nikko am
Nikko Asset Management

NIKKO AM NZ CORPORATE BOND FUND

Monthly Fact Sheet 31 October 2016

Investment objective

The objective of the Fund is to construct a portfolio of permitted investments that outperform the Fund's benchmark return by 1.5% per annum over a rolling three year period before fees, expenses and taxes.

Benchmark

Bloomberg NZBond Govt 0+ Yr Index (from 1 July 2016)

Fund description

The Fund is designed to provide regular income by constructing an actively managed investment portfolio of New Zealand bonds, deposits and cash, while protecting the capital value of investors' funds.

The Fund gains its exposure by investing directly into market securities and is managed by the Nikko AM NZ Fixed Income team.

Distributions

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

Currency management

Foreign currency exposures created as a consequence of capital markets investments are hedged to NZD within an operational range of 97.5% to 102.5%.

Management fees and other charges

A management fee of 0.70% per annum calculated 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 0.08% per annum.

Buy/sell spread

Nil

Investment restrictions

Below are the investment ranges for the credit rating exposures and the sector limits in which the Fund will primarily invest.

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

Credit Rating	Fund Exposures	Maximum exposure per issuer
AAA	0% ⇔ 100%	15.0%
AA- to AA+	0% ⇔ 100%	10.0%
A- to A+	0% ⇔ 80%	7.5%
BBB- to BBB+	0% ⇔ 30%	5.0%

Sector Limits	Maximum
NZ Government, Government Department or Government Guaranteed	100%
NZ Corporate and Bank Debt	100%
NZD Kauri Bonds	40%
Offshore issued NZ Corporate Debt Hedged to NZD	20%
NZ Mortgage Backed and Asset Backed Securities	20%

Performance

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

1 month	3 months	6 months	1 year
-0.89%	-0.16%	2.04%	4.71%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
6.10%	6.20%	6.11%	6.96%

* July 2009

Distributions

Cents per unit	Mar	Jun	Sep	Dec
2016	1.15	0.85	0.90	
2015	1.25	1.30	1.20	0.75
2014	1.60	0.80	1.50	1.25
2013	1.30	1.30	0.80	1.10

Asset allocation (% of fund)

Corporate bonds	39.4%
NZ registered banks	49.2%
Local authority	6.1%
NZ government and government equivalent	5.3%

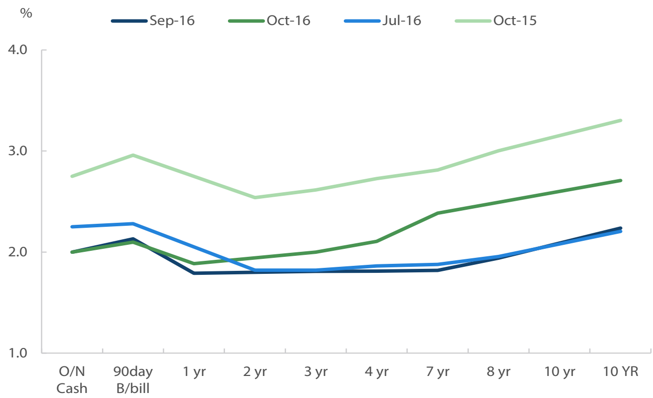
Credit rating profile

S&P rating	% portfolio	Number of holdings
AAA	3.3%	9
AA	48.5%	58
A	21.8%	24
BBB	26.4%	31

Duration and yield

Duration	Fund 3.8 years versus benchmark 4.7 years
Yield	Fund (gross) 3.85% versus benchmark 2.26%

New Zealand yield curve



Top 10 issuers (% of fund)

ANZ Bank	9%	Rabo Bank	6%
Westpac Banking Corp	9%	NZ Government	5%
Bank of NZ	8%	Transpower	5%
ASB Bank	7%	Auckland Intl Airport	4%
Fonterra	6%	Power Co	3%

Commentary

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 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.

A combination of better economic data locally and rising US bond yields pressured NZ interest rates higher throughout the month. The shape of the NZ swap yield curve steepened - widening from a spread of 47 basis points between the 2 and 10-year swap rates to 70 basis points as longer maturity bonds experienced larger increases in yield than shorter maturities. For example; the NZ Government 2019 bond moved higher in yield by 10 basis points, the NZ Government 2021 bond was 25 basis points higher, and the NZ Government 2027 finished 44 basis points higher in yield. This rise in interest rates has taken the market back to the yield highs that we saw briefly in September when interest rates spiked before retracing most of the move before month end.

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.