nikko am
Nikko Asset Management

NIKKO AM GLOBAL BOND FUND

Monthly Fact Sheet 31 March 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
0.00%	0.79%	-1.27%	2.66%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
3.76%	5.25%		5.59%

* December 2013

Asset allocation

Credit quality rating	Fund
AAA	32.8%
AA+, AA. AA-	21.3%
A+, A, A-	33.6%
BBB	12.1%
BB	0.2%

Sector	Fund	Index
Governments	49.4%	50.7%
Agency	4.5%	9.1%
Credit	16.7%	21.1%
Collateralised & MBS	33.2%	12.8%
Emerging market debt	2.0%	6.3%
Cash, derivatives, other	-5.8%	0.0%

Duration and yield

Duration	Fund 6.77 years versus benchmark 6.78 years
Yield to Maturity	Fund 3.21% versus benchmark 3.03%

Market commentary

Over the quarter rates moved to varying degrees across regions. The US 10-year rate fell 6bps to close at 2.39%, UK fell 10bps to close at 3.01% while the French rate rose 29bps to close at 0.97% and German rose 12 bps to close at 0.33%.

At its March meeting, the US Federal Reserve (Fed) tightened monetary policy for the third time since the global financial crisis, raising the target range for the federal funds rate 25bps, to 0.75-1%. The minutes raised expectations that the Fed will start reducing its balance sheet around year end. The fund is underweight US rates and agency mortgage-backed securities (MBS).

European political risk remains contained, as markets weathered the official start of Brexit negotiations and the far right lost to centrists in the Dutch elections. Improved economic data and the European Central Bank's (ECB) upward revisions to its growth and inflation targets have raised speculation that the central bank may raise interest rates this year. GSAM don't anticipate a rate hike before 2019 and expect the ECB will first unwind its quantitative easing (QE) program, starting in early 2018. The fund is overweight European rates versus US rates.

Fund commentary

The fund outperformed its index over the quarter. Stock selection within the government/swaps sector added the most value (12bps) followed by country allocation and cross sector allocation (7bps each). Stock selection within the securitized sector detracted the most value (7bps), followed by duration strategy (detracting 5bps).

The fund is overweight rates in Australia versus the US based on divergent monetary policy outlooks. GSAM expect the Reserve Bank of Australia (RBA) to maintain an accommodative policy stance as the economy continues to transition from dependence on the mining sector. In contrast, GSAM see inflation rising amid a tightening labor market in the US, thereby supporting monetary tightening. The fund is also underweight long-end UK rates—predominately versus European rates— on the belief that risk premiums do not adequately reflect Brexit negotiation uncertainties.

Agency mortgage-backed securities (MBS) underperformed over the quarter by 27bps. Performance fluctuated amid evolving news around the Fed's future pace of rate hikes and its strategy for reducing its balance sheet holdings of both agency MBS and US Treasury securities.

GSAM expect agency MBS spreads to widen this year due to increased interest rate volatility and rising concerns over the Fed's strategy for reducing its balance sheet. The fund is underweight agency MBS, and within the sector, predominately in Ginnie Mae securities, and underweight lower coupon securities and overweight higher coupons. GSAM continue to believe senior CLOs and Federal Family Education Loan Program (FFELP) ABS offer attractive spreads with strong credit protection, and therefore remain among the most compelling sectors in securitized products. GSAM are also positive on residential mortgage credit, particularly legacy non-agency MBS. These securities are supported by negative net supply and show improving collateral performance.

Investment grade corporate credit was relatively unchanged. The fund is modestly underweight with GSAM preferring securitized credit for yield. Factors supporting investment grade credit include stabilization in corporate leverage and fundamentals, and positive seasonal trends. That being said, GSAM remain cautious due to stretched valuations and headwinds posed by positioning signals, as well as policy challenges in the US and political uncertainties in Europe and the UK. The fund is overweight US dollar-denominated credits, due to a positive near-term US growth outlook and underweight euro-denominated credits, in part due to excessive valuations which perhaps a consequence of QE. Among sectors, GSAM see value in US Banks, which may benefit from an unwind of regulations and rising US rates. For similar reasons the fund is overweight Life Insurance. GSAM are also constructive on Pipelines, which stand to benefit from a pick-up in US activity, while we are underweight Pharmaceuticals and Media industries.