Nikko AM NZ Unit Trusts (Retail) — Fund Summary

Nikko AM Global Bond Fund — 31 May 2016

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. We actively manage NZ$5.0 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

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.

nikko am
Nikko Asset Management

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

1 month	3 months	6 months	1 year
0.43%	2.34%	3.79%	6.12%
2 years (pa)	**3 years (pa)**	**5 years (pa)**	**Inception (pa)***
6.10%	n.a.	n.a.	6.89%

* December 2013

Asset allocation

Credit quality rating	
AAA	36.2%
AA+, AA, AA-	13.5%
A+, A, A-	30.4%
BBB	19.6%
BB	0.3%
Unrated	0.0%

Sector	Fund	Index
Governments	35.1%	51.9%
Agency	8.6%	9.3%
Credit	24.3%	20.7%
Collateralised & MBS	26.1%	12.0%
Emerging market debt	4.6%	6.1%
Cash, derivatives, other	1.3%	0.0%
Number of holdings	449	17,342

Duration and yield

Duration	Fund 5.7 years	vs benchmark 6.6 years
Yield to Maturity	Fund 3.7%	vs benchmark 3.3%

Commentary

Government bonds rallied broadly across developed markets over the month of May. In the US, however, the benchmark 10-year yield closed the month 2bps higher at 1.85%. Rates on UK government bonds rallied, ending the month at 1.43%, down 17bps. In Japan, the 10-year yield went further negative to close at -0.11%, down 3bps. In Europe, German 10-year yields decreased 13bps to end the month at 0.14%. European peripheral spreads also widened over the period, with Spanish and Italian 10-year yields widening by 12bps and 13bps, respectively.

The Fund's short position in US rates was maintained over the month. The hawkish Fed statement in May led to tightening US financial conditions and a rally in the US dollar. Weaker than expected payrolls significantly reduced market probabilities for a rate hike in June or July. In Europe, the ECB will start its corporate sector asset purchase program in June, which will be carried out by six national central banks, with the ECB coordinating the purchases and full risk-sharing. The Fund remained neutral in European rates in May. News that Prime Minister of Japan Shinzo Abe will postpone the consumption tax hike scheduled for next year had little impact on Japanese government bonds. The Fund maintained its short position in Japan.

Agency mortgage-backed securities (MBS) outperformed duration-neutral US Treasuries by 17bps in May. March TIC (Treasury International Capital) data, released in mid-May, show that overseas investors added $15.4bn in agency MBS over the month, led by Japan ($11.7bn). Additionally, US commercial bank demand for agency MBS has also picked up in the second quarter, with banks adding over $20bn in mortgage securities on a net basis. This follows a first quarter where banks only added $8bn in agency MBS.

The Fund remains underweight agency MBS as GSAM expect bank demand to be notably weaker in the second and third quarters similar to past years, while a stronger housing market and summer seasonal factors should lead to an increase in net mortgage supply. The Fund remains underweight 15 year mortgages, as valuations continue to appear full relative to 30 year mortgages. GSAM believe senior collateralized loan obligations (CLOs) and Federal Family Education Loan Program (FFELP) student loan asset-backed securities (ABS) offer attractive spread with strong credit protection and remain among the most compelling sectors in securitized products. GSAM are positive on residential mortgage credit, particularly legacy non-agency MBS, which continue to benefit from negative net supply and show improving collateral performance.

Despite May being one of the highest new issuance months, **investment grade corporates** widened only modestly, highlighting the strength of the market to absorb the large issuance. Spreads on the Barclays Global Aggregate Corporates Index widened 3bps to 146bps over sovereigns. US corporates also weakened, with spreads on the Barclays US Aggregate Corporates Index widening 3bps to 149bps over sovereigns. European corporates underperformed US corporates, with spreads on the Barclays Euro Aggregate Corporates Index widening 6bps to 128bps over sovereigns. Gross new issuance for the month amounted to roughly $152bn in the US, which is the highest monthly issuance year-to-date. European markets also saw high issuance of around $77bn, mainly led by non-financials, an impact of the ECB's Corporate Sector Purchase Program.

GSAM have a modestly positive to flat view on credit. There appears to be reduced chances of significant near-term weakness in credit, but GSAM remain cautious in exposure given we are in the later stages of the credit cycle. Within the credit quality spectrum, the Fund maintains a down-in-quality bias, favouring triple-B rated credit, as well as a preference for the intermediate part of the corporate term structure. GSAM see value in consumer products, pipelines and tobacco, mainly as a result of single-security, bottom-up views rather than thematic sector-level decisions. The Fund is also overweight banks as GSAM are becoming more positive on the sector, particularly in the US. The Fund is underweight the energy, insurance and chemicals industries.

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