nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 30 June 2016

Investment objective

The objective of the Fund is to construct a portfolio of permitted investments that earn a return of 8% per annum over a rolling three year period before fees, expenses and taxes.

Benchmark

Composite of (from 1 July 2016):

Bloomberg NZBond Govt 0+ Yr Index	70%
Bloomberg NZBond Bank Bill Index plus 4% per annum	30%

Fund description

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

The Fund gains its investment exposures by investing into the Nikko AM Corporate Bond Fund and the Nikko AM Wholesale Option Fund which are managed by the Nikko AM NZ Fixed Income team.

Distributions

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

Currency management

Any foreign currency exposures of Nikko AM NZ Corporate Bond Fund created as a consequence of capital markets investment are hedged to NZD within an operational range of 97.5% to 102.5%. The Nikko AM Wholesale Option Fund hedges any foreign currency cash holdings to the NZD with an operational range of 98.5% to 101.5%. If there are any currency hedging contracts in place, they are held within the Nikko AM NZ Corporate Bond Fund and/or the Nikko AM Wholesale Option Fund.

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.

Nikko AM may also recover expenses (including the Trustee fee) from the Fund up to a maximum of 0.25% per annum of the Fund's net asset value. Estimate of expenses as at 1 July 2016 are 0.25% per annum.

Buy/sell spread

Nil

Strategic asset allocation

	Target	Range
Nikko AM Wholesale Option Fund	30%	20% ⇔ 40%
Nikko AM NZ Corporate Bond Fund	70%	60% ⇔ 80%
Cash on call for investor transactions	0%	0% ⇔ 5%

Refer to the SIPO for full details of permitted investments and restrictions.

Performance

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

1 month	3 months	6 months	1 year
0.17%	1.55%	4.15%	8.37%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
8.04%	7.56%	6.35%	7.81%

* October 2007

Distributions

Cents per unit	Mar	Jun	Sep	Dec
2016	1.25	1.50		
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 (% of fund)

Nikko AM Wholesale Option Fund	34.0%
Nikko AM NZ Corporate Bond Fund	66.0%
Cash	0.0%

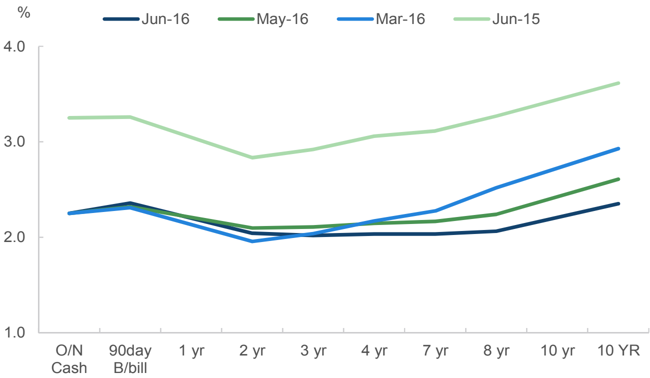
Top 5 corporate issuers (% of fund)

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

Corporate Bond Fund yield (gross)

3.7%

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** fell 0.74% in June. The month was eventful, delivering surprises that produced wide ranging and volatile markets. The event that was most unexpected by financial markets was the UK public voting to leave the EU in the 23 June referendum. Markets assumed the "remain" vote would carry the day, however as votes were being counted and the reality of a "shock" result began to set in, chaotic trading conditions ensued with wild swings in illiquid asset markets, especially in currency markets.

The GBP/USD traded in a 17 cent range, reaching a 30-year low and having its largest one-day fall under the free-float regime. In this "risk off" environment there was strong buying of US Treasury bonds with the 10-year bond yield falling from 1.74% before the poll closed to an intraday low of 1.4% as the UK result became more certain. The monthly trading range was 1.85% to 1.4%. The sharp fall in yields meant a number of call options were exercised resulting in the negative returns for June.

Earlier in the month, the US May non-farm payrolls report rose by just 38,000 – much weaker than anticipated and confirmed a slowdown in US employment. Soon after, US Federal Chair Yellen seemed to back off her previous guidance that a tightening in monetary policy was likely in coming months. Later the Fed's Open Market Committee (FOMC) confirmed that there is no urgency to raise rates. The UK vote to exit the EU is also further confirmation that the Fed will be slow and cautious in any policy tightening. The general consensus is that Brexit will lead to marginally slower global growth and more geopolitical tensions as a number of countries ready themselves for general elections over the next year. With heightened investor anxiety surrounding these events little upward movement in interest rates is likely over 2016 and into 2017.

Even though the Option Fund registered a negative return in June, conditions remain favourable for an acceptable level of performance 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.

Over the month New Zealand Government bond and swap rates performed strongly as interest rates moved lower in yield. The New Zealand Government Bond Index produced a return of 0.93% for the month while the All Swap Index returned 1.09% and the NZ Corporate A Index 0.68%.

For the month the Fund's shorter duration and higher credit holdings detracted value. Under performance over the quarter was also attributed to credit as government bonds and swaps on longer duration bonds performed better as New Zealand interest rates moved sharply lower in yield following the Brexit vote by the UK to leave EU membership. Before the vote the New Zealand Government 2033 bond moved higher in yield (close to 3%) with expectations the UK would stay, subsequently the NZGS 2033 bond fell approximately 30 basis points in yield to 2.67% at the end of June. The New Zealand yield curve has flattened significantly in shape with the 2-10 year swap spread narrowing from 64 to 43 basis points, led by long maturities as uncertainty increases and expectations for global growth is revised downwards. An important point is that Brexit has little direct impact on New Zealand, however financial markets have been relatively volatile and this may increase the likelihood of a further reduction in the New Zealand cash rate. New Zealand interest rates are at historic lows, but are generally much lower 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.

Credit markets did not perform as well as other bond sectors in the "risk off" environment. Uncertainty as to where pricing should be saw two local bond issuers delaying their deals. Subsequently there have been some relatively large corporate issues globally that have received good pricing support. New issuance levels locally should offer reasonable value and we are happy continuing to extend the duration of the Fund to take advantage of higher credit margins. Over our 3-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.