

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. We actively manage NZ\$5.0 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.

Performance

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

1 month	3 months	6 months	1 year
0.68%	2.62%	4.32%	9.58%
2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
7.98%	6.93%	6.61%	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	34.5%
Nikko AM NZ Corporate Bond Fund	65.5%
Cash	0.0%

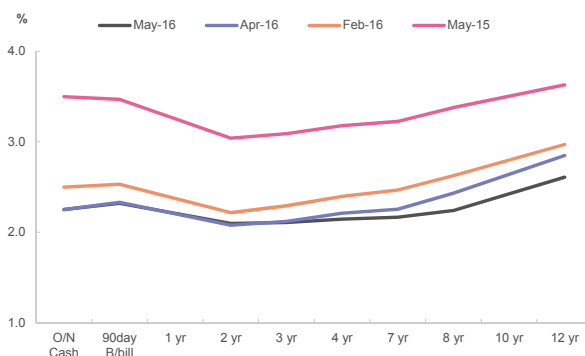
Top 5 corporate issuer exposures (% of fund)

Bank of New Zealand	6%
Westpac Banking Corporation	6%
ANZ Bank New Zealand	6%
ASB Bank Limited	5%
Rabobank	4%

Corporate Bond Fund yield (gross)

3.75%

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 1.23% in May. US 10 year Treasury bonds traded in a narrow 19 basis point range – from a high of 1.89% to a low of 1.70% before closing the month virtually unchanged at 1.85%. The modest interest rate movements meant the 10 year bond comfortably traded within the ranges established by the Fund's written call and put options. The docile market has seen volatility reduce, which lead to lower income receipts from writing options, however, the return generated by the Fund continued to be at an acceptable level in an environment of low yielding investment alternatives.

The US Federal Reserve is getting nearer the time for a further rate rise, however, it is not expected they will shock markets with the magnitude of monetary policy tightenings. The Federal Reserve Chair, Janet Yellen, said during a panel discussion at Harvard University "it's appropriate ... for the Fed to gradually and cautiously increase our overnight interest rate over time, and probably in the coming months such a move would be appropriate".

It will not come as a surprise to markets that the Fed is going to raise short term rates, the main uncertainty is the exact timing. The Fed will likely act cautiously and not want to push rates to levels that may choke off signs of resurgent economic growth. We are therefore of the opinion yields on US 10 year Treasury bonds will continue to trade in modest ranges 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.

The New Zealand Government Bond Index produced a return of 0.84% for the month while the All Swap Index returned 0.25%, and the New Zealand Corporate A Index returned 0.39%. New Zealand interest rates are now near historic lows, but it is important to note that they are still high relative to interest rates available in other developed countries. We continue to expect a reasonable amount of interest in New Zealand assets with attractive yields and the currency showing some stability.

Swap rates underperformed government bonds. Swap maturities five years and shorter widened in spread by approximately 8 basis points relative to similar maturities of government bonds. The move wider in the 10 year swap was more pronounced with a 20 basis point expansion in spread. Widening swap margins impact corporate bonds in that swap rates form a component of the yield on corporate bond issues.

A positive feature of the month was credit margins stabilising and narrowing slightly. Credit margins have absorbed some of the negative impact of widening swap spreads, particularly for bond issues popular with retail investors who are more focussed on the absolute nominal yield level. We have continued to extend the duration of the Fund's credit holdings to take advantage of higher credit margins. New Zealand government bonds have been the best performers recently; however over our three year investment horizon we expect credit to add value over lower yielding government and swap bond investments. The accrual trade of having a higher yielding portfolio 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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