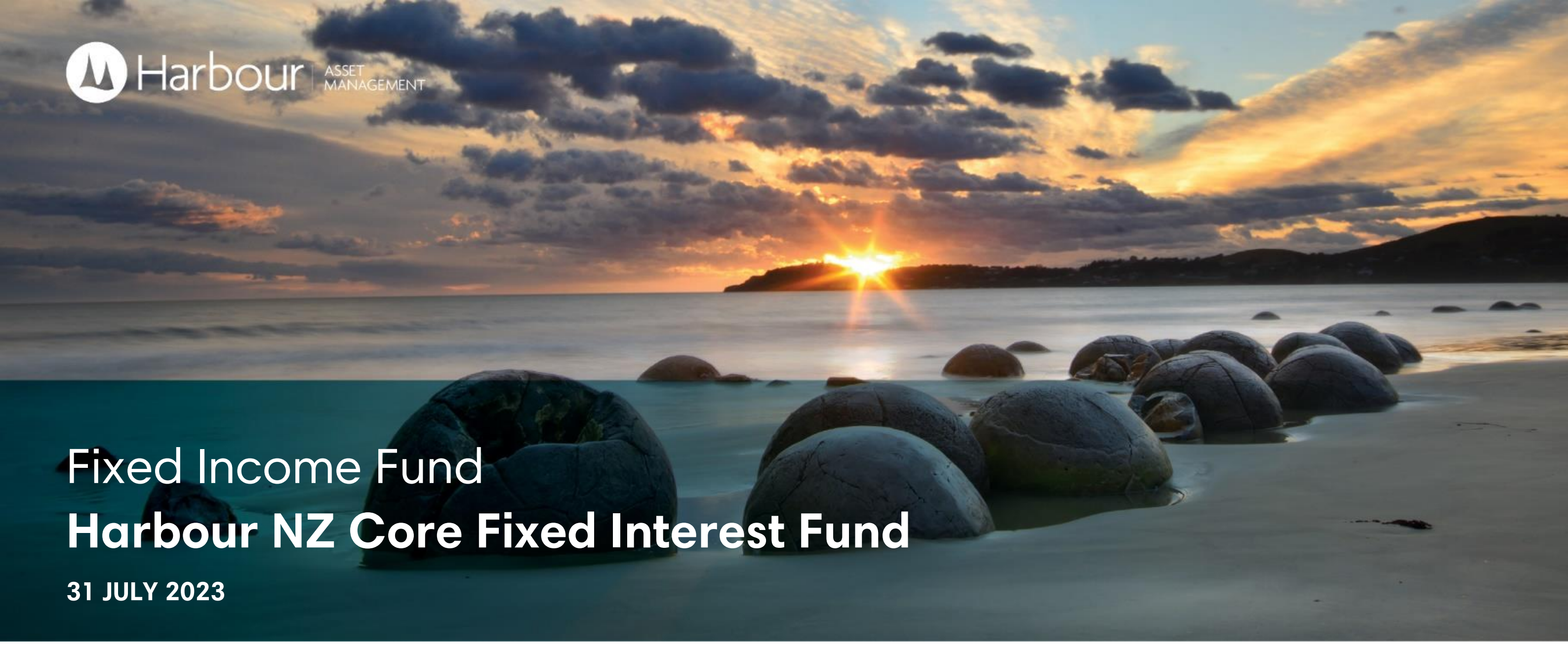


Fixed Income Fund

Harbour NZ Core Fixed Interest Fund

31 JULY 2023

1 month performance	1 year performance	Fund size	Average credit rating
0.10%	**-0.72%**	**$571,829,628**	**AA-**
Before fees & tax	Before fees & tax	NZD	

The fixed interest market was relatively volatile during July, but ultimately delivered a fairly modest positive return. Expectations that global central banks might deliver more hikes were elevated after activity data continued to highlight the US economy's resilience to higher interest rates. However those concerns dissipated when inflation data showed that core inflation was declining nicely. In New Zealand the converse is broadly applying. The NZIER's Survey of Business Opinion suggested a weak economy getting weaker, yet core inflation is not noticeably declining yet. Overall, central banks are seeing the desired response to tighter monetary policy but progress is slow and persistently high interest rates are expected for some time. We expect the Official Cash Rate to remain at 5.5% through the rest of the year.

The Fund return was positive and was modestly ahead of the benchmark return. Small gains were generated from duration and yield curve positioning. We have added to positioning that reflects a view that market rates will decline, although this appears more likely to occur through 2024 than over the remainder of this year.

Performance	1 MONTH	3 MONTH	1 YEAR P.A.	2 YEAR P.A.	3 YEAR P.A.	5 YEAR P.A.	10 YEAR P.A.	SINCE INCEPTION P.A.
Return before fees & tax	0.10%	-1.25%	-0.72%	-3.29%	-2.48%	0.96%	3.14%	3.58%
Benchmark return	0.01%	-1.51%	-1.85%	-4.50%	-3.99%	0.08%	2.50%	2.86%
Relative performance	0.09%	0.26%	1.13%	1.20%	1.51%	0.88%	0.64%	0.71%
Tracking error	-	-	-	-	0.66%	-	-	0.65%
Information ratio	-	-	-	-	2.27	-	-	1.09

Inception: 1 September 2011. Benchmark: Bloomberg NZBond Composite 0+ Yr Index, effective 1 January 2019. Prior benchmark was 50/50 weighted average of S&P/NZX Govt Bond Index & S&P/NZX A-Grade Corporate Bond Total Return Index. Past performance is not indicative of future results.

Key yield movements	90 DAY BANK BILL	2YR NZ GOVT STOCK	A-AAA AVERAGE CREDIT SPREAD TO NZ GOVT STOCK	10 YR NZ GOVT STOCK
Yield	5.67%	5.26%	0.43%	4.69%
1m change	-0.04%	0.09%	-0.05%	0.06%
12m change	2.53%	2.07%	-0.18%	1.26%

Source: Bloomberg.

Fund characteristics

	FUND	BENCHMARK
Yield to maturity	5.65%	5.17%
Modified duration (years)	5.37	4.57
Credit duration (years)	1.07	1.21
Weighted average rating factor (WARF) ^	AA-	
Number of issuers	58	

^ Calculated as the weighted average credit rating of the fixed interest securities using a Moody's WARF factor. Securities not rated by a ratings agency are assigned an internally-assessed rating by Harbour.

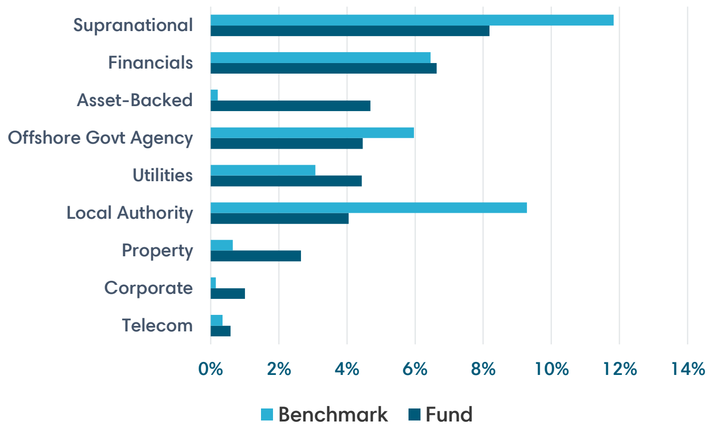
Top 10 issuer exposures

	POSITION
New Zealand Government	60.56%
World Bank Group	4.66%
ASB / CBA	2.79%
Asian Development Bank	2.23%
NZ Local Government Funding Agency	2.22%
Rentenbank	2.15%
Kiwibank	1.64%
Cash	1.63%
BNZ / NAB	1.47%
Resimac Versailles Trust	1.45%

Rating composition

	FUND
AAA	77.01%
AA	13.07%
A	3.82%
BBB	4.03%
NR	2.07%

Credit sector vs benchmark



Fund attribution	1 MONTH	3 MONTH	1 YEAR P.A.	3 YEAR P.A.	5 YEAR P.A.	10 YEAR P.A.	SINCE INCEPTION P.A.
Credit allocation	-0.02%	-0.02%	-0.02%	0.00%	0.01%	0.04%	0.05%
Duration & yield curve	0.02%	0.00%	-0.60%	-0.20%	-0.11%	-0.03%	0.01%
Relative value	0.07%	0.11%	0.72%	0.43%	0.27%	0.22%	0.25%
Inflation - indexed	-0.02%	0.10%	0.49%	0.69%	0.34%	0.15%	0.17%
Security selection, transaction costs & other	0.03%	0.07%	0.53%	0.59%	0.37%	0.25%	0.24%
Total	0.09%	0.26%	1.13%	1.51%	0.88%	0.64%	0.71%

Outlook and strategy

Global growth has become increasingly uneven over the past month. The US economy has been surprisingly strong. Q2 GDP data showed the economy expanded at an annualised pace of 2.4%, following a 2.0% annualised increase in Q1. The services sector remains healthy, and a tight labour market continues to generate high rates of wage growth. This is keeping core inflation rates high, while headline inflation has been able to drop meaningfully on lower food and energy prices. Economic data out of Europe and China, in contrast, has disappointed. Europe is suffering from the combined forces of policy tightening, a stalled Chinese economy and ongoing geopolitical uncertainty from the Ukraine-Russia war. In China, expectations of stimulus increased slightly following the July Politburo meeting where some support for the property and capital markets was indicated. This likely comes too late for 2023, however, with economic forecasts for GDP growth this year downgraded from 5.5% to 5.2% over the past few weeks.

Most global central banks are close to the end of their tightening cycles but that doesn't mean cuts are coming soon. Recent policy decisions and communication by the US Federal Reserve, the European Central Bank and Reserve Bank of Australia suggest further tightening from these central banks will be data dependent. But given high rates of core inflation and low unemployment rates, we think rate cuts are some way off. The US market looks particularly vulnerable to a repricing higher of rate expectations with the market currently anticipating almost 130bp of cuts next year to a Fed Funds rate of 4.2%, 40bp below the Fed's own forecasts. In Japan, the recent expansion of the Bank of Japan's yield curve control to allow the 10-year JGB to trade as high as 1%, from 0.5% previously, will likely allow a better calibration of policy to incoming data.

Increased US Treasury issuance, in the context of high levels of US government debt, is pushing longer-term bond yields higher. This dynamic was punctuated by Fitch cutting the USA's foreign currency credit rating from AAA to AA+, citing governance concerns after the recent debt ceiling impasse and last-minute resolution. With term premia historically low, these concerns may place further upward pressure on long-term Treasury yields.

The Reserve Bank of New Zealand's (RBNZ's) view that it has delivered sufficient policy tightening has largely been supported over the past month. Business surveys of experienced activity continue to suggest very little economic growth this year. This is also supported by responses which suggest a lack of demand, rather than a lack of labour, is constraining output. On the price side, selling price and wage growth expectations continue to drop, albeit from high levels. The export sector is experiencing a combination of falling export demand and lower prices, that looks likely to continue. Concerns have risen about the country's current account deficit, generating some risk for global appetite for New Zealand bonds and the New Zealand Dollar. Data for Q2 revealed high core inflation and a still-tight labour market but due to the lagged nature of these economic variables, this won't come as a surprise to the RBNZ. Migration appears to be adding helpfully to labour supply but is also moderating from the astronomical levels seen earlier this year.

Looking ahead, we don't anticipate RBNZ rate hikes. Tight monetary policy is working and is still in the process of delivering its peak impact. Despite no change in the Official Cash Rate (OCR), 1- and 2-year mortgage rates have pushed c.30bp higher over the past month to levels around 7%. 50% of borrowers are scheduled to refix to these high rates over the next year and may lock in this restrictive policy for longer tenors due to the negative slope of the mortgage curve. We continue to expect a long-period of below-trend economic growth that creates higher levels of unemployment and lowers core inflation. We anticipate there will be enough evidence of this that the RBNZ will begin cutting the OCR at the beginning of next year but it will likely be careful in indicating an easing cycle before then.

Investment Strategy

Investment strategy has continued to reflect our judgement that over the next 3-12 months we will experience a continued phase of soft domestic activity, with headline and core inflation falling towards the Reserve Bank of New Zealand's 1% to 3% target range. We do not think it is realistic to be confident that inflation will conveniently settle within the target range, but we do think it is very likely that inflation will be moving lower. In the new year we envisage an environment where inflation is heading below 4% from the current 6% rate, where the labour market is less tight and where households are increasingly facing cash flow challenges from persistently high mortgage rates. If this outlook becomes apparent, we would expect the fixed interest market to be more willing to anticipate rate cuts from the Reserve Bank. At present the market prices the Official Cash Rate to remain above 4.5% over the next 3 years. This seems a conservative expectation and we see risks skewed towards lower interest rates being anticipated. All of this has led us to lengthen the average duration of the Fund's investments.

This strategy is primarily focused on 3 to 7 year maturities. This part of the yield curve is more sensitive to domestic monetary policy expectations and it is this aspect of the outlook that we have greater confidence in. Our view on longer maturity bonds is more circumspect. This is driven by some concern that offshore demand for New Zealand government debt may be tested as we face increased issuance of bonds to finance the government's deficits, with additional risk coming from the possibility that the current account deficit remains very high. The prospect of reduced tourist receipts and soft demand for our exports, notably in the dairy sector are the primary factors that are increasing the current account risk. As a nation with a relatively small store of financial wealth, New Zealand is reliant of offshore support to fund our consumption and investment. The risk is not so much that support is absent. It is all about marginal changes, but this can be enough to adversely affect longer-maturity bonds.

Looking beyond interest rate strategy, we are continuing to add to credit positions in the market sectors where pricing is more attractive. This continues to be within the listed property and mortgage-backed sectors. At times, new issuance of bank debt has also been appealing. Conversely, high grade credit has become more expensive relative to NZ Government stock, so with reduced yield pick-up available, we are considering reducing. Our holding in inflation-indexed bonds has been retained. They benefit from high running yield and provide protection in the event that inflation does not settle below 2.5% over the next decade.

Disclaimer

Data sources:

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Compliance Certificate

Harbour NZ Core Fixed Interest Fund (the "Fund")

Investment Mandate Compliance Certificate

for month ended 31 July 2023

Harbour Asset Management Limited (the "Manager"), certifies that to the best of our knowledge, and having made reasonable enquiries, that, and except as specified in this certificate;

1. The Fund has at all times complied with the Fund's Trust Deed;
2. The Fund has complied with internal investment guidelines, established as at 28 Sept 2011.
3. The Manager has at all times during the month complied with the policy and procedures set out in its Compliance Manual.

_______________________________ 03.08.2023

Tim Morrison
Head of Compliance
Harbour Asset Management Limited

Date