nikko am
Nikko Asset Management

Nikko AM NZ Unit Trusts

31 January 2016

Nikko AM Wholesale Global Bond Fund

Fund manager

Goldman Sachs Asset Management Australia Pty Ltd – via Nikko Asset Management New Zealand Limited.

Nikko AM is Asia's premier global asset manager. In New Zealand we actively manage NZ$4 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).

Nikko AM utilise Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest 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 interest assets in June 2012.

Fund launch

December 2007 – a similar portfolio has been operated by Nikko AM since March 2002.

Investment objective

Over a rolling three year period, to target a return which exceeds the benchmark by 1% per annum, before fees.

Benchmark

Barclays Capital Global Aggregate Index hedged into 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 Investor Rate. Information is provided to the IRD and unit holders on an annual basis.

Investment 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.

Distributions

At any date for any period fixed by the Manager

Hedging policy

Assets are 100% hedged into NZD

Management fees and other charges

Investment management fees will be negotiated separately with each investor and invoiced outside the Fund.

All Fund statutory and operating costs will be met directly by the Manager.

Buy/sell spread

Nil

Trustee

Public Trust

Custodian

Public Trust as legal custodian, BNP Paribas Fund Services Australasia Pty Limited delegated as functional custodian.

Selected investors only

Participation in the Fund is limited to persons or entities who are New Zealand resident, and:

(a) whose principal business is the investment of money; or

(b) who, in the ordinary course of and for the purposes of their business, habitually invest money;

and, consequently (or for other reasons) do not constitute "the public" for the purposes of the Securities Act 1978 (**Exempt Person**). Nikko AM will not therefore be required to produce a registered prospectus or an investment statement in relation to the proposed investment (such documents otherwise being required were this offer to be made to persons or entities that are not Exempt Persons), and such documents will not be produced accordingly. Investors in the Fund will be required to acknowledge their status as an Exempt Person as part of their subscription in the Fund. Investors in the Fund will also be required to undertake to Nikko AM that any transfers of interests in the Fund will only be to Exempt Persons.

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Performance (NZD gross returns)

	Fund %	Benchmark %	Excess %
1 month	1.40	1.75	-0.35
3 months	**1.65**	**2.00**	**-0.35**
6 months	3.08	3.36	-0.28
1 year	**4.41**	**3.87**	**0.55**
2 years (pa)	7.32	7.78	-0.46
3 years (pa)	**6.64**	**6.59**	**0.06**
5 years (pa)	7.10	7.20	-0.10
10 years (pa)	**7.46**	**7.67**	**-0.21**

Fund size $276 million

Asset allocation

Credit quality rating	
AAA	29.9%
AA+, AA, AA-	11.1%
A+, A, A-	30.2%
BBB	24.0%
Unrated	0.3%
Derivatives & liquidity	4.5%

Sector allocation	Fund	Index
Governments	30.8%	51.4%
Agency	4.0%	9.4%
Credit	29.9%	20.4%
Collateralised & MBS	25.9%	12.6%
Emerging market debt	4.9%	6.2%
Cash, derivatives, other	4.5%	0.0%
Number of holdings	482	17,124

Duration and yield

Duration	Fund 6.58 years	vs benchmark 6.37 years
Yield to Maturity	Fund 4.27%	vs benchmark 3.76%

Commentary

Government bond yields tightened across developed markets in January. In the US, the benchmark 10-year yield closed the month 35 basis points lower at 1.92%. Rates on Japanese and UK government bonds followed this downward trend, ending the month at 1.56% and 0.10%, respectively. In Europe, German 10-year yields tightened 30 basis points ending the month at 0.32%. European peripheral spreads tightened over the period with Spanish and Italian 10-year yields tightening by 14 basis points and 18 basis points, respectively.

In the US, financial conditions have crept near recent tights, driven by a strong dollar and weakness in credit markets. These levels suggest the Federal Reserve (Fed) is unlikely to raise interest rates more than three times this year, after announcing liftoff following the Federal Open Markets Committee (FOMC) meeting in December. GSAM has moved from long to neutral in US rates over the course of the month. Dovish comments from members of the FOMC following the January meeting support this view that the Fed may not raise interest rates in March. GSAM is neutral in Europe, as upside surprises in recent economic data contend with expectations for further easing from the European Central Bank (ECB) given persistently low inflation data.

Within the G10, GSAM maintains a long position in European rates and short positions in the US and UK. The ECB was on hold in January, but signalled it will likely ease again in March. GSAM expects low inflation to prompt the ECB to maintain its accommodative stance with the potential for further easing. GSAM has a positive view on peripherals, expecting low core yields, strong growth, and tighter spreads to result from ECB buying programs.

Agency **mortgage-backed securities** (MBS) underperformed duration-neutral US Treasuries in January. A decline in the headline 30-year mortgage rate led to renewed market concern about the potential for rising prepayment speeds. In addition, the market responded negatively to relatively dovish Fed commentary which lowered investors' expectations for a further Fed rate hike in March. Ginnie Mae (GNMA) MBS had experienced sustained underperformance versus conventionals in the first half of 2015 following policy action that stimulated higher GNMA prepayment speeds. GNMA MBS have since partially corrected and modestly outperformed conventionals in January.

GSAM has re-established an underweight position in agency MBS following underperformance in the sector in January. Within the mortgage sector, GSAM maintains an overweight in GNMA MBS which continues to trade at attractive levels. We expect GNMA prepayment speeds to continue their convergence to lower conventional mortgage prepayment speeds, which should further benefit GNMA valuations versus those of Fannie Mae and Freddie Mac mortgage securities.

Investment grade **corporate credit** spreads widened over January, with spreads on the Barclays Global Aggregate Corporates Index widening 24 basis points to 183 basis points over sovereigns. US corporates weakened, with spreads on the Barclays US Aggregate Corporates Index widening 28 basis points to 193 basis points over sovereigns. European corporates outperformed US corporates, with spreads on the Barclays Euro Aggregate Corporates Index widening 16 basis points to 150 basis points over sovereigns. Gross new issuance in the US for January was approximately US$103 billion, with industrial issuers representing the largest portion. Issuance was weaker in the European market, at around US$34 billion.

GSAM holds an overweight position in investment grade credit, which has reached attractive valuations in recent months. However, they have reduced their exposure due to the potential impact of lower oil prices on corporate credit at this late stage of the credit cycle, as well as in relation to rising concerns that the downturn in the US manufacturing sector may spread to the rest of the economy. GSAM's constructive credit view is underpinned by a number of factors including valuations that look attractive based on fair value estimates and that would require spreads to widen over the next 12 months to the 85th-90th (widest) percentile of the historical distribution to offset the current level of carry on a mark-to-market basis. Within the credit quality spectrum, GSAM maintains a bias to lower-quality credit as well as a preference for the intermediate part of the corporate term structure. GSAM has overweight positions in banking, consumer products and pipelines (mainly as a result of bottom-up views), while are underweight the energy, electrics and media non-cable industries.