

NIKKO AM INCOME FUND

Monthly Fact Sheet

31 December 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
0.00%	-4.39%	-1.92%	2.14%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.18%	5.85%	6.04%	7.08%

* October 2007

Distributions

Cents per unit	Mar	Jun	Sep	Dec
2016	1.25	1.50	1.80	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 (% of fund)

Nikko AM Wholesale Option Fund	34.25%
Nikko AM NZ Corporate Bond Fund	65.63%
Cash	0.12%



Winner – New Zealand Fixed Interest Sector

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Top 5 corporate issuers

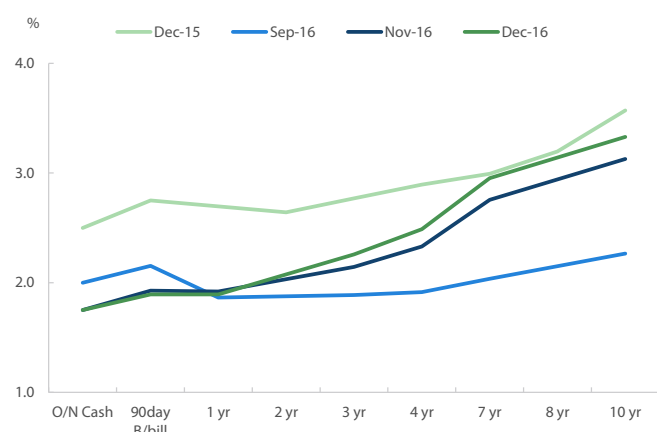
ANZ Bank	13.50%
Westpac Banking Corp	10.10%
Rabobank	9.70%
ASB	8.70%
Kiwi Bank	8.50%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross)

4.05%

New Zealand yield curve



Commentary

Corporate bond

The Nikko AM NZ Corporate Bond Fund returned -0.46% (gross of fees and taxes) for December and -2.16% for the quarter. Returns from the NZ bond indices were negative as interest rates moved higher in yield. For the month the Bloomberg NZ Government Bond Index produced a return of -0.61% while the All Swap index returned -0.69%, and the NZ Bond Corporate A Index returned -0.72%.

Overall it was a poor quarter for bonds as market sentiment remained negative for bonds on the perception that President elect Trump's expansionary policies of tax cuts and a higher fiscal spend will promote growth, higher inflation and larger borrowings for the US. With more protectionist trade policies there will also likely be "winners and losers" which could impact our major trading partners. NZ longer term interest rates are typically highly correlated with movements in US interest rates, whereas shorter maturities are more influenced by local factors with low cash rates anchoring the front end of the yield curve. Longer maturity bonds have been the worst performing bond assets with greater movements higher in yield than shorter maturities.

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Corporate bonds also moved higher in yield although credit margins were relatively stable, and the higher running yield of corporate holdings will benefit the Fund over the medium term.

Longer term interest rates in NZ have been under some pressure over the past three months as domestic and offshore economic news has generally been on an improving trend. The sentiment bias has been for higher interest rates, however there is now a lot of "positive sentiment" factored in with a higher and steeper yield curve and the market may want to see some more solid proof of improvement before taking yields higher - which could see some stability in rates or an unwind of the move. There remains a lot of debt in the world and large areas of the global economy are still underperforming. We have seen a large move higher in interest rates in a short amount of time and this has been steepening yield curves as longer term interest rates rise on the transition from a very limited inflation outlook to the prospects of recovering inflation. With a positive shaped yield curve bonds roll down the yield curve and move lower in yield as they become closer to maturity. The accrual trade of having a higher yielding portfolio is helping to offset some of the move higher in interest rates.

The **Option Fund** returned 1.21% for December. It was pleasing the Fund had a positive month given the poor performance over the quarter as US interest rates moved much higher in yield through November following Donald Trump's victory. The US 10-year interest rate remained relatively volatile in December spiking higher in yield by 25 basis points to 2.63% before unwinding most of the move and closing the year at 2.44%. The Fund coped much better with the volatility through the month given the options have now been reset around the new range of the US 10-year and premium income was much higher following the large moves in interest rates.

US interest rates increased significantly over the quarter with the US 10-year yield moving from 1.60% to 2.44%. Large interest rate movements over a short period of time is the primary risk the Option Fund is exposed to, however with bond market volatility at elevated levels the income the Fund generates from writing options has increased significantly. Option premium income is currently approximately 2.5 to 3 times the levels received prior to Trump's victory. If US Treasury bonds return to trading more modestly and volatility stays elevated the Fund should trade well over the next 6 to 9 months.