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$5 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 AUD1,083 billion in assets under management. GSAM's Global Fixed Income Team manages AUD451 billion of global fixed income assets.

Fund launch

October 2008

Investment objective

To construct a portfolio of authorised investments that outperform the Fund's benchmark return by 1.0% per annum over a rolling three year period before fees.

Benchmark

Barclays Capital Global Aggregate Index hedged into NZD

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%.

Distributions

At any date for any period fixed by the Manager

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.

Management fees

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.

Performance (NZD gross returns)

	Fund	Benchmark	Excess
1 month	1.52%	1.99%	-0.47%
3 months	2.68%	2.94%	-0.26%
6 months	6.34%	6.96%	-0.62%
1 year	9.69%	10.05%	-0.37%
2 years (pa)	7.67%	8.44%	-0.78%
3 years (pa)	8.20%	8.30%	-0.10%
5 years (pa)	7.59%	7.67%	-0.08%
10 years (pa)	7.99%	8.17%	-0.18%

Fund size

NZ$280 million

Asset allocation

Credit quality rating	
AAA	40.4%
AA+, AA. AA-	13.2%
A+, A, A-	29.1%
BBB	18.2%
BB	0.3%
Unrated	-1.2%

Sector	Fund	Index
Governments	42.3%	52.5%
Agency	8.2%	9.4%
Credit	20.8%	20.3%
Collateralised & MBS	25.5%	11.7%
Emerging market debt	4.4%	6.1%
Cash, derivatives, other	-1.2%	0.0%

Duration and yield

Duration	Fund 6.38 years versus benchmark 6.76 years
Yield	Fund 3.37% versus benchmark 3.12%

Commentary

Government bonds rallied broadly across developed markets over the quarter. US 10-year rates were down 30bps to 1.47%, UK 10-year down 55bps to 0.87%, and German down 28bpts to -0.13%.

Over the quarter the **Fund** marginally underperformed, returning 2.68% versus the benchmark of 2.94%. Country allocation detracted the most value (-14bps), followed by duration management and stock selection within government stock and swaps (-8 bps each). Cross sector allocation added the most value (+14bps).

The Global Manufacturing Purchasing Managers Index (PMI) rose marginally to 50.4 in June, from 50.0 in May, signaling modest expansion in global manufacturing. The average pace of expansion over Q2 2016 as a whole was the weakest since Q4 2012.
The extent of recent rallies in US Treasuries, as well as relatively loose financial conditions, signs of improvement in US economic data and resilient risk asset performance is expected to put some pressure on rates to retrace higher. GSAM believe the Bank of England will likely cut rates in the wake of the UK referendum on EU membership, while recent comments from European Central Bank President Mario Draghi suggest the ECB is unlikely to use the rate channel further.

The Fund is short Europe versus long the UK in Country strategy. The Fund maintained its short position in US rates and neutral position in European rates over the quarter. The UK referendum has increased uncertainty in European growth forecasts and fueled concerns about higher loan losses from Italian banks. Japanese rates rallied on the Brexit result. Prime Minister Shinzo Abe has pledged to use all available policy tools to minimize the uncertainty caused by Brexit in the Japanese market. The Fund maintains its short position in Japan.

Agency **mortgage-backed** securities (MBS) underperformed duration-neutral US Treasuries by 30bps in June, and outperformed by 3bps over the quarter. US Treasuries rallied to a post-financial crisis low after the UK referendum to leave the EU, contributing to the underperformance of agency MBS. However, agency MBS outperformed most other risk assets following Brexit due to their superior liquidity and a scarcity of positive yielding assets globally. The Fund is underweight agency MBS, on the expectation of bank demand weakening due to a decline in agency MBS yields and expectations for increased prepayments and increased supply.

Investment grade **corporates** weakened over the month of June, largely as a result of uncertainty arising from the UK referendum. Spreads on the Barclays Global Aggregate Corporates Index widened 8bps to 154bps over sovereigns over the month, and tightened 3bps over the quarter. US corporates and European corporates both weakened with Sterling corporates the most affected. UK banks were impacted the most, delaying their recovery and creating a headwind for earnings. The UK referendum also had a strong dampening effect on primary markets. Gross new issuance for the month around $72bn in the US and $23bn in European markets, significantly lower from the previous month.

The Fund position moved to a modest underweight in corporate credit. Uncertainty around the impact of the UK referendum result and nearing US elections are likely to result in some volatility, while the extent of spread tightening from earlier in the year provides an attractive entry point. Additionally, summer seasonals and late cycle trends tend to be negative for credit. However, GSAM expect the UK referendum outcome will most directly impact UK and European banking sectors. Within the credit quality spectrum, GSAM maintain a down-in-quality bias to triple-B rated credit as well as a preference for the intermediate part of the corporate term structure. GSAM see value in consumer products, tobacco and pipelines, mainly as a result of single-security, bottom-up views rather than thematic sector-level decisions. The Fund is underweight the insurance, media non-cable and energy industries.

Compliance

The Fund complied with its investment mandate during the month.