nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 31 October 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
-0.31%	0.96%	3.13%	7.21%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
8.34%	7.54%	7.64%	7.71%

* 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	33.5%
Nikko AM NZ Corporate Bond Fund	66.5%
Cash	0.0%

FundSource

Winner – New Zealand Fixed Interest Sector

Fund Manager of the Year Awards are announced by FundSource, the investment strategy and research company. These awards should not be read as a recommendation by FundSource. For further advice on the relevance of this award to your personal situation consult your authorised financial advisor.

Top 5 corporate issuers (% of fund)

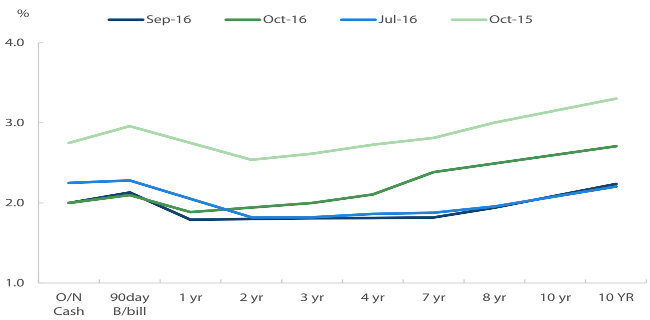
ANZ Bank	13.3%
Westpac Banking Corp	11%
Rabo	10.3%
ASB Bank	9.2%
Kiwi Bank	8%

Aggregated of Option and Corpoate Bond Funds

Corporate Bond Fund yield (gross)

3.85%

New Zealand yield curve



Commentary

The Nikko AM Wholesale **Option Fund** gained 0.95% over October. This return compares favourably to the negative returns generated by many equity and bond markets around the globe.

Central Banks held short term rates steady over the month, however a bond sell-off occurred as economic data revealed improvements in key economies. The improved data flow resulted in markets growing increasingly uneasy over the duration of easy monetary policy settings. Financial markets priced in greater odds of a December US interest rate rise and speculated over the future of the European Central Banks asset purchase programme. Global bond yields have been drifting higher since July, but more aggressive selling saw yields higher over the month. German rates were 0.28% higher and 0.50% higher in the UK. US 10-year rates were 0.28% higher over the month, rising from 1.6% to 1.88% before closing at 1.83%.

Rising inflation expectations in the US and increasing conviction the Fed would deliver a second rate hike in December played a role in the US bond market sell-off.

It is unhelpful that the role of the Federal Reserve is becoming more politicised and is perhaps another reason why the Fed seems sensitive to limit the impact of policy changes on financial markets.

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. If future rate movements are modest we believe the environment will remain favourable for the Option Fund, especially when viewed in the context of a modest return outlook from other sectors of financial markets.

Returns from the NZ bond indices were negative in October as interest rates moved higher in yield. For the month the Bloomberg NZ Government bond index produced a return of -1.38% while the All Swap index returned -1.08%, and the NZ Bond Corporate A Index returned -0.65%.

The **Corporate Bond Fund's** return was negative during October as interest rates moved markedly higher in yield over the month. Shorter maturity corporate bonds were the best performing bond assets, and longer maturity governments the worst performers. The Fund is positioned with a shorter duration (less exposure to changes in interest rates) relative to the benchmark so performed better as the Fund's bond prices declined less when interest rates moved higher in yield. Corporate bonds in general delivered a better return than NZ 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.

Credit markets were relatively stable, although there were some new issues of subordinated bank debt, lower rated and unrated corporate bonds that failed to receive a convincing demand response. Institutional investors typically don't have a very high capacity to hold lower rated and unrated bonds in their funds, and as a result these issuers rely more heavily on greater retail participation. Generally the better performing assets are corporate bond issuers that have strong name recognition with retail investors (for example Auckland International Airport) who often issue at slightly tighter credit spreads and receive stronger retail demand support than deals that rely more on institutional demand. Although interest rates have moved higher the accrual trade of having a higher yielding portfolio is helping to offset some of this move. With a positively shaped yield curve bonds roll down the yield curve and move lower in yield as they become closer to maturity.

NZ data has recently surprised on the positive side; business and consumer confidence, GDP, inflation outcomes, and dairy prices have been improving. Interest rates are low and supportive of activity with the possibility of a further cash rate cut. Challenges are the high level of the NZD which continues to frustrate the Reserve Bank and they would also 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.