

Nikko AM NZ Bond Strategy

Monthly Update 31 May 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

- NZ bonds had a positive month as yields finished slightly lower.
- Credit continues to perform well with issuance volumes down approximately 45% (relative to last year) supporting margin performance.
- Looking forward we remain optimistic that bond returns will be supported by cash rate cuts later this year and longer rates moving lower.

Fund Highlights

- The fund had a good month receiving income accrual plus some capital gain as interest rates moved lower.
- We have increased duration when bonds have been higher in yield and believe locking in higher rates for longer will benefit returns.
- We like the higher yield of quality credit and expect the demand/supply dynamics to remain supportive.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale¹	1.15%	1.16%	4.33%	-0.38%	0.94%	3.58%
Benchmark²	0.86%	0.92%	3.25%	-1.36%	-0.26%	2.55%
Retail³	1.08%	0.99%	3.69%	-1.00%	0.27%	2.82%

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).

Five Year Cumulative Performance, \$10,000 invested^{1,2}



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.

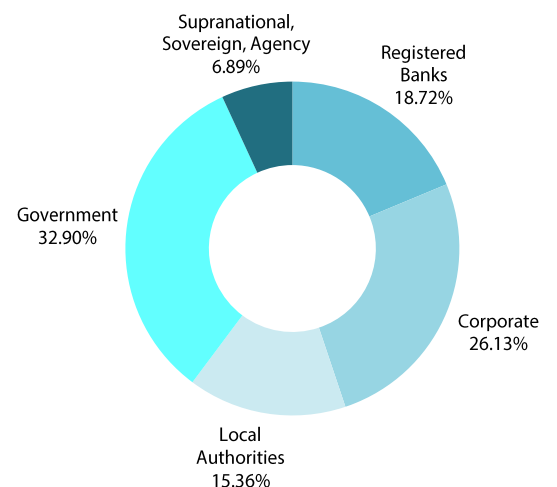
Overview

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.

Sector Allocation



Top 5 Corporate Issuers*	(%)
New Zealand Local Govt Funding Agency	9.75
Housing New Zealand	6.85
Kiwibank	5.28
Auckland International Airport	4.19
Bank of New Zealand	4.07

* Excludes NZ central government

Credit Quality	(%)
AAA	58.55
AA	9.60
A	27.80
BBB	4.05

Green, sustainable and social bonds
22.77% of the fund
Duration
Fund 6.28 years vs Benchmark 4.85 years
Yield to Maturity*
Fund (gross) 5.37% vs Benchmark 5%

* Excluding the inflation component of government inflation linked bonds

Market Commentary

It was pleasing to deliver a strong positive month for NZ bonds due to lower interest rates. Interest rates closed last year at low levels (pricing earlier rate cuts in 2024), and this set a difficult starting point to achieve further near-term capital gains from bonds in the first quarter. In terms of attribution, credit holdings continue to perform well benefiting the funds through a higher yield and some margin contraction as demand outweighs supply. Issuance of NZ corporate bonds so far this year is a lot lower than at the same time last year, and there doesn't appear to be much issuance in the pipeline so it makes sense to lock in higher rates for longer with the extra yield of quality credit. Mid-May bond yields were around 20 basis points lower, but they had a steep rise into month end as US rates climbed higher. At month end government yields finished as follows; 2yr -1bp, 5yr -7bps and 10yr -8bps. For comparison swap maturities were 2yr +1bps, 5yr -8bps and 10yr -11bps.

NZ interest rates have been volatile month-on-month, albeit in a moderate range (around +/- 40-50 basis points). A positive is that this has provided opportunities to build a longer duration position at better levels by buying bonds when higher in yield. We do expect better returns from bonds over the medium term, but ultimately, we will need to see the data support a believable lower inflation story for bonds to hold at lower levels. Our plan remains to build a higher yield through quality credit and hopefully participate in further capital gains as rates move lower over the next year. Going forward local data outcomes (in terms of inflation) and offshore bond moves will be the main drivers for the direction of rates. The NZ budgets impact on the market was very muted, with the increase in government borrowing requirements largely expected. The tax rate cuts may be slightly stimulatory in the near term, but they will be funded out of reduced government spend in other areas, and fiscal flexibility remains very limited in terms of achieving targets.

Fund Commentary

The fund had a positive return for the month of May and outperformed the Bloomberg NZ Composite benchmark.

The move lower in interest rates was the main driver of absolute and relative returns. We have continued to add longer maturity bonds when yields were high to extend our relative position. The fund is positioned with a long duration with a view that the ultimate direction of rates is lower over the next 12-18 months. Our preference is to hold higher yielding quality credit, but we have added NZ government bonds when they look cheap relative to swap. NZ government bonds are approximately 2/3rds of the benchmark.

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: \$544.2m
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.

Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com

This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme. This information is for the use of researchers, financial advisers and wholesale clients. This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute financial advice, and must not be relied on as such. Recipients of this document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult a Financial Advice Provider and the relevant Product Disclosure Statement. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party. For full details on the fund, please refer to our Product Disclosure Statement on nikkoam.co.nz.