nikko am
Nikko Asset Management

Factsheet 30 September 2018

NIKKO AM GLOBAL BOND STRATEGY

Applies to: Nikko AM Wholesale Global Bond Fund and Nikko AM Global Bond Fund (retail)

Market Overview

- The US Federal Reserve (FED) raised the funds rate target by 0.25% to 2.25% at its September meeting.
- Italian government bonds have sold-off, with the 10-year yield exceeding 3% after Italy published its updated Stability programme, which confirms the government will adopt looser fiscal policy.
- Emerging market (EM) asset performance improved in September after a weak August. The JP Morgan EMBI Global Diversified Index returned 1.5% over the month and spreads tightened by 0.35% to 3.35% over US Treasuries.

Fund Highlights

- The Fund outperformed the benchmark over the quarter, returning 0.22% vs -0.04% (gross, NZD).
- Duration strategy and sector allocation contributed most to performance while country selection and currency underperformed over the quarter.
- We remain underweight agency MBS as we expect spreads to widen further as the Fed continues to reduce its reinvestments and given reduced demand from banks.

Performance

	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	-0.23%	0.22%	1.91%	4.04%	5.48%	6.64%
Benchmark[2]	-0.38%	-0.04%	1.15%	3.58%	5.24%	6.50%
Retail[3]	-0.34%	0.09%	0.97%	2.98%		

1. Returns are before tax and before the deduction of fees
2. Benchmark: Bloomberg Barclays Global Aggregate Index, hedged into NZD. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any)

Investment Manager

Nikko AM NZ uses Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers. GSAM's Global Fixed Income Team manages over US$525 billion of global fixed income and currency assets.

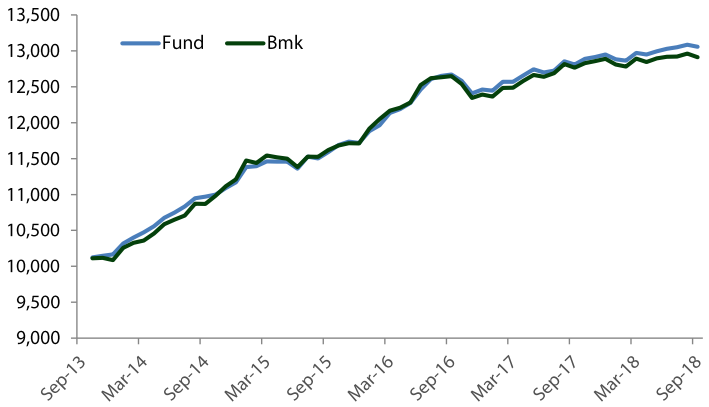
Overview

The Strategy aims to provide investors with regular income by constructing an actively managed investment portfolio of permitted investments, with the potential for capital gain from global fixed interest markets.

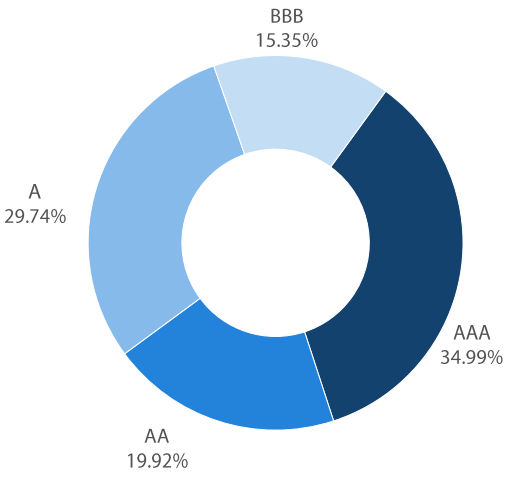
Objective

The Strategy aims to outperform the benchmark return by 1.00% per annum before fees, expenses and taxes over a rolling three year period.

Five Year Cumulative Performance[1, 2]



Asset Allocation



Sector Allocation (% of fund)	Fund	Index
Governments	30.90%	50.48%
Agency	9.52%	8.89%
Collateralised & MBS	33.93%	12.47%
Credit	23.18%	21.48%
Emerging market debt	6.97%	6.68%
Cash, derivatives, other	-4.50%	0.00%

Duration
Fund 6.76 years vs Benchmark 6.90 years

Yield
Fund (gross) 3.17% vs Benchmark 2.87%

Market Commentary (source: GSAM)

The US Federal Reserve raised the funds rate target by 0.25% to 2.25% at its September meeting. The median policymaker projection points to one further rate hike this year and three in 2019. This is consistent with our expectations but more than market-implied pricing. We retain our bias to be underweight front–end US rates, though we have used a recent sell- off in developed market rates as an opportunity to scale back underweight exposure.

Italian government bonds have sold-off, with 10-year yield exceeding 3% after Italy published its updated Stability Programme, which confirms the government will adopt looser fiscal policy. The government projects a 2019 government deficit-to-GDP ratio of 2.4%, while market participants expected this to be set below 2% based on recent communications by the Finance Minister. We think the budget deficit-to-GDP ratio will be higher than 2.4% in 2019 as real GDP growth is unlikely reach 1.5% as projected by the Italian finance ministry.

Emerging market performance improved in September after a weak August. The JP Morgan EMBI Global Diversified Index returned 1.5% over the month and spreads tightened 0.35% to 3.35% over US Treasuries. Several factors drove performance in September; policymaker actions including a larger-than-expected rate hike in Turkey, constructive trade developments between the US, Canada and Mexico and a revised International Monetary Fund stand-by arrangement deal for Argentina.

Fund Commentary

The fund outperformed the benchmark over the quarter, returning 0.22% vs -0.04% (gross, NZD). Duration strategy and sector allocation contributed the most to performance while country selection and currency underperformed over the quarter. We remain underweight agency MBS as we expect spreads to widen further as the Fed continues to reduce its reinvestments and given reduced demand from Banks. Within the sector we are underweight lower coupon securities where performance is challenged by high new supply, while we are overweight higher coupons.

We are overweight investment grade corporate credit. The macro backdrop is more nuanced given political uncertainty in Italy (and in the UK) as well as ongoing trade tensions between the US and China. That said, contagion to risk assets, including corporate credit, has been limited and idiosyncratic concerns across EM markets appear to have calmed. Looking beyond these headwinds, the underlying macro and corporate fundamentals picture is constructive; economic growth is still expansionary, corporate earnings growth is strong and a decline in new issuance ahead of third-quarter earnings releases should serve as a near-term tailwind.

Key Fund Facts

Distributions

Wholesale fund: Calendar quarter
Retail fund: Calendar quarter

Estimated annual fund charges

Wholesale: Negotiated outside of unit price
Retail: 0.90%, refer PDS for more details

Hedging

All investments will be hedged to New Zealand dollars within an operational range of 98.5% - 101.5%.

Buy / Sell spread

0.00% / 0.00%

Strategy size

$250.3m

Strategy Launch

October 2008

Compliance

The Fund complied with its investment mandate and trust deed during the month.

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