

# 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 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

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.

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### Performance (NZD gross returns)

	Fund	Benchmark*	Excess
1 month	-1.41%	-1.37%	-0.04%
3 months	-2.59%	-2.87%	0.28%
6 months	-0.15%	-0.95%	0.80%
1 year	4.37%	4.16%	0.21%
2 years (pa)	5.84%	5.38%	0.46%
3 years (pa)	6.43%	5.99%	0.44%
5 years (pa)	5.88%	4.27%	1.61%
1 month	-1.41%	-1.37%	-0.04%

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

### Fund size

NZ\$287 million

### Asset allocation (% of fund)

Government stock	27.7%
SOE and local authority	17.8%
NZ registered banks	39.7%
Corporate debt	14.8%

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

AAA	13%
AA	63%
A	19%
BBB	5%

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

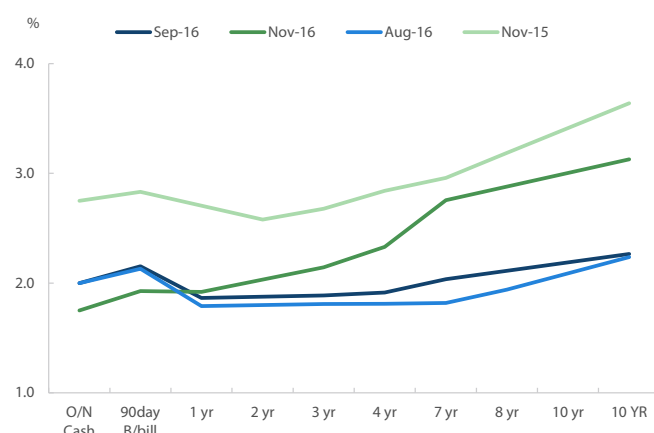
NZ Local Government Funding Agency	10.8%
Bank of New Zealand	8.5%
Westpac Banking Corporation	6.6%
Rabobank	6.5%
Fonterra Co-Operative Group	6.1%

\* excludes central government

### Duration and yield

Duration	Fund 4.57 years versus benchmark 4.48 years
Yield	Fund (gross) 3.62% versus benchmark 2.52%

### New Zealand yield curve



### Compliance

The Fund complied with its investment mandate during the month.

### Commentary

The Nikko AM Wholesale NZ Bond Fund returned -1.41%. Returns from the NZ bond indices were negative in November as interest rates moved higher in yield. For the month the Bloomberg NZ Government bond index produced a return of -1.37% while the All Swap index returned -1.18%, and the NZ Bond Corporate A Index returned -0.66%.

It was a difficult month for bonds with yields moving higher through the month after the result of the US elections. Market sentiment turned negative for bonds on the perception that President Elect Trump’s expansionary policies of tax cuts and a higher fiscal spend will promote growth, higher inflation and larger borrowings for the US. With more protectionist trade policies there will also likely be “winners and losers” which could impact our major trading partners. NZ longer-term interest rates are typically highly correlated with movements in US interest rates, whereas shorter maturities are more influenced by local factors with low cash rates anchoring the front end of the yield curve. NZ interest rates followed similar moves to the US and the shape of the NZ yield curve steepened considerably (widening from a spread of 70 basis points between the 2 and 10-year swap rates to 100 basis points). Longer maturity bonds were the worst performing bond assets, and there was little difference between the performances of government bonds versus similar maturities of swap. The NZ Government 2019 bond moved higher in yield by 15 basis points, the NZ Government 2021 bond was 30 basis points higher, and the NZ Government 2027 finished 42 basis points higher in yield. Funds that were positioned with shorter durations (less exposure to changes in interest rates) performed better as their prices declined less when interest rates moved higher in yield. Corporate bonds also moved higher in yield although credit margins were relatively stable, and the higher running yield of corporate holdings will help benefit the Fund over the medium term.

Longer term interest rates in NZ have been under some pressure over the past 3 months as economic news has generally been on an improving trend; business and consumer confidence, GDP, inflation outcomes, and dairy prices have been improving. Interest rates are low and supportive of activity, and there will be additional spends following the recent Kaikoura earth quake. At this stage it appears we may have seen the low in yields in NZ and the sentiment bias is for higher interest rates, however with the latest move higher in yields there is now a lot of “positive economic sentiment” factored in with a higher and steeper yield curve and the market may want to see some more solid proof of improvement before taking yields higher. With a positive shaped yield curve bonds roll down the yield curve and move lower in yield as they become closer to maturity. We expect credit to outperform lower yielding government and swap bond investments over our three year investment horizon. The accrual trade of having a higher yielding portfolio is helping to offset some of the move higher in interest rates. At the same time we don’t want to have an undue amount of risk to rising interest rates and the Fund will likely be positioned shorter in duration than its index.