



# Qualitative Fund Research

Nikko AM Core Equity Fund

November 2018



Fund Manager of the Year  
New Zealand Equities Sector - Finalist

## About the Manager

Nikko Asset Management (Nikko AM) acquired Tyndall Investments, both Australia and New Zealand in 2011, with Tyndall changing its name to Nikko Asset Management New Zealand Ltd (the Manager, Nikko NZ). Nikko NZ is one of New Zealand's largest asset managers, providing solutions to a broad range of clients, including corporate superannuation schemes, various trust structures, financial planners, banks, KiwiSaver Schemes and retail investors through platforms, as detailed [here](#).

Nikko NZ is an active investment manager with a medium term focus, who can leverage the broader team of ~200 investment professionals across 11 [global-offices](#), Nikko NZ see this as being a unique advantage.

Nikko NZ, through Nikko AM, believe in strong [governance](#) frameworks, leveraging its global resources to deliver best in class systems, policies and procedures. This extends to dedicated statements on [social responsibility](#). FundSource view corporate citizenship and governance frameworks as extremely important foundations from which a manager starts to engage with the clients' experience, this is overseen by Nikko NZ's [Executive Chairman](#).

## Using this Fund

**This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.**

The Nikko AM Core Equity Fund ("the Fund") is wholesale unit trust that invests predominantly in to New Zealand equities, and to some lesser extent Australian equities. As such the Fund will generally sit within the growth component of a balanced portfolio, more specifically the equity asset class.

The Fund's objective is to outperform the Fund's benchmark, being the S&P/NZX 50 Index Gross with Imputation Credits, by 3%pa over a rolling three year basis before fees.

The Fund is suitable for investors with an investment horizon of more than five years and is subject to

Nikko NZ manages fourteen funds:

- [Nikko AM Core Equity Fund](#)
- Nikko AM Concentrated Equity Fund
- Nikko AM Global Shares Fund
- Nikko AM Global Equity Unhedged Fund
- Nikko AM Global Equity Hedged Fund
- Nikko AM Cash Fund
- Nikko AM NZ Bond Fund
- Nikko AM Corporate Bond Fund
- Nikko AM Income Fund
- Nikko AM Global Bond Fund
- Nikko AM Option Fund
- Nikko AM Conservative Fund
- Nikko AM Balanced Fund
- Nikko AM Growth Fund

The funds are managed by a team of seven investment professionals, [four](#) being dedicated equity strategies and [three](#) to fixed income strategies. The global equities strategy is a multi-manager approach, managed by a Sydney based specialist team. Goldman Sachs Asset Management is the appointed global fixed income manager, while JP Morgan Alternative Asset Management are the appointed alternatives manager. As the global equity, bond and alternatives funds are managed by either external Nikko teams or external managers, for the number of funds being managed the team is adequately resourced.

equity market risk and movements (both positive and negative), from New Zealand and Australian markets. Accordingly, capital losses can be incurred.

The Fund is a NZD denominated Portfolio Investment Entity (PIE) that may enter into derivative contracts to manage market risks. Returns are distributed by way of semi-annual distributions and redemptions. Monthly distributions are paid at the Managers discretion.

Question	What the Manager says	What FundSource thinks																						
<p>What are the Manager's assets under management - in total and in this Fund?</p>	<p>Nikko AM NZ is solely in the business of investment management. Nikko AM NZ actively manages NZ\$5 billion of investments for corporate superannuation schemes, community trusts, charitable trusts, foundations, financial planners, banks, insurance companies, KiwiSaver Schemes, corporations, other fund managers and retail investors through platforms.</p> <p>Retail Funds Under Management (FUM), as at 31 March 2017:</p> <table data-bbox="587 636 1002 904"> <tr> <td>Core Equity</td> <td>\$7.25M</td> </tr> <tr> <td>Concentrated Equity</td> <td>\$31.93M</td> </tr> <tr> <td>Global Equity Unhedged</td> <td>\$123.95M</td> </tr> <tr> <td>Global Equity Hedged</td> <td>\$96.13M</td> </tr> <tr> <td>Cash</td> <td>\$121.43M</td> </tr> <tr> <td>NZ Bond</td> <td>\$62.38M</td> </tr> <tr> <td>NZ Corporate Bond</td> <td>\$338.33M</td> </tr> <tr> <td>Income</td> <td>\$10.56M</td> </tr> <tr> <td>Global Bond</td> <td>\$21.20M</td> </tr> <tr> <td>Multi-Strategy</td> <td>\$118.75M</td> </tr> <tr> <td><b>Total FUM:</b></td> <td><b>\$5,000.0M</b></td> </tr> </table>	Core Equity	\$7.25M	Concentrated Equity	\$31.93M	Global Equity Unhedged	\$123.95M	Global Equity Hedged	\$96.13M	Cash	\$121.43M	NZ Bond	\$62.38M	NZ Corporate Bond	\$338.33M	Income	\$10.56M	Global Bond	\$21.20M	Multi-Strategy	\$118.75M	<b>Total FUM:</b>	<b>\$5,000.0M</b>	<p>Nikko Asset Management New Zealand is one of the larger fund manager's in New Zealand. For the types and number of strategies the business has significant total funds under management.</p> <p>The Core Equity Fund commenced in May 2010, and as at 31 October 2018, has \$477 million of wholesale and retail money invested. The retail component accounts for \$7.25 million.</p>
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<p>Who is accountable for managing the Fund, and how long has the investment team worked together?</p>	<p>Stuart Williams is the Portfolio Manager for the Core Equity Fund. Williams has over 20 years of experience in the investment management industry and a strong track record in portfolio management of both benchmark relative and high conviction funds. He has a Bachelor of Commerce degree from the University of Auckland and is a Chartered Accountant. The Nikko AM New Zealand equity team comprises of Stuart Williams (Head of Equities), James Lindsay (Senior Portfolio Manager), Michael Sherrock (Portfolio Manager) and Michael De Cesare (Research Analyst). All members of the team have research and recommendation responsibilities and average 16 years' experience.</p>	<p>Williams has held the role of Portfolio Manager (PM) since commencing with the Manager in 2014. With over 20 years' experience Williams has specialised in several sectors for both benchmark aware and high conviction funds. While Williams tenure at the Manager is relatively short, he is supported by James Lindsay, who been a member of the Nikko investment team since 1999, and Sherrock with over 10 years tenure at Nikko.</p> <p>The Fund is a reasonably broad portfolio typically comprising 30 ±5 companies. The New Zealand based investment team can leverage the broader Nikko global investment platform, spread across 12 countries. This is particularly useful considering this Fund can comprise up to 20% Australian listed companies, where Nikko NZ can leverage the Nikko Australian equity team, if required. FundSource believes the depth and breadth of resources for this fund as being adequate.</p>																						
<p>What objective is the Manager trying to achieve?</p>	<p>The objective of the Fund is to construct a portfolio of authorised investments that outperform the Fund's benchmark return by 3.0% per annum over a rolling three year period before fees, expenses and taxes. The current benchmark for the Fund is S&amp;P/NZX 50 Index Gross with Imputation.</p>	<p>The Manager is one of the few fund managers in New Zealand to specify an expected return, above the Funds benchmark, being the S&amp;P NZX 50 Index Gross with Imputation. FundSource believes this provides investors with a quantifiable expectation, and make informed decisions, with respect to the Fund's performance. FundSource views this positively.</p> <p>FundSource notes that the Manager reports performance in its <a href="#">Factsheets</a> and their website before tax, and after fees and expenses. FundSource prefers that performance calculations are net of fees</p>																						

		and annual fund charges, this can be found on the <a href="#">Disclose site</a> . The Fund's outperformance of its benchmark is also calculated before fees, expenses and taxes. FundSource believes that this diminishes an investor's ability to understand the Fund's outperformance target.
What does the Manager invest your money into?	The Nikko AM Core Equity Fund primarily invests in NZX listed equities however there is the ability to invest up to a maximum of 20% in ASX listed equities.	<p>The Fund aims to provide investors with exposure, primarily, to New Zealand companies, and a smaller number of select Australian companies. The Manager is an active manager, and the Fund an investment portfolio offering potential for growth of income and capital.</p> <p>Fundamental research underpins the Managers process to produce insight and conviction in companies. The process aims to identify mis-priced companies that offer a blend of value, growth and sustainability, highlighting the Managers view that markets can be inefficient. Companies held in the portfolio should offer value through the cycle, have sustainable high quality returns, and the Manager expects them to grow.</p> <p>Investors in the Fund should have a minimum investment horizon of at least five years. Over shorter periods, there is potential for the fund to fall materially in value.</p>
What are the inherent risks imbedded in the Fund?	<p>Investing in the fund has some general investment risks which are covered in the Core Equity Funds PDS - being Market Risk, Company Specific Risk, Liquidity Risk and Currency Risk.</p> <p>Nikko aims to construct portfolios with excellent risk/reward characteristics. Although we take a high active share approach, we expect our future portfolio risk to remain broadly consistent with market risk.</p> <p>Key risks are continually assessed during the investment process. The team produce a weekly research pack covering portfolio and market analytics, companies research notes (written by our analysts) and portfolio risk measures. In addition to this Nikko AM has a Global Risk and Compliance team monitoring portfolio risk and formally meeting with the team on a monthly basis. Nikko AM's risk management group have deployed a market leading risk model for risk analysis and monitoring. The independent risk team is dedicated to analysing portfolio's risk exposures in terms of manager, sector, country, currency, security, interest rate, credit etc. up on a daily basis.</p>	<p>The Manager has a structured approach to managing risks in the portfolio, and has highlighted a series of risks they are mindful of when constructing and managing the portfolio.</p> <p>The security selection process is structured. All members conduct research and contribute ideas to the portfolio, based on the 15-25 companies that each analyst research in the sector they cover. Importantly each sector has a lead analyst and a backup analyst. FundSource believes this structured approach helps to mitigate key person risk.</p> <p>The Manager uses a mix of objective factors, such as intrinsic valuation, portfolio risk and liquidity, combined with subjective factors such as industry assessment, qualitative assessments of management and boards. These two factors assist in the portfolio construction process, bringing consistency, which in itself, assists in mitigating risk.</p>
Why do they believe the future prices of the Fund's investments will vary?	The Core Equity Fund is an actively managed Australasian equity fund. The future performance of the fund will largely be driven by the stock selection decisions made by the team. These decisions result	The Manager aims to hold 30 ±5 companies in the portfolio, and expects this to vary by no more than ±5 in certain circumstances. FundSource considers this to be quite a diverse portfolio, with a higher

	<p>from the strong fundamental research process the team carries out. In addition, the funds future price will be influenced by the general direction of the NZ market.</p>	<p>number of stocks than typically seen in New Zealand funds.</p> <p>The Manager's ability to accurately determine the intrinsic value of company becomes integral to the decisions made. This is based on the Manager's research, which in turn, carries a qualitative assessment of a company's management and board. The subjective elements will be integral to the Funds' performance, compared to its benchmark and peers.</p> <p>FundSource notes that the Manager maintains a strong program of company contact and the formal weekly investment team meeting, which should assist in mitigating below benchmark performance.</p>
<p>Why does the Manager believe you should give them your money rather than to someone else or to an inexpensive index fund?</p>	<p>Under the leadership of Stuart Williams, the team has fostered a dynamic culture that serves as a platform for ongoing success. The team has a high level of experience and skill with Nikko AM, providing best in class infrastructure and operational resources. Under Stuart's leadership the team has built a strong track record compared to peers and the benchmark. Over the past 3 years the Core Equity Fund has returned 2.5% p.a.* above the Index. The passive offering in New Zealand costs 0.50%, by comparison, the Nikko AM Core Equity Fund costs 1.0%.</p> <p>*Note all performance data quoted is Gross Returns</p>	<p>FundSource believes that the Manager's commitment to sustainable investing, environment, social and governance (ESG), is a positive step that many managers are moving toward. Nikko Asset Management is an early adopter of this global framework, and has embedded it in to the New Zealand operations.</p> <p>Compared to the 27 peer funds in the FE Analytics NZMI Equity New Zealand sector, the Fund performance has been above the sector average for most periods. Since Williams assumed PM responsibilities Fund performance has remained above the FE Analytics sector average. This has been achieved without any material change to the Fund's volatility, despite volatility being higher than the FE Analytics sector average.</p>
<p>How does the Manager decide to buy or sell investments?</p>	<p>Nikko AM NZ's domestic equity philosophy is based on the premise that the New Zealand market is information inefficient. The core of making a buy or sell decision is based on the analysts and team assessment of stock mispricing in the market versus Nikko's valuation expectation. The ultimate decision on when to buy and sell investments rests with the portfolio manager of the fund. Portfolio managers cover each other in the event a decision is required when the lead portfolio manager is out of the office. The team is constantly assessing buy and sell decisions on stocks under consideration. The team meets formally every Monday to review portfolio positions, review markets and discuss researched ideas. In addition to this the team work closely throughout the week so buy/sell ideas and potential execution is carried out on a timely basis.</p>	<p>The Manager typically takes a long-term view of companies held in the portfolio. Companies are typically bought and sold when the valuation is below the Manager's calculated intrinsic value, when buying. As expected, companies are sold when valuations rise to or above the Manager's calculated intrinsic value. The Manager's intrinsic valuation calculations are not a one-off calculation. As new information comes to market, the intrinsic valuation calculations are revised, positively or negatively. This can lead to increasing, reducing, buying or selling a company. This all contributes to turnover.</p> <p>The Fund is not required to be invested in all sectors, however, the Manager does give consideration to the composition of the S&amp;P/NZX50 index. The investment team's weekly meeting is a key to the initial evaluation process, with quantitative screening identifying companies for further investigation. A proprietary model scores and ranks companies using a consistently applied eight factor model. From here analysts will undertake fundamental research.</p>

<p>Has the CIO personally invested in the Fund? If so, paying the same fees as other investors?</p>	<p>Stuart Williams has a significant investment in the Core Equity Fund</p>	<p>FundSource believes that managers should 'eat their own cooking'. Correspondingly, FundSource views Williams significant investment positively.</p> <p>FundSource believes that the interests of investment personnel are better aligned to those of the investors, when investment personnel are significantly invested, and at the same fees. FundSource believes that the investment team pay the same fees as investors.</p>														
<p>How much latitude does the Manager have to deviate from the weightings of the Benchmark portfolio?</p>	<p>The manager has considerable latitude to deviate from the S&amp;P/NZX50 benchmark. For a security that is a member of the S&amp;P/NZX50 Index, the maximum weight permissible for a single stock is the index weight +6%. There is no requirement to hold any security at a minimum weight. For any security listed on the New Zealand or Australian exchange but not in the S&amp;P/NZX50 Index the maximum weight permissible is 6%. The fund can invest up to 20% in Australian listed securities.</p> <table border="0" data-bbox="587 860 1007 1032"> <tr> <td>Tracking Error</td> <td>2% to 5%</td> </tr> <tr> <td>Cash Allocation:</td> <td>0% to 10%</td> </tr> <tr> <td>Australasian Equities</td> <td>95% to 100%</td> </tr> <tr> <td>Australian Equities</td> <td>0% to 20%</td> </tr> <tr> <td>Single security S&amp;PNZX50:</td> <td>Index +6%</td> </tr> <tr> <td>Unlisted securities:</td> <td>0% to 2%</td> </tr> <tr> <td>Hedging:</td> <td>0% to 105%</td> </tr> </table>	Tracking Error	2% to 5%	Cash Allocation:	0% to 10%	Australasian Equities	95% to 100%	Australian Equities	0% to 20%	Single security S&PNZX50:	Index +6%	Unlisted securities:	0% to 2%	Hedging:	0% to 105%	<p>FundSource believes the Fund to be quite diversified, at 30 ±5 holdings. This does not prevent the Manager from having significant positions in a company, compared to the reference benchmark. The fund aims to regularly hold 2-3 companies &gt;4% relative to the benchmark weight. This can extend to the Australian companies held in the portfolio. FundSource notes a small number of companies listed on the NZX can have significant market size, representing &gt;10% of the market.</p> <p>FundSource notes that the top 10 holdings in the fund regularly represents &gt;50% of the Fund's net asset value. FundSource highlights that the Fund's tracking error to date has consistently been at the lower end of the targeted range.</p> <p>FundSource notes the Fund can invest in unlisted companies, but highlights the Manager has strict criteria around that company listing on either the NZX or ASX. The potential to invest in Australian listed companies at up to 20% introduces some currency risk. The Fund manages currency actively, with currency hedging ranging from 0%-105%.</p>
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<p>On what basis does the Manager believe the fees they charge are justified?</p>	<p>Relative to similar actively managed offerings in the market the Nikko AM Core Equity Fund has a lower total fee offering strong value for money. Investing in the Nikko AM Core Equity Fund provides investors access to an experienced well-resourced team with a strong track record of outperforming the benchmark.</p>	<p>FundSource believes the Manager is transparent from a fees perspective, noting the administration and underlying manager fees are disclosed in the <a href="#">Product Disclosure Statement</a>, and <a href="#">Disclose</a> website.</p> <p>FundSource notes that the Manager's Basic Fee, of 0.76%, is lower than the average fee, of the 26 peer funds in the FE Analytics NZMI Equity New Zealand sector. FundSource highlights that the Manager caps the operating expense fee of 0.25%.</p> <p>FundSource notes the Manager does not charge a performance fee for this Fund.</p>														
<p>How would you describe the quality of your organisational and investment governance processes?</p>	<p>Nikko AM NZ has a robust globally monitored governance structure, with well-established committees and an experienced, mature Board. Decision making is timely but considered, with a careful process to ensure all relevant information is presented prior to a decision. Decision making authority is clearly set out in a combination of policy and committee</p>	<p>The Manager has a strong governance and compliance framework. The Manager's governance and compliance systems and personnel are separated from the investment team functions. The localised team have direct reporting lines to respective Global Heads. The Manager's commitment to compliance and governance can be viewed <a href="#">here</a>.</p>														

	<p>charters. All Board and committee meetings are minuted, (generally by an internationally qualified company secretary) and records are kept in a central, secure database. Nikko AM NZ views compliance, systems and controls as a critical part of the investment process. The portfolio managers adhere to the mandate rules and risk profile in constructing and managing portfolios. Tim Morrison, Head of Compliance, is responsible for monitoring investment risk and has a local reporting line to the Managing Director and an offshore reporting line to the Global Head of Investment Risk. The Compliance function also monitors mandate rule compliance on a post-trade basis. The New Zealand Compliance, Risk and Disclosure Committee has an oversight of portfolio risk. The Tokyo-based Performance and Risk team monitor portfolio risk and have meetings with the New Zealand fixed interest team at least once a month to review/discuss.</p>	<p>Nikko Asset Management became a signatory to the UN PRI in 2007, and believes that environment, social and governance underpin sustainable responsible investing, which can be viewed <a href="#">here</a>.</p> <p>FundSource notes that Nikko Asset Management NZ has appointed Tracey Jones as an independent non-executive director. FundSource has not met with Jones, but is aware of her financial services background. FundSource commends Nikko for improving the diversity of its New Zealand directors.</p> <p>FundSource views formal Investment Committees positively. The Manager's Investment Committee is responsible for ensuring that investment mandates, and Statements of Investment Policy and Objectives (SIPO), are adhered to. The Investment Committee is not involved in day to day portfolio investment decisions.</p>
<p>Is there alignment of interests through; ownership of the Manager, and remuneration of the investment team?</p>	<p>Nikko Asset Management New Zealand Limited is a wholly owned subsidiary of Nikko Asset Management Co., Ltd, which is headquartered in Tokyo, Japan. Nikko Asset Management New Zealand is one of Asia's largest asset managers, providing high-conviction, and active fund management across a range of Equity, Fixed Income and Multi-Asset strategies. In addition, our complementary range of passive strategies covers more than 20 indices and includes some of Asia's largest exchange-traded funds (ETFs).</p> <p>Investment personnel are remunerated by way of competitive market based salary, and short and long term incentives.</p>	<p>To preserve capital and generate a long-term positive return for investors, the Manager must remain operational. The Manager has significant funds under management, which has grown over time. Being a wholly owned subsidiary of a global company headquartered in Japan can come with risk, however since acquiring Tyndall, Nikko Asset Management has strengthened its commitment to New Zealand, adding new resources to the local team.</p> <p>FundSource highlights that the corporate alignment and remuneration of investment personnel is in line with large corporates. The investment team being invested in the products they are responsible is seen as being the strongest link to an investors experience, and is viewed positively.</p>

## Conclusion and Rating

The Fund provides an investor with exposure to a reasonably concentrated Australasian equity portfolio that is focuses on New Zealand companies, with an allocation to a select number of Australian companies. The Manager is aware of the benchmark, but does not manage the fund to the benchmark. The Fund is reasonably diverse, however, has held some large positions historically.

FundSource notes that the Fund states an expected outperformance, above the Fund’s benchmark. FundSource notes this is one of the few NZ PIE funds that sets an outperformance expectation. FundSource views this positively and views this as a benchmark for other fund managers to consider.

FundSource’s conviction in the Manager is underpinned by several, small in isolation, factors which FundSource expects will contribute positively to an investor experience. The investment team has been stable, post a 2014 restructure. The investment team can leverage resources around the Nikko group, particularly for macro inputs and additional analysis and insights for Australian

companies. The risk management, compliance and governance oversight is very strong, and embedded in to the culture of Nikko NZ. Nikko AM is well resourced globally, and the investment teams can, and do, communicate ideas. There is a good mix of local expertise, blended with strong global oversight. An encouraging sign is the recent appointment of a non-executive director to Nikko NZ, bringing independent views and adding diversity to the Nikko NZ board.

The Manager’s basic fee is well below the peer average in the FE Analytics NZMI Equity Australasia sector. This remains the case when other management and administration expenses are charged.

FundSource recommends that investors carefully consider that the Managers benchmark aware focused high conviction approach to managing Australian equities, meets their investment needs and objectives.

### FundSource Rating: **AA**

Fund ratings are current as at the date of publication of this report. FundSource reserve the right to review and update fund ratings from time to time.

## Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score
Corporate & Investment Governance	15%	3.75 / 5
Investment Philosophy & Process	20%	3.60 / 5
People	25%	3.67 / 5
Portfolio Construction & Implementation	15%	3.83 / 5
Risk Management	15%	4.20 / 5
Investment Fees	10%	4.29 / 5

Overall Average Score: **3.93 / 5**

## FundSource Rating Guide

The qualitative rating of a fund is a function of the FundSource Research Factor Weighting process, which is built around the six core qualitative research process categories. The weighted scores result in an overall score, out of five, which is then matched to the following rating:



### AAA: Highly Recommended

Funds that have superior average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, significantly experienced and stable senior personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management company will also have established effective controls to maintain that philosophy.

### AA: Recommended

Funds that have strong average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced and stable personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management philosophy must be coherent and consistent with existing portfolios and processes.

### A: Investment Grade

Funds that have good average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced personnel, a sound track record a defined investment philosophy and process, and a portfolio consistent with that philosophy and process.

### FW: Fund Watch

There has been a material change with either the manager, this may include, but is not limited to, departures, new hires, process changes, changes to the investment philosophy. This is considered to be an interim measure, to enable further investigation, re-evaluation and an appropriate course of action to be determined.

### S: Sell

This category covers previously recommended funds that are no longer recommended because of some material change. Removal from recommended status might be for a variety of reasons such as a fundamental change in the fund management company or in the manager's investment strategy, or because a fund did not meet its original expectations. The implications for ongoing service are that the fund should be reviewed on an individual client basis to ensure it still matches their original investment objective.

### NR: Not Rated – Screened/ Not Rated

Funds in the Not Rated – Screened category have provided information and/or FundSource has conducted an initial analysis of the fund, but has chosen not to provide a recommendation at this stage. FOR Not Rated funds the manager may have provided information, but no review meeting has been conducted

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NZX provides high quality information, data and tools to support business decision making. NZX builds and operates capital, risk and commodity markets, and the infrastructure required to support them.

NZX owns a suite of securities and agricultural information businesses; managed fund research house FundSource; exchange traded funds provider Smartshares; and managed funds provider SuperLife.



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