nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 31 January 2017

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
0.78%	-3.35%	-2.42%	1.84%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.28%	5.90%	6.04%	7.11%

* 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	35.05%
Nikko AM NZ Corporate Bond Fund	64.83%
Cash	0.12%

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

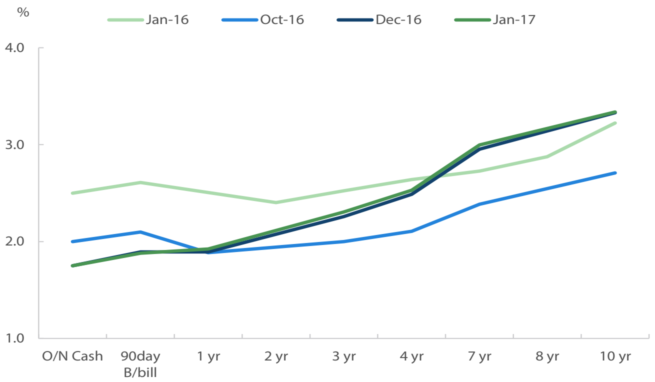
ANZ Bank	13.47%
RaboBank	9.78%
ASB	8.57%
KiwiBank	8.51%
Westpac Banking Corp	8.45%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross)

4.14%

New Zealand yield curve



Commentary

Corporate bond

NZ interest rates finished January little changed, however there was a reasonable amount of volatility in interest rate movements during the month. Swap spreads to government bonds were relatively stable over the month. NZ credit margins were stable to slightly narrower over the month with limited market activity due to the holiday season. A higher running yield of corporate holdings was of benefit to the fund over the month.

The NZ economy remains in expansionary mode, very strong immigration, tourism, and strength in other areas of the economy have picked up the slack from a weak dairy sector. Inflation appears to be recovering across a broad base and it is the first time back in the target band for some time and we expect inflation to remain contained over the near term. Given the relative strength of the NZ economy, higher growth and interest rates it is likely the NZD will continue to remain reasonably well supported, and expect dips to remain relatively shallow. With this background NZ short-term rates out to 3 years in maturity will continue to be primarily influenced by local factors and the actions of the Reserve Bank.

The cash rate at 1.75% should help anchor the front end of the yield curve. The market is currently pricing an earlier start to interest rate increases than the Reserve Bank, and we believe the bank may be slower to raise interest rates as this is likely the path of least regret with uncertainties still remaining in the global economy, while inflation remains relatively benign and the NZ dollar high on a TWI basis. Longer term interest rates in NZ will likely be more heavily influenced by offshore events with the NZ 10-year interest rate following the direction of the US. There is already a reasonable amount of good news factored in with interest rates moving markedly higher over the last quarter of 2016, markets may have got ahead of actual policy in the US, and Trump will most likely continue to be a source of “surprises”. The medium term directional bias is most likely upward, but we don’t expect large movements higher in yield from here and expect a reasonable amount of volatility along the way.

The **Option Fund** returned 1.78% for January. The US 10-year government bond rate finished January unchanged at 2.45%, and traded in a 24 basis point range over the month. The Fund coped well with the modest level of volatility through the month and the options have now been reset around what appears to be the new range in yield for the US 10-year government bond. Premium income has remained at reasonable levels and counterparties have been happy to buy options as a fair amount of uncertainty remains in the US around what the Trump presidency will mean for the economy and financial markets.

Large interest rate movements over a short period of time is the primary risk the Option Fund is exposed to. The US 10-year bond has been more range bound to start the new year and there is already a reasonable amount of good news factored in with interest rates moving markedly higher in the US over the last quarter of 2016, markets may have got ahead of actual policy in the US, and Trump will most likely continue to be a source of “surprises”. The market consensus has the medium term directional bias as likely upward, but we don’t expect large movements higher in yield from here near term, and expect a reasonable amount of volatility along the way.

The US Fed held few surprises as they left rates on hold and said “measures of consumer and business sentiment have improved of late”. The Fed reiterated risks to the outlook are “roughly balanced” and officials would continue to “closely monitor inflation indicators and global economic and financial developments”. The Fed also highlighted “inflation increased in recent quarters but is still below the committee’s 2% longer-run objective”. More importantly, the Committee reiterated its intention to move "gradually" with respect to rate hikes this year. In particular, the policy statement gave no reason to think that a March rate hike was any more probable than it was prior to this meeting.