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 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

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%	0.16%	0.10%
3 months	0.75%	0.49%	0.26%
6 months	1.54%	0.99%	0.55%
1 year	3.18%	2.16%	1.02%
2 years (pa)	3.37%	2.52%	0.85%
3 years (pa)	3.73%	2.92%	0.81%
5 years (pa)	3.83%	2.85%	0.98%
10 years (pa)	4.84%	3.79%	1.05%

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

Fund size

NZ$628 million

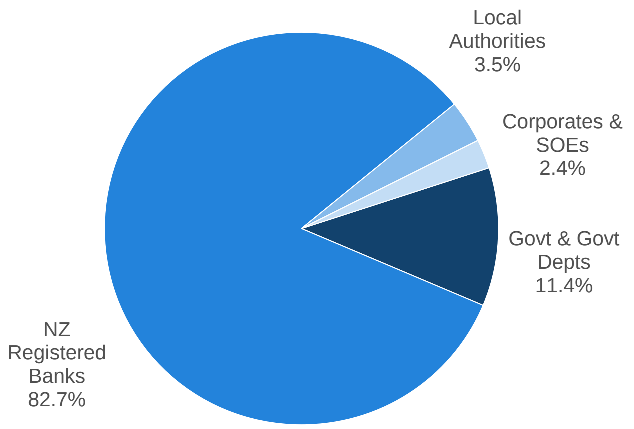
Duration and yield

Duration	Fund 117 days versus benchmark 45 days
Yield	Fund 2.87% versus benchmark 1.88%

Credit quality

AAA	1.2%
AA	77.2%
A	21.6%

Asset allocation (% of fund)



Top 5 issuers (% of fund)

Westpac Banking Corporation	21.4%
Kiwibank	16.0%
ASB	13.7%
ANZ Bank	12.2%
NZ Government Departments	11.4%
Number of issuers in portfolio	**18**

Compliance

The Fund complied with its investment mandate during the month.

Fund commentary

The Fund outperformed its benchmark over the quarter. The higher yield was the main contributor with the longer than benchmark duration also adding value. The higher yield should lead to continued strong performance of the Fund. Margins on 12-month term deposits remain attractive. Margins on fixed and floating rate bonds are attractive when looking at global comparisons and we have been taking advantage of this recently.

Market commentary

The short end of the yield curve is upward sloping, indicating the market believes the rate cutting cycle has likely finished for now, with the RBNZ leaving the Official Cash Rate at an all-time low of 1.75% at the June OCR review.

Over June the 90-day rate moved up 4 points to 1.99%, and the 1-year swap rate was up 6 points to 2.09%.

The RBNZ used the statement at the OCR review to reiterate its most recent forecast published at the Monetary Policy Statement, and the OCR is firmly on hold. GDP growth was 0.5% for the March Quarter and below forecasts of 1.1%. The construction sector lagged, while dairy and the primary sector had a strong positive contribution. Growth per capita remains modest. It is worth noting that quarterly GDP numbers can be heavily influenced by short term movements in particular sectors, and are subject to being volatile. Consumer and business confidence are both at good levels, albeit down from recent highs. Wage inflation remains moderate, but is expected to increase due to labour market capacity constraints. The housing market, particularly in Auckland, has slowed and will likely continue to do so up to the election. The main take away from this is that the economy is growing modestly, not roaring away unsustainably, and that the OCR at these levels and the RBNZ forecast of being on hold for the foreseeable future seems entirely appropriate. Q2 CPI is due during July - this will help form a picture around the timing of potential future changes in the OCR. The market is currently pricing an 80% chance of a hike by March 2018.

On the global front the European Central Bank, the Bank of England, and to a lesser extent the US Fed, at the end of June had co-ordinated statements around the future path of interest rates and monetary conditions. In a nut shell, the Central Bankers have said that they see inflation reappearing, and monetary conditions normalising in due course. This was all likely in response to a global market that did not appear to believe this to be the case, as evident in the recent global bond rally. As a result of this global bonds have sold off, and yield curve steepened out to the long end. New Zealand bonds have followed suit, with our 10-year Government bond yields rising by 0.26% at the end of June. If global central banks do begin to be more aggressive in normalising rates and tightening monetary conditions, it would make it easier for the RBNZ to begin to hike rates. Our view is that the RBNZ would not want to be the only central bank raising interest rates again, as was the case in 2014.