

# Nikko AM Wholesale NZ Bond Fund

## Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM NZ).

In New Zealand we actively manages around 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).

## Fund launch

October 2007 – a similar portfolio has been operated by Nikko AM NZ since January 1992.

## 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

Bloomberg NZBond Govt 0+ Yr Index (from 1 July 2016)

## Structure and taxation

The Fund vehicle is a Portfolio Investment Entity (PIE) which is priced daily. Investors elect their own Portfolio Investor Rate. Information is provided to the IR and investors on an annual basis.

## Distributions

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

## Currency management

Investments will be in New Zealand dollars

## 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 NZ'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 corporates issuing NZ dollar debt 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.
- A minimum of 95% of the value of the Fund must be invested in assets rated A- or better.
- Derivatives can only be transacted with counterparties listed in the Nikko AM NZ Approved Counterparty List.

The use of derivatives is limited to contracts related to Authorised Investments described in the investment mandate. 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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### Performance (NZD gross returns)

	Fund	Benchmark*	Excess
1 month	1.16%	0.89%	0.27%
3 months	2.74%	2.68%	0.06%
6 months	5.25%	5.29%	-0.04%
1 year	7.45%	7.33%	0.11%
2 years (pa)	8.58%	8.35%	0.23%
3 years (pa)	7.43%	6.59%	0.84%
5 years (pa)	7.28%	5.94%	1.35%
10 years (pa)	7.33%	6.56%	0.77%

\* S&P/NZX NZ Government Stock Index prior to 1 July 2016

### Fund size

NZ\$294 million

### Asset allocation (% of fund)

Government stock	27.5%
SOE and local authority	17.9%
NZ registered banks	40.3%
Corporate debt	14.3%

### Credit quality (S&P ratings; % of fund)

AAA	12.7%
AA	63.6%
A	19.8%
BBB	3.9%

### Top 5 corporate issuers (% of fund)\*

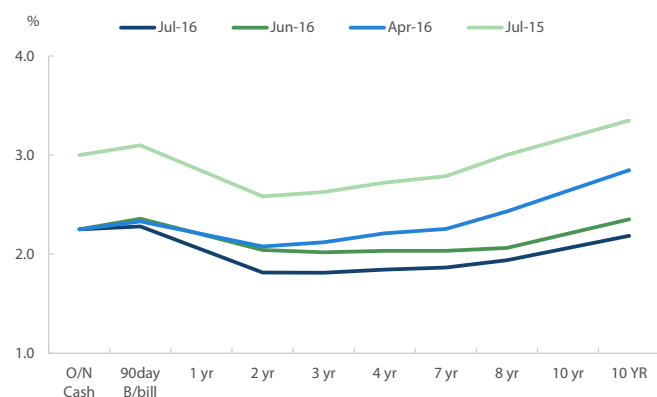
NZ Local Government Funding Authority	10.8%
Bank of New Zealand	8.9%
Rabobank	7.2%
Fonterra Co-operative Group	6.0%
Westpac Banking Corporation	5.1%

\* excludes central government

### Duration and yield

Duration	Fund 4.2 years versus benchmark 4.39 years
Yield	Fund (gross) 3.0% versus benchmark 1.92%

### New Zealand yield curve



### Commentary

The Nikko AM Wholesale NZ Bond Fund returned 1.16% for July. Over the month the NZ Government Bond Index produced a return of 0.89%, the All Swap Index returned 1.05%, and the A Grade Corporate Index returned 0.96%.

In summary the Fund had a good month as a result of corporate bond holdings and swap rates performing better than similar maturities of NZ government bonds. NZ interest rates continued to move lower in yield with longer maturity swaps falling more than equivalent maturities of governments. Credit holdings performed well as the higher running yield was of benefit and the margins they trade at over swap rates were slightly lower to stable.

Over the month there were some new issues to market that received good support, this was positive as there had been little issuance locally to gauge market demand since the ructions in financial markets surrounding the Brexit vote.

NZ interest rates have continued lower as the global growth outlook remains weak and on expectations the Reserve Bank will further reduce the Cash Rate. Longer maturity bonds continued to be the best performing sector of the yield curve. The price of longer maturity bonds is more sensitive to changes in interest rates, (they have a higher duration as their cash flows extend further into the future) and consequently their value increases more than shorter maturity bonds when interest rates move lower in yield. When interest rates are falling we want the Fund to have more "interest rate exposure" (a longer duration). Over the month the move lower in interest rates was relatively consistent across the yield curve resulting in an approximately parallel shift lower in interest rates. For example the 2-year swap rate moved 19 basis points lower in yield over the month, and the 10-year swap decreased by 22 basis points. For comparison the NZGovt 12/17 maturity bond was 19 basis points lower in yield over the month, and the NZGovt 04/27 yield decreased by 14 basis points. The NZ yield curve is still upward sloping in shape with the 2-10 year swap spread at 40 basis points. Currently shorter maturities out to 3 years are somewhat anchored by the Cash Rate and therefore more influenced by the monetary policy actions of the Reserve Bank, whereas longer maturity bonds 7 years + have been more closely correlated to movements in US 10-year rates and our relative attractiveness compared to yields in other developed markets.

We are continuing to extend the duration of the Fund's credit holdings to take advantage of higher credit margins. Over our 3 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.