

Nikko AM NZ Bond Strategy

Monthly Update 31 December 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 positive over the quarter with October negative and November and December both positive months.
- The yield curve steepened in shape over the quarter as short-term rates performed better than longer maturity bonds.
- There has been an increase in new bond deals to the market which has caused a modest widening in credit margins.

Fund Highlights

- The benefits of longer duration have varied depending on the maturity term of bonds held. Bonds inside 10 years maturity performed better than longer maturities which were dragged higher in sympathy with offshore bond moves.
- There was a reasonable amount of new bond issuance over the quarter, and we continue to add quality credit to maintain a higher yield.
- We expect the fund 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.)
Wholesale¹	0.83%	0.65%	6.62%	2.50%	1.81%	3.75%
Benchmark²	0.61%	0.67%	5.69%	1.38%	0.60%	2.66%
Retail³	0.75%	0.46%	5.92%	1.85%	1.14%	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.

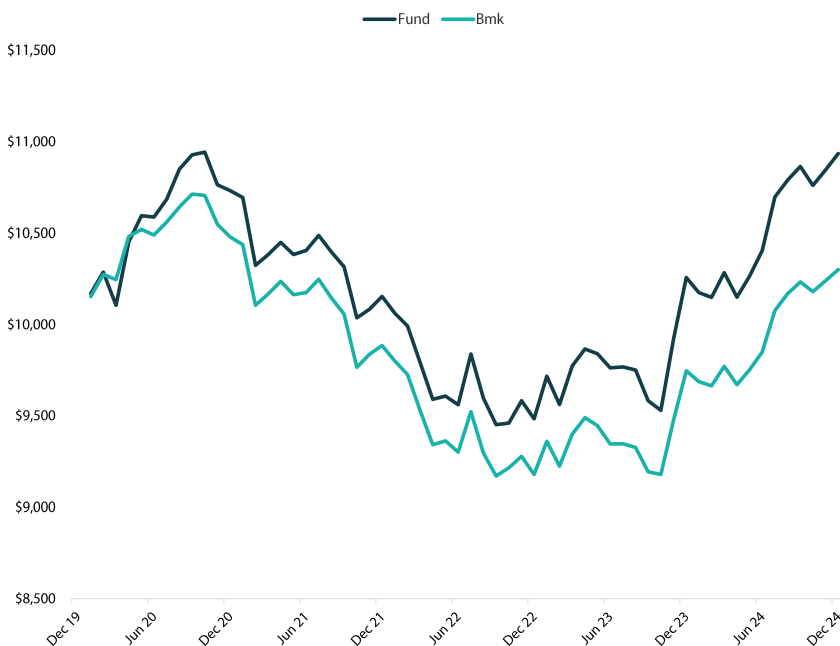
Overview

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.

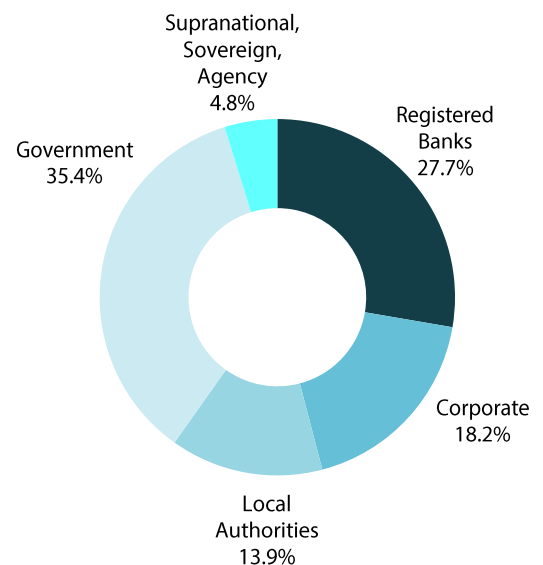
Objective

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^{1,2}



Sector Allocation



Top 5 Corporate Issuers*	(%)
New Zealand Local Govt Funding Agency	7.38
Bank of New Zealand	6.44
Westpac New Zealand	6.16
Kiwibank	5.71
Housing New Zealand	4.88

* Excludes NZ central government

Credit Quality	(%)
AAA	54.08
AA	20.79
A	20.70
BBB	4.43

Green, sustainable and social bonds
19.98% of the fund
Duration
Fund 5.69 years vs Benchmark 4.66 years
Yield to Maturity*
Fund (gross) 4.45% vs Benchmark 4.07%

* Excluding the inflation component of government inflation linked bonds

Market Commentary

The 2024 year finished with a positive return for bonds both in December and over the quarter. Interest rate moves were the main driver of absolute and relative returns with a negative return in October when interest rates moved higher and positive in November and December with interest rates generally lower. Shorter maturity bonds outperformed longer maturity bonds with the yield curve steepening in shape, for example the 2-year NZ Government bond rate fell 20bps over the quarter whereas the 10-year was 17bps higher. The fund has been positioned for lower rates with a longer duration than benchmark over the past quarter.

Performance across sectors of the bond market has been mixed with government bonds continuing to underperform due to high and increasing supply. Swap rates performed better and their spread relative to similar maturities of governments has continued to expand (Swap trades below Govt rates). Credit holdings performed well, adding to performance through a higher yield. Over the quarter there has been some widening of credit margins from tight levels following an increase in supply, but over the medium term a higher yield accrual should help support performance.

Interest rate moves for NZ government bonds for December were 1yr -18bps, 5yr -16bps, 10yr +4bps, and the 2054 bond +14bps. NZ Swap rates were 1yr -32bps, 5yr -23bps, 10yr -14bps. For the quarter moves were governments 1yr -20bps, 5yr unchanged, 10yr +17bps, and the 2054 bond +24bps. Swaps were 1yr -49bps, 5yr -4bps, 10yr -4bps.

The NZ bond market continues to remain reasonably well supported relative to global bonds with our market viewed as a "safer bet" supported by a weaker economy, and a lower rates outlook. Shorter maturity bonds have outperformed as they are more influenced by the actions of the RBNZ and local economic outcomes that we expect should remain supportive with the cash rate moving lower. Longer maturity bonds look attractive in terms of a higher yield and potential for further modest capital gains. The caveat is longer bonds are more subject to the direction of offshore bond moves and there is greater uncertainty around growth and inflation outcomes in the US which has kept curves steeper. 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 steeply positive in shape. NZ government bonds look cheap relative to swap rates and where appropriate we hold an increased weighting to governments with the view that they will likely outperform swap product over the medium term.

Fund Commentary

The fund returned 0.83% for December outperforming its benchmark the Bloomberg Composite which returned 0.61%. Returns for the quarter were fund 0.65%, and benchmark 0.67%. The move in interest rates was the main driver of absolute and relative returns. The fund has a longer duration positioning which had mixed results over the quarter as shorter bonds performed better than longer maturities in terms of interest rates moves. Credit margins have widened slightly (from previously tight levels) with an increase in issuance, but a gradual widening should benefit returns through a higher yield over the medium term. The fund holds an increased weighting to NZ government bonds as these have become cheap relative to swap with margins expanding as a function of greater supply. Over the quarter the fund had inflows, and we reduced the longer duration positioning in view of offshore moves remaining unhelpful with yield curves steepening.

We continue to favour adding quality credit to maintain a higher fund yield which has proved a consistent value add over time. We expect bonds can continue to perform well as cash rates are moved lower. The upward sloping yield curve will provide the fund with opportunity to execute a carry and roll strategy which should provide an additional contribution to future returns.

Key Fund Facts

Distributions		Hedging:	Any foreign currency exposure are hedged to NZD within operational range of 95%-105%	Strategy Launch:	October 2007
Wholesale:	Calendar quarter	Exclusions:	Controversial weapons	Strategy size:	\$854.4m
Retail:	Calendar quarter	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 .	Buy / Sell spread:	Click to view
Estimated annual fund changes (incl. GST)					
Wholesale:	Negotiated outside of unit price				
Retail:	0.65%, refer PDS for more details				

Compliance

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

Contact Us

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