nikko am
Nikko Asset Management

# NIKKO AM NZ 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 NZBond Govt 0+ Yr Index (from 1 July 2016)

## Fund description

The Fund aims to provide investors with regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash with the potential for capital gain from New Zealand dollar fixed interest markets.

The Fund gains its investment exposure by investing into the Nikko AM Wholesale NZ Bond Fund which is managed by the Nikko AM NZ Fixed Income team.

## Distributions

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

## Management fees and other charges

A management fee of 0.60% per annum calculated as a percentage of the net asset value of the Fund will be 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. As at the time of publication these expenses are estimated to be 0.125% per annum.

## Buy/sell spread

Nil

## Investment restrictions

Nikko AM Wholesale NZ Bond Fund

- A minimum of 25% of the wholesale fund is to be invested in securities issued or guaranteed by the New Zealand Government or securities accepted by the RBNZ's Overnight Reserve Repo Facility.
- A minimum of 50% of the wholesale fund is restricted to debt securities with a credit rating equal to or higher than New Zealand Government.
- Minimum of 95% of the wholesale fund to be invested in assets rated A- or better.
- Portfolio modified duration range of +/- 1.5 years around index duration.
- Cash and cash equivalent investments must have a minimum credit rating of Standard & Poor's A1 short-term and A long-term.

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 |
|---|---|---|---|
| 0.57% | 1.75% | -1.89% | 1.62% |

| 2 years (pa) | 3 years (pa) | 5 years (pa) | Inception (pa)* |
|---|---|---|---|
| 3.78% | 5.43% | 4.96% | 5.67% |

* January 2011

## Distributions

| Cents per unit | Mar | Jun | Sep | Dec |
|---|---|---|---|---|
| 2017 | 0.20 | | | |
| 2016 | 1.40 | 1.25 | 1.05 | 1.25 |
| 2015 | 0.90 | 1.25 | 1.15 | 1.30 |
| 2014 | 0.90 | 0.50 | 0.80 | 0.80 |

## Asset allocation (% of fund)

| | |
|---|---|
| Government stock | 28.2% |
| SOE and local authority | 19.0% |
| NZ registered banks | 38.7% |
| Corporate debt | 14.1% |

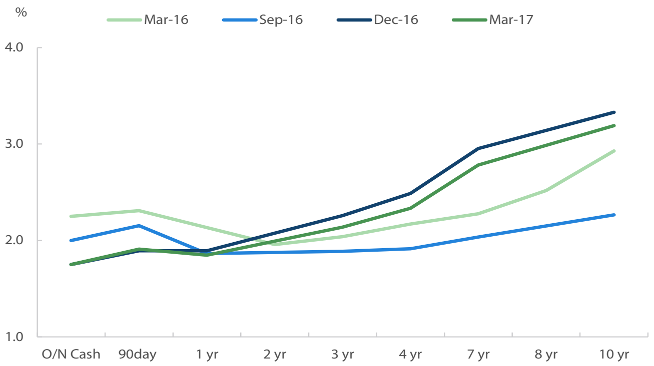
## Credit quality (% of fund)

| | |
|---|---|
| AAA | 11.1% |
| AA | 66.0% |
| A | 18.6% |
| BBB | 4.3% |

## Duration and yield

| | |
|---|---|
| Duration | Fund 4.04 years versus benchmark 4.46 years |
| Yield | Fund (gross) 3.52% versus benchmark 2.56% |

## New Zealand yield curve




## Top 5 corporate issuers (% of fund)*

| | |
|---|---|
| NZ Local Government Funding Agency | 12.2% |
| Bank of New Zealand | 7.7% |
| Westpac Banking Corporation | 7.4% |
| RaboBank | 6.3% |
| Fonterra Co-Operative Group | 6.0% |

* excludes central government

## Fund commentary

The higher portfolio running yield and a moderate contraction in credit margins were the main contributors to the outperformance (gross return versus the benchmark). Longer maturity corporate bond issues were added to the portfolio and funded by cash and selling some shorter-to-maturity bonds. We favour credit to perform better than similar maturities of governments and we are currently holding closer to minimum levels of NZ Government bonds. The portfolio has a small underweight duration position which was a slight detractor from performance.

## Market commentary

It was a good start to the 2017 year for NZ Bonds as interest rates finished the March quarter lower in yield following similar moves in offshore bond markets and credit margins contracted in spread. Perhaps surprisingly given some of the events that were of concern leading into last years close (the inauguration of Trump and geopolitical concerns) the level of volatility in financial markets have been low so far this year. The range of yield movements in NZ interest rate markets (around 25 basis points) has been subdued in comparison to the monthly movements in yield experienced through late 2016 when interest rates moved much higher.

We have seen some tentative unwind of the 2016 move higher in interest rates that was driven by optimism over pro-growth policies in the US and recovering inflation and growth in the global economic environment. The NZ Government 2019 bond moved lower in yield by 13 basis points, the NZ Government 2021 bond was 21 basis points lower, and the NZ Government 2027 finished 17 basis points lower in yield. Markets have recalibrated how much "optimism' should be reflected in interest rate levels given Trump has been frustrated in his efforts to fully instigate his policy changes and subsequently there has been a shift to downgrade the lift in US growth and inflation due to the new administration's policies.

NZ credit margins have been slower to contract than offshore credit margins so far this year; however this is not unusual as NZ credit has historically been less volatile in margin fluctuations than offshore markets. New bond issuance to the local market has been relatively limited so far this year, but bond issues have received strong buy volume demand which should be supportive of future performance. We continue to have a positive view on credit and expect having a higher portfolio running yield will be one of the main attributors to outperformance over the course of this year. We prefer to hold more mid curve maturity (4-7 years) credit rather than longer government bonds that have a lower yield and greater interest rate risk.

The NZ economy continues to perform well although forecasters expect some slowing of activity with capacity constraints in sectors such as construction. The Reserve Bank has indicated they see stable cash rates with risks evenly balanced at present, this should help anchor the front end of the yield curve at current levels. Credit/housing related excesses are being more actively curtailed, which lessens the odds of imbalances building. Numerous support factors remain, which should allow annual GDP growth to hover around 3% over 2017.