweight position on China Policy Bank versus overweight China government bonds. Our position detracted as China Policy Bank spreads tightened versus government bonds amid People's Bank of China (PBOC) policy easing.

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. 0.80%, refer to PDS for more details.	Exclusions:	Controversial weapons.	Strategy size:	\$693.3m
Retail:		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 .	
Distributions:					
Wholesale:	Calendar quarter				
Retail:	Calendar quarter				

Compliance

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

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