

New Zealand Fixed Interest Fund

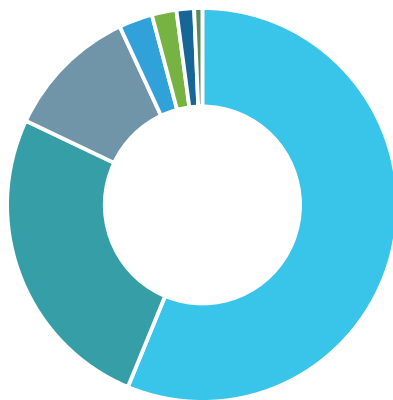
Investor Factsheet for the quarter ended 31 December 2024

	Quarter Performance	1 year	3 years*	5 years*	Since Inception*
Gross Fund Return**	0.87%	6.40%	3.03%	2.22%	5.24%
Bloomberg NZBond Composite 0+ Yr Index***	0.67%	5.69%	2.49%	1.69%	4.98%
Out/under performance	0.20%	0.71%	0.54%	0.53%	0.26%
Tracking error	n/a	0.23%	0.47%	0.90%	0.92%
Information ratio	n/a	3.07	1.16	0.59	0.29
Sharpe ratio	n/a	0.25	-0.29	-0.14	0.76

Key Fund Facts as at 31 December 2024

Fund Name	New Zealand Fixed Interest Fund	Risk Indicator	1 2 3 4 5 6 7
Inception Date	26/06/2008	Market Index***	Bloomberg NZBond Composite 0+Yr
Fund Value (NZD)	\$204,605,155	Yield to maturity ¹	4.35%
Unit Price	2.0314	Duration (years) ¹	4.90
		Average credit quality ²	AA-

INVESTMENTS BY SECTOR



● NZ Government Stock, 56.2%	● Supranationals, 2.0%
● Corporate Investment, 25.8%	● Local Authority stock, 1.5%
● LGFA Securities, 11.0%	● NZ State Owned Enterprises, 0.7%
● Cash and cash equivalents, 2.8%	

The fund in its macro context

Returns for New Zealand fixed interest investors were generally favourable over the December quarter.

Indeed, in a one-two combination, market participants were further emboldened to believe that the Reserve Bank of New Zealand (RBNZ) would continue in its aggressive easing of local monetary policy.

Firstly, the New Zealand Treasury's negative assessment of domestic economic performance released in its Half Year Economic and Fiscal Update (HYEFU) painted a grim picture over the forecast period. The second major release for the month was September's gross domestic product (GDP) data, which also disappointed, confirming a contraction in economic output over the third quarter of last year.

All told, in our view the data substantiated the general market consensus that the RBNZ will have to provide further stimulation to increase economic activity; we see the official cash rate (OCR) moving to 3.00% sometime over next year, with (increasing) risks skewed towards an OCR dropping to around 2.50% before end of 2025.

* Annualised

** Gross Fund Returns are calculated before deduction of taxes and fund charges but after deduction of trading expenses and including imputation credits where applicable. Market index returns do not have any deductions for fund charges, trading expenses or tax.

*** For periods prior to July 2023 the market index/benchmark return is the S&P/NZX Investment Grade Corporate Bond Index.

¹ Portfolio yield to maturity is the weighted average yield to maturity of the securities within the fund. Portfolio duration is the weighted average modified duration of the securities within the fund.

² Average credit quality is the weighted average credit rating of the securities held within the fund. Where an issue is not rated, we have used the issuer rating. Where both are unrated, we have assigned an internal rating.

Portfolio attribution

For the quarter to 31 December the New Zealand Fixed Interest Fund delivered a gross return of 0.72%, outperforming the fund's market index return of 0.61%.

For the four quarters to 31 December the Fund delivered a gross return of 6.40%, outperforming the fund's market index return of 5.69%

The December quarter was characterised by an incredible amount of volatility; the market's reaction to the outcome of the US presidential elections, a local economy still in recession, and the unresolved and continuation of armed conflicts around the world.

Over the December quarter it was the portfolio's gross yield-to-maturity, sitting around 4.40%, that was the major contributor to investors' returns.

Portfolio conviction

Locally, our current thinking is that it's too simplistic to think that lower domestic interest rates will mechanically result in a material lift in domestic economic performance. The HYEFU report points to structural issues that need deep resets. On this basis, we intend to remain fully invested and hold minimal cash in the fund.

We're currently constructing an investment thesis of a "liquidity trap" where households use the benefits of lower mortgage rates and tax breaks to save, rather than spend. We're also highly sceptical that lower interest rates will cause businesses to mechanically restart capital investment.

In our opinion, after a near death economic experience, participants are likely to wait-watch-and-worry. Against this backdrop, we believe that the RBNZ is on course to lower its OCR to stimulatory, rather than neutral levels.

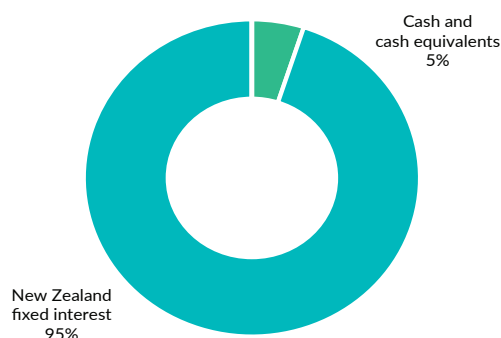
The fund's duration, a measure of how sensitive the portfolio is to a given change in New Zealand wholesale interest rates, was around 4.90 years at the end of December and our intention is to increase it to around 5.0 years and beyond.

The fund's gross yield to maturity, calculated as the weighted-average gross yield of all securities in the portfolio, was around 4.40% and the weighted-average portfolio credit quality was AA- (where a security does not have an external credit rating, we have assigned an internal credit rating based on our assessment. We use the lowest available credit rating for New Zealand Government bonds, Fitch's AA+, consistent with the fund's benchmark and market index).

Our investment strategy is to continue to accumulate New Zealand Government bonds while rationing capital to short-dated and preferred non-government securities. In general, corporate bond spreads, roughly the difference in yield between a government security and its non-government equivalent, are simply too narrow, in our view.

In summary, we expect on-going positive returns for investors in the fund, either through the fund's gross yield-to-maturity or capital gains.

TARGET ASSET ALLOCATION



FUND CREDIT BREAK-DOWN

Credit rating	% exposure
AAA	2.02%
AA (+ to -)	71.04%
A (+ to -)	2.12%
BBB (+ to -)	12.90%
Speculative	0.17%

TOP 10 FUND HOLDINGS AT QUARTER END

Security	Weight
New Zealand Government 4.50% 15/05/2030	7.8%
New Zealand Government 1.5% 15/05/2031	6.3%
New Zealand Government 14/04/2033 3.5%	5.6%
New Zealand Government 3% 20/04/2029	5.1%
New Zealand Government 4.50% 15/04/2027	5.0%
New Zealand Government 15/05/2028 0.25%	4.8%
New Zealand Government 15/05/2032 2.00%	4.2%
New Zealand LGFA Ltd 15/05/2030 4.50%	4.0%
Westpac New Zealand 1.439% 24/02/2026	3.1%
New Zealand Government 4.25% 15/05/2034 Green Bond	2.9%
Major holdings as % of total portfolio	48.9%

Investment Philosophy and Thesis

Octagon is an active investment manager. Our investment philosophy focuses on developing a repeatable process that systematically looks for short-to-medium term inefficiencies in market pricing of securities with a solid economic basis.

Octagon builds its fixed interest and cash portfolios based on several investment philosophies, namely:

- That the risk free rate oscillates around the neutral cash rate as the regulator implements monetary policy.
- New Zealand fixed interest and cash investors have historically been rewarded for credit more than duration.
- Successful research can identify attractive investment opportunities within the credit sector.
- New Zealand fixed interest and cash markets provide multiple sources for alpha generation from; duration, yield curve positioning, sector and security selection and secondary market trading.
- New Zealand Fixed Interest and Enhanced Cash funds are both core strategies not unreasonably constrained by benchmarks.

Portfolio Manager



Craig Alexander
Head of Fixed Interest and ESG

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