

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. We actively manage over NZ\$4.9 billion of investments for a diverse group of clients, including superannuation schemes, charitable trusts, KiwiSaver scheme providers, corporations and local government all 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

The wholesale fund is generally fully hedged into the 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.

Performance

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

| 1 month | 3 months | 6 months | 1 year |
|--------------|--------------|--------------|-----------------|
| 0.48% | 2.71% | 3.86% | 5.33% |
| 2 years (pa) | 3 years (pa) | 5 years (pa) | Inception (pa)* |
| 6.51% | n.a. | n.a. | 6.95% |

* December 2013

Asset allocation

| Credit quality rating | |
|-------------------------|-------|
| AAA | 40.7% |
| AA+, AA, AA- | 10.9% |
| A+, A, A- | 29.8% |
| BBB | 20.7% |
| BB | 0.3% |
| Unrated | 0.2% |
| Derivatives & liquidity | -2.6% |

| Sector | Fund | Index |
|--------------------------|-------|--------|
| Governments | 39.2% | 52.1% |
| Agency | 6.4% | 9.4% |
| Credit | 26.4% | 20.4% |
| Collateralised & MBS | 25.7% | 11.9% |
| Emerging market debt | 4.9% | 6.2% |
| Cash, derivatives, other | -2.6% | 0.0% |
| Number of holdings | 474 | 17,189 |

Duration and yield

| | | |
|-------------------|-----------------|------------------------|
| Duration | Fund 5.55 years | vs benchmark 6.6 years |
| Yield to Maturity | Fund 3.76% | vs benchmark 3.3% |

Commentary

Government bonds sold-off across developed markets over the month of April. In the US, the benchmark 10-year yield closed the month 6 basis points higher at 1.83%. Rates on UK government bonds followed this upward trend, ending the month at 1.60%, up 18 basis points. In Japan, the 10-year yield went further negative to close at -0.08%, down 5 basis points. In Europe, German 10-year yields increased 12 basis points to end the month at 0.27%. European peripheral spreads also widened over the period, with Spanish and Italian 10-year yields widening by 4 basis points and 15 basis points, respectively.

GSAM maintained the Fund's short **duration** position in US rates over the course of the month though the Fed statement in April was slightly more dovish than expected. In Europe, the ECB published further details of its corporate sector asset purchase program in April. Purchases will start in June and will be carried out by six national central banks, with the ECB coordinating the purchases and full risk-sharing. GSAM maintained the neutral position in European rates in April. A small short position was added in Japan as the yield curve has experienced significant flattening since the introduction of negative rates. GSAM believe stretched valuations and a number of upcoming fiscal and monetary policy meetings will pressure rates higher, particularly at the long end of the curve.

Investment grade **corporates** strengthened over April as risk appetite improved on better economic data and stronger oil prices, with spreads on the Barclays Global Aggregate Corporates Index tightening 15 basis points to 143 basis points over sovereigns. US corporates strengthened, with spreads on the Barclays US Aggregate Corporates Index tightening 17 basis points to 146 basis points over sovereigns. European corporates underperformed US corporates, with spreads on the Barclays Euro Aggregate Corporates Index tightening 9 basis points to 122 basis points over sovereigns. Also notable was that following recent months of underperformance, investment grade banks have started to narrow their performance gap with non-financials. Credit derivatives underperformed cash bonds in the US and Europe, with spreads on the CDX IG S26 Index tightening 1 basis point to 77 basis points, and spreads on the iTraxx EUR S25 Index remaining unchanged at 73 basis points. Gross new issuance for the month declined further, amounting to roughly \$68 billion in the US and \$69 billion in Europe.

The Fund holds a modest long position in corporate credit. However, the overweight position has been pared back as a result of meaningful rallies since February, less risk premia due to reduced market concern over global risk factors and the fact that seasonals tend to be less supportive in May and June. Large rallies have driven valuations to levels that warrant a more modest overweight, in our view. Given we are in the late stage of the credit cycle, we want to take this opportunity to reduce exposure to names that have recently tightened and that were very illiquid during the first quarter of the year. Within the credit quality spectrum, we maintain a bias to triple-B rated credit as well as a preference for the intermediate part of the corporate term structure. The Fund has an overweight position in consumer products, banking and tobacco (mainly as a result of single-security, bottom-up views rather than thematic sector-level decisions), while underweight the energy, insurance and media non-cable industries.

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General Enquiries: NZenquiries@nikkoam.com | +64 9 307 6363