

## Nikko AM Wholesale NZ Bond Fund

### Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. In New Zealand we actively manage NZ\$4.8 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).

### Fund launch

October 2007. A similar portfolio has been operated by Nikko AM since January 1992.

### Investment objective

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

### Benchmark

S&P/NZX NZ Government Stock Index

### 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.

### Distributions

Quarterly – last day of March, June, September and December

### Hedging policy

All assets are NZD denominated

### 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

### Investment process

The Fund invests directly into tradeable capital market securities. Nikko AM's decision-making process starts with a global economic overview and then compares New Zealand's risk premium to international markets. Portfolio construction decisions follow where the government/corporate mix and duration positions are determined.

### Investment guidelines

Authorised investments are cash, deposits and debt securities issued or guaranteed by any NZ registered bank, or equivalent overseas institution, SOE, NZ and foreign Government, NZ local authority NZ and overseas corporate and derivative instruments.

Constraints:

- Duration range of the Fund is +/- 1.5 times the index duration
- A minimum of 25% of the Fund is to be invested in securities issued or guaranteed by the NZ Government or securities accepted by the RBNZ's Overnight Reverse Repo Facility.
- A minimum of 50% of the Fund restricted to issuers with a credit rating equal to or higher than NZ Government.
- Cash and cash equivalent investments must have minimum credit rating of A1 short-term an A long term.
- Up to 5% of the fund may be exposed to assets rated below A-

Derivative counter parties must have A+ or better credit rating and all derivative exposure shall be covered by cash or physical holdings. Derivatives shall not be used to leverage the Fund – instead, utilised to implement investment strategy. The combined physical equivalent (effective exposure) of all derivative instruments must be no greater than 40% of the Fund.

*For full details see investment mandate.*

### Trustee

Public Trust

### Custodian

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

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#### 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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**Nikko AM Wholesale NZ Bond Fund**

Performance (NZD gross returns)

	Fund %	Benchmark %	Excess %
1 month	0.50	0.37	0.13
<b>3 months</b>	<b>2.44</b>	<b>2.54</b>	<b>-0.10</b>
6 months	3.42	3.77	-0.34
<b>1 year</b>	<b>7.34</b>	<b>7.11</b>	<b>0.23</b>
2 years (pa)	8.17	7.74	0.43
<b>3 years (pa)</b>	<b>5.70</b>	<b>4.31</b>	<b>1.39</b>
5 years (pa)	7.29	5.94	1.35
<b>10 years (pa)</b>	<b>7.16</b>	<b>6.37</b>	<b>0.80</b>

Fund size \$260 million

Asset allocation

Government Stock	29.0
SOE and Local Authority	17.1
NZ Registered Banks	38.6
Corporate Debt	15.3

Credit rating profile (% of fund)

AAA	0.9
AA	73.3
A	21.1
BBB	4.7

S&P ratings

Top 5 corporate\* issuer exposures (% of fund)

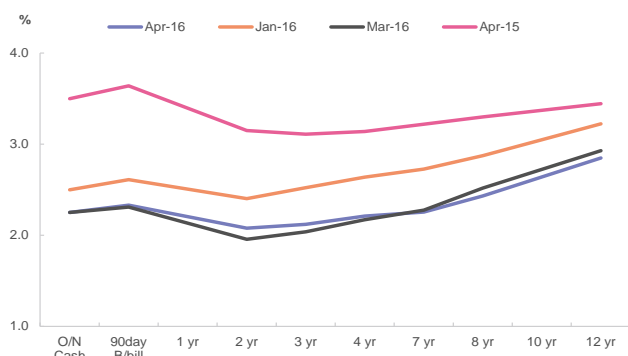
NZ Local Government Funding Authority	10.6
Bank of New Zealand	8.4
Rabo Bank	8.0
ANZ Banking Corporation	6.2
Fonterra Co-operative Group	6.1

\*excludes central govt.

Duration and yield

Duration	Fund 4.54 years	vs benchmark 4.36 years
Yield	Fund (gross) 3.42%	vs benchmark 2.29%

New Zealand yield curve



Commentary

Movements in New Zealand interest rates were relatively modest during April. The New Zealand yield curve flattened as short maturity bonds moved higher in yield while maturities 5 years and longer finished lower in yield. The spread between the 2 year and 10 year swap rates finished the month at 73 basis points. Swap rates moved in the same direction as government bonds but longer maturity swaps underperformed widening in spread as they failed to rally to the same extent as similar maturities of Governments. There has been a reasonable amount of interest in New Zealand assets with yields remaining high relative to other developed economies and the currency showing some stability.

New Zealand short term rates ticked higher in yield at month end. The RBNZ left the Official Cash Rate unchanged, and gave no sense that they are in any hurry to cut rates any lower than 2%, leaving the market with the possibly of one further 25 basis point cut. The RBNZ's commentary was generally viewed as more hawkish than expected. The RBNZ is still positive regarding the domestic economy's prospects; strong inward migration, construction activity, and tourism with accommodative monetary policy supporting the economy. Areas of concern are Auckland house price growth which has picked up of late and market pressures spilling over to other regions, and dairy export prices remaining below breakeven for most farmers. The RBNZ remains cautious about global prospects noting "global growth has deteriorated over recent months", with China again singled out. It continues to highlight concern over lower inflation expectations, and was a little more direct in its language towards currency. The currency has been stubbornly strong as interest rate expectations have also fallen in other countries which has weakened their currencies relative to the New Zealand dollar and it is unlikely this will unwind soon.

A positive for the month has been that credit margins have stabilised and narrowed slightly after being a negative contributor in the March quarter. Resultantly, returns from credit holdings have generally outperformed government and swap investments. We have been extending the duration of the Fund's credit holdings at these wider margin levels. There are a reasonable number of bond maturities this year and these monies will likely be recycled into bonds further along the yield curve looking for a higher return. Although credit markets have been challenging, we are not overly negative and expect that although credit margins may expand further they will likely peak this year. Predicting the exact timing of the peak or troughs in a cycle is difficult and we will be incrementally extending duration to take advantage of higher credit margins. Our investment horizon is the medium to long term and we continue to expect credit to add value over low yielding government and swap investments. Higher yields should ultimately benefit the Fund as bonds roll down the yield curve and move lower in yield as they become closer to maturity.

Compliance

The Fund complied with its investment mandate during the month.