nikko am
Nikko Asset Management

Factsheet 31 December 2018

NIKKO AM GLOBAL BOND STRATEGY

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

Market Overview

- US Federal Reserve (Fed) delivered its fourth rate hike of 2018 at its December meeting though the median policymaker projection for rate hikes in 2019 and was lowered from three to two.
- Over the quarter, a loss of momentum in global activity data and tighter global financial conditions (mainly in the US due to lower equity prices and wider corporate credit spreads) led to concerns. This weighed on investor risk sentiment and prompted underperformance in spread sectors, including corporate credit.
- Agency mortgage-backed securities (MBS) underperformed duration-neutral US Treasuries by 0.15% in December and by 0.59% in 2018. This marks the weakest annual performance versus US Treasuries since 2011.

Fund Highlights

- The fund underperformed the benchmark over the quarter.
- Duration and sector allocation were the main detractors to value over the quarter while country selection was the main contributor.

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

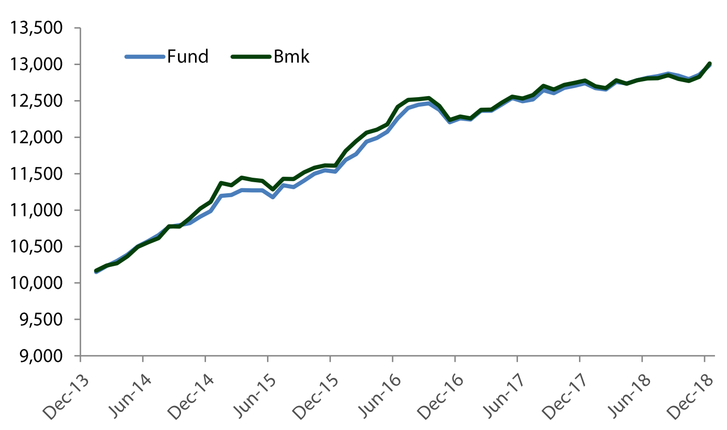
The Strategy aims to outperform the benchmark return by 1% per annum before fees, expenses and taxes over a rolling three year period.

Performance

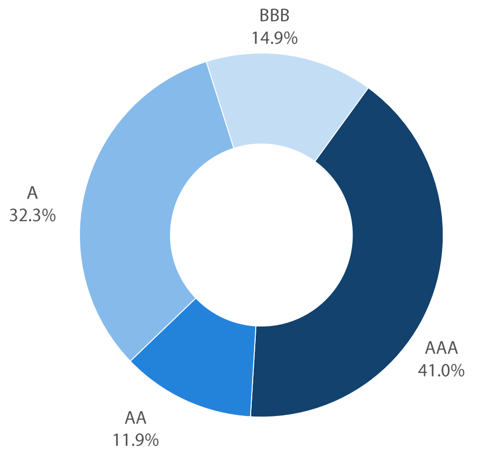
	One month	Three months	One year	Three years (p.a.)	Five years (p.a.)	Ten years (p.a.)
Wholesale[1]	1.04%	1.15%	1.98%	4.06%	5.37%	6.54%
Benchmark[2]	1.42%	1.65%	1.82%	3.87%	5.41%	6.09%
Retail[3]	1.00%	0.98%	1.13%	3.06%	4.31%	

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)

Five Year Cumulative Performance[1, 2]



Asset Allocation



Sector Allocation (% of fund)	Fund	Index
Governments	28.97%	51.23%
Agency	9.30%	8.62%
Collateralised & MBS	32.15%	12.69%
Credit	24.03%	20.92%
Emerging market debt	6.89%	6.54%
Cash, derivatives, other	-1.34%	0.00%

Duration
Fund 6.97 years vs Benchmark 6.83 years

Yield
Fund (gross) 3.11% vs Benchmark 2.64%

Market Commentary (source: GSAM)

The US Federal Reserve (Fed) delivered its fourth rate hike of 2018 at its December meeting though the median policymaker projection for rate hikes in 2019 and was lowered from three to two. Agency mortgage-backed securities (MBS) underperformed duration-neutral US Treasuries by 0.15% in December and by 0.59% in 2018. This marks the weakest annual performance versus US Treasuries since 2011. Underperformance was induced by several factors including rate volatility, supply-demand headwinds and broader risk-off investment sentiment. We attribute the majority of underperformance to higher rate volatility, with US 10-year Treasury yields moving beyond the 'range-bound' trend observed in 2017. Reduced reinvestments saw the Fed's balance sheet size decline by -$130bn in 2018. We estimate a further -$180bn decline in 2019. A diminishing Fed footprint in the Agency MBS market requires a greater participation from private investors, prompting wider spreads over US Treasuries. During the fourth quarter, particularly in the final month, lower coupon MBS outperformed higher coupon amid lower US Treasury yields and a flatter US Treasury yield curve. Broader risk-off market sentiment contributed to an unwind of positions which accelerated weakness in the sector. Although US asset-backed securities (ABS) and agency MBS generated negative excess returns over duration neutral US Treasuries last year, they generally outperformed other spread sectors. Investment grade corporate credit weakened in December, with spreads on the Bloomberg Barclays Global Aggregate Corporate index widening by 0.12% to 1.55% over Sovereigns.

Fund Commentary (source: GSAM)

The fund underperformed the benchmark over the quarter. Duration and sector allocation were the main detractors to value over the quarter while country selection was the main contributor.

Our base case expectation for US monetary tightening in 2019 has also been lowered to two rate hikes from three previously. That said, we remain hawkish relative to market-implied pricing which points to rate cuts in 2019. As such, in our **duration strategy** we retain our bearish front-end (short-term) US rate bias. We are underweight agency **MBS** as we expect spreads to widen amid the Fed's balance sheet runoff.

Following a sharp reset lower in valuations in 2018, particularly during the final quarter, we think the early-2019 investment backdrop presents an opening to add exposure to high conviction views at attractive levels in **corporate credit**. We are overweight BBB-rated bonds, while underweight AA- and A-rated securities. We believe the BBB segment of the market offers attractive carry and opportunities for active security selection give its large size and sector range. Additionally, BBB-rated companies that have increased leverage in the current cycle tend to operate in defensive sectors. Many are also large market capitalization companies with greater ability to preserve their credit rating through corporate actions such as reduced dividend payments and asset sales.

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

$255.9m

Strategy Launch

October 2008

Compliance

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

Contact Us

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