nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 30 September 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 daily as a percentage of the net asset value of the Fund will be 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. As at the time of publication these expenses are estimated to be 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
0.48%	2.58%	4.16%	8.27%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
8.18%	8.08%	7.91%	7.82%

* October 2007

Distributions

Cents per unit	Mar	Jun	Sep	Dec
2016	1.25	1.50	1.80	
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	34.9%
Nikko AM NZ Corporate Bond Fund	65.1%
Cash	0.0%

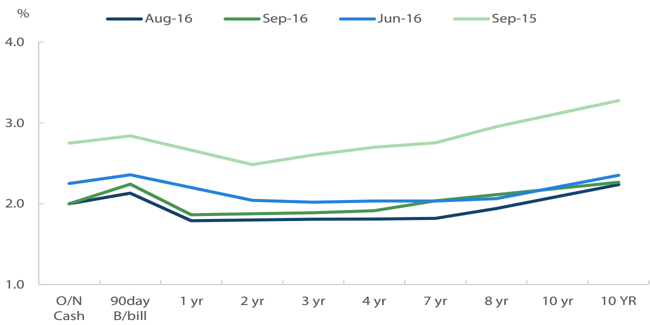
Top 5 corporate issuers (% of fund)

Westpac Banking Corporation	9%
Bank of New Zealand	9%
ANZ Bank	9%
ASB Bank	7%
Fonterra Co-operative	6%

Corporate Bond Fund yield (gross)

3.5%

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 Nikko AM Wholesale **Option Fund** continued to perform well over September, gaining 1.23%. This return compares favourably to the return generated from cash and bond markets as the low nominal yields on fixed income assets begin to constrict returns from these sectors.

Income generated by the Option Fund by writing options on 10-year US Treasury bonds is not significantly impacted by low bond yields and we anticipate Fund returns will continue to outperform more traditional fixed income investment strategies over the year ahead.

US 10-year bonds traded in a 23 basis point range over the month - this range is modest, but larger than the 18 bp range seen in August. Bond yields started the month at 1.58% and closed at similar levels. The intra month low was 1.52% and the high point was 1.75%. Due to the narrow trading range, bond yields stayed within the option bands established so no options were exercised. A low level of volatility in markets at present has led to option premium income being lower than average, but still high enough to generate an attractive level of return.

The Federal Reserve seem to be inching closer to their second rate rise, the first was December 2015. The US economy is steadily improving and we believe the Fed needs to protect their credibility by raising rates soon. While a move in rates in 2016 is probable, the Fed will be careful not to unsettle markets and therefore forward guidance on future moves is likely to indicate only a modest and slow increase. The US Presidential election is occurring on 8 November and financial markets will undoubtedly undergo mood and sentiment swings around this event. We believe the yield movement on longer dated Treasury bonds is likely to be muted even if short-term rates rise as investors' global search for yield will ensure the demand for relatively high yielding US bonds remains strong. We continue to believe this environment remains favourable for the Option Fund, especially when viewed in the context of a modest return outlook from other sectors of financial markets.

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 corporate bonds and swaps delivered a better return than government bonds as they didn't move higher in yield to the same extent as similar maturities of government bonds. Corporate bonds also have the advantage of a higher running yield which helps to dampen the volatility of returns. NZ interest rates were volatile intra-month with the NZ Government 2033 bond moving higher in yield by close to 40 basis points before retracing most of this move and finishing at 2.61%. Swap margins contracted in spread to government bonds as the underlying swap rates didn't move higher in yield to the same extent as government bonds.

Over the quarter interest rates still managed to finish lower in yield despite rising in September. Government bonds were only marginally lower in yield, but swap rates performed better, falling an additional 10-15 basis points compared to similar maturities of government bonds. The shape of the NZ swap yield curve has remained relatively stable over the past three months with the 2-10 year swap spread currently at 47 basis points. As credit markets tentatively settled the strategy of having a higher yielding portfolio is showing some benefit as the higher yield isn't eroded by widening credit margins. With a positive shaped yield curve bonds roll down the yield curve and move lower in yield as they become closer to maturity. We expect credit to outperform lower yielding government and swap bond investments over our 3 year investment horizon.

NZ is performing well on a relative basis compared to other developed economies; business and consumer confidence, GDP, inflation, and dairy prices have been improving. Interest rates are low and supportive of activity with the possibility of a further rate cut. Challenges are the high level of the NZD that continues to frustrate the Reserve Bank and they would like to see house price appreciation slow. The direction of NZ short-term interest rates will continue to be influenced by local factors with low cash rates anchoring the front end of the yield curve. Bonds 5 years and longer in maturity will likely remain more heavily influenced by global events and movements in US bond rates.