NIKKO AM INCOME FUND

Monthly Fact Sheet 31 May 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
0.98%	2.38%	4.30%	2.47%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.97%	6.11%	6.25%	7.24%

* 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	34.28%
Nikko AM NZ Corporate Bond Fund	65.72%
Cash	0.00%

FundSource

Winner – New Zealand Fixed Interest Sector

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Top 5 corporate issuers

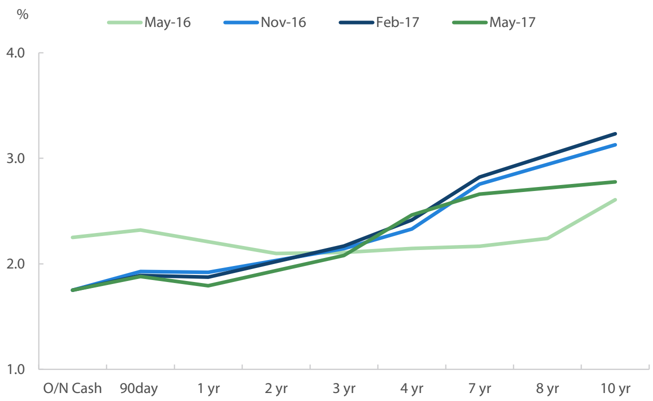
ANZ	11.6%
Rabo	9.6%
Kiwi Bank	8.4%
Westpac Banking Corp	7.6%
ASB Bank	7.5%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross)

3.82%

New Zealand yield curve



Corporate Bond Fund commentary

The higher portfolio running yield and a moderate contraction in credit margins was a positive for performance. 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.

The month of May continued the good performance of NZ bonds as interest rates moved lower in yield. Similar to the previous month there was a reasonably large difference in performance across the different sectors of the NZ bond market. The Bloomberg NZ Government Bond index returned 1.27%, The NZX 1-10 year swaps retuned +0.91% and the Corporate A +0.95 %.

NZ interest rates moved in line with falling global interest rates, in particular longer maturity US interest rates are now back to pre-election lows in yield. Locally, there was strong offshore demand for NZ Government bonds and fixed rate swaps.

NZ credit margins continued to contract in spread and credit has generally outperformed similar maturities of swap and governments since the start of this year. The portfolio has benefited from having higher weightings to credit with both a higher running yield and margin contraction.

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. At this stage we expect movements in NZ bond yields to remain relatively muted, but we may adjust the fund duration if we see opportunities.

Option Fund commentary

The Option Fund returned 0.88% over May. Interest rate movements in longer term US Treasury bonds continues to be modest with the rate on the 10-year bond moving between 2.18% and 2.42% before closing the month at 2.20%. Income from writing option contracts on Treasury bonds remained low over the month, however yield movements were also low resulting in an acceptable level of returns for the Fund. We are expecting a low level of volatility to remain over the short term however, as the frequency of options being struck is also low the total return of the Option Fund should remain satisfactory.

Some softer US economic data including inflation indicators, created doubt about the future path of Fed rate hikes. FCMC minutes from their May meeting put June in the spot light for the next rate rise however further rate rises and the speed of them remains data dependent. Of particular interest is the economic slowdown seen in quarter one and whether this is an indication of the future trajectory of US economic growth.

Political risk also weighed on investor sentiment in the US market after investigations began into President Trump's link to potential Russian interference in the US election ramped up. With Trump fighting fires on many fronts, markets took the view that his pro-growth strategy was under threat and further delays were likely for any fresh policy initiatives.

The US Federal Reserve has mooted plans to unwind its balance sheet that ballooned in size over the GFC as quantative easing helped restore confidence in the US financial markets. It is possible this process will begin in early 2018 and the eventual reduction of the Fed's balance sheet has the potential to influence long term interest rates over and above the impact of Fed funds rate changes. We expect any unwind of the balance sheet will be gradual and not designed to unsettle financial markets.

With economic outcomes and financial market impacts still uncertain we believe interest rate movements on long term US bonds will continue to be modest over the months ahead. If we are correct the returns of the Option Fund will continue to be satisfactory over the months ahead.