NIKKO AM INCOME FUND

Monthly Fact Sheet

Why Nikko Asset Management NZ?

As a dedicated global investment manager Nikko AM NZ pairs local knowledge and experience with significant global resources. The Nikko group manages over US$200 billion globally, including around NZ$5 billion in New Zealand.

Fund overview

The Fund aims to provide investors with regular income from an actively managed investment portfolio while protecting the capital value of investors' funds.

Benchmark

Composite of (from 1 July 2016)

- Bloomberg NZBond Govt 0+ Yr Index	70%
- Bloomberg NZBond Bank Bill Index plus 4% pa	30%

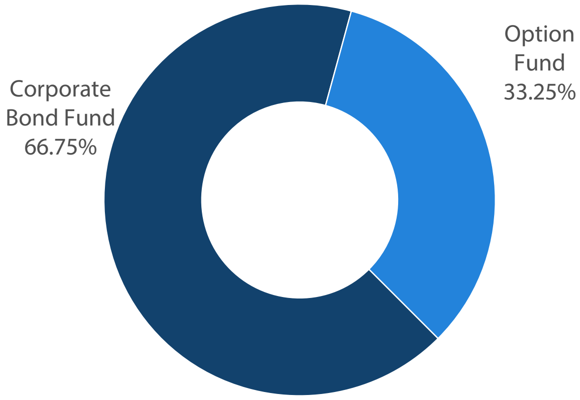
Performance objective

The aim is to construct a portfolio that earns a return of 6.5% per annum over a rolling three year period before fees, expenses and taxes.

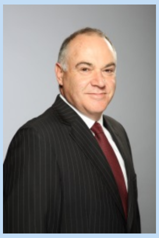
Risk indicator

Standard deviation of returns before tax and after fees over a rolling 5 years to the last calendar quarter

Asset allocation



Portfolio management team



Fergus McDonald is Head of Bonds and Currency and is responsible for the investment of the Bond, Cash and Currency mandates.

Fergus has been actively involved in the NZ financial markets since 1981.

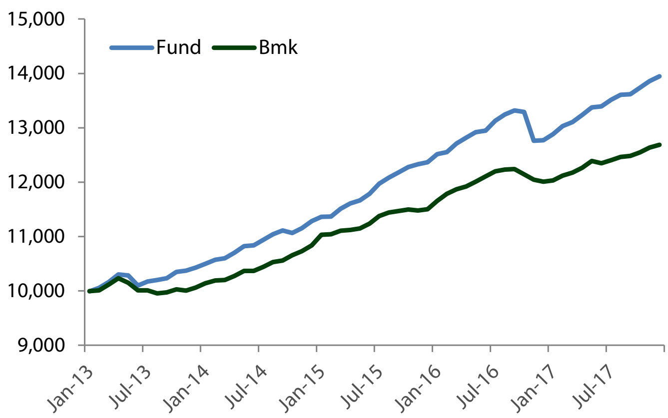
The portfolio management team for the domestic fixed income funds includes Ian Bellow, Fixed Income Manager and Tim O'Loan, Fixed Income Analyst.

Performance returns

	Gross[1]	Benchmark	Net[2]
1 month	0.62%	0.40%	0.50%
3 months	2.43%	1.63%	2.13%
1 year	9.20%	5.64%	8.05%
2 years	6.19%	4.85%	5.07%
3 years (pa)	7.32%	6.54%	6.15%
5 years (pa)	6.88%	7.91%	5.84%
10 years (pa)	8.28%	8.95%	7.32%

1. Gross Returns are before tax and before the deduction of fees.
2. Net Returns are before tax but after the deduction of fees and expenses.

Five year cumulative performance (gross) [1]



Top 5 corporate issuers (% of fund)

Westpac Banking Corporation	12.0%
ANZ	11.4%
Kiwibank	10.1%
Rabobank	8.0%
ASB Bank	7.7%

Aggregation of the Option and Corporate Bond Funds

Corporate Bond Fund yield (gross): 3.36%

Key fund facts

Strategy launch date
October 2007

Strategy FUM
$11.3m

Fund structure
PIE fund - retail

Fees in retail fund:
Management fee 0.80%p.a
Expenses (maximum) 0.25%p.a
Expenses (current) 0.25%p.a

Buy/sell spread
nil

Distributions
Calendar quarter

Benchmark
Composite of (from 1 July 2016):
Bloomberg NZBond Govt 0+ Yr Index @ 70% plus Bloomberg NZBond Bank Bill Index plus 4% pa @ 30%

Hedging
All investments will be in New Zealand dollars

Corporate Bond Fund commentary

The fund underperformed over the month as credit holdings failed to keep pace with the move lower in government yields. NZ bonds performed well over the 2017 year; interest rates moved lower in yield and credit performed well due to a higher running yield and a reasonable contraction in credit margins as demand for yield remained strong.

Over December performance was mixed across the different sectors of the NZ bond market. NZ government bonds were generally the best performers as yields moved slightly lower, swaps underperformed as they moved marginally higher in yield widening in spread relative to similar maturities of government bonds.

In yield movements, NZ government bonds finished 7 basis points lower in yield, the mid curve 5-7 year maturities and the 2037 maturity were the better performers, whereas the 10 year was unchanged. Swaps moved higher in yield with the 1 year rate 3 basis points higher and longer maturity swap rates 7-10 basis points higher in yield. This move has expanded swap margins to similar maturities of government bonds out to spreads of around 45 basis points which is the widest level for some time. The positive shape of the yield curve was little changed with a spread of 0.93% between the 2-year and 10-year swap rates.

Credit has had a very good year and it would be optimistic to expect much more margin contraction from current levels, although we don't expect margins will expand significantly while the demand/supply dynamics remain supportive.

The sentiment on NZ had been surprisingly negative through the last quarter although we note the NZ dollar had a reasonably strong recovery into year-end and NZ bond yields finished close to annual lows. The global economic outlook continues to improve and commodity prices have had a reasonable recovery. There is no longer an expectation of additional monetary easing and central banks are on hold, or moving to a slow and cautious approach for reducing stimulus. With the growth outlook improving, one of the big questions for bond markets will be expectations for inflation but so far lower than expected inflation outcomes have reduced expectations for higher interest rates. NZ may be more vulnerable to higher inflation expectations if the NZD is lower and we start to see an increase in wage inflation.

Option Fund commentary

The Option Fund returned 1.21% over December. The US 10 -year Treasury bond opened and closed the month at a yield of 2.41% and traded in a 19 basis point range. The high in yield was 2.50% and reached a low of 2.31%. The narrow trading range benefitted the fund as no options were struck meaning all income from selling options was retained by the fund. Selling options with a two month expiry date remains more attractive than selling options with shorter terms however low volatility levels means option income remains modest.

The US Federal Reserve raised the Fed Funds rate for the third time in 2017 at its December meeting. This rate rise was well anticipated by the market and did not cause any disruption when it was delivered. Soft US inflation data also helped keep bond yields stable. Despite revising downwards its unemployment rate forecasts, the Fed's Open Market Committee kept its interest rate and inflation forecasts unchanged for 2018. This is perhaps a less hawkish signal than expected and may indicate future interest rate hikes will occur at a modest rate.

International rate movements may also be having an influence on US rates. In the second half of the month the US 10-year Treasury bond hit 2.50%, its highest level since March. This coincided with upwards pressure on German 10-year rates which hit a two month high of 0.43%. A number of factors may have influenced the move higher including some hawkish talk from some ECB council members, US tax reform getting close to being implemented and more signs of improving economic growth across Europe and the US.

Compliance

The Fund complied with its investment mandate, SIPO and trust deed during the month.

Contact us

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