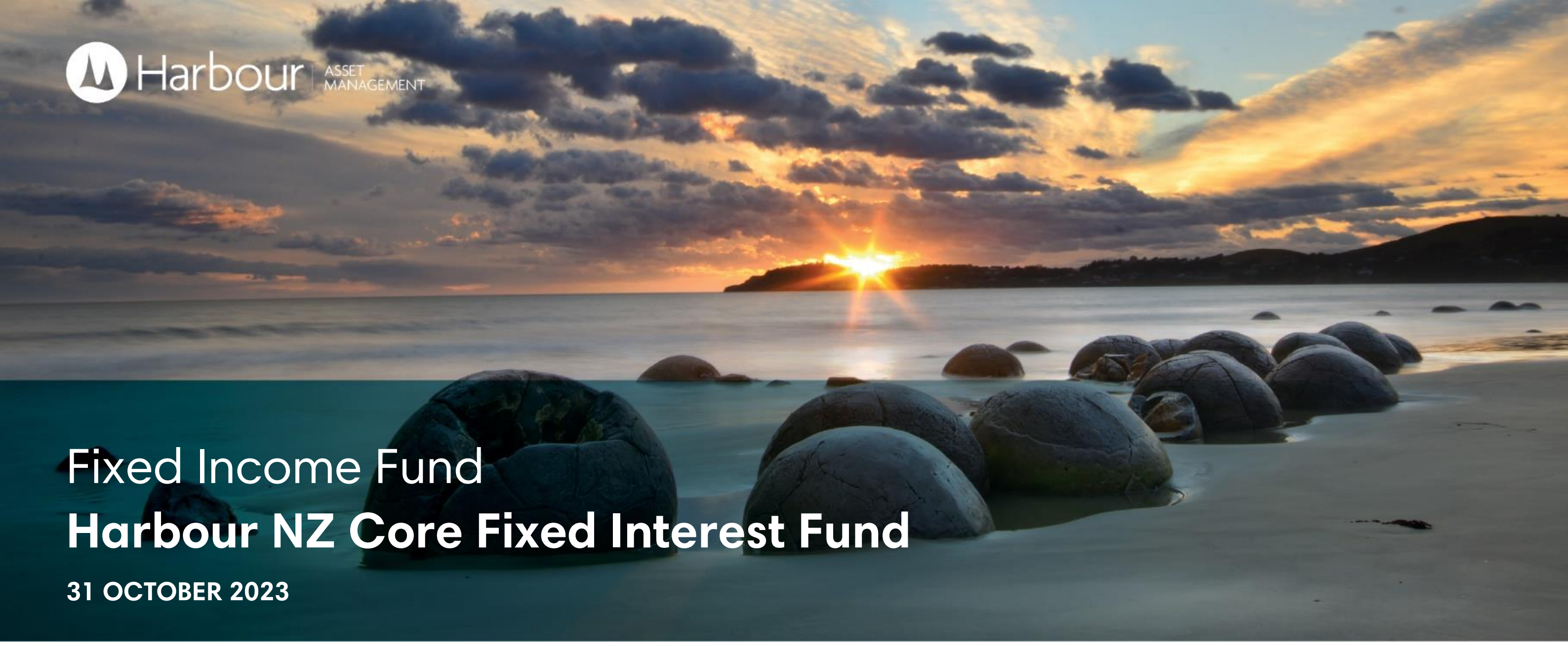


Harbour ASSET MANAGEMENT

Fixed Income Fund

Harbour NZ Core Fixed Interest Fund

31 OCTOBER 2023

1 month performance	1 year performance	Fund size	Average credit rating
-0.13%	**0.28%**	**$574,890,413**	**AA-**
Before fees & tax	Before fees & tax	NZD	

Fixed interest returns were soft again in October, despite inflation declining faster than expected. Domestically, economic data have been supportive of declining interest rates and stronger returns. However, US data that pushed global bond yields higher more than offset the better domestic news, taking yields on longer-maturity New Zealand bonds higher. The Reserve Bank of New Zealand (RBNZ) will be pleased that inflation is declining and that it appears that monetary policy is doing the job, with further declines in inflation quite probable through 2024. The market took the election result in its stride, with the initial outcome looking likely to result in a smooth transfer of power.

The Fund return of -0.1% was just ahead of the index return, with positive contributions coming from inflation-indexed bonds and security selection.

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	-0.13%	-1.97%	0.28%	-2.35%	-3.77%	0.29%	2.86%	3.33%
Benchmark return	-0.16%	-1.79%	-0.40%	-3.05%	-5.00%	-0.58%	2.29%	2.65%
Relative performance	0.03%	-0.18%	0.68%	0.70%	1.23%	0.86%	0.57%	0.68%
Tracking error	-	-	-	-	0.68%	-	-	0.65%
Information ratio	-	-	-	-	1.81	-	-	1.05

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	5.64%	5.48%	0.43%	5.57%
1m change	-0.10%	-0.15%	0.05%	0.25%
12m change	1.54%	1.17%	-0.44%	1.39%

Source: Bloomberg.

Fund characteristics

	FUND	BENCHMARK
Yield to maturity	6.06%	5.55%
Modified duration (years)	5.65	4.27
Credit duration (years)	1.19	1.10
Weighted average rating factor (WARF) ^	AA-	
Number of issuers	57	

^ 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.

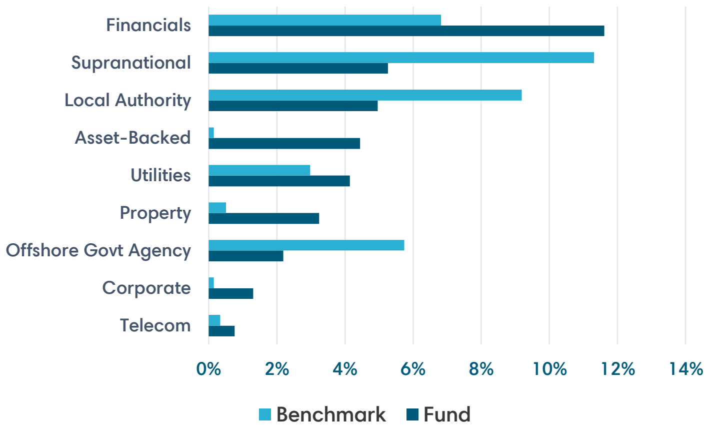
Top 10 issuer exposures

	POSITION
New Zealand Government	59.73%
BNZ / NAB	4.57%
World Bank Group	2.86%
Westpac	2.33%
Kiwibank	2.15%
Auckland Council	2.05%
NZ Local Government Funding Agency	1.95%
ASB / CBA	1.94%
Cash	1.73%
Transpower New Zealand	1.33%

Rating composition

	FUND
AAA	69.22%
AA	18.09%
A	5.31%
BBB	4.69%
NR	2.68%

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	-0.01%	-0.01%	-0.03%	-0.03%	0.00%	0.04%	0.05%
Duration & yield curve	-0.06%	-0.41%	-0.30%	-0.30%	-0.18%	-0.09%	-0.02%
Relative value	0.04%	-0.01%	0.32%	0.45%	0.30%	0.21%	0.24%
Inflation - indexed	0.03%	0.11%	0.51%	0.65%	0.37%	0.16%	0.17%
Security selection, transaction costs & other	0.03%	0.15%	0.18%	0.46%	0.38%	0.25%	0.24%
Total	0.03%	-0.18%	0.68%	1.24%	0.86%	0.57%	0.68%

Outlook and strategy

The US economy continues to show surprising resilience, growing almost 5% in Q3 on an annualised basis. Strength is concentrated in services, rather than manufacturing. Household consumption is being supported by an ongoing reduction in household savings and 30-year mortgages providing a degree of insulation from the impact of higher interest rates. With US house prices rising in recent months, after only modest declines in H2 2022, and global equities still 4% higher YTD, household balance sheets aren't providing much impetus to reduce consumption. US Federal Reserve Chair Powell noted recently that recent strength in domestic demand may require further tightening if it slows progress on lowering inflation and loosening the labour market.

The recent tightening in financial conditions, however, should help to cool the US economy. Longer-dated US interest rates have increased 30-40bp over the past month to the highest in 15 years. Inflation remains on a downward trend and labour market pressures are easing. Annual core inflation is now 3.7% from being above 5.5% in March last year. The substantial drop in the quit rate suggests wage growth should continue to decline towards pre-Covid levels of 3.5-4.0% y/y after peaking at almost 6.0% early last year.

Economic performance in the rest of the world lags the US considerably. Chinese economic growth appears to be stabilising at low levels, growing 1.3% in Q3. A pickup in official

PMIs in September suggests the worst may be over for the Chinese economy but structural challenges remain when it comes to consumption and the property sector. Recent indicators suggest the euro area economy may avoid recession this year, but growth is still likely to be anaemic. As such, markets assume the European Central Bank has finished its tightening cycle.

Monetary policy is working in New Zealand and the Reserve Bank of New Zealand (RBNZ) seems happy to be on hold at 5.5%. Annual core inflation dropped from 5.7% to 5.2% in Q3. Business surveys suggest the labour market has loosened considerably, likely helped by the recent high rates of migration. Firms are no longer struggling to find labour and are instead being constrained by a lack of demand. A net 17% of firms reported lower activity in Q3 which is consistent with no GDP growth in the coming quarters. At its October Monetary Policy Review, the RBNZ noted that tight policy is working "as required" with the near-term risk that activity and inflation don't slow as much as needed offset by the medium-term risk of a greater slowdown in global demand. **We don't expect further tightening and anticipate the first rate cut in May next year.**

House price gains stalled in September. The new National-led government, however, is likely to encourage a reacceleration in house prices in the coming months, as they plan to reintroduce interest cost deductibility for landlords, change the "bright-line" property rule for capital gains on investment properties to 2 years (from 5 years for new builds and 10 years for other properties) and allow foreigners to buy houses above $2mn. But housing market challenges remain with almost half of all outstanding mortgages to roll on to materially higher rates this year, house prices still 20-30% above fair value (based on house price-to-income ratios and the amount of household disposable income needed to service an average mortgage, vs. historical averages) and unemployment likely to rise.

The new government is unlikely to materially change the outlook for fiscal balances and the corresponding bond programme. The Half-Yearly Economic and Fiscal Update in December is likely to show fiscal surpluses don't return until fiscal year 2027, the same story we heard from Labour in September. But the new government may need to incorporate a less rosy outlook for the economy which would have a negative impact on tax revenue and place more pressure on bond issuance to fill the gap. The RBNZ expects the economy to contract 0.2% over the next three quarters, while Treasury expect it to expand 1.3%. On the other hand, coalition partner, ACT, has a more fiscally conservative attitude that may pressure government spending to be reduced.

Investment Strategy

Over recent months our investment view has steadily shifted from being relatively balanced to one that has a higher degree of conviction. The change has arisen from a growing belief that the economy is slowing and that inflation will decline meaningfully in 2024. Meanwhile market pricing during October went in the opposite direction, pricing not only some scope for another hike in the Official Cash Rate, but also a very limited expectation that the OCR would fall in years to come. We are firmly of the view that financial conditions are tight in New Zealand and that the period of intense pressure in the labour market is passing.

Our view is that the economy is moving into an environment of declining inflation (from very lofty levels) and will continue to do so while the present tight monetary policy is in play. This is cyclical in nature and does not eliminate the risk that a more secular inflationary environment may resurface in time. If inflation does prove to be an issue in future years, it may mean that the OCR can only be lowered to somewhere near 3% to 4%. But for now, 5% looks a very tough level for households and businesses to cope with. Therefore, we see a balance of risks that will take interest rates lower through 2024. For this reason, the portfolio has a long duration position which is focussed on the 2-5 year maturity range, which is where medium term monetary policy expectations are priced. In early November, the Q3 jobs data have been released and provided further evidence that the labour market pressure is easing. This caused market rates to fall and we see scope for this to continue.

There are other themes that are reflected in the portfolio. For the last few decades New Zealand has benefitted from a highly impressive and credible fiscal policy regime, supported by successive governments. However Covid-19 prompted a fairly significant shift in approach, with debt issuance increasing significantly to support households through this time. Concurrently, the need to rebuild infrastructure, due to both neglect and weather-related events, has meant that even more debt has needed to be issued. New Zealand still remains at the better end of global rankings in this regard, but the fixed interest market is showing signs of indigestion as the issuance of central and local government debt increases. The global backdrop is also concerning, notably in the United States, where similar challenges are faced. This has meant that the 'term premium', which captures the extra yield required to entice investors to own longer-term bonds has increased. New Zealand citizens bear this cost and a greater proportion of government revenue will be taken up with debt servicing costs. The development of this theme has been a focal point in markets over recent months and has led us to be somewhat circumspect about investing in bonds with a maturity of 10 years or greater. We don't anticipate a buyer's strike; more likely is an environment of periodic jumpiness that requires prudent risk management.

Finally, the corporate bond sector remains of interest to us, despite the expectation of a weaker economy, which can stress firms that are excessively geared or cyclical in nature. Recently the Reserve Bank released their Financial Stability Report and reaffirmed the judgement that the major banks in New Zealand are in a strong financial position. We agree with that and have, through the year, participated in new bond deals where pricing is attractive. In areas such as mortgage-backed securities we have been only investing in the most senior (and best protected) deals. This has been the case for 2 years, ever since interest rates started to rise. Overall, we are willing to add to credit investments where quality and pricing are appealing.

Disclaimer

also manages a retail version, which is part of Harbour Investment Funds. The retail fund invests wholly in the wholesale fund. Harbour Asset Management Limited is the issuer of Harbour Investment Funds (Funds). A copy of the Product Disclosure Statement (PDS) for the retail version of this fund is available at https://www.harbourasset.co.nz/our-funds/investor-documents/. Past performance is not indicative of future results and no representation is made regarding future performance of the Funds. No person guarantees the performance of any funds managed by Harbour Asset Management Limited.

Data sources:

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COMPLIANCE CERTIFICATE

Harbour NZ Core Fixed Interest Fund (the "Fund") (Wholesale Unit Trust)

For month ended 31 October 2023

Harbour Asset Management Limited (the "Manager"), certifies that, to the best of our knowledge, after having made reasonable enquiries, 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

Tim Morrison
Head of Compliance
Harbour Asset Management Limited

Dated 04 November 2023