Nikko AM
Nikko Asset Management

Nikko AM NZ Unit Trusts (Retail) Fund Summary

Nikko AM Income Fund 30 April 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$4.9 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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30 April 2016

Performance

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

1 month	3 months	6 months	1 year
0.69%	2.17%	3.95%	9.21%
2 years (pa)	**3 years (pa)**	**5 years (pa)**	**Inception (pa)***
8.19%	6.50%	6.64%	7.87%

* October 2007

Distributions

cents per unit	Mar	Jun	Sep	Dec
2016	1.25			
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

Asset allocation

Nikko AM Wholesale Option Fund	35.5%
Nikko AM NZ Corporate Bond Fund	64.5%
Cash	0.0%

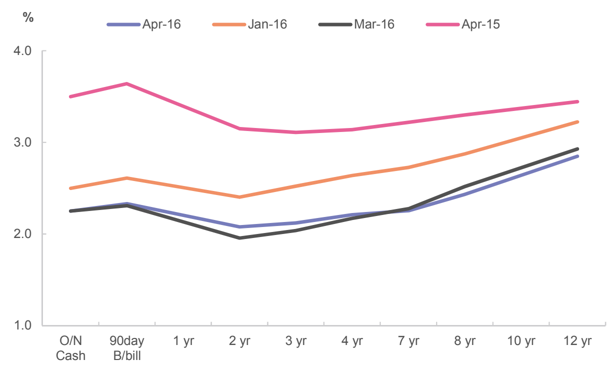
Top 5 corporate issuer exposures (% of fund)

ANZ Bank New Zealand	6%
Bank of New Zealand	6%
Westpac Banking Corporation	6%
ASB Bank Limited	5%
Rabobank	5%

Corporate Bond Fund yield (gross)

3.72%

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** continued to perform well, gaining 1.47% over April. US 10 year Treasury bonds traded over a 26 basis point range between a high of 1.94% and low of 1.68% before closing at 1.83% – virtually unchanged over the month. The modest yield movements meant 10 year bonds traded comfortably within the ranges established by the Fund's written call and put options.

The run of US economic data was mixed with the key trend being one of strong employment growth amidst a sluggish economy. This was evident with Q1 2016 GDP growth running at a modest annualised 0.5% following the previous 1.4% annualised gain in Q4 2015. The US Federal Reserve was not expected to raise rates again at its April meeting and that proved to be the case with only modest changes to the published statement. The Federal Open Market Committee (FOMC) seeks to foster maximum employment and price stability. The FOMC currently expects that, with gradual adjustments to the stance of monetary policy, economic activity will expand at a modest pace and labour market indicators will continue to strengthen. Inflation is expected to remain low in the near term, but recover to around 2% over the medium term as the transitory effects of declines in energy and import prices dissipate and the labour market strengthens further. The FOMC reiterated that the actual path of US rates will depend on economic outlook and incoming data.

We remain of the view that US Treasury bond yields will trade in a modest range over the next year which should create a good operating environment for the Fund.

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

Movements in New Zealand interest rates were relatively modest during April. The New Zealand yield curve flattened as short maturity bonds moved higher in yield while maturities 5 years and longer finished lower in yield. The spread between the 2 year and 10 year swap rates finished the month at 73 basis points. Swap rates moved in the same direction as government bonds but longer maturity swaps underperformed widening in spread as they failed to rally to the same extent as similar maturities of Governments. There has been a reasonable amount of interest in New Zealand assets with yields remaining high relative to other developed economies and the currency showing some stability.

A positive for the month has been that credit margins stabilised and narrowed slightly after being a negative contributor in the March quarter. Resultantly, returns from credit holdings have generally outperformed government and swap investments. We have been extending the duration of the Fund's credit holdings at these wider margin levels. 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. Although credit markets have been challenging, we are not overly negative and expect that although 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 duration 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 low yielding government and swap investments. Higher yields should ultimately benefit the Fund as bonds roll down the yield curve and move lower in yield as they become closer to maturity.

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