

## 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	0.76	0.84	-0.08
<b>3 months</b>	<b>2.02</b>	<b>2.03</b>	<b>-0.01</b>
6 months	4.52	5.16	-0.63
<b>1 year</b>	<b>7.68</b>	<b>7.92</b>	<b>-0.24</b>
2 years (pa)	7.91	7.64	0.28
<b>3 years (pa)</b>	<b>6.13</b>	<b>5.09</b>	<b>1.04</b>
5 years (pa)	7.15	5.80	1.35
<b>10 years (pa)</b>	<b>7.20</b>	<b>6.40</b>	<b>0.81</b>

Fund size \$267 million

Asset allocation

Government Stock	28.3%
SOE and Local Authority	16.9%
NZ Registered Banks	39.7%
Corporate Debt	15.1%

Credit rating profile (% of fund)

AAA	0.8%
AA	73.7%
A	20.7%
BBB	4.8%

S&P ratings

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

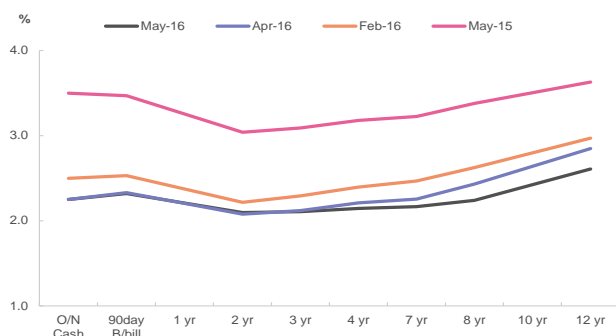
NZ Local Government Funding Authority	11%
Bank of New Zealand	8%
Rabobank	8%
ANZ Banking Group	6%
Fonterra Co-operative Group	6%

\*excludes central govt.

Duration and yield

Duration	Fund 4.5 years	vs benchmark 4.44 years
Yield	Fund (gross) 3.4%	vs benchmark 2.23%

New Zealand yield curve



Commentary

Over the month there was a relatively large difference in performance across the various New Zealand bond indices with New Zealand Governments the better performing sector.

The New Zealand Government Bond Index produced a return of 0.84% for the month while the All Swap Index returned 0.25% and the New Zealand Bond Corporate A returned 0.39%. New Zealand government bonds were supported by strong demand during the month with longer bonds the best performers. The New Zealand yield curve continues to flatten as offshore issues (continued uncertainty around the US and its possible interest rate rises) impact longer maturity bonds locally. The New Zealand government maturities inside three years were slightly higher in yield whereas the 2021 maturity finished 7 basis points lower in yield, and the 2023 maturity rallied strongly finishing 26 basis points lower in yield. Locally the New Zealand budget gave further support to government bonds forecasting a much reduced bond issuance programme which saw bonds rally strongly. New Zealand interest rates are now near historic lows, but it is important to note that they are still high relative to interest rates available in other developed countries. We continue to expect a reasonable amount of interest in New Zealand assets with attractive yields and the currency showing some stability.

Swap rates underperformed government bonds. Swap maturities 5-years and shorter widened in spread by approximately 8 basis points relative to similar maturities of government bonds. The move wider in the 10-year swap was more pronounced with a 20 basis point expansion in spread. Widening swap margins impact corporate bonds in that swap rates form a component of the yield on corporate bond issues. For example the yield on the BNZ 18/06/20 bond at month end was 3.51% comprising the underlying government rate of 2.18%, the equivalent swap rate traded at 2.43% a margin of 25 basis points over government, added to this is a credit margin of 1.08% above swap.

A positive feature of the month was credit margins stabilising and narrowing slightly. Credit margins have absorbed some of the negative impact of widening swap spreads, particularly for bond issues popular with retail investors who are more focussed on the absolute nominal yield level. We have continued to extend the duration of the Fund's credit holdings to take advantage of higher credit margins. New Zealand government bonds have been the best performers recently; however over our three year investment horizon we expect credit to add value over lower yielding government and swap bond investments. The accrual trade of having a higher yielding portfolio should ultimately be of benefit with a positive shaped yield curve 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.