

JMIS FIXED INCOME FUND

Performance Comments

The asset value of the Fund at 31 December 2016 was \$73.2 million and the base price was \$1.0701, a fall of (1.4%) over the quarter, including the 0.75 cent distribution. The 90-day bank bill rate provided a return of +0.6% in the same three-month period.

Wholesale interest rates in New Zealand have been falling since 2014 (following interest rises seen in 2013). In 2014 the benchmark 5-year interest rate swap was trading at 4.70% - this rate steadily fell reaching a low point of 2.06% in August of 2016.

The three months ending 31 December 2016 represented the first material retracement of this trend. At the close of the September 2016 quarter, the benchmark rate was 2.12%. Over the course of October 2016, local term interest rates rose. These initial movements were prompted by stronger than expected domestic data, e.g. third quarter CPI.

At the same time, it was expected that the Reserve Bank of New Zealand would leave the Official Cash Rate unchanged due to concerns over downside risks to inflation outcomes and the continued strength of the New Zealand dollar.

The result was the beginning of a change to the shape of the New Zealand interest rate curve, a change that accelerated as the US election loomed. The unexpected victory by Donald Trump has produced a reaction in US Treasury markets not dissimilar to the "taper tantrum" that occurred in 2013, when interest rate markets reacted aggressively over concerns that the Federal Reserve would start to taper the accommodative monetary policy settings.

The market reaction has seen the 5-year swap rate in New Zealand climb to 2.95%, a move closely correlated to the movement seen in the US Treasury market. Donald Trump has signalled a number of policy measures – lower corporate tax structures, increased Government spending, lighter regulatory touch – that the interest rate market believes will increase inflation and growth outcomes. The US 10-year Treasury bond rate has climbed from 1.56% to 2.33%.

Fund Performance

The JMIS Fixed Income Fund has performed as follows:

To 31.12.16	3 Months %
Fund net return*	(1.4)
Benchmark Index**	0.6
Difference	(2.0)
* These returns are after deductions for charges and before tax	
** Reflects no deduction for charges and tax	
Past performance is not necessarily indicative of future performance.	

Outlook

The key factors for the direction of interest rates are the extent to which the broad policy statements made by the incoming administration in the US are actually implemented. However we would broadly expect the tone and intent of the incoming administration to contribute to upward pressure on interest rates over the course of 2017. This is likely to continue to pressure longer term local interest rates.

However there remains little short-term pressure on the Reserve Bank of New Zealand to change the OCR and our expectation would be that short-term rates in New Zealand remain at low levels. So the argument for a steeper yield curve remains valid. This will potentially put pressure on capital values of longer-dated instruments over the course of the year, but increase the opportunity cost of the safe-haven of cash and short-term deposits.

Over the last twelve months the Fund has returned 3.36% pre-tax compared to a before-tax return of 2.51% for the Index.

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