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Nikko Asset Management

YOUR GOALS,
OUR COMMITMENT.

Nikko AM NZ Cash Strategy

Monthly Update 30 June 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

- First quarter GDP came in at +0.2%, in line with RBNZ expectations but above market expectations of +0.1%.
- The positive print was flattered by population growth, on a per capita basis GDP continues to decline, now 4% lower than its September 2022 peak.
- Signs of labour market weakness are building. The BNZ/Seek employment report now has job adverts down 30.5% YoY, their lowest levels since February 2016.

Fund Highlights

- The fund holds a longer than benchmark duration position reflecting a view that the RBNZ's hiking cycle is complete.
- We are looking to maintain a long duration position; however, this may be tempered should markets price cuts at a too rapid 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]	0.50%	1.58%	6.49%	4.11%	3.12%	3.25%
Benchmark[2]	0.46%	1.40%	5.79%	3.62%	2.45%	2.49%
Retail[3]	0.43%	1.51%	6.15%	3.79%	2.80%	2.91%
KiwiSaver[3]	0.43%	1.50%	6.13%	3.68%	2.70%	

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).

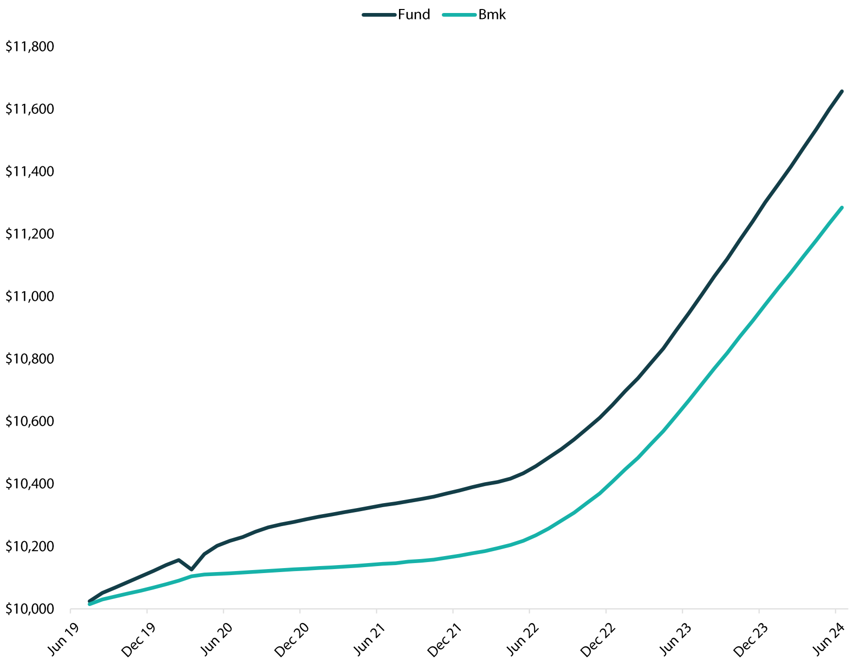
Overview

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

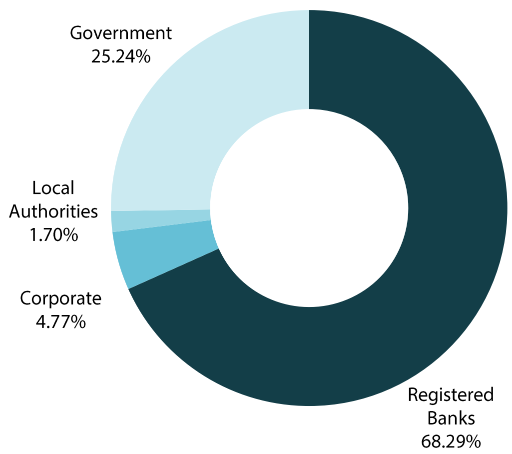
Objective

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	(%)
Tax Management NZ Limited	14.27
Westpac New Zealand Ltd	13.12
NZ Tax Trading Co	10.97
Kiwibank Ltd	9.68
Cooperatieve Rabo U.A.	7.42

Credit Rating	(%)
AAA	25.24
AA	29.17
A	45.59

Duration
Fund 85 days vs Benchmark 45 days
Portfolio Yield (YTM with FRN yield to next reset date)
Fund (gross) 6.25% vs Benchmark 5.60%

Market Commentary

90-day bank bills tracked sideways over June, trading in a 3-basis point range and ending the month much unchanged at 5.63%. This was as expected with no OCR review in June and the likelihood of a pivot occurring in the upcoming July MPR low. Conversely, a slew of weak economic data has seen markets increase bets that the RBNZ's stance will need to change, and OCR cuts will be brought forward from the RBNZ's guidance of the second half of 2025. Key amongst economic data was first quarter GDP, which came in at +0.2%, in line with RBNZ expectations. However, this positive story is only surface deep being only the second quarter in the last six where the economy hasn't contracted. On top of this, headline GDP continues to be flattered by population growth - on a per capita basis GDP fell 0.3% and is now 4% lower than its September 2022 peak. It is also worth remembering that GDP is a backward-looking statistic and reflects a period of activity of some three to six months ago. Since this time, the economic state of play has further weakened.

Looking to the labour market, we note unemployment is on an upward trend, having increased in each of the last four quarters. This decline in demand for labour is clearly seen in the BNZ/Seek employment report which has job adverts down 30.5% YoY, now at their lowest level since February 2016. Of further interest the ratio of applications per job ad is some 69% higher than a year earlier. Ultimately less job adverts, and more applicants is highly consistent with rising unemployment and correspondingly less inflation pressure from consumption. At the same time, discretionary consumer spending is under pressure as tight monetary policy syphons away cash through higher mortgage rates putting further downward pressure on consumption. Caution must be applied in extrapolating this weak data to OCR cuts, especially as the RBNZ has an inflation-only mandate. None-the-less, it increasingly appears the economic dominoes are falling, with the only remaining obstacle to the argument for cuts the outright level of CPI (which is declining). Should the RBNZ stick to their guidance of cutting in the second half of 2025, it's likely the economy will be in worse shape than otherwise and deeper cuts required. We expect the RBNZ may get the inflation data it desires through second and third quarter CPI prints which may allow cuts to occur in November this year or at least a pivot in stance at that juncture.

Fund Commentary

The fund outperformed its benchmark over the June quarter (1.58% vs 1.40%). Over the quarter 90-day bills have been reasonably range bound, trading in a 5-basis point range, ending the quarter at 5.63% little changed from where they started. This was much as expected as the RBNZ's stance of cuts not occurring until the second half of 2025 was consistent over the quarter. Similarly, the probability of the RBNZ pivoting to an easing bias in their July MPR looks low. Conversely, longer dated yields presented more volatility over the quarter trading in a 25-basis point range with lows of 5.30% and highs at 5.55%. This volatility was driven by the ebb and flows of weak economic data and the RBNZ's hawkish higher for longer rhetoric. In general, when markets have seen weak economic data, bets around OCR cuts have been brought forward, yet these have then been tempered by the RBNZ's very consistent rhetoric of cuts not occurring in 2024 and inflation being too high. The fund has used this volatility to add duration when rates have been elevated, equally we have been willing to roll off duration in periods where markets have over exuberantly priced cuts.

This conflict of market expectations and RBNZ's guidance shows as negative carry when we look at adding duration. As of the end of the quarter 1-year swap is some 25bps below 90-day bills – in other words we have negative carry of ~2 bps per month. Negative carry notwithstanding, our view remains the RBNZ will indeed need to cut earlier than its current guidance. As such we continue to look for opportunities to add duration, however, we are willing to be patient at this stage and may let duration positions fade should cuts be priced too aggressively.

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:	$1,014m
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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