Nikko AM NZ Unit Trusts (Retail) Fund Summary

Nikko AM Global Bond Fund 31 January 2016

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. We actively manage over NZ$4.8 billion of investments for a diverse group of clients, including superannuation schemes, charitable trusts, KiwiSaver scheme providers, corporations and local government along with providing services to financial intermediaries through wrap platforms.

We offer investment management services in domestic sectors (equities, fixed interest and cash) through our Auckland-based investment team and employ offshore managers to manage global sectors (global equities, global bonds and alternative investments).

Investment manager

Nikko AM use Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed income assets.

Established in 1988, GSAM is one of the world's leading asset managers with US$702 billion in assets under management. GSAM's Global Fixed Income Team manages US$306 billion of global fixed income assets and has a breadth of investment management expertise with over 200 investment professionals. The globally integrated team has independent strategy teams capturing value across top down (duration, cross sector and country) and bottom up (investment grade credit, high yield, MBS/ABS, government/agency and emerging market debt) strategies.

GSAM was appointed to manage Nikko AM's global fixed income assets in June 2012.

Fund launch

June 2012 (a similar portfolio has been operated by Nikko AM since March 2002).

Investment objective

The objective of the Fund is to construct a portfolio of authorised investments that outperform the Fund's benchmark return by 1.0% per annum over a rolling three year period before fees, expenses and taxes.

Benchmark

Barclays Capital Global Aggregate Index hedged into NZD

Investment philosophy and process

GSAM's investment philosophy and style is such that they aim to generate outperformance over time without being unduly exposed to one particular investment strategy or market circumstance. GSAM's global approach enables them to capture diverse sources of excess returns and their risk management process ensures the portfolio is not dependent on any particular market inefficiency that may dissipate. The GSAM global fixed interest portfolio is constructed in such a way that aims, over time, to react well to different economic conditions.

The management of GSAM's global fixed interest portfolios is team-based with investment decisions taken collectively, following thorough discussion and debate. The investment process encompasses three key steps:

Step 1: Build a risk budget that takes account of the investment objectives, guidelines and benchmark of the mandate.

Step 2: Identify attractive investment opportunities and implement the best ideas from the specialist top down and bottom up investment strategy teams.

Step 3: Monitor risk and attribution to ensure risks are consistent with investment guidelines.

Hedging policy

All assets are 100% hedged into NZD.

Structure and taxation

The Fund vehicle is a Unit Trust and Portfolio Investment Entity (PIE) which is priced daily. Unit holders elect their own Portfolio Investment Rate. Information is provided to the IRD and unit holders on an annual basis.

The Fund gains its exposure by investing in the Nikko AM Wholesale Global Bond Fund.

PIE eligibility

Nikko AM may take any action it deems appropriate to ensure the Fund remains eligible to be a PIE. This includes the ability of Nikko AM to compulsorily withdraw a unit holder's units and pay the proceeds to that unit holder's nominated bank account.

Distributions

Quarterly. Last business days of March, June, September and December.

Investment restrictions

Nikko AM Wholesale Global Bond Fund – the wholesale unit trust that the Nikko AM Global Bond Fund invests into.

- Authorised investments include global investment grade bonds, global high yield and emerging market debt securities, money market instruments, spot and forward currency contracts; mortgage backed securities; structured securities; derivative instruments including futures, swaps, Forward Rate Agreements and options; and affiliated mutual funds.
- Long term rated securities must be rated BBB- or higher by Standard & Poor's, Moody's and/or Fitch.
- Short term rated money market investments must be rated A2/P2/F2 or better by Standard & Poor's, Moody's and/or Fitch.
- Weighted average modified duration within +/- 2.5 years of the benchmark's weighted average modified duration.
- Unrated securities are permissible if, in the opinion of the Manager, the credit quality of the security is equal to or better than the minimum permissible credit quality.
- Maximum of 5% aggregate exposure to bonds of any one corporate issuer, excluding single-name credit default swap exposures.

Management fees and other charges

A management fee of 0.65% per annum calculated as a percentage of the gross asset value of the Fund will be calculated and deducted from the Fund. This fee is calculated daily and is payable to Nikko AM. The management fee may be reduced or waived at our discretion.

Nikko AM may recover expenses (including the Trustee fee) up to a maximum of 0.25% per annum from the Fund.

Buy/sell spread

Nil

Trustee

Public Trust

Custodian

Public Trust as legal custodian, BNP Paribas Fund Services Australasia Pty Limited delegated as functional custodian.

Minimum investment

Initial investment	$5,000
Further investments	$1,000

The Manager may accept applications for investments below the minimum investment amount at its discretion.

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Performance
(NZD returns; before tax, after fees and expenses)

1 month	3 months	6 months	1 year
1.00%	1.12%	2.41%	3.30%
2 years (pa)	**3 years (pa)**	**5 years (pa)**	**Inception (pa)***
6.18%	n.a.	n.a.	6.45%

* December 2013

Asset allocation

Credit quality rating	
AAA	29.9%
AA+, AA, AA-	11.1%
A+, A, A-	30.2%
BBB	24.0%
Unrated	0.3%
Derivatives & liquidity	4.5%

Sector	Fund	Index
Governments	30.8%	51.4%
Agency	4.0%	9.4%
Credit	29.9%	20.4%
Collateralised & MBS	25.9%	12.6%
Emerging market debt	4.9%	6.2%
Cash, derivatives, other	4.5%	0.0%
Number of holdings	482	17,124

Duration and yield

Duration	Fund 6.58 years	vs benchmark 6.37 years
Yield to Maturity	Fund 4.27%	vs benchmark 3.76%

Commentary

Government bond yields tightened across developed markets in January. In the US, the benchmark 10-year yield closed the month 35 basis points lower at 1.92%. Rates on Japanese and UK government bonds followed this downward trend, ending the month at 1.56% and 0.10%, respectively. In Europe, German 10-year yields tightened 30 basis points ending the month at 0.32%. European peripheral spreads tightened over the period with Spanish and Italian 10-year yields tightening by 14 basis points and 18 basis points, respectively.

In the US, financial conditions have crept near recent tights, driven by a strong dollar and weakness in credit markets. These levels suggest the Federal Reserve (Fed) is unlikely to raise interest rates more than three times this year, after announcing liftoff following the Federal Open Markets Committee (FOMC) meeting in December. GSAM has moved from long to neutral in US rates over the course of the month. Dovish comments from members of the FOMC following the January meeting support this view that the Fed may not raise interest rates in March. GSAM is neutral in Europe, as upside surprises in recent economic data contend with expectations for further easing from the European Central Bank (ECB) given persistently low inflation data.

Within the G10, GSAM maintains a long position in European rates and short positions in the US and UK. The ECB was on hold in January, but signalled it will likely ease again in March. GSAM expects low inflation to prompt the ECB to maintain its accommodative stance with the potential for further easing. GSAM has a positive view on peripherals, expecting low core yields, strong growth, and tighter spreads to result from ECB buying programs.

Agency **mortgage-backed securities** (MBS) underperformed duration-neutral US Treasuries in January. A decline in the headline 30-year mortgage rate led to renewed market concern about the potential for rising prepayment speeds. In addition, the market responded negatively to relatively dovish Fed commentary which lowered investors' expectations for a further Fed rate hike in March. Ginnie Mae (GNMA) MBS had experienced sustained underperformance versus conventionals in the first half of 2015 following policy action that stimulated higher GNMA prepayment speeds. GNMA MBS have since partially corrected and modestly outperformed conventionals in January.

GSAM has re-established an underweight position in agency MBS following underperformance in the sector in January. Within the mortgage sector, GSAM maintains an overweight in GNMA MBS which continues to trade at attractive levels. We expect GNMA prepayment speeds to continue their convergence to lower conventional mortgage prepayment speeds, which should further benefit GNMA valuations versus those of Fannie Mae and Freddie Mac mortgage securities.

Investment grade **corporate credit** spreads widened over January, with spreads on the Barclays Global Aggregate Corporates Index widening 24 basis points to 183 basis points over sovereigns. US corporates weakened, with spreads on the Barclays US Aggregate Corporates Index widening 28 basis points to 193 basis points over sovereigns. European corporates outperformed US corporates, with spreads on the Barclays Euro Aggregate Corporates Index widening 16 basis points to 150 basis points over sovereigns. Gross new issuance in the US for January was approximately US$103 billion, with industrial issuers representing the largest portion. Issuance was weaker in the European market, at around US$34 billion.

GSAM holds an overweight position in investment grade credit, which has reached attractive valuations in recent months. However, they have reduced their exposure due to the potential impact of lower oil prices on corporate credit at this late stage of the credit cycle, as well as in relation to rising concerns that the downturn in the US manufacturing sector may spread to the rest of the economy. GSAM's constructive credit view is underpinned by a number of factors including valuations that look attractive based on fair value estimates and that would require spreads to widen over the next 12 months to the 85th-90th (widest) percentile of the historical distribution to offset the current level of carry on a mark-to-market basis. Within the credit quality spectrum, GSAM maintains a bias to lower-quality credit as well as a preference for the intermediate part of the corporate term structure. GSAM has overweight positions in banking, consumer products and pipelines (mainly as a result of bottom-up views), while are underweight the energy, electrics and media non-cable industries.

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