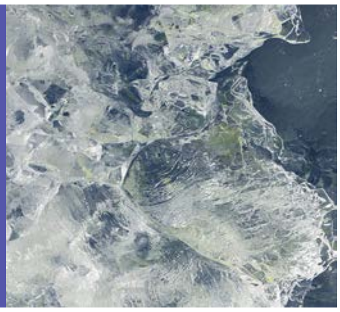
nikko am
Nikko Asset Management

NIKKO AM GLOBAL BOND FUND

Monthly Fact Sheet 31 July 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 vehicle is a NZ domiciled Portfolio Investment Entity (PIE) which is priced daily. 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 0.25% 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
-0.04%	0.41%	1.91%	0.39%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
4.13%	4.44%		5.33%

* December 2013

Asset allocation

Credit quality rating	Fund
AAA	37.1%
AA+, AA. AA-	10.2%
A+, A, A-	36.4%
BBB	16.1%
BB	0.2%

Sector	Fund	Index
Governments	37.1%	50.9%
Agency	9.0%	9.1%
Credit	19.2%	21.1%
Collateralised & MBS	30.0%	12.3%
Emerging market debt	2.5%	6.3%
Cash, derivatives, other	2.2%	0.0%

Duration and yield

Duration	Fund 6.92 years vs benchmark 6.79 years
Yield to Maturity	Fund 3.22% vs benchmark 2.83%

Fund commentary

The fund underperformed its index over the month. Our Country Strategy underperformed in July driven by our relative value trades that included our long Canada, Europe versus US rates and long Europe versus UK rates as European and Canadian rates underperformed due to hawkish comments from ECB & BoC towards end of June.

Market commentary/Fund positioning (source: GSAM)

The Fed kept policy unchanged at its July meeting and indicated that it will begin to taper reinvestments of maturing securities held on its balance sheet "relatively soon". Despite three rate hikes this year, US financial conditions continue to ease and the yield on the 10-year US Treasury bond declined marginally over the month. The Bank of Canada (BoC) raised its policy rate by 25bps to 0.75%, the first rise since 2010. The yield on the 10-year Canadian **government bond** increased and ended the month 29bps higher. In Europe, economic data continued to strengthen but inflation remains below both the European Central Bank's (ECB) target and forecast. Yields on 10-year government bonds in France, Spain and Italy declined by 1bps, 4bps, and 6bps, respectively.

We are overweight rates in Canada versus the US as we believe the market is mispricing the pace of rate hikes in each market. In our view, the BoC will raise rates at a slower pace than the Fed due to weak inflation dynamics and high household debt. We are overweight European rates versus the US and UK. We believe a weak inflation backdrop in the Euro area, driven largely by labor market slack and migrant flows from low wage countries, will warrant low policy rates for a prolonged period of time. We have a modest overweight position in Australian rates versus the US. Policymakers in Australia are faced with a strengthening currency which may challenge the growth outlook and subdued inflation backdrop. We do not expect near term rate hikes in Australia.

Low market volatility and firm demand for spread assets helped **Agency mortgage-backed securities (MBS)** outperform duration-neutral US Treasuries by 24bps in July. Non-Agency residential mortgage backed securities (RMBS) have performed well so far this year. The sector is backed by tight supply and firm demand dynamics. Net supply of non-agency RMBS has been negative and the outstanding amount of securities in the market continues to shrink from over $2tn in 2007 to less than $600bn today. Meanwhile, demand remains strong, particularly from Insurers and Asset Managers due to favorable capital treatment of RMBS.

We remain underweight agency MBS as we expect spreads to widen in response to increased interest rate volatility and Fed tapering of agency MBS reinvestments. Within the sector we are underweight lower coupon securities and overweight higher coupons, specifically within the Ginnie Mae sector. We continue to believe Federal Family Education Loan Program (FFELP) asset backed securities (ABS) offer attractive spread with strong credit protection and remain among the most compelling sectors in securitized products. We are also positive on collateralized loan obligations (CLOs), and residential mortgage credit, particularly legacy non-agency MBS, with the latter continuing to benefit from negative net supply and improving collateral performance. We are underweight collateralized mortgage backed securities (CMBS) which we believe face headwinds from structural challenges in the retail sector and late stage credit cycle dynamics.

Investment grade corporate credit strengthened in July, with spreads on the Bloomberg Barclays Global Aggregate Corporates index tightening by 7bps to 102bps over sovereigns. Spreads on the Bloomberg Barclays US Aggregate Corporate index tightened by 7bps to 102bps over treasuries and spreads on the Bloomberg Barclays Sterling Corporate index tightened by 3bps to 123bps over Gilts. European credit outperformed the US and UK, with spreads on the Bloomberg Barclays Euro Aggregate Corporate index tightening by 10bps to 92bps over sovereigns. The region was supported by ongoing positive macro data.

Policy and political uncertainty has led many corporates to press pause on late-stage cycle activities such as share buybacks, mergers and acquisitions, and capital expenditure. Nonetheless, we believe valuations are tight and we have reservations about the ability of non-financial companies to withstand external shocks due to high levels of leverage, which are at multi-decade highs. As such, we are are cautious in our exposures at this late stage of the cycle. Among sectors, we see value in Banks and Insurance Companies which may benefit from higher rates and a steeper yield curve. We are also constructive on Pipelines, which stand to benefit from improving credit quality within the sector and low exposure to underlying crude oil prices. We are underweight the Telecom and Pharmaceutical industries mainly due to the impact of potential mergers and acquisitions activity within these sectors.