nikko am
Nikko Asset Management

NIKKO AM GLOBAL BOND FUND

Monthly Fact Sheet 31 January 2017

Investment objective

The objective of the Fund is to construct a portfolio of permitted 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

Bloomberg Barclays Global Aggregate Index, hedged into NZD

Fund description

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

The Fund gains its investment exposure by investing into the Nikko AM Wholesale Global Bond Fund. The nominated global manager (Goldman Sachs Asset Management) is responsible for the investment management of the assets of the Nikko AM Wholesale Global Bond Fund.

Currency management

Foreign currency exposures created as a consequence of capital markets investment remain hedged to NZD within an operational range of 98.5% to 101.5%. Currency hedging contracts are held in the Nikko AM Wholesale Global Bond Fund.

Management fees and other charges

A management fee of 0.65% per annum calculated as a percentage of the net asset value of the Fund will be calculated and deducted from the Fund.

Nikko AM may also recover expenses (including the Trustee fee) from the Fund up to a maximum of 0.25% per annum of the Fund's net asset value. An estimate of expenses as at the time of publication is 0.20% per annum.

Buy/sell spread

Nil

Strategic asset allocation

	Target	Range
Nikko AM Wholesale Global Bond Fund	100%	95% ⇔ 100%
Cash on call for investor transactions	0%	0% ⇔ 5%

Refer to the SIPO for full details of permitted investments and restrictions.

Performance

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

1 month	3 months	6 months	1 year
-0.19%	-1.30%	-1.49%	3.90%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
3.60%	5.41%		5.57%

* December 2013

Asset allocation

Credit quality rating	Fund
AAA	38.0%
AA+, AA. AA-	13.7%
A+, A, A-	32.6%
BBB	15.5%
BB	0.2%

Sector	Fund	Index
Governments	36.6%	51.1%
Agency	4.6%	9.3%
Credit	16.2%	21.2%
Collateralised & MBS	31.7%	12.3%
Emerging market debt	3.6%	6.1%
Cash, derivatives, other	7.3%	0.0%

Duration and yield

Duration	Fund 7.04 years versus benchmark 6.73 years
Yield to Maturity	Fund 3.37% versus benchmark 3.09%

Commentary

The **Fund** outperformed over the month of January. Country allocation added 0.08% and sector allocation added 0.04%. Stock selection within the government sector added 0.09%. The detractors were stock selection within the securitised sector of -0.04% and duration strategy of -0.03%.

The rise in US Treasury **yields** moderated in January with yields relatively unchanged over the month from 2016 year-end levels. Government bond yields in Europe rose over the month, with the yield on the 10-year government bond in the UK and Germany rising 17bps and 28bps, respectively. The yield on the Japanese 10-year government bond rose by 4bps over the month to end the month at 0.08%, but has remained relatively range bound since the introduction of the Bank of Japan's (BoJ) yield curve control policy. Elsewhere in Europe, the yield on 10-year Spanish and Italian government bonds increased by 21bps and 45bps, ending the month at 1.60% and 2.26%, respectively. In terms of duration, the Fund underweight US rates owing to relatively hawkish comments from Fed Chair Janet Yellen, recent easing in US financial conditions and continued strength in economic data. The Federal Open Market Committee (FOMC) left its policy stance unchanged at its first meeting of the year and the statement indicated no sense of urgency to tighten. GSAM believe the Fed will remain on hold in March but expect three rate hikes this year. Elsewhere, the BoJ and ECB kept policy unchanged at their January meetings, and GSAM expect both central banks to maintain easy monetary policy amid weak growth and core inflation outlooks. GSAM remain neutral European and Japanese rates.

Agency **mortgage-backed** securities (MBS) underperformed duration-neutral Treasuries by 24bps in January. Early in the month the Federal Housing Administration (FHA) announced a reduction in mortgaged insurance premiums. Ginnie Mae securities widened on the news but later tightened following a reversal of the cut by the new US Administration. The agency MBS sector faces headwinds from elevated interest rate volatility, the ongoing impact of longer mortgage durations and potentially reduced demand owing to changes in regulations. A reduction in the Fed's holdings of agency mortgages adds to the unfavorable backdrop for the sector. GSAM are underweight agency mortgages owing to rich valuations, regulatory uncertainty which may result in reduced demand, prospects for the Fed reducing its holdings of agency mortgages, deteriorating technical factors from seasonal trends which involve reduced reinvestment demand from the Fed and an increase in MBS originations, as well as a less favorable carry profile.

Within the sector, and predominantly in Ginnie Mae securities, the Fund is underweight lower-coupon securities—where GSAM expect the quality of the outstanding float to continue to deteriorate—and overweight higher coupons. GSAM believe senior collateralized loan obligations (CLOs) and Federal Family Education Loan Program ABS offer attractive spread with strong credit protection and remain among the most compelling sectors in securitized products. GSAM are also positive on residential mortgage credit, particularly legacy non-agency MBS, which continue to benefit from negative net supply and show improving collateral performance.

Investment grade corporate spreads tightened modestly over the month. The market remained relatively robust despite strong primary market issuance and underlying weakness in sovereign rates. Spreads on the Bloomberg Barclays Global Aggregate Corporates index tightened by 2bps to 123bps over sovereigns. January marked a new record for monthly US investment grade corporate debt issuance with over $150bn in deals being priced. Issuance was equally strong in European investment grade, rising over 60% year-over-year. Financials dominated new issuance in both markets as banks prepare to meet their TLAC (Total Loss Absorbing Capacity – minimum standard issued by Financial Stability Board) requirements.

Factors supporting the asset class include an improvement in corporate fundamentals, a pick-up in earnings, stabilizing leverage and positive seasonals. That being said, GSAM are cautious with exposures due to stretched valuations, positioning signals and policy uncertainty surrounding the new US Administration. The three most impactful issues GSAM are monitoring during President Trump's first 100 days are proposed fiscal expansion, including tax reform and infrastructure spending, and an unwinding of legislation and regulations in the healthcare, financial and energy sectors. In terms of positioning, the Fund maintains a down-in-quality bias, namely overweight BBB rated bonds. GSAM also prefer the intermediate part of the corporate term structure where the risk-reward balance as attractive. The Fund is overweight the banking sector as GSAM believe banks may benefit from regulatory developments, namely, potential lessening of US financial regulation, as well as support from rising rates. GSAM also see value in pipelines and consumer product industries, while underweight media and P&C insurance industries.