nikko am
Nikko Asset Management

Nikko AM Wholesale Global Bond Fund

Fund manager

Goldman Sachs Asset Management Australia Pty Ltd – via Nikko Asset Management New Zealand Limited.

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).

Nikko AM NZ utilise Goldman Sachs Asset Management Australia Pty Ltd (GSAM) for the management of global fixed interest assets. Established in 1988, GSAM is one of the world's leading asset managers with AUD 1,126 billion in assets under management. GSAM's Global Fixed Income Team manages AUD451 billion of global fixed income assets.

Fund launch

October 2008

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 Barclays Global Aggregate Index (100% hedged into NZD)

Currency management

Foreign currency exposures created as a consequence of capital markets investment remain hedged to NZD within an operational range of 98.5% to 101.5%.

Distributions

Generally on calendar quarters, or at any date for any period determined by the Manager.

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.

Investment process

GSAM's investment philosophy and style is such that they aim to generate outperformance over time without being unduly exposed to one particular investment strategy or market circumstance. GSAM's global approach enables them to capture diverse sources of excess returns and their risk management process ensures the portfolio is not dependent on any particular market inefficiency that may dissipate. The GSAM global fixed interest portfolio is constructed in such a way that aims, over time, to react well to different economic conditions.

The management of GSAM's global fixed interest portfolios is team-based with investment decisions taken collectively, following thorough discussion and debate. The investment process encompasses three key steps:

Step 1: Build a risk budget that takes account of the investment objectives, guidelines and benchmark of the mandate.

Step 2: Identify attractive investment opportunities and implement the best ideas from the specialist top down and bottom up investment strategy teams.

Step 3: Monitor risk and attribution to ensure risks are consistent with investment guidelines.

Management fees

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	0.43%	0.39%	0.04%
3 months	-1.66%	-2.02%	0.36%
6 months	0.00%	-1.07%	1.07%
1 year	6.33%	5.82%	0.52%
2 years (pa)	5.62%	5.14%	0.48%
3 years (pa)	7.02%	7.10%	-0.08%
5 years (pa)	6.54%	6.35%	0.19%
10 years (pa)	7.45%	7.49%	-0.04%

Fund size

NZ$245million

Asset allocation

Credit quality rating	
AAA	36.0%
AA+, AA. AA-	9.1%
A+, A, A-	37.2%
BBB	17.5%
BB	0.2%

Sector	Fund	Index
Governments	36.4%	51.2%
Agency	4.8%	9.0%
Credit	21.1%	21.2%
Collateralised & MBS	31.4%	12.5%
Emerging market debt	3.7%	6.1%
Cash, derivatives, other	2.6%	0.0%

Duration and yield

Duration	Fund 6.67 years versus benchmark 6.75 years
Yield to Maturity	Fund 3.27% versus benchmark 3.07%

Commentary

The Fund out performed its benchmark over the month and quarter. Over the quarter security selection in governments and swaps added the most value of 0.13%, followed by sector allocation adding 0.07%, duration strategy, country allocation and stock selection within the securitized sector added 0.06% each.

US **Treasury yields** continued to trend higher in December, with a notable rise in shorter-dated bonds following the Fed's decision to proceed with its hiking path. Government bond yields diverged between the US and Europe over the month, with the US 10-year yield rising 7bps (+85bps for quarter), closing the year at 2.43%, while the yields on UK and German 10-year government bonds fell 17bps and 7bps (+49bps and +33 bps for the quarter), ending the year at 1.24% and 0.20%, respectively. The Japanese 10-year yield increased by 2bps (+14bps for the quarter), remaining relatively range-bound since the introduction of the Bank of Japan's (BoJ) 'yield curve control' and ended the month at 0.04%.

The portfolio has an underweight **duration** position in US rates and remains neutral in European and Japanese rates. While a hike in US interest rates in December was expected, the revision to interest rate projections, which point to a slightly steeper trajectory of interest rates, took markets by surprise. Three hikes are implied for 2017 and forecasts for growth and inflation were revised upwards, while the unemployment rate was revised down. US government yields have trended higher following Donald Trump's election victory, on expectations for fiscal stimulus and less regulation. Contained financial conditions and reasonable payroll employment gains will bolster the case for a rate hike in March.

Investment grade corporate spreads concluded the year tighter. Markets strengthened over December, with spreads on the Bloomberg Barclays Global Aggregate Corporates index tightening by 5bps to 125bps over sovereigns. Regionally, US and UK corporates outperformed their European counterparts, as spreads on the Bloomberg Barclays US Aggregate Corporate index and the Bloomberg Barclays Sterling Corporate index tightened by 6bps to end the year at 123bps and 143bps respectively, while the Bloomberg Barclays Euro Aggregate Corporate index tightened 3bps to 123bps over sovereigns. The portfolio is modestly overweight investment grade credit. Factors supporting a more positive stance on the asset class include an improvement in corporate fundamentals, a pick-up in earnings, stabilizing leverage and positive seasonals. That being said, GSAM are cognisant of late-stage credit cycle characteristics, as well as the impact of a more hawkish stance by the Fed. As such the positioning is modest and GSAM are selective in their exposures. Within the portfolio, there is a down-in-quality bias (overweight BBB rated bonds), as GSAM continue to see scope for modest compression within the high quality spectrum. GSAM also prefer the intermediate part of the corporate term structure. Accommodative central bank policy supports the tactical overweight in European corporates, as does GSAM's view that European corporates are not as late in the credit cycle as US corporates. GSAM see value in the consumer products, pipelines and electrics industries, and are underweight media and automotive issuers.

Agency **mortgage-backed securities** (MBS) outperformed duration-neutral Treasuries by 6bps in December due to weakness in US Treasuries following the Fed rate hike, but underperformed by 11bps over the year as post-US election volatility led to extension in agency MBS. Primary mortgage rates increased almost 75bps following the election due to the rise in Treasury rates. Consequently the MBA refinancing index fell 20% in December to a post financial crisis low. The J.P. Morgan collateralized loan obligation (CLO) index returned 5.2% in 2016, marking the strongest year for performance since 2012. The portfolio is underweight agency MBS. Opportunities for positive excess return appear limited given current valuations and the significant extension of mortgage durations following the US election. Within the sector, and predominantly in Ginnie Mae securities, the portfolio is underweight lower coupon securities—where GSAM expect the quality of the outstanding float to continue to deteriorate—and overweight the 4% coupon. GSAM believe senior CLOs and Federal Family Education Loan Program (FFELP) asset-backed securities (ABS) offer attractive spread with strong credit protection and remain among the most compelling sectors in securitized products. GSAM are also positive on residential mortgage credit, particularly legacy non-agency MBS, which continue to benefit from negative net supply and show improving collateral performance.

Compliance

The Fund complied with its investment mandate during the month.