Nikko AM NZ Unit Trusts

31 January 2016

Nikko AM Wholesale NZ Bond Fund

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. In New Zealand we actively manage NZ$4 billion of investments for a diverse group of clients, including superannuation schemes, charitable trusts, KiwiSaver scheme providers, corporations and local government along with providing services to financial intermediaries through wrap platforms.

We offer investment management services in domestic sectors (equities, fixed interest and cash) through our Auckland-based investment team and employ offshore managers to manage global sectors (global equities, global bonds and alternative investments).

Fund launch

October 2007. A similar portfolio has been operated by Nikko AM since January 1992.

Investment objective

Over a rolling three year period to target a return which exceeds the benchmark by 1% per annum, before fees.

Benchmark

S&P/NZX NZ Government Stock Index

Structure and taxation

The Fund vehicle is a Unit Trust and Portfolio Investment Entity (PIE) which is priced daily. Unit holders elect their own Portfolio Investor Rate. Information is provided to the IRD and unit holders on an annual basis.

Distributions

Quarterly – last day of March, June, September and December

Hedging policy

All assets are NZD denominated

Management fees and other charges

Investment management fees will be negotiated separately with each investor and invoiced outside the Fund.

All Fund statutory and operating costs will be met directly by the Manager.

Buy/sell spread

Nil

Investment process

The Fund invests directly into tradeable capital market securities. Nikko AM's decision-making process starts with a global economic overview and then compares New Zealand's risk premium to international markets. Portfolio construction decisions follow where the government/corporate mix and duration positions are determined.

Investment guidelines

Authorised investments are cash, deposits and debt securities issued or guaranteed by any NZ registered bank, or equivalent overseas institution, SOE, NZ and foreign Government, NZ local authority NZ and overseas corporate and derivative instruments.

Constraints:

- Duration range of the Fund is +/- 1.5 times the index duration
- A minimum of 25% of the Fund is to be invested in securities issued or guaranteed by the NZ Government or securities accepted by the RBNZ's Overnight Reverse Repo Facility.
- A minimum of 50% of the Fund restricted to issuers with a credit rating equal to or higher than NZ Government.
- Cash and cash equivalent investments must have minimum credit rating of A1 short-term an A long term.
- Up to 5% of the fund may be exposed to assets rated below A-.

Derivative counter parties must have A+ or better credit rating and all derivative exposure shall be covered by cash or physical holdings. Derivatives shall not be used to leverage the Fund – instead, utilised to implement investment strategy. The combined physical equivalent (effective exposure) of all derivative instruments must be no greater than 40% of the Fund.

For full details see investment mandate.

Trustee

Public Trust

Custodian

Public Trust as legal custodian, BNP Paribas Fund Services Australasia Pty Limited delegated as functional custodian.

Selected investors only

Participation in the Fund is limited to persons or entities who are New Zealand resident, and:

(a) whose principal business is the investment of money; or

(b) who, in the ordinary course of and for the purposes of their business, habitually invest money;

and, consequently (or for other reasons) do not constitute "the public" for the purposes of the Securities Act 1978 (**Exempt Person**). Nikko AM will not therefore be required to produce a registered prospectus or an investment statement in relation to the proposed investment (such documents otherwise being required were this offer to be made to persons or entities that are not Exempt Persons), and such documents will not be produced accordingly. Investors in the Fund will be required to acknowledge their status as an Exempt Person as part of their subscription in the Fund. Investors in the Fund will also be required to undertake to Nikko AM that any transfers of interests in the Fund will only be to Exempt Persons.

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Performance (NZD gross returns)

	Fund %	Benchmark %	Excess %
1 month	1.54	1.67	-0.13
3 months	**0.96**	**1.20**	**-0.23**
6 months	2.09	1.94	0.15
1 year	**5.64**	**4.84**	**0.80**
2 years (pa)	7.64	7.03	0.61
3 years (pa)	**5.84**	**4.36**	**1.48**
5 years (pa)	7.21	5.79	1.42
10 years (pa)	**7.09**	**6.21**	**0.88**

Fund size $262 million

Asset allocation

Government Stock	29.1
SOE and Local Authority	17.8
NZ Registered Banks	37.4
Corporate Debt	15.7

Credit rating profile (% of fund)

AAA	8.7
AA	62.2
A	24.4
BBB	4.7

S&P ratings

Top 5 corporate* issuer exposures (% of fund)

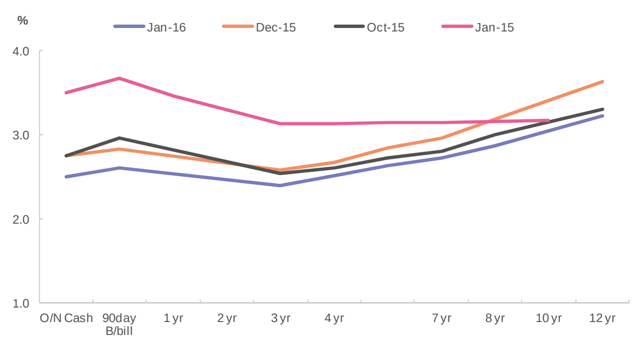
NZ Local Government Funding Authority	10
Rabobank	8
Fonterra Co-operative Group	6
ANZ Banking Group	6
ASB Bank	5

**excludes central govt.*

Duration and yield

Duration	Fund 4.53 years	vs benchmark 4.48 years
Yield	Fund (gross) 3.72%	vs benchmark 2.71%

New Zealand yield curve



Commentary

It was a volatile start to the year for financial markets, and surprisingly similar to how 2015 started. Market sentiment has been fickle and price swings have seen "risk assets" experiencing some sharp falls in value, recoveries, and then further falls. Overall the general trend has been lower for equities, commodities and interest rates with increasing concerns around the pace of global growth. The New Zealand Government Bond Index produced a return of 1.67% for the month while the All Swap Index returned 1.54%.

The New Zealand 10-year government bond yield started January at 3.57%, and declined to 3.22% through the month, and the 2-year government yield moved from 2.64% to 2.40%. Longer maturity bonds had larger falls in yield and subsequently performed better than mid curve and shorter maturity bonds. It was a similar story for New Zealand swap rates with the yield curve flattening in shape as the spread between the 2-year and 10-year swap rates narrowed to 78 basis points from 90 at year end 2015.

Government bonds generally outperformed credit as it was not a great environment for credit with margins on banks and lower rated credit expanding in sympathy with offshore moves. There was little New Zealand corporate issuance to gauge market appetite locally, although there was some Kauri issuance (by highly rated offshore borrowers issuing in New Zealand dollars) which received relatively limited support locally and resultantly was predominately placed to offshore holders and bank balance sheets. Corporate names that are popular with retail investors are still managing to outperform, and we prefer to focus on issues that will likely have good secondary demand. There still appears to be some disconnect or limited differentiation between the pricing of credit margins across the credit rating spectrum. This can be explained in part by the limited supply and lack of name diversity to the market and also demonstrates how important an influence retail demand is for the New Zealand bond market as retail investors are happy to buy local names that they know and understand. The steeper yield curve is typically of benefit to bond investors and we have been purchasing additional longer maturity bonds when suitable bonds have been available while selling shorter maturities to increase the portfolio running yield.

The RBNZ left the cash rate unchanged at 2.5% but commented that "Uncertainty about the strength of the global economy has increased due to weaker growth in the developing world and concerns about China and other emerging markets. Prices for a range of commodities, particularly oil, remain weak. Financial market volatility has increased, and global inflation remains low. The domestic economy softened during the first half of 2015 driven by the lower terms of trade. However, growth is expected to increase in 2016 as a result of continued strong net immigration, tourism, a solid pipeline of construction activity, and the lift in business and consumer confidence."

Compliance

The Fund complied with its investment mandate during the month.