nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 28 February 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
1.10%	1.88%	-2.12%	2.72%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.91%	6.06%	6.26%	7.17%

* 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	35.03%
Nikko AM NZ Corporate Bond Fund	64.96%
Cash	0.01%

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

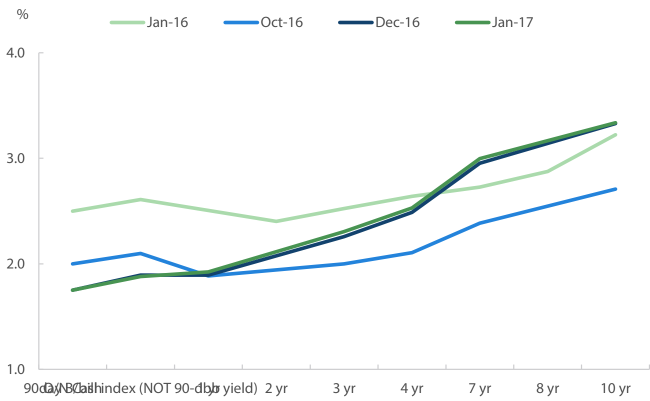
ANZ	13.6%
Westpac Banking Corp	11.6%
Rabo Bank	9.5%
ASB Bank	8.8%
Kiwi Bank	7.6%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross)

3.85%

New Zealand yield curve



Commentary

The **Corporate Bond** Fund returned 0.86% (net of fees) for February. For the month the Bloomberg NZ Government Bond Index produced a return of 0.79% while the All Swap index returned 0.76%, and the S&P NZ Bond Corporate A Index returned 0.78%.

NZ interest rates finished lower in yield over the month. Swap spreads to government bonds were virtually unchanged at the end of the month with the upward shape of the yield curve between the 2 and 10-year swap rates at a spread of +1.13%. NZ credit margins were stable to slightly narrower over the month although there has been limited market activity to test investor interest. A higher running yield of corporate holdings and yield curve positioning was of benefit to the Fund over the month.

The NZ economy remains in expansionary mode supported by high population growth, strong tourism and construction sectors. Rising commodity prices together with improved consumer and business sentiment, has also improved the New Zealand and global outlook.

In a recent speech, the RBNZ Governor said risks around future Official Cash Rate movements are equally weighted, reflecting balanced risks around inflation.

The Bank sees the balance of risks for the global outlook to be to the downside highlighting ongoing surplus capacity and rising geo-political uncertainty. Global headline inflation has increased, partly due to rising commodity prices. Long term rates have also increased however monetary policy is expected to remain stimulatory, but less so than in the past, especially in the United States.

We are expecting a prolonged period of ‘no change’ in the OCR however expect the next change will be an increase. Longer term NZ Interest rates will continue to be influenced by the direction of US rates. The Trump administration will continue to be a source of surprises and the US fiscal stimulus that is expected to be delivered via tax cuts to ‘middle’ America and infrastructure spending is subject to significant implementation risk. If policy initiatives are not fully implemented the optimism currently priced into markets may well prove to be unfounded.

We do not expect large movements of interest rates in New Zealand over the near term however a reasonable amount of financial market volatility is to be expected. This volatility may open up investment opportunities in the months ahead.

The **Option Fund** returned 1.67% over February. US 10-year Treasury bonds traded over a modest range over the past month. The 10-year rates traded to a low of 2.31% and a high of 2.52% before closing the period at 2.4% and closed 7 basis points lower than the start of the month.

The Fund coped well with this modest trading range however we are seeing some reduction in the income the Fund receives from writing options as bonds seem comfortable remaining in a 2.3% to 2.6% band.

The US Federal Reserve’s monetary policy outlook remains the key market driver with signs the US economy is heating up. Some Federal Reserve members expressed the view at their February meeting that a further rise in the federal funds would be appropriate fairly soon. The unemployment reading of 4.7% is viewed by many as consistent with the Fed’s maximum employment objective and business and consumer confidence levels are higher due to the expectations of economic stimulus to come.

Newly elected President Trump and his policy agenda also remains a focus for financial markets. While Trump teased about the prospect of a future ‘phenomenal’ tax package announcement, the talk around Washington was of a fiscal minefield ahead.

Potential delays to the fiscal stimulus timetable seemed to have some impact on bond markets resulting in rates falling from recent highs. After the significant increase in global rates late last year investors seem less concerned that further significant increases in bond yields are imminent.