Nikko Asset Management

Nikko AM NZ Unit Trusts

29 February 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	1.17	1.35	-0.18
3 months	**2.45**	**3.07**	**-0.62**
6 months	2.63	2.74	-0.10
1 year	**6.87**	**6.41**	**0.46**
2 years (pa)	7.96	7.51	0.45
3 years (pa)	**6.21**	**4.82**	**1.38**
5 years (pa)	7.26	5.93	1.33
10 years (pa)	**7.16**	**6.32**	**0.85**

Fund size

$254 million

Asset allocation

Government Stock	29.9
SOE and Local Authority	17.1
NZ Registered Banks	37.3
Corporate Debt	15.7

Credit rating profile (% of fund)

AAA	12.8
AA	61.6
A	21.1
BBB	4.5

S&P ratings

Top 5 corporate* issuer exposures (% of fund)

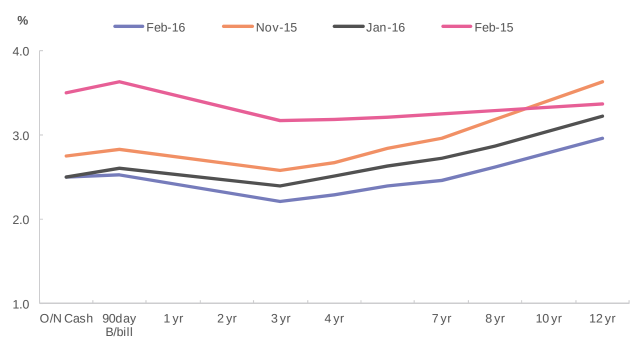
NZ Local Government Funding Authority	10.9
Rabobank	7.8
Bank Of New Zealand	6.2
Fonterra Co-operative Group	6.2
ANZ Banking Group	5.8

**excludes central govt.*

Duration and yield

Duration	Fund 4.58 years	vs benchmark 4.44 years
Yield	Fund (gross) 3.60%	vs benchmark 2.48%

New Zealand yield curve



Commentary

The Nikko AM Wholesale NZ Bond Fund returned 1.17% for February. For comparison the NZ Government bond index produced a return of 1.35% for the month while the All Swap index returned 1.52%. The NZBond Credit Index returned 0.74%.

New Zealand bond markets produced another strong monthly return as interest rates continued lower in yield. The month was again volatile with the US 10-year trading as low as 1.53% before recovering to close at 1.73%. On a positive note offshore market sentiment has improved somewhat with equities and commodities recovering after large down moves during the month. NZ interest rates continued lower in yield throughout the month. The NZ 10-year government bond yield started February at 3.22%, and declined to 2.97% through the month, and the 2-year government yield moved lower in yield from 2.40% to 2.22%. Longer maturity bonds have had slightly larger falls in yield and subsequently performed better than mid curve and shorter maturity bonds. It was a similar story for NZ Swap rates with the yield curve flattening in shape as the spread between the 2-year and 10-year swap rates narrowed from 78 to 66 basis points over the month.

Swaps were the best performing interest rate sector as swap margins narrowed marginally (on average 3.5 basis points) relative to Government rates. The next best performing sector was Government bonds which generally outperformed credit as margins on banks and lower-rated credit have continued to expand in sympathy with offshore moves. There has been little new bond issuance locally to gauge investor appetite but credit has had a tough start to the year underperforming both swaps and governments. Fonterra (rated A- S&P) issued $150M of a new 7-year bond at a margin of +155 basis points above swap. This issue received satisfactory demand, but in general investors have been wary of credit, and spreads in the secondary market have widened throughout the month. Corporate names that are popular with retail investors are still managing to outperform bank and wholesale focussed bond deals in the corporate sector and we prefer to focus on issues that will likely have good secondary demand. There are a reasonable number of bond maturities this year and these monies will likely be recycled into bonds further along the yield curve looking for a higher return. Bond issues up to $100M to $150M in size that appeal to retail investors are likely to remain well supported. For these reasons although credit markets have been challenging we are not overly negative and expect that although credit margins may expand some more, they will likely peak this year. Predicting the exact timing of the peak or troughs in a cycle is most likely difficult and we will be incrementally extending the duration of our credit holdings to take advantage of higher credit margins. Our investment horizon is the medium to long term and we continue to expect credit to add value over this time frame. These higher yields should ultimately be of benefit with a positive shaped yield curve as bonds roll down the yield curve and move lower in yield as they become closer to maturity.

Compliance

The Fund complied with its investment mandate during the month.