

New Zealand Fixed Interest Fund

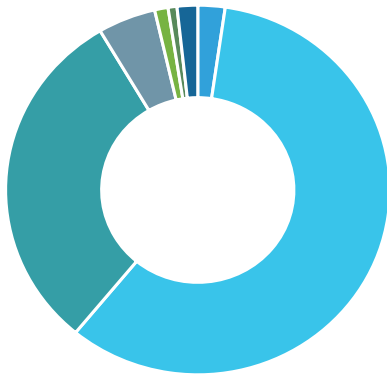
Investor Factsheet for the quarter ended 30 September 2024

	Quarter Performance	1 year	3 years*	5 years*	Since Inception*
Gross Fund Return**	4.08%	12.10%	2.29%	1.85%	5.27%
Bloomberg NZBond Composite 0+ Yr Index***	3.89%	11.29%	1.78%	1.32%	5.02%
Out/under performance	0.19%	0.80%	0.52%	0.53%	0.26%
Tracking error	n/a	0.31%	0.47%	0.90%	0.93%
Information ratio	n/a	2.58	1.11	0.58	0.28
Sharpe ratio	n/a	1.31	-0.36	-0.18	0.78

Key Fund Facts as at 30 September 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)	\$183,055,025	Yield to maturity ¹	4.40%
Unit Price	\$2.0178	Duration (years) ¹	4.80
		Average credit quality ²	AA-

INVESTMENTS BY SECTOR



- NZ Government Stock, 58.68%
- Corporate Investment, 30.55%
- LGFA Securities, 4.87%
- Supranationals, 2.29%
- Local Authority Stock, 1.13%
- Cash and cash equivalents, 1.73%
- NZ State Owned Enterprises, 0.75%

The fund in its macro context

The quarter to the end of September was in general a positive one for New Zealand fixed interest investors. An unsurprising result given the rhetoric earlier in the quarter around monetary easing from the Reserve Bank of New Zealand (RBNZ). The central bank followed up its rhetoric with a dramatic announcement in the August Monetary Policy Statement (MPS) that the long-awaited easing of monetary policy had officially begun. A significant pivot from the previous MPS in June this year that suggested the RBNZ was still contemplating interest rate increases.

Local economic data continues to be poor, and the US Federal Reserve has reset market participant thinking by delivering a larger than expected 0.50% cut to the Fed funds rate. While we acknowledge the positive bounce in economic sentiment associated with forward looking expectation surveys, we think however the actual reality could be different.

Emboldened participants continued to push bond yields and term interest rates significantly lower over the quarter, delivering material capital gains to investors in the New Zealand Fixed Interest Fund.

* 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.

Widely observed market analysis is forecasting a terminal Official Cash Rate (OCR) of around 3.00%. A prediction we expect to be scrutinised and recalibrated as additional inflation and employment data is released and assessed prior to the RBNZ's November MPS.

Portfolio attribution

For the quarter to 30 September the New Zealand Fixed Interest Fund delivered a gross return of 4.08%, outperforming the Fund's market index return of 3.89%.

For the four quarters to 30 September the Fund delivered a gross return of 12.10%, outperforming the Fund's market index return of 11.29%.

Our investment strategy is to continue to accumulate New Zealand Government bonds while rationing capital to extremely short-dated non-Government securities. Corporate bond spreads, roughly the difference in price between a Government security and its non-Government equivalent, are simply too tight and do not currently reflect the risks of the next economic cycle, in our view.

Portfolio conviction

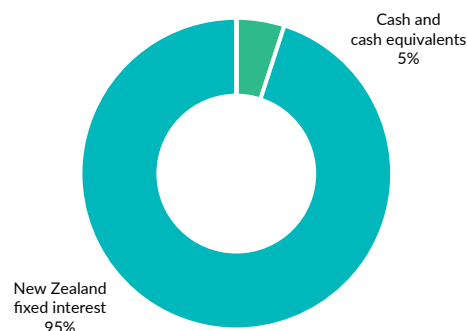
We anticipate that broad-based economic activity will continue to be weak until greater certainty returns to the employment market – and we're betting that the employment market will deteriorate further in a combination of less job offers and lower remuneration. Here, our thinking aligns with the RBNZ in that we anticipate the unemployment rate to peak sometime towards the middle of next year at around 5.5%, significantly higher than last June's 4.6%

We're also beginning to wonder if employment uncertainty could reignite deeper concerns around the wider economy. Our nascent thesis is that a domestic "liquidity trap" occurs where households look to save tax cuts and use the benefit of lower mortgage rates to accelerate loan repayments, rather than spend the interest savings.

The catalysts here, in our view, are likely to be a disrupted political outcome in the upcoming US presidential election and, or, a failure of Chinese authorities to reflate the struggling Chinese economy.

On this basis, our strategy continues to be the accumulation of "hard duration" in the form of Government bonds and Government bond proxies in order to (1) deliver further capital gains to investors well in excess of the Fund's yield-to-maturity, albeit at a slower rate of return than over the previous few months and (2) better protect the portfolio against an anticipated deterioration in corporate credit spreads.

TARGET ASSET ALLOCATION



FUND CREDIT BREAK-DOWN

Credit rating	% exposure
AAA	2%
AA (+ to -)	80%
A (+ to -)	2%
BBB (+ to -)	16%
Speculative	0%

TOP 10 FUND HOLDINGS AT QUARTER END

Security	Weight
New Zealand Government 4.50% 15/05/2030	7.2%
New Zealand Government 1.5% 15/05/2031	7.1%
New Zealand Government 14/04/2033 3.5%	5.8%
New Zealand Government 3% 20/04/2029	5.8%
New Zealand Government 4.50% 15/04/2027	5.7%
New Zealand Government 15/05/2028 0.25%	5.3%
New Zealand Government 15/05/2032 2.00%	4.8%
Westpac New Zealand 1.439% 24/02/2026	3.4%
New Zealand Government 4.25% 15/05/2034 Green Bond	3.3%
Precinct Properties NZ Ltd 4.42% 7/11/2024	2.9%
Major holdings as % of total portfolio	51.2%

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.

Conclusion

To be frank, we're not interested with the market's infatuation of whether the RBNZ will cut the OCR in multiples of 0.25% or 0.50% or even more recently 0.75% before year end; the trajectory is clear. The RBNZ is moving from the starting rate of 5.50% towards a lower number. The New Zealand economy is weak and the RBNZ has done its job of engineering a recession. We also believe the OCR's move lower will be fraught with angst and subject to wild swings in sentiment as the weak New Zealand economy delivers varied macro signals.

As an active manager, we're well positioned to benefit from the anticipated volatility in domestic fixed interest markets. Looking forward, we expect disciplined and systematic trading to increase the contribution to the Funds' returns.

Portfolio Manager



Craig Alexander
Head of Fixed Interest and ESG

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