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	0.25%	0.19%	0.06%
3 months	0.79%	0.58%	0.22%
6 months	1.62%	1.20%	0.42%
1 year	3.34%	2.64%	0.70%
2 years (pa)	3.82%	3.08%	0.74%
3 years (pa)	3.89%	3.11%	0.78%
5 years (pa)	3.96%	2.94%	1.02%
10 years (pa)	5.18%	4.18%	1.00%

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

Fund size

NZ$706 million

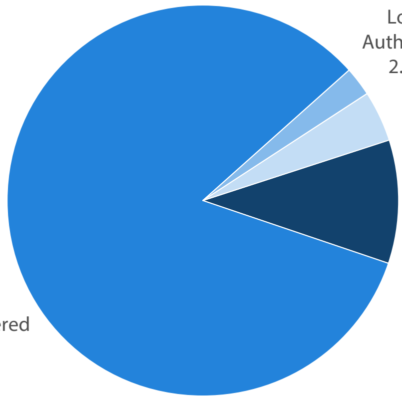
Duration and yield

Duration	Fund 106 days versus benchmark 45 days
Yield	Fund 2.99% versus benchmark 2.10%

Credit quality

AAA	0.7%
AA	72.5%
A	26.8%

Asset allocation (% of fund)



Top 5 issuers (% of fund)

Bank of New Zealand	17.6%
Westpac Banking Corp	16.3%
Kiwibank	16.2%
ASB Bank Limited	12.5%
ANZ Bank	11.5%
Number of issuers in portfolio	20

Compliance

The Fund complied with its investment mandate during the month.

Commentary

Over the month of October the Fund returned 0.25%, compared to the Benchmark return of 0.19%. The Fund remains a high credit quality, low interest rate risk portfolio. The average credit rating is targeted around AA- S&P, the duration of the portfolio is currently 106 days.

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 12 points to 2.13%, 1-year swap was up 2 points to 2.07%.

The Official Cash Rate (OCR) is at an all-time low of 2%. Reserve Bank Assistant Governor John McDermott gave a speech on “Understanding Low Inflation in New Zealand.” He spoke about tradable inflation, which has been negative due to the high NZD and low inflation in our import prices. Strong migration and labour supply has also been a factor in dampening inflation, while allowing New Zealand to grow at a robust pace. The RBNZ maintains its strong easing bias, and continues to downplay recent strong domestic economic indicators and focuses on the downside risks. CPI inflation came in at 0.3% for the September quarter and 0.4% annually. At the end of October the market was pricing in an 85% chance of a 25 basis point cut at the November Monetary Policy Statement. 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, but given the strength of the RBNZ’s communication regarding inflation and inflation expectations we see the likelihood of a further cut as very high.

Global interest rates have been heading higher, and global central banks seem to be stepping away from further monetary easing, albeit cautiously. The wording of the RBNZ’s upcoming Monetary Policy Statement and the forecast for the 90-day bill track will be crucial for the RBNZ to get the desirable market reaction. Given domestic economic activity it would be difficult in our view to justify and forecast any further cut to the short term rates. The RBNZ also has the US election, and the US Fed decision to contend with. We will continue to monitor these as to their impact on the New Zealand market and the Cash Fund. The low interest rate and credit risk nature of the Cash Fund should mean that it is protected from any negative market reactions to these events.

The Cash Fund has a higher yield and a longer duration than the 90-day Bank Bill index. The higher yield should lead to continued strong performance of the Fund. We have been buying high credit quality commercial paper as a source of added liquidity and portfolio duration. 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.