Nikko AM Wholesale NZ Cash 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

1 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 0.2% per annum over a rolling three year period before fees.

Benchmark

Bloomberg NZBond Bank Bill Index (from 1 July 2016)

Investment philosophy

Nikko AM's focus on duration management and achieving a high running yield on the portfolio enables us to deliver an investment outcome that has a high probability of out-performing the benchmark.

Nikko AM NZ's decision-making process revolves around interpreting and forecasting possible changes to monetary policy in the months ahead and quantifying the likely impact on portfolio performance.

The Fund invests directly into capital market securities. We seek to enhance the return from the cash sector by the selective use of floating rate notes and short dated corporate debt.

Investment guidelines

Authorised investments are cash, deposits and debt securities with an interest rate exposure of up to 365 days, issued or guaranteed by any NZ registered bank, SOE, NZ Government, NZ local authority and NZ and overseas corporate.

Securities issued by corporates and registered banks must have minimum credit rating of A1 short-term and A long term (Standard and Poors). Derivative counter parties must have A or better credit rating and all derivative exposure shall be covered by cash or physical holdings.

For full details see investment mandate.

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

All 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

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	0.30%	0.22%	0.08%
3 months	0.82%	0.63%	0.19%
6 months	1.61%	1.30%	0.31%
1 year	3.50%	2.82%	0.68%
2 years (pa)	3.98%	3.26%	0.71%
3 years (pa)	3.95%	3.14%	0.81%
5 years (pa)	3.99%	2.98%	1.01%
10 years (pa)	5.30%	4.32%	0.98%

* S&P/NZX Bank Bills 90-Day Index prior to 1 July 2016

Fund size

NZ$682 million

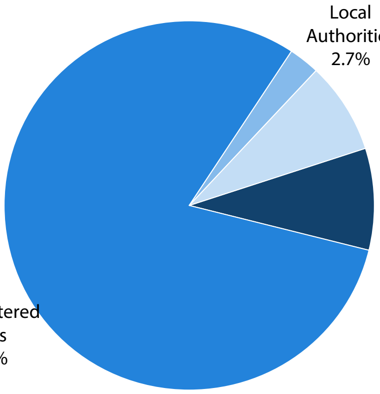
Duration and yield

Duration	Fund 110 days versus benchmark 45 days
Yield	Fund 3.10% versus benchmark 2.28%

Credit quality

AAA	0.7%
AA	72.8%
A	26.5%

Asset allocation (% of fund)



Top 5 issuers (% of fund)

Bank of New Zealand	24.8%
KiwiBank	15.2%
ASB	9.6%
Westpac Banking Corp	9.3%
Government	8.9%
Number of issuers in portfolio	24

Compliance

The Fund complied with its investment mandate during the month.

Commentary

Over July the Fund returned 0.30%, compared to the Benchmark return of 0.22%. The Fund remains a high credit quality, low interest rate risk portfolio. The average credit rating is targeted around AA- S&P.

Short term interest rates fell over the month and the yield curve remains inverted. The 90-day rate closed down 14 points to 2.28%, 1-year swap was down 16 points to 2.09%.

The RBNZ released an impromptu economic update during July, and was decidedly dovish. "Prospects for growth in the global economy have diminished despite very stimulatory monetary policy and low oil prices. Significant downside risks remain. Financial market volatility increased following the UK referendum and long-term interest rates have fallen." The special announcement was about increased concern with the strength of the NZ Dollar, and signaled to markets that currency levels and pricing for cuts was not in line with future policy direction. Our view for some time has been that the New Zealand economy is doing well, and that rate cuts appear to be at odds with domestic economic activity. Strong net migration, construction, tourism and agriculture ex-dairy, are all supportive. However the RBNZ appears to have taken the line that lower interest rates will address the strength of the NZD and assist in getting inflation back into the Banks 1-3% target range.

Earlier in July the RBNZ had begun consultation on new nationwide investor LVR mortgage lending restriction. Governor Wheeler stated that the banking system is heavily exposed to the property market with residential mortgages making up 55% of banking system assets. Investor lending has been increasing rapidly and is a significant contributing factor to the current market strength. The proposed restrictions recognise the higher risks associated with such lending. The proposal includes restricting no more than 5% of bank lending to residential property investors across New Zealand would be permitted with an LVR of greater than 60% (i.e. a deposit of less than 40%). The RBNZ has expressed an expectation that the banks will put these new restrictions in with immediate effect.

The market is now pricing a full 25 point cut at the August 11 Monetary Policy Meeting. The risk is that they are more aggressive than this, signaling more cuts to come, or potentially cutting 50 points. Our expectation is that the RBNZ cuts 25 points, and has a strong easing bias.

The Cash Fund has a longer than benchmark duration, which should lead to continued strong performance as the Fund is invested to receive the benefit of higher income than the yield relative to the 90-day Bank Bills Index. We have been buying high credit quality commercial paper as a source of added liquidity and portfolio duration, as we see risk that the curve rallies further should the RBNZ be more aggressive than market pricing at the MPS. Highly rated short term fixed and floating rate securities remain in strong demand, however term deposits continue to offer attractive returns compared to other short term assets. Recently the margins we have received for 12 month terms deposits have been the most attractive, and fit our interest rate view.