

Nikko AM NZ Bond Strategy

Monthly Update 31 January 2025

Assets are held in the Nikko AM Wholesale NZ Bond Fund. The Nikko AM NZ Bond Fund (retail) and the GoalsGetter KiwiSaver Scheme Nikko AM NZ Bond Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- There is considerable uncertainty starting 2025: Trump, tariffs, immigration, a strong US economy could turn, weaker China.
- Bond returns were muted for January as interest rates finished modestly higher.
- The yield curve remains steep and should garner investor interest at some stage with longer government bond yields around 5%.
- The issuance calendar is usually slow to start in NZ; ANZ will issue a 5-year deal, and the DMO has announced a tap of the 2035 government bond maturity.

Fund Highlights

- Returns were negative – both absolute and relative, with the longer duration positioning unhelpful as interest rates moved higher.
- NZ government bonds played some catch up and performed better than swap rates over the month.
- We expect the funds will 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	-0.23%	1.39%	7.23%	2.73%	1.42%	3.53%
Benchmark²	-0.04%	1.14%	6.29%	1.66%	0.28%	2.42%
Retail³	-0.27%	1.21%	6.52%	2.09%	0.76%	2.79%

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.

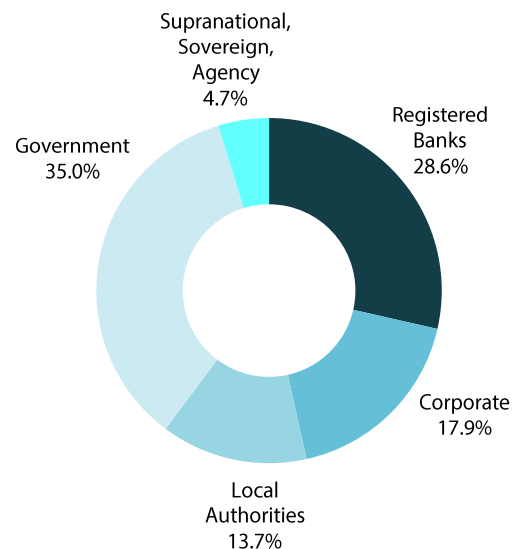
Objective

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*	(%)	Credit Quality	(%)	Green, sustainable and social bonds
Bank of New Zealand	7.63	AAA	53.38	19.75% of the fund
New Zealand Local Govt Funding Agency	7.29	AA	21.44	Duration
Westpac New Zealand	6.08	A	20.55	Fund 5.55 years vs Benchmark 4.59 years
Kiwibank	5.68	BBB	4.63	Yield to Maturity*
Housing New Zealand	4.81			Fund (gross) 4.53% vs Benchmark 4.13%

* Excludes NZ central government

* Excluding the inflation component of government inflation linked bonds

Market Commentary

NZ bond returns were muted as interest rates moved higher over January. Financial markets in general had a tough holiday period with interest rates moving higher as the market unwound expectations for rate cuts with the US economy looking robust. Fortunately, mid-month following US CPI there was a re-evaluation that growth is slowing, dis-inflation continues, and rates pared back 25-35bp finishing only modestly higher.

Interest rates sub one year finished lower in yield with the RBNZ expected to cut 50bps in February, the rest of the yield curve finished higher. Interest rate moves for NZ government bonds for January were 1yr -0.5bp, 5yr +10.5bps, 10yr +7bps, and the 2054 bond +2bps. NZ Swap rates were 1yr -8bps, 5yr +16bps, 10yr +17bps. NZ Government bonds were the best performing sector with governments finally having some catch up relative to swap rates. Previously government bond spreads had widened to record levels (trading around 60bps above swap) with high and increasing issuance. Where relevant we have incrementally increased our weighting to government bonds when they look cheap on the expectation this will add value over the medium term.

There remains considerable uncertainty in markets starting 2025 - tariffs could result in higher inflation, but growth would likely slow. We expect the local economy remains weak and the RBNZ continues to cut interest rates which will support the front of the yield. Longer maturity bonds have been higher with US rate moves and this has kept the curve steep (also factored in higher term premium and supply). Toward month end longer bonds were better supported by investors and on a carry and roll basis government bond yields around 5% offer an attractive return without taking too much risk.

In general, we moderated the fund's longer duration position over the last quarter of 2024 but think a modest longer position will add value over the medium term supported by carry and roll. We continue to like quality credit for extra yield, and we receive a wider credit margin for investing longer.

Fund Commentary

The fund returned -0.23% for January an underperformance of its benchmark the Bloomberg Composite which returned -0.04%.

The move higher in interest rates was a key driver of absolute and relative returns. The outperformance of government bonds (which make up over 60% of the benchmark) was also unhelpful on a relative basis. We reduced the fund's longer duration position last quarter but still maintain a longer position as we believe a steep yield curve and carry and roll investment strategies will support returns over the medium term. Credit margins have remained stable although credit is priced as a margin above swap rates which had larger moves higher in yield than government bonds last month.

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 and in turn investors seek value further along the yield curve. 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:	\$860.2m
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 month.

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