

# Nikko AM NZ Bond Strategy

Monthly Update 31 October 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

- Bond returns were negative although the local market outperformed offshore bond markets.
- The yield curve steepened in shape over October as short-term rates followed the cash rate lower and long-term rates followed offshore bonds higher.
- Credit market movements continue to remain relatively benign with NZ margins slightly tight.

## Fund Highlights

- The longer duration position was unhelpful as interest rates moved higher and longer maturity bonds underperformed.
- There was a reasonable amount of new bond issuance over the month. We continue to add quality credit to maintain a higher yield.
- We expect the funds will continue to perform well over the medium term as the cash rate continues lower and carry and roll makes a larger contribution to returns with a positive shaped yield curve

## 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>	-0.96%	0.59%	12.93%	2.35%	1.23%	3.74%
<b>Benchmark<sup>2</sup></b>	-0.51%	1.03%	10.91%	1.40%	0.10%	2.73%
<b>Retail<sup>3</sup></b>	-1.01%	0.42%	12.17%	1.71%	0.57%	3.00%

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).

## 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.

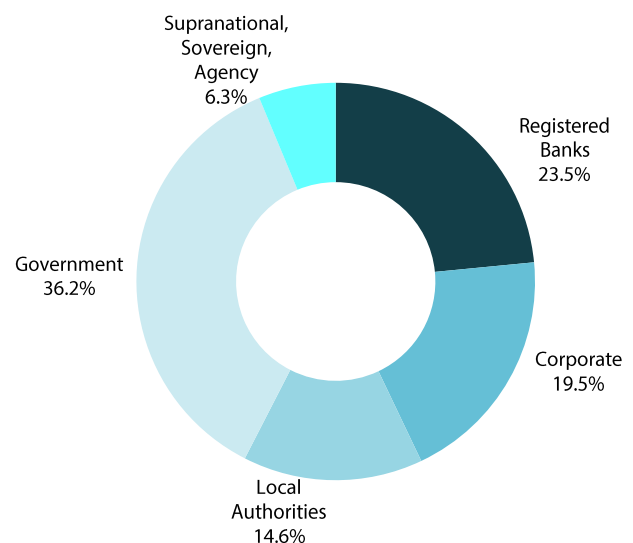
## Objective

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

## Five Year Cumulative Performance, \$10,000 invested<sup>1,2</sup>



## Sector Allocation



Top 5 Corporate Issuers*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
New Zealand Local Govt Funding Agency	6.16	AAA	56.12	21.29% of the fund
Housing New Zealand	6.00	AA	17.71	<b>Duration</b>
Westpac New Zealand	5.38	A	22.12	Fund 6.04 years vs Benchmark 4.75 years
Dunedin City Treasury	4.91	BBB	4.05	<b>Yield to Maturity*</b>
Kiwibank	4.57			Fund (gross) 4.71% vs Benchmark 4.23%

\* Excludes NZ central government

\* Excluding the inflation component of government inflation linked bonds

## Market Commentary

Returns for NZ bonds were negative in October although the NZ bond market performed better than global bonds supported by a weaker economic, and lower rates outlook. Offshore bond markets dragged NZ rates higher with the US 10-year bond moving around 0.5% higher pre-election, pricing a greater chance of a Trump victory. Over the month the key driver of returns was the move in interest rates which resulted in a steepening of the yield curve with 1 and 2-year rates lower and longer bonds higher in yield. This didn't suit our longer duration positioning as we hold a higher weighting to longer maturity bonds which underperformed.

Across NZ bond sectors credit and NZ governments were the better performers, with swaps underperforming as they had larger moves higher in yield. NZ credit continues to perform well with margins remaining steady, and slightly on the tight side despite a reasonable amount of bond issuance over the month. Interest rate moves for NZ government bonds were 1yr -30bps, 5yr +21bps, 10yr+23bps, and the 2054 bond +14.5bps. NZ Swap rates were 1yr -15bps, 5 yr+22, 10yr +30bps, and 30yr+33bps.

In terms of portfolio positioning the RBNZ has reduced the cash rate faster than initially expected and closer to market expectations, (another 50bps reduction is expected in November). This resulted in larger falls in shorter bond maturities out to 5 years and subsequently a steeper yield curve with longer maturities underperforming. On a positive note, as the cash rate is cut lower towards neutral around 3.5-3.0% we think longer term bond rates can outperform, although we note their direction is more heavily influenced by offshore rates. We continue to like quality credit to maintain a higher yield and expect that carry and roll will make a larger contribution to returns going forward with the yield curve more positive in shape. NZ government bonds have remained cheap relative to swap rates because of higher supply and where appropriate we are increasing the portfolio weighting to governments with the view that they will likely outperform swap product over the medium term.

## Fund Commentary

The fund had a negative month returning -0.96% and underperformed its benchmark the Bloomberg Composite which returned -0.51%.

The fund's longer duration positioning was unhelpful with short term interest rates falling and longer-term interest rates rising. Both absolute and relative performance were largely driven by the fund's longer duration and yield curve positioning. Sector allocation was generally positive with credit continuing to provide a higher fund yield and margins remaining stable. We continue to be comfortable with our exposure to NZGB long bonds as they are currently trading at historically wide spreads above swap rates, and we believe longer maturity bonds can outperform as cash rates are moved lower. Whilst we see no imminent reason for these spreads to normalize, our holdings here provide protection should the government's financial position improve and its borrowing program fall.

Going forward as the Reserve Bank delivers on its expected easing program, we expect the return of a normal upward sloping yield curve will provide the fund with opportunity to execute a carry and roll strategy which should positively contribute to future returns.

## 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>	\$647.1m
<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

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