

# 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 NZ domiciled 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 and 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       | 0.93%  | 0.79%      | 0.14%  |
| 3 months      | 0.64%  | 0.24%      | 0.40%  |
| 6 months      | -1.96% | -2.64%     | 0.68%  |
| 1 year        | 2.53%  | 1.30%      | 1.23%  |
| 2 years (pa)  | 4.67%  | 3.82%      | 0.85%  |
| 3 years (pa)  | 6.11%  | 5.40%      | 0.72%  |
| 5 years (pa)  | 5.93%  | 4.24%      | 1.69%  |
| 10 years (pa) | 6.77%  | 5.98%      | 0.79%  |

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

### Fund size

NZ\$297 million

### Asset allocation (% of fund)

|                         |       |
|-------------------------|-------|
| Government stock        | 27.3% |
| SOE and local authority | 19.3% |
| NZ registered banks     | 39.2% |
| Corporate debt          | 14.2% |

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

|     |       |
|-----|-------|
| AAA | 11.3% |
| AA  | 65.4% |
| A   | 18.8% |
| BBB | 4.5%  |

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

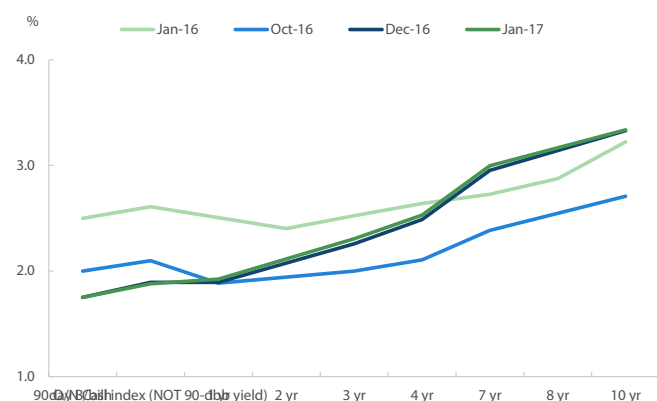
|                                    |       |
|------------------------------------|-------|
| NZ Local Government Funding Agency | 12.4% |
| Bank of New Zealand                | 8.1%  |
| Westpac Banking Corporation        | 7.3%  |
| Rabobank                           | 6.4%  |
| Fonterra Co-Operative Group        | 5.9%  |

\* excludes central government

### Duration and yield

|          |   |
|----------|---|
| Duration | Fund 4.14 years versus benchmark 4.45 years |
| Yield    | Fund (gross) 3.57% versus benchmark 2.61%   |

### New Zealand yield curve



### Compliance

The Fund complied with its investment mandate during the month.

### Commentary

The Nikko AM Wholesale NZ Bond Fund returned 0.93% for February. For the month the Bloomberg NZ Government Bond Index produced a return of 0.79% while the All Swap index returned 0.76%, and the S&P NZ Bond Corporate A Index returned 0.78%.

NZ interest rates finished lower in yield over the month. The NZ Government 2019 bond finished lower in yield by 15 basis points (2.17%), the NZ Government 2027 bond was 12 basis points lower (3.24%), and the NZ Government 2033 finished 9 basis points lower in yield (3.60%). Swap spreads to government bonds were virtually unchanged at the end of the month with the upward shape of the yield curve between the 2 and 10-year swap rates at a spread of +1.13%. NZ credit margins were stable to slightly narrower over the month although there has been limited market activity to test investor interest. A higher running yield from corporate holdings and yield curve positioning was of benefit to the Fund over the month.

The NZ economy remains in expansionary mode supported by high population growth, strong tourism and construction sectors. Rising commodity prices together with improved consumer and business sentiment, has also improved the New Zealand and global outlook.

In a recent speech, the RBNZ Governor said risks around future Official Cash Rate movements are equally weighted, reflecting balanced risks around inflation. The Bank sees the balance of risks for the global outlook to be to the downside highlighting ongoing surplus capacity and rising geo-political uncertainty. Global headline inflation has increased, partly due to rising commodity prices. Long term rates have also increased however monetary policy is expected to remain stimulatory, but less so than in the past, especially in the United States.

We are expecting a prolonged period of 'no change' in the OCR however expect the next change will be an increase. Longer term NZ Interest rates will continue to be influenced by the direction of US rates. The Trump administration will continue to be a source of surprises and the US fiscal stimulus that is expected to be delivered via tax cuts to 'middle' Americans and infrastructure spending is subject to significant implementation risk. If policy initiatives are not fully implemented the optimism currently priced into markets may well prove to be unfounded.

We do not expect large movements of interest rates in New Zealand over the near term however a reasonable amount of financial market volatility is to be expected. This volatility may open up investment opportunities in the months ahead.