nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 30 June 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 vehicle is a NZ domiciled Portfolio Investment Entity (PIE) which is priced daily. 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
0.06%	1.97%	4.37%	2.37%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.50%	6.11%	6.13%	7.18%

* October 2007

Distributions

Cents per unit	Mar	Jun	Sep	Dec
2017	1.25	1.10		
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	34.51%
Nikko AM NZ Corporate Bond Fund	65.49%
Cash	0.00%

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

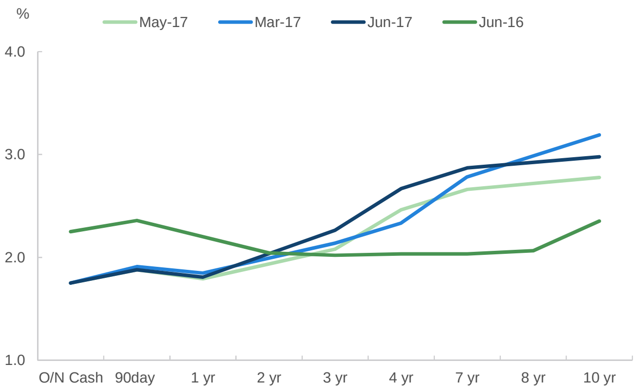
ANZ	11.5%
Rabobank	9.9%
Kiwibank	8.5%
ASB	7.7%
BNZ	6.6%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross)

3.98%

New Zealand yield curve



Corporate Bond Fund commentary

Bonds were sold off over the month, however the fund outperformed the benchmark. The underweight duration position was a positive contribution to performance. The higher portfolio running yield and a moderate contraction in credit margins also contributed to performance. 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.

Central Bankers have said that they see inflation reappearing, and monetary conditions normalising in due course. This was likely in response to a global market that did not appear to believe this to be the case, as evident in the recent global bond rally. As a result of this global bonds have sold off, and the yield curve steepened out to the long end. New Zealand bonds have followed suit, with NZ 10-year Government bonds selling off 26 points at the end of June. Swap yields have also gone higher, but have outperformed bonds.

NZ credit margins continued to contract in spread, and credit has generally outperformed similar maturities of swap and government bonds 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.

The RBNZ reiterated the OCR is firmly on hold. GDP growth was 0.5% for the March Quarter and below forecasts of 1.1%. The construction sector lagged, while dairy and the primary sector had a strong positive contribution. Growth per capita remains modest. It is worth noting that quarterly GDP numbers can be heavily influenced by short term movements in particular sectors, and are subject to being volatile. Consumer and business confidence are both at good levels, albeit down from recent highs. Wage inflation remains moderate, but is expected to increase due to labour market capacity constraints. The housing market, particularly in Auckland, has slowed and will likely continue to do so to the election. The main take away from this is that the economy is growing modestly, not roaring away unsustainably, and that the OCR at these levels and the RBNZ forecast of being on hold for the foreseeable seems entirely appropriate.

Option Fund commentary

The Option Fund returned 0.72% over June. For most of the month interest rate movements in longer term US Treasury bonds were modest with the rate on the 10-year bond moving between 2.21% and 2.13%, and premium income reflected this low level of volatility. We have taken some leverage off at the lows in yields and volatility. At the end of the month global central banks came out in a co-ordinated effort to tell the market that inflation was reappearing and a normalisation of rates was forecast. Bonds sold off globally, and the US 10-year bonds ended the month at 2.31%, moving up 16 points in four days. Option premium has subsequently increased as a result of the bond sell off.

The US Federal Reserve hiked the funds rate range to 1.0-1.25% and outlined a path of balance sheet reduction. We expect any unwind of the balance sheet will be gradual as to not unsettle financial markets. We expect this to be affirmed by the FOMC meeting minutes that are due out in the first week of July.

Much of June saw US rates being exceptionally stable, with very little market-moving data points or surprises. US Q1 GDP was revised up from a disappointing initial result, lending support to future US Fed hikes. The big movement in longer term bonds at the end of the month was the result of coordinated statements from the European Central Bank and the Bank of England, and to a lesser degree the US Fed. In a nut shell the Central Bankers have said that they see inflation reappearing, and monetary conditions normalising in due course. This was all likely in response to a global market that did not appear to believe this to be the case, as evident in the recent global bond rally. As a result of this global bonds have sold off, and global yield curves steepened out to the long end.

Political risk continued to weigh on investor sentiment in the US. With Trump fighting fires on many fronts, market optimism that was once very evident had begun to wane. There are serious questions over policy goals in light of messy healthcare reform, and other issues reflecting badly on the administration's ability to push its agenda.