nikko am
Nikko Asset Management

NIKKO AM INCOME FUND

Monthly Fact Sheet 31 August 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
0.57%	1.46%	3.87%	1.67%

2 years (pa)	3 years (pa)	5 years (pa)	Inception (pa)*
5.03%	6.01%	6.08%	7.20%

* 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	34.45%
Nikko AM NZ Corporate Bond Fund	65.55%
Cash	0.00%

FundSource

Winner – New Zealand Fixed Interest Sector - 2016
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

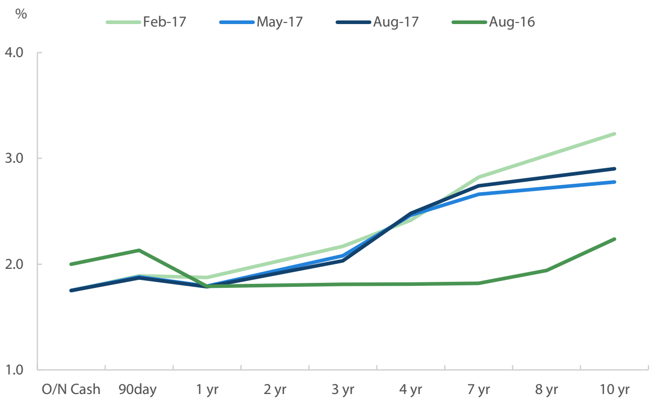
Top 5 corporate issuers (% of fund)

ANZ	27.7%
Rabobank	24.9%
Westpac	22.0%
Kiwibank	20.2%
ASB Bank	17.5%

Aggregated of Option and Corporate Bond Funds

Corporate Bond Fund yield (gross): 3.84%

New Zealand yield curve



Corporate Bond Fund commentary

The move lower in NZ interest rates during the month of August was fairly consistent across maturities with NZ government bond rates finishing approximately 7bps lower in yield. On a sector basis similar maturities of swap performed slightly better than government bonds as swap margins contracted (1 to 5bps) relative to governments. Longer dated maturities of swap were the better performers contracting more in margin than shorter maturities. The tightening in local credit margins appears to have stalled with margins relatively stable over the month. NZ credit outperformed offshore credit where there was some widening in margins due to risk-off sentiment. With a near parallel shift lower in interest rates in the government yield curve, and some small contraction in swap margins, the best performing bonds over the month were longer dated maturities that have more price gain exposure to falling interest rates. Higher yielding maturities of credit also continued to perform well.

Interest rates have remained in a relatively narrow range so far this year and volatility in financial markets has been subdued with the events and geopolitical concerns that the market was concerned passing with little disruption. Potential “bumps in the road ahead” could be an escalation of North Korean tensions and the unwinding of the Fed’s bond buying program. At the same time financial market expectations have become increasingly positive that economies appear to be recovering. Central banks are on hold neutral, or moving closer to a slow and cautious approach for reducing stimulus. In contrast, lower than expected or dormant inflation outcomes have effectively reduced expectations for higher interest rates.

We remain happy to extend the duration of credit maturities out to mid curve through spending cash and selling shorter maturities when pricing makes sense. 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 continues to maintain their view that the OCR is firmly on hold and this should help to support short to medium term bond maturities from moving much higher in yield. Longer maturity bonds will continue to be more heavily influenced by the direction of offshore markets, particularly by movements in the US 10 year bond. We don’t expect a significant impact to NZ financial markets from the upcoming election, although some investors may stay on the side-lines until there is more clarity. A change of government could lead to more government bond supply, a steeper curve and potentially reduced liquidity. Over the medium to long term there may be more potential impacts to consider depending on government policy.

Option Fund commentary

The Option Fund returned 0.51% over August. Global bond rates were generally lower over the month with the US 10 year Treasury bond closing 18 basis points lower at 2.12%. Bond yields traded over a 24bps range, from 2.32% to an intraday yield of 2.08%. Option contracts were not exercised during the month, however by month end the market rate was within 10 basis points of some call strike levels. The fund continued to sell a number of two month options to take advantage of higher premium levels as short term volatility pricing remains modest. This should set the fund up to deliver a satisfactory level of returns over the months ahead.

US 10-year rates ended the month lower as the market became less convinced that US monetary policy would tighten much further as the US continued to face a backdrop of low inflation. After North Korea fired a missile over Japan, the 10 year rate reached an intraday low of 2.08%, the lowest level of 2017. With tensions remaining high the ‘flight to safety’ trade has continued to keep US treasury yields low. Trump was also in the headlines a lot, particularly his lacklustre response to racial violence in Charlottesville, Virginia. A number of politicians and business leaders tried to distance themselves from Trump, adding to the view that his policy agenda remained well off track. Tackling the US debt ceiling and tax reform are the latest two issues to be negotiated however of more immediate concerns is how the White House deals with the impact of Hurricane Harvey. The devastation in Texas gives Trump the opportunity to show the American people he is a man of action and a true leader. Fail in this task and his support will fade further.