Nikko AM Wholesale NZ Bond Fund

Fund manager

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

In New Zealand we actively manage 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 years relative to 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.

Performance (NZD gross returns)

	Fund	Benchmark*	Excess
1 month	0.52%	0.15%	0.37%
3 months	2.50%	1.98%	0.52%
6 months	4.57%	4.05%	0.52%
1 year	7.33%	6.90%	0.43%
2 years (pa)	8.36%	7.93%	0.43%
3 years (pa)	7.77%	7.03%	0.74%
5 years (pa)	7.05%	5.56%	1.49%
10 years (pa)	7.29%	6.50%	0.77%

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

Fund size

NZ$290 million

Asset allocation (% of fund)

Government stock	28.3%
SOE and local authority	18.6%
NZ registered banks	38.4%
Corporate debt	14.7%

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

AAA	9.3%
AA	66.8%
A	20.0%
BBB	3.9%

Top 5 corporate issuers (% of fund)*

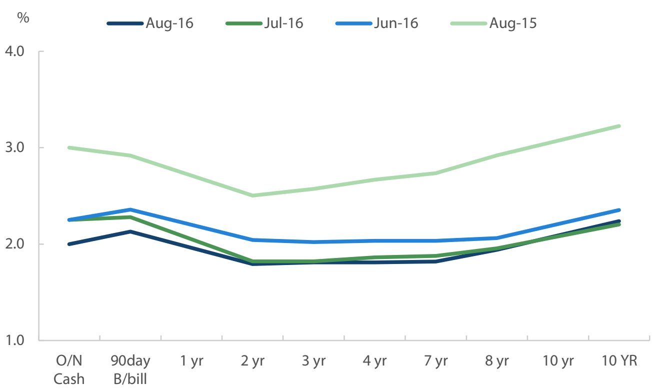
NZ Local Government Funding Authority	11.0%
Bank of New Zealand	9.0%
Rabobank	7.3%
Westpac Banking Corporation	5.5%
ASB	5.0%

* excludes central government

Duration and yield

Duration	Fund 4.35 years versus benchmark 4.4 years
Yield	Fund (gross) 3.0% versus benchmark 1.92%

New Zealand yield curve



Commentary

The Nikko AM Wholesale Bond Fund returned 0.52% over August comfortably exceeding the 0.15% return of the New Zealand Government Stock Index. The All Swap Index returned 0.40% and the A Grade Corporate Index returned 0.49%.

The yield on the Fund is circa 1.1% higher than that of the New Zealand Government Stock Index. This higher than index yield contributed to the monthly outperformance as did the narrowing of credit and swap margins on non-government bonds held by the Fund.

The global 'hunt for yield' continues unabated and is a significant factor for the strong recent performance of higher yielding bonds with investment grade credit ratings. Lower cash rates in New Zealand and low rates globally force investors who require income to buy longer duration assets and non- government debt or a combination of both. This investment dynamic is unlikely to change in the near term.

The Reserve Bank of New Zealand (RBNZ) and the Reserve Bank of Australia both cut rates by 25 basis points to record lows of 2.0% and 1.5% respectively, only to see their currencies higher as these cuts had been well anticipated. The RBNZ maintained a strong easing bias however it made the point it is taking a gradual approach towards trying to meet its 1-3% inflation target. The prospect of further cuts saw the 2-year swap rates 5 basis points lower at 1.99% and the 5-year swap rates 6 basis points lower at 2.09%. The long end of the New Zealand government bond curve was an exception to the fall in rates – 10 year government bonds were up 4 basis points to 2.24% as the market needed time to absorb a new $2 billion issue of April 2037 bonds.

We are continuing to extend the duration of the Fund's credit holdings to take advantage of higher credit margins available on longer term bonds. 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 over time 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.