Nikko AM Global Bond Strategy

Monthly Update 31 May 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

- A favourable mix of steady growth, slowing inflation (evident in US CPI and PCE figures), and robust first-quarter corporate earnings bolstered risk assets, including corporate bonds and securitized credit in May.
- US Treasury's were supported by cooler economic data into the month as well as less hawkish US Federal Reserve (Fed) commentary, maintaining rate hikes were unlikely.
- Sovereign bonds began to weaken mid-month on more resilient inflation data leading markets to reassess the pace of rate cuts.
- In Europe, firm services inflation challenged German bunds. Meanwhile, hawkish remarks from the Bank of Japan (BoJ) saw the 10-year Japanese government bond yield exceed 1% for the first time since 2012.

Fund Highlights

- The fund posted a positive return, outperforming its benchmark.
- Outperformance was driven by our Cross-sector and Country strategies, respectively.
- By contrast, our Government/Swaps selection strategy detracted from excess returns.

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).

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	1.18%	0.48%	4.22%	-1.75%	1.03%	3.22%
Benchmark[2]	0.87%	0.12%	2.89%	-2.02%	0.04%	2.62%
Retail[3]	0.53%	0.18%	3.70%	-2.56%	0.23%	2.27%

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.

Overview

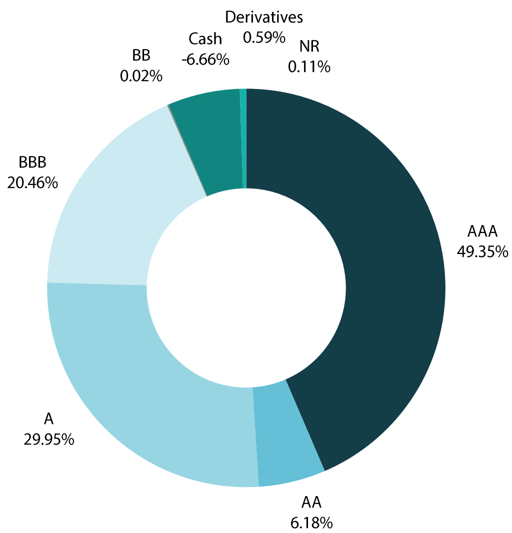
The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

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	21.08%	43.99%
Agency	4.34%	8.00%
Collateralised & MBS	49.61%	11.43%
Credit	26.73%	20.59%
Emerging market debt	4.31%	15.99%
Cash, derivatives, other	-6.07%	0.00%

*Includes deferred settlements

Duration
Fund 5.55 years vs Benchmark 6.52 years
Yield to Maturity
Fund (gross) 5.82% vs Benchmark 5.45%

Market Commentary

A favourable mix of steady growth, slowing inflation (evident in US CPI and PCE figures), and robust first-quarter corporate earnings bolstered risk assets, including corporate bonds and securitized credit in May. However, sovereign bonds faltered. US Treasury's were supported by cooler economic data into the month as well as less hawkish US Federal Reserve (Fed) commentary, maintaining rate hikes were unlikely. That said, sovereign bonds began to weaken mid-month on more resilient inflation data leading markets to reassess the pace of rate cuts.

In Europe, firm services inflation (education, hospitality etc) challenged German bunds. Meanwhile, hawkish remarks from the Bank of Japan (BoJ) saw the 10-year Japanese government bond yield exceed 1% for the first time since 2012.

Broadly, across developed market economies, we are watching three key indicators: consumer spending, labour markets and the rate and extent of disinflation. We think the first Fed rate cut will be delayed from September to December. We flag uncertainty on the exact timeline given the impact of the upcoming elections and if economic data fails to restore confidence in labour market rebalancing and the disinflation trajectory. Elsewhere, we are closely monitoring inflation expectations, wage trends, and services inflation around the European Central Bank (ECB). These are key indicators of inflation persistence that will determine the pace and scope of the ECB's rate cutting cycle and currently expect the ECB to adopt a gradual, quarterly easing strategy. Elsewhere, we anticipate the Bank of England's (BoE) easing cycle to possibly start in August although the exact timing will depend on signals from inflation persistence indicators. Lastly, we foresee additional, but limited interest rate increases for the Bank of Japan (BoJ) as Japan's real rates remain low and financial conditions are loose in relation to the inflation backdrop.

We continue to think current market conditions require discerning signal from noise. There is a growing sense of normalization in data and market trends, yet the investment landscape is not without its challenges—downside growth risks, potential inflation spikes, and geopolitical uncertainties. This underscores the importance of active security selection, as well as the defensive role of government bonds and perceived safe-haven currencies like the US dollar. Elsewhere, we maintain a preference for spread sectors like corporate, securitized, and emerging market (EM) credit.

Fund Commentary

The portfolio outperformed its benchmark. This was driven by our Cross-sector and Country strategies, respectively. By contrast, our Government/Swaps selection strategy detracted from excess returns.

Outperformance of our Cross-sector strategy was driven by our overweight beta to commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLO). Macroeconomic data concentrated in the first half of the month displayed relatively positive signals conducive to risk asset outperformance, supported by market optimism for a soft-landing. AAA-rated CMBS and CLO spreads tightened by 7bps and 26bps, respectively. Our Country strategy also contributed to returns. This was driven by our cross-market overweight to UK versus Japanese rates position. Hawkish remarks from the Bank of Japan saw the 10-year Japanese government bond yield exceed 1% for the first time since 2012, supporting our position. Our overweight Swedish versus Swiss short-end position also contributed, driven by a 25bps rate cut by the Riksbank considering disinflation progress.

Lastly, our Government/Swaps selection strategy underperformed. This was primarily driven by positioning for US swap spreads to widen and our European curve steepener position whereby we are overweight 5- and 7-year portion of the European yield curve, and underweight 10- and 20-year nodes.

Key Fund Facts

Estimated annual fund charges (incl. GST)	
Wholesale: **Retail:**	Negotiated outside of the unit price. 0.80%, refer to PDS for more details.
Distributions:	
Wholesale: **Retail:**	Calendar quarter Calendar quarter

Hedging:	All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.
Exclusions:	Controversial weapons.
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.

Strategy Launch:	October 2008
Strategy size:	$567.7m
Buy / Sell spread:	0.00%/0.00%

Compliance

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

Contact Us

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