Nikko AM Wholesale NZ Cash 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

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 NZ'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 Prescribed 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	0.26%	0.19%	0.07%
3 months	0.84%	0.60%	0.24%
6 months	1.63%	1.20%	0.43%
1 year	3.39%	2.68%	0.72%
2 years (pa)	3.87%	3.14%	0.73%
3 years (pa)	3.92%	3.12%	0.79%
5 years (pa)	3.98%	2.96%	1.02%
10 years (pa)	5.22%	4.23%	1.00%

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

Fund size

NZ$713 million

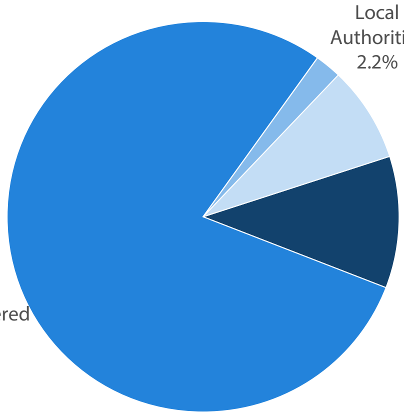
Duration and yield

Duration	Fund 95 days versus benchmark 45 days
Yield	Fund 3.10% versus benchmark 2.25%

Credit quality

AAA	0.7%
AA	74.9%
A	24.4%

Asset allocation (% of fund)



Top 5 issuers (% of fund)

Bank of New Zealand	21.7%
KiwiBank	15.0%
Westpac Banking Corp	13.7%
NZ Government	10.9%
ASB Bank Limited	10.7%
Number of issuers in portfolio	19

Compliance

The Fund complied with its investment mandate during the month.

Commentary

Over the month of September the Fund returned 0.26%, compared to the benchmark return of 0.19%. Over the quarter the Fund returned 0.84% compared to the benchmark return of 0.60%. The Fund remains a high credit quality, low interest rate risk portfolio. The average credit rating is targeted around AA- S&P with the duration of the portfolio currently 95 days.

Short term interest rates fell over both the month and the quarter. The short end of the yield curve remains inverted which indicates the market is expecting lower rates in the months ahead. Over September the 90-day rate closed down 3 points to 2.25% and the 1-year swap was down 4 points to 2.05%. Over the quarter the 90-day rate closed down 22 points and the 1-year swap was down 17 points.

The RBNZ left the Official Cash Rate (OCR) unchanged at 2% at the September review. Over the quarter the RBNZ has continued to note that despite unprecedented levels of monetary stimulus, global growth remains weak. Uncertainly around political risk, commodity prices and the prospect for global growth is helping keep interest rates at record lows. This is particularly unhelpful from the RBNZ's point of view as global rates relative to New Zealand are keeping the exchange rate high. The RBNZ maintains its strong easing bias, and continues to downplay recent strong domestic economic indicators and focuses on the downside risks.

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, agriculture ex-dairy (dairy appears to be improving), strong labour markets and confidence are all supportive. The recent quarterly survey of business opinion in particular points to how strong confidence is and indicates accelerating GDP growth and capacity constraints pressure, but without the pricing pressures that would normally accompany it. The market is pricing a 70% chance of a 25 basis point cut to the OCR in November. We tend to agree with this assessment given the weak inflation backdrop and the RBNZs prior statements.

We can however see risks that the RBNZ moves from an easing bias to being on hold. A case can be made for a rate hike from the US Fed in December. The ECB appears to be building consensus to taper its QE programme and other central banks appear to have lowered the prospect of further easing. This could indicate a NZD weakening, an increase in tradable inflation and an end to the easing cycle. We will continue to monitor this situation as it evolves.

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. The margins on 12 month term deposits remain attractive. Highly rated short-term fixed and floating rate securities remain in strong demand, and we have been active here at good margins considering the market supply and demand dynamics. This has all been of benefit to the Fund as rates have continued to go lower.