Nikko AM NZ Unit Trusts (Retail) — Fund Summary

Nikko AM Income Fund — 29 February 2016

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. We actively manage over NZ$4.8 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).

Portfolio managers

Fergus McDonald, Head of Bonds and Currency – Fergus is responsible for the investment strategy and portfolio construction of Bond, Cash and Currency mandates. He has been actively involved in the New Zealand financial markets since 1981 and has considerable experience in developing and managing a diverse range of fixed interest and option portfolios.

Ian Bellew, Fixed Income Manager – Ian joined Nikko AM in 1998 and is responsible for the implementation of investment strategy and day to day management of the fixed income and option portfolios. Ian also contributes to team decision making by analysing economic information and identifying global and domestic investment trends.

Fund launch

1 October 2007

Investment objective

The objective of the Fund is to construct a portfolio of authorised investments that earn a return in excess of 10% per annum measured over interest rates cycles before fees, expenses and taxes.

Investment philosophy

The Fund is managed by Nikko AM's fixed interest team. It is designed to provide regular quarterly income from an actively managed investment portfolio while protecting the capital value of investors' funds by investing in the Nikko AM NZ Corporate Bond Fund and the Nikko AM Wholesale Option Fund. The Fund is constructed to achieve a weighted average credit rating of A (Standard and Poor's rating) on capital invested.

The Nikko AM NZ Corporate Bond Fund invests in a diversified portfolio of corporate debt.

The Nikko AM Wholesale Option Fund invests into New Zealand Registered Banks with a minimum long term credit rating of A from Standard & Poor's, or equivalent from a recognised rating agency, producing a steady and secure income stream. The assets are then used as collateral security for derivatives, in particular selling options on long-term US Treasury Bonds. Options are also permitted to be sold on NZ, UK, Euro bloc or Australian Government stock.

Structure and taxation

The Fund vehicle is a Unit Trust and Portfolio Investment Entity (PIE) which is priced daily. Unit holders elect their own Portfolio Investment Rate. Information is provided to the IRD and unit holders on an annual basis.

PIE eligibility

Nikko AM may take any action it deems appropriate to ensure the Fund remains eligible to be a PIE. This includes the ability of Nikko AM to compulsorily withdraw a unit holder's units and pay the proceeds to that unit holder's nominated bank account.

Distributions

Quarterly. Last business days of March, June, September and December.

Hedging policy

Assets and liabilities are hedged to NZD at the discretion of the Manager.

Investment restrictions

	Range
Nikko AM NZ Corporate Bond Fund	60% – 80%
Nikko AM Wholesale Option Fund	20% – 40%

Management fees and other charges

A management fee of 0.80% per annum calculated as a percentage of the Net Asset Value of the Fund will be calculated and deducted from the Fund. This fee is calculated daily and is payable to Nikko AM. The management fee may be reduced or waived at our discretion.

Nikko AM may recover expenses (including the Trustee fee) up to a maximum of 0.25% per annum from the Fund.

Buy/sell spread

Nil

Trustee

Public Trust

Custodian

Public Trust as legal custodian, BNP Paribas Fund Services Australasia Pty Limited delegated as functional custodian.

Minimum investment

Initial investment	$5,000
Further investments	$1,000

The Manager may accept applications for investments below the minimum investment amount at its discretion.

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Nikko Asset Management

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Performance
(NZD returns; before tax, after fees and expenses)

1 month	3 months	6 months	1 year
0.24%	1.65%	3.39%	9.20%
2 years (pa)	**3 years (pa)**	**5 years (pa)**	**Inception (pa)***
7.78%	6.64%	6.78%	7.78%

* October 2007

Distributions

cents per unit	Mar	Jun	Sep	Dec
2015	1.00	1.25	1.50	1.25
2014	1.50	1.00	1.50	1.00
2013	1.50	1.50	1.50	1.50
2012	1.50	1.00	1.00	1.50

Asset allocation

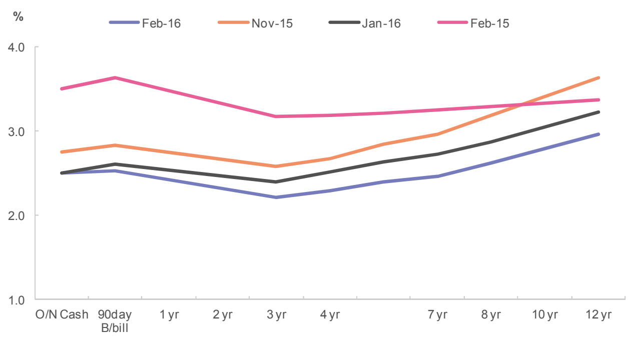
Nikko AM Wholesale Option Fund	29.8%
Nikko AM NZ Corporate Bond Fund	70.2%
Cash	0.0%

Top 5 corporate issuer exposures (% of fund)

Bank of New Zealand	6%
ANZ Bank New Zealand	6%
ASB Bank Limited	5%
Rabobank	4%
NZ Government	4%

Corporate Bond Fund yield (gross)
4.00%

New Zealand yield curve



Commentary

The **Nikko AM Income Fund** is invested in the Nikko AM Wholesale Option Fund and the Nikko AM NZ Corporate Bond Fund.

The **Option Fund** had a disappointing month, declining 0.96% in February. Yields on 10 year US Treasury Bonds have fallen significantly since the beginning of 2016 resulting in a number of the Fund's call options being exercised and subsequent losses being absorbed by the Fund. Yields fell from a high of 2.32% early in January to an intra-day low of 1.53% on 12 February.

Bond markets were well supported by expectations of further central bank easing. The Bank of Japan (BoJ) surprised markets by introducing a negative interest rate policy at the end of January and consequently Japan's 10 year rate went into negative territory. The 10 year JGB rate ended February at -0.06% helped by the BoJ's easing actions. The ECB's President Dragi added to the 'bond rally' by indicating further stimulus would be forthcoming in Europe if it was required.

These global influences help explain why US 10 year Treasury yields ended lower at the end of February. With European bond rates heading towards new lows and Japanese rates negative, US rates remain relatively attractive, even when well below 2%. This lead to the US bond market being well bid over the month, despite stronger than expected US economic activity and inflation data. Counteracting the impact of this stronger than expected data is investors continue to believe the US Federal Reserve will be cautious in terms of further monetary tightening over 2016.

Even though the Fund produced a negative return over February, we believe the environment remains sound for the Option Fund to generate acceptable returns over the months ahead.

The primary source of income for the **Corporate Bond Fund** is interest earned from a diversified portfolio of New Zealand investment grade bonds.

New Zealand bond markets produced another strong monthly return as interest rates continued lower – the NZ 10 year government bond yield started February at 3.22%, and declined to 2.97% through the month; while the 2 year government yield moved lower from 2.40% to 2.22%.

There has been little new bond issuance locally to gauge investor appetite but credit has had a tough start to the year underperforming both swaps and governments. Fonterra (rated A- S&P) issued $150 million of a new seven year bond at a margin of +155 basis points above swap. Demand for this issue was okay, but in general investors have been wary of credit, and spreads in the secondary market have widened throughout the month. Corporate names that are popular with retail investors are still outperforming bank and wholesale-focussed bond deals in the corporate sector and we prefer to focus on issues that will likely have good secondary demand.

Although credit markets have been challenging, we are not overly negative and expect that while credit margins may expand further they will likely peak this year. Predicting the exact timing of the peak or troughs in a cycle is difficult and we will be incrementally extending the duration of our credit holdings to take advantage of higher credit margins. Our investment horizon is the medium to long term and we continue to expect credit to add value over this time frame. These higher yields should ultimately be of benefit with a positive shaped yield curve as bonds roll down the yield curve and move lower in yield as they become closer to maturity.

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