Nikko AM NZ Unit Trusts (Retail) Fund Summary

Nikko AM NZ Bond 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

January 2011 (a similar portfolio has been operated by Nikko AM since January 1992).

Investment objective

The objective of the Fund is to construct a portfolio of authorised investments that outperform the Fund's benchmark by 1.0% per annum over a rolling three year period before fees, expenses and taxes.

Benchmark

S&P/NZX NZ Government Stock Index

Investment philosophy

The Fund is managed by Nikko AM's fixed interest team and is designed to provide regular quarterly income with the potential for capital gain from NZD fixed interest markets. The Fund currently obtains investment exposures by investing into the Nikko AM Wholesale NZ Bond Fund, a wholesale unit trust managed by Nikko AM.

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

All assets are NZD denominated.

Investment restrictions

Nikko AM Wholesale NZ Bond Fund – the wholesale unit trust that the Nikko AM NZ Bond Fund invests into.

- Authorised investments are cash, deposits and debt securities issued or guaranteed by any New Zealand registered bank, or equivalent overseas institution, SOE, New Zealand and foreign Government, New Zealand local authority, New Zealand and overseas corporate, trust vehicles and derivative instruments.
- A minimum of 25% of the Fund is to be invested in securities issued or guaranteed by the New Zealand Government or securities accepted by the RBNZ's Overnight Reserve Repo Facility.
- A minimum of 50% of the Fund is restricted to debt securities with a credit rating equal to or higher than New Zealand Government.
- Cash and cash equivalent investments must have a minimum credit rating of Standard & Poor's A1 short-term and A long-term.
- Up to 5% of the Fund may be exposed to assets rated below A-.
- Portfolio modified duration range of +/- 1.5 years around index duration.

Management fees and other charges

A management fee of 0.60% per annum calculated as a percentage of the gross 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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Performance
(NZD returns; before tax, after fees and expenses)

1 month	3 months	6 months	1 year
1.11%	2.21%	2.18%	5.87%
2 years (pa)	**3 years (pa)**	**5 years (pa)**	**Inception (pa)***
6.99%	5.27%	6.32%	6.47%

* January 2011

Distributions

cents per unit	Mar	Jun	Sep	Dec
2015	0.90	1.25	1.15	1.30
2014	0.90	0.50	0.80	0.80
2013	1.10	1.25	1.30	1.25
2012	2.50	2.25	1.65	1.25

Asset allocation

Government Stock	29.9%
SOE and Local Authority	17.1%
NZ Registered Banks	37.3%
Corporate Debt	15.7%

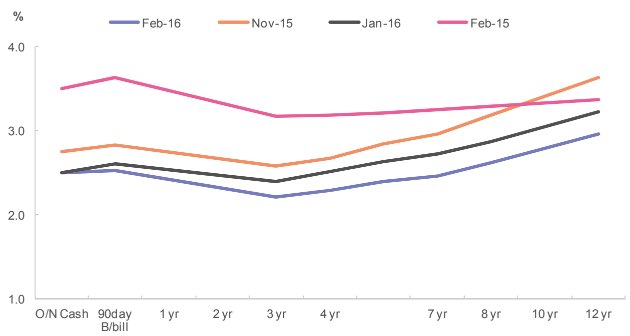
Credit rating profile

S&P Rating	% of portfolio
AAA	12.8%
AA	61.6%
A	21.1%
BBB	4.5%

Duration and yield

Duration	Fund 4.58 years	vs benchmark 4.45 years
Yield	Fund (gross) 3.60%	vs benchmark 2.48%

New Zealand yield curve



Top five corporate issuer exposures (% of fund)

NZ Local Government Funding Authority	11%
Bank of New Zealand	8%
Rabobank	8%
Fonterra Co-operative Group	6%
ANZ Banking Group	6%

Commentary

New Zealand bond markets produced another strong monthly return as interest rates continued lower – the NZ Government Bond Index produced a return of 1.35% while the All Swap Index returned 1.51% and the NZ Bond Credit Index returned 0.74%. Globally, February was again volatile with the US 10 year trading as low as 1.53% before recovering to close at 1.73%. On a positive note, offshore market sentiment has improved somewhat with equities and commodities recovering after large down moves during the month. New Zealand interest rates continued lower in yield throughout the month – 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%. Longer maturity bonds have had slightly larger falls in yield and subsequently performed better than mid curve and shorter maturity bonds. It was a similar story for New Zealand swap rates with the yield curve flattening in shape as the spread between the 2 year and 10 year swap rates narrowed from 78 to 66 basis points over the month.

Swaps were the best performing interest rate sector as margins narrowed marginally (on average 3.5 basis points) relative to government rates. The next best performing sector was government bonds which generally outperformed credit as margins on banks and lower rated credit have continued to expand in sympathy with offshore moves. 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 managing to outperform bank and wholesale focussed bond deals in the corporate sector and we prefer to focus on issues that will likely have good secondary demand.

There are a reasonable number of bond maturities this year and these monies will likely be recycled into bonds further along the yield curve looking for a higher return. Bond issues between $100 million and $150 million that appeal to retail investors are likely to remain well supported. For these reasons, 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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