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	0.25%	0.16%	0.08%
3 months	0.74%	0.49%	0.25%
6 months	1.52%	0.99%	0.52%
1 year	3.08%	2.07%	1.00%
2 years (pa)	3.26%	2.41%	0.86%
3 years (pa)	3.64%	2.82%	0.82%
5 years (pa)	3.80%	2.83%	0.97%
10 years (pa)	4.74%	3.68%	1.06%

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

Fund size

NZ$585 million

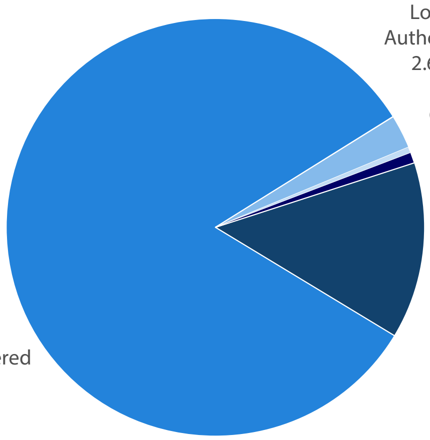
Duration and yield

Duration	Fund 99 days versus benchmark 45 days
Yield	Fund 2.85% versus benchmark 1.87%

Credit quality

AA	69.6%
A	30.4%

Asset allocation (% of fund)



Top 5 issuers (% of fund)

Kiwibank	17.5%
Westpac Banking Corporation	16.9%
ASB	14.2%
New Zealand Government Departments	13.6%
ANZ	12.5%
Number of issuers in portfolio	**17**

Compliance

The Fund complied with its investment mandate during the month.

Fund commentary

The Fund outperformed its benchmark over the month. The higher than benchmark portfolio yield was the main contributor and should lead to continued strong performance of the fund. Margins on 12-month term deposits remain attractive. Margins on A1 rated commercial paper have widened over the month, driven by an increase in issuance. The secondary market for short terms bonds has been very quiet, and margins have come in slightly adding to performance.

The fund has held a long duration position for some time now, on the basis that we have not seen any urgent need for a rise in the OCR, and credit margins being attractive at the 1 year point of the interest rate curve. It is our expectation that the RBNZ maintains its recent forecast regarding interest rate hikes starting in 2019.

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. The 90-day bill rate ended August unchanged at 1.96% and the 1-year swap rate was down 1 basis point to 2.02%.

In the August Monetary Policy Statement the RBNZ left the OCR unchanged at 1.75%. In its key forecast variables the RBNZ has the OCR on hold until mid-2019 as inflation slowly tracks back to the mid target of 2%. The short end of the curve barely moved over August. Going forward low inflation and the level of the NZD will act to impede a move higher in rates at the short end. The NZ dollar was down around 5% over August, but from a relatively high level due to recent US dollar weakness. The lower NZ dollar has not at this stage changed the market pricing for a rate hike, with a full hike priced in at the end of 2018, 6 months earlier than RBNZ forecasts. The housing market is slowing, and we are seeing tighter credit conditions via increased lending margins and a banking sector generally less willing to lend. New Zealand's economic expansion is ongoing, but at a slower pace. Business confidence eased over August, but is still at elevated levels. Employment intentions are lower; this is likely a reflection of uncertainty around the upcoming election. We do not see the election as a big risk event, we are however mindful of costly election promises, and proposed policies to address the housing market, along with the downstream impact these may have on the government books, inflation and future direction of short term rates.