nikko am
Nikko Asset Management

# NIKKO AM INCOME FUND

Monthly Fact Sheet 31 March 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 NZ 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 |
|---|---|---|---|
| 0.47% | 2.36% | -2.13% | 1.94% |

| 2 years (pa) | 3 years (pa) | 5 years (pa) | Inception (pa)* |
|---|---|---|---|
| 5.53% | 6.14% | 6.25% | 7.15% |

* October 2007

## Distributions

| Cents per unit | Mar | Jun | Sep | Dec |
|---|---|---|---|---|
| 2017 | 1.25 | | | |
| 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 |

## Asset allocation (% of fund)

| | |
|---|---|
| Nikko AM Wholesale Option Fund | 34.76% |
| Nikko AM NZ Corporate Bond Fund | 65.24% |
| Cash | 0.00% |

FundSource

**Winner – New Zealand Fixed Interest Sector**
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## Top 5 corporate issuers

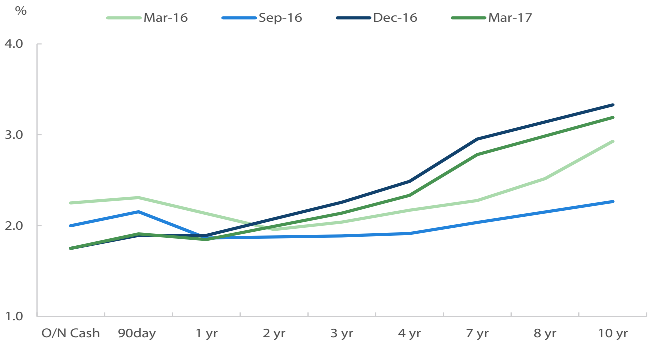
| | |
|---|---|
| ANZ | 13.3% |
| Westpac Banking Corp | 10.0% |
| Rabo Bank | 9.5% |
| ASB Bank | 8.7% |
| BNZ | 8.1% |

Aggregated of Option and Corporate Bond Funds

## Corporate Bond Fund yield (gross)

3.84%

## New Zealand yield curve




## Corporate Bond Fund commentary

The higher portfolio running yield and a moderate contraction in credit margins was a positive for outperformance. Longer maturity corporate bond issues were added and funded by cash and selling shorter  maturity bonds. The moderate underweight duration position was a detractor. The Corporate Bond Fund will typically be positioned around 3.5 years in duration with less interest rate risk than the NZ Government Bond benchmark.

It was a good start to 2017 for NZ Bonds as interest rates finished the March quarter lower in yield following similar moves in offshore bond markets and credit margins contracted. The range of yield movements in NZ interest rate markets (around 25 basis points) has been subdued in comparison to the monthly movements experienced through late 2016 when interest rates moved much higher.

We have seen some tentative unwind of the 2016 move higher in interest rates that was driven by optimism over pro-growth policies in the US and recovering inflation and growth in the global environment. Markets have recalibrated how much “optimism’ should be reflected in interest rate levels given Trump has been frustrated in his efforts to fully instigate his policy changes and subsequently there has been a shift to downgrade the lift in US growth and inflation due to the new administration’s policies.

NZ credit margins have been slower to contract than offshore credit margins so far this year; however this is not unusual as NZ credit has historically been less volatile in margin fluctuations than offshore markets. We continue to have a positive view on credit and expect having a higher portfolio running yield will be one of the main attributors to outperformance over the course of this year.  We prefer to hold more mid curve maturity (4-7 years) credit rather than longer government bonds that have a lower yield and greater interest rate risk.

The NZ economy continues to perform well although forecasters expect some slowing of activity with capacity constraints in sectors such as construction. The Reserve Bank has indicated they see stable cash rates with risks evenly balanced at present, this should help anchor the front end of the yield curve at current levels. Credit/housing related excesses are being more actively curtailed, which lessens the odds of imbalances building. Numerous support factors remain, which should allow annual GDP growth to hover around 3% over 2017.

## Option Fund commentary

The Option Fund returned 0.26% over March. The US 10-year Treasury bond traded to a high of 2.63% and an intraday low of 2.35% over the month before closing at a yield of 2.39%. The month’s performance was negatively impacted by the Fund protecting against a larger increase in bond yields than eventuated, however a modest monthly return was still generated. Income that the Fund received from writing options continues to be at the lower end of historical income levels but should provide the basis for an acceptable level of performance over the months ahead.

Much of the focus over the past month was on the Federal Reserve’s guidance towards a March increase in the Fed Funds Rate. A 25 basis point increase was expected and delivered. This rate rise was the third in this cycle and the forecasts surrounding the announcement were largely unchanged, with the Fed having no particular concern about the inflation outlook. The yield on US 10-year bonds peaked at 2.63% immediately prior to the FOMC rates meeting and subsided immediately after. After the rate rise US politics took centre stage. President Trump’s healthcare bill to unwind Obama-Care did not proceed due to the lack of support within the Republican Party. This bill was expected to deliver over $340b in savings over the next decade to help offset the costs of future tax cuts. Financial markets took the view that the prospects for meaningful US fiscal stimulus had diminished. Trump’s failure to pass the healthcare bill highlighted the gridlock often seen in Washington and the difficulty that Trump’s administration will have in fully achieving their policy agenda. With the magnitude of US economic stimulation being dimmed, bond yields look to remain within recent trading ranges.