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Nikko Asset Management

YOUR GOALS,
OUR COMMITMENT.

Nikko AM NZ Cash Strategy

Monthly Update 30 September 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 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.
- Markets increased bets that the RBNZ may use 50bps cuts in October and November, cumulatively pricing 90bps of cuts over these two meetings.
- Interest rates fell in sympathy with the idea the RBNZ may cut faster than forecast. 90-day bills fell 36bps to 4.87%, 6-month bills fell 34bps to 4.61% and 1-year swap fell 42bps to 4.07%.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting our view that a prolonged easing cycle has started.
- The fund has a long duration position, however also holds meaningful positions 3-months and shorter to protect the fund should the RBNZ stick to its August MPS guidance and cut at a more measured pace.
- Credit quality remains high and is expected to perform well in the face of a recession.

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]	0.51%	1.61%	6.52%	4.60%	3.30%	3.30%
Benchmark[2]	0.45%	1.42%	5.79%	4.07%	2.66%	2.54%
Retail[3]	0.49%	1.57%	6.22%	4.29%	2.99%	2.96%
KiwiSaver[3]	0.49%	1.56%	6.20%	4.19%	2.88%	

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).

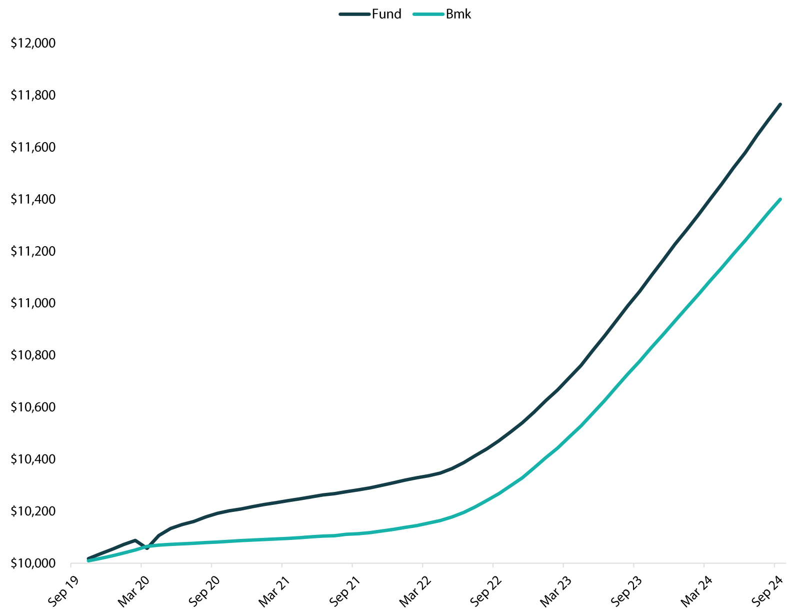
Overview

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

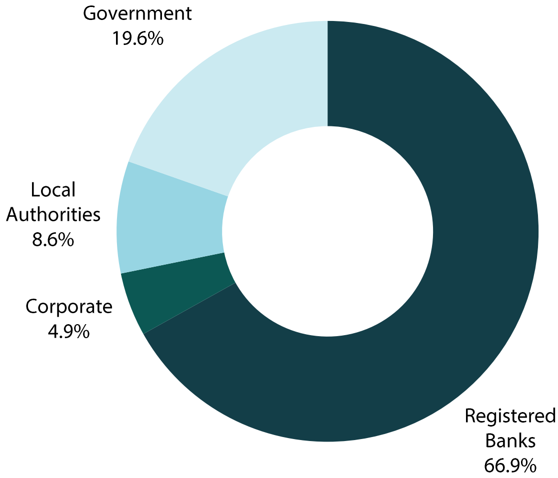
Objective

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

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



Sector Allocation



Top 5 Issuers	(%)
Westpac New Zealand	10.91
Bank of New Zealand	9.94
Tax Management NZ	9.91
NZ Tax Trading Co	9.71
Rabo Bank	8.37

Credit Rating	(%)
AAA	24.99
AA	33.23
A	41.78

Duration
Fund 86 days vs Benchmark 45 days
Portfolio Yield (YTM with FRN yield to next reset date)
Fund (gross) 5.79% vs Benchmark 5.03%

Market Commentary

September was a month of declining rates primarily driven by the Fed opening its easing cycle with an aggressive 50bps cut and supported by ongoing weakness in New Zealand's domestic data. The Fed starting their easing cycle was widely expected, however, somewhat surprisingly they used a larger than standard 50bps cut - a move historically used in periods of crisis. Prior to September's decision, an opening cut of 50bps or more has only been used on three prior occasions:

- 50bps for the Global Financial Crisis for 2007
- 100bps for the Dotcom recession of 2001
- 150bps for the Covid pandemic in 2020

A set of markets that looked remarkably more stressed than what we observe in the US today. Perhaps in a nod to this dissonance the Fed cautioned markets against assuming the 50bps move sets a precedent for the easing cycle with Powell stating "I do not think that anyone should look at this and say, oh, this is the new pace". In a similar vein the FOMC raised its estimate of the longer run Feds funds estimate to 2.875% (previously 2.75%) with Powel noting that "he feels that the neutral interest rate is higher than it was previously, but he does not know how high as yet" and that we are "not going back to the era where there were trillions of dollars of sovereign bonds trading at negative rates".

As to implications for the RBNZ, the Fed moving by 50bps makes it easier for the RBNZ to do likewise. New Zealand's economy is in a significantly worse state than the US and arguably needs more supportive monetary policy settings. This however does not make a 50bps cut a certainty, one should note the Feds caution and that the RBNZ's August Monetary Policy Statement delivered only 7 weeks ago did not guide for 50bps cuts absent further deterioration in data. Nonetheless New Zealand's rates markets have taken to pricing aggressive cuts with abandon, pricing with some 90bps of easing by year end and a cash rate below 3% in a year's time. Whilst we thoroughly agree that the OCR is coming down, we are cautious and see potential for the market to be disappointed with the pace at which cuts are delivered.

Fund Commentary

The fund performed well in the September quarter returning 1.61% outperforming its benchmark the 90-day Bank Bill Index which returned 1.42%. Over quarter interest rates meaningfully fell, primarily driven the RBNZ pivoting to easing in August and the Fed opening its easing cycle with an aggressive 50bps cut in September. Further contributing to these falls were a set of weak economic data showing declining inflation and inflation expectations along with ongoing weak growth and labour market statistics. 90-day bills fell 76bps to 4.87%, 6-month bills fell 101bps to 4.61% and 1-year swap fell a remarkable 130bps to 4.07%. Correspondingly the fund's long duration position positively contributed to performance.

Whilst long duration has been a positive contributor, we are cautious as to its future performance. Markets have rapidly increased bets around the pace and magnitude of cuts. As of September month-end some 89bps of cuts are priced for 2024, whilst a sub 3% OCR is priced one year ahead. By comparison at the end of June markets were expecting a year end OCR of ~5.2% only 6bps below todays level. Likewise, the RBNZ's August MPS delivered only 7 weeks ago guides for an OCR average over the quarter of 4.9% for 4Q24 and one of 3.8% for 4Q25, both well above market pricing. Whilst we thoroughly agree that the OCR is coming down, we are cautious and see potential for the market to be disappointed with the pace at which cuts are delivered. In light of this whilst we continue to expect to hold a long duration position, we see risk mitigating value in holding sub 3-month positions and floating notes.

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:	$1,202m
Buy / Sell spread:	0.00% / 0.00%

Compliance

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

Contact Us

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