Nikko AM NZ Bond Strategy

Monthly Update 30 September 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

- The swap curve bull steepened with short term rates falling by more than long term rates in anticipation of rapid and deep cuts from the RBNZ.
- Government bonds underperformed swap with the governments ongoing large and possibly increasing issuance program continuing to place pressure on yields to attract investors.
- The Federal Reserve opened its easing cycle with an aggressive 50bps cut, markets viewed this as increasing the probability the RBNZ may also take a more aggressive stance to easing.

Fund Highlights

- With rates falling the fund continues to benefit from its long duration position.
- Government bonds underperformed credit with this most notable for longer dated government bonds where yield increased over the month.
- After a long period of limited issuance, issuance resumed in September creating opportunities to undertake relative value trades.

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.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	0.70%	4.43%	13.38%	1.75%	1.33%	3.96%
Benchmark[2]	0.63%	3.89%	11.29%	0.58%	0.06%	2.89%
Retail[3]	0.64%	4.30%	12.66%	1.11%	0.66%	3.21%

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).

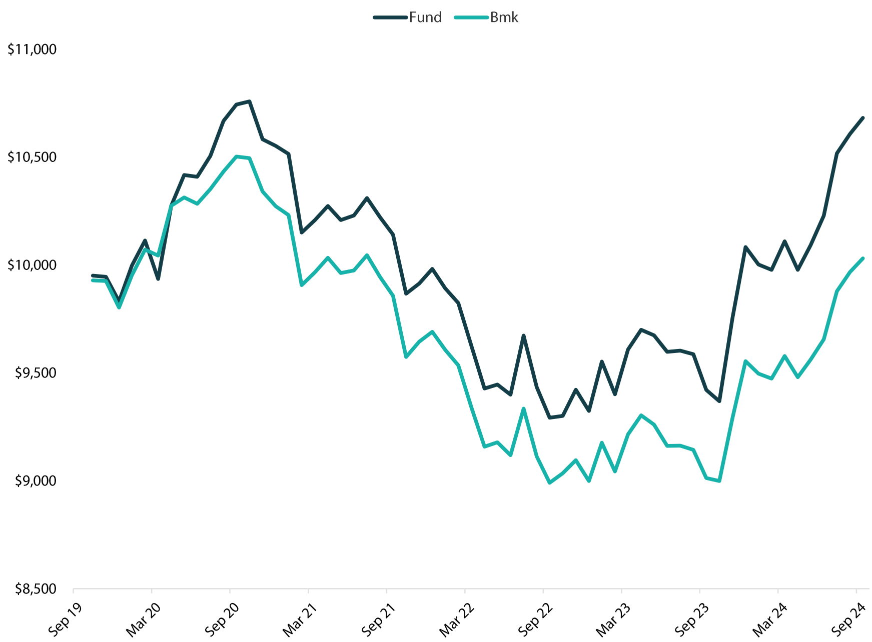
Overview

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.

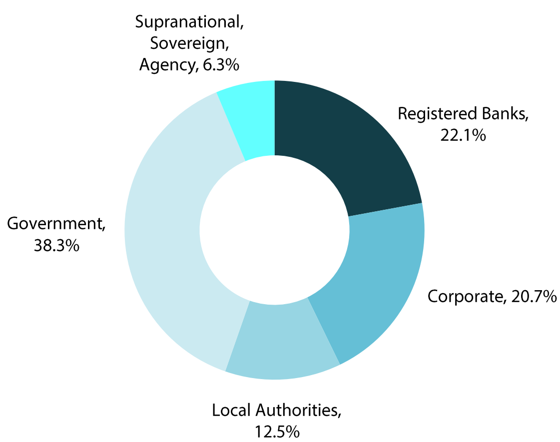
Objective

The fund aims to outperform the benchmark return by 0.60% per annum before fees, expenses and taxes over a rolling three-year period.

Five Year Cumulative Performance, $10,000 invested[1,2]



Sector Allocation



Top 5 Corporate Issuers*	(%)
New Zealand Local Govt Funding Agency	7.46
Housing New Zealand	6.16
Westpac New Zealand	5.61
Kiwibank	4.68
Auckland International Airport	3.06

* Excludes NZ central government

Credit Quality	(%)
AAA	59.87
AA	12.79
A	23.74
BBB	3.60

Green, sustainable and social bonds
20.65% of the fund
Duration
Fund 6.17 years vs Benchmark 4.83 years
Yield to Maturity*
Fund (gross) 4.50% vs Benchmark 4.12%

* Excluding the inflation component of government inflation linked bonds

Market Commentary

Interest rates fell with the Fed starting its easing cycle with gusto, reducing its funds rate by 50bps. Whilst the Fed cautioned that the larger than standard opening cut was not necessarily a harbinger of the pace and level of cuts to come, markets nevertheless viewed this positively reducing interest rates across the curve. Domestic inferences were rapidly drawn with the consensus being that the Fed easing by 50bp increased the probability the RBNZ could do likewise, particularly if they were already that way inclined.

Considering these expectations, markets priced for the RBNZ to undertake a faster and deeper easing program than previously assumed with some 90bps of easing priced by year end and a terminal OCR level below 3%. In a similar vein most bank economists echoed this view updating their OCR calls to 50bps cuts for October and November.

Bonds rallied with swap rates falling as follows: 2-year down 35bps, 5-year down 18bps, 10-year down 10bps and 15-year down 7bps. Government bonds with maturities 10-years and under also rallied, however continue to underperform swap with the government's issuance overhang placing upward pressure on yields. Falls in reference government bond rates follow: 2-year down 27bps, 5-year down 11bps, 10-year down 2.5bps and 15-year up 4.5bps

As we stand at the end of the month, markets are finely balanced. The Reserve Bank next meets for a short-form Monetary Policy Review (MPR) on 9 October. With expectations for accelerated cuts very high the potential for volatility exists, especially with the limited communication bandwidth of an MPR a statement typically of only several hundred words with no economic forecast updates. The fund continues to be positioned for further interest rate falls; however, we are becoming increasingly cautious and see the potential for markets to be disappointed.

Fund Commentary

The fund returned 4.43% over the quarter, outperforming its benchmark the Bloomberg Composite which returned 3.89% by 0.54%.

Performance in the September quarter was primarily driven by a dovish shift by the RBNZ and other global central banks. This pivot from a higher for longer inflation fighting stance to one of ongoing easing resulted in a strong rally with interest rates down across the curve. Over the quarter swap rates were down: 137bps at 2-year, 89bps at 5-year and 60bps at 10-Year. Similarly NZGBs were down 105bps at 2-year, 76bps at 5-year and 42bps at 10-year.

The fund has held a long duration position in the range of 1.3 to 1.4 years longer than benchmark over the quarter. This strongly contributed to its outperformance. Of additional note in the above interest rate numbers is that swap significantly outperformed governments – this also strongly contributed to performance as the fund holds a large underweight to the government sector.

Whilst over the prior quarter duration was a strong driver of performance, as we move forward we expect smaller gains from this factor. Pleasingly as the RBNZ delivers on its expected easing program, we expect the return of a normal upward sloping yield curve which will provide the fund with opportunity to execute a carry and roll strategy which should positively contribute to future returns.

Key Fund Facts

Distributions	
Wholesale: **Retail:**	Calendar quarter Calendar quarter
Estimated annual fund changes (incl. GST)	
Wholesale: **Retail:**	Negotiated outside of unit price 0.65%, refer PDS for more details

Hedging:	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%
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:	$644.8m
Buy / Sell spread:	Click to view

Compliance

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

Contact Us

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