nikko am

FUND PERFORMANCE UPDATE

July 2014

Nikko AM Japan Dividend Equity Fund

Highlights

- The Fund returned 1.65% (in SGD terms) in the month of July and rose 11.36% (in SGD terms) since inception (1 July 2013).
- The Japanese equity market rose in July, as measured by the Tokyo Stock Exchange Price Index (TOPIX), which gained 2.13% during the month. 22 out of the 33 TOPIX sectors saw stock price gains in May, while the remaining 11 sectors saw price declines.
- The Japanese equity market advanced on better-than-expected corporate earnings for the first fiscal quarter. We are likely to see further upward revisions of earnings and dividend increases when companies release their fiscal first half earnings results in October. Therefore, we continue to expect Japanese stocks to continue their upward trend.

Performance Review

	Performance		
	July 2014 (% change)	**Year-to-Date** (% change)	**Since Inception** (% change)
Nikko AM Japan Dividend Equity Fund SGD Hedged Class Units (Net of fees)	1.65	4.10	11.36
Nikko AM Japan Dividend Equity Fund SGD Hedged Class Units (Net of fees and charges[1])	-3.43	-1.11	6.20
Benchmark (TOPIX Total Return Index[2])	2.13	0.15	14.68

Source: ©2014 Morningstar & Nikko Asset Management Asia Limited as of 31 July 2014. Returns are calculated on a NAV-NAV basis and assuming all dividends and distributions are re-invested if any. Past performance is not indicative of future performance.

[1]Takes into account maximum sales and realisation charges, where applicable.
[2] The Fund's benchmark is TOPIX Total Return Index and is stated in JPY terms. The Fund's investment approach is not relative or constrained to its benchmark. The currency exposure of the "SGD Hedged Share Class" is hedged from the Fund's base currency – JPY to the Share Class' currency, to remove the currency conversion risk from the Fund's base currency to the Share Class' currency.
Since inception: 1 July 2013

Portfolio Review and Activity

The Japanese equity market traded firmly in July on the back of strong sentiment in overseas stock markets and generally positive earnings results for the fiscal first quarter. We maintained the Fund's stock weighting during the month at around 95%–96%, similar to the level at end-June. Major trades in July included the newly added financial holding company AEON Financial Service. In addition, we also sold off our holdings in industrial sealing product maker Nippon Valqua Industries, stapler manufacturer Max and real estate investment trust Japan Prime Realty Investment Corporation.

AEON Financial Service is the financial holding company of the retailer giant AEON Group. The firm oversees AEON Credit Service, the group's credit card business. The company is seeing a large increase in credit card holders through AEON retail outlets and has strong potential for growth as the group expands its retail operations across Asia. However, investor concerns about the short-term economic slowdown in

Asia and the effects of the consumption tax hike in Japan led to the decline of its share price. Therefore, this makes the company an attractive investment in terms of dividend yield. Meanwhile, the development of magnesium cell materials by Nippon Valqua Industries resulted in a rise of its share price. However, we exited our position in the company as we believe that earnings upsides from this development would be limited. At the same time, while Max and Japan Prime Realty Investment Corporation showed reasonably good business performance, we exited our holdings in these companies as we believe they have limited prospects for future dividend growth.

Stocks that made significant positive contributions in July included video games developer Tecmo Koei and automaker Nissan Motor. Both announced strong earnings results for the April-June quarter. Telecommunications giant Nippon Telegraph and Telephone, commercial bank Aozora Bank and real estate investment trust company Japan Hotel REIT also added significantly to the monthly performance as they benefited from positive market expectations. In contrast, stocks that contributed negatively included distributor of petroleum products TonenGeneral Sekiyu as the company revised its earnings downward. Similarly, home improvement products retailing company DCM Holdings, golf course operator Accordia Golf, financial holding company Mizuho Financial Group as well as wholesaler of consumer goods and over-the-counter pharmaceutical products Paltac contributed negatively to the monthly performance. These companies were impacted from investor concerns about earnings growth in the short-term.

As at end-July, the portfolio consisted of 48 issues with an average forward dividend yield of 3.00%.

Market Review

Japanese stock market rose in July

The Japanese equity market rose in July, with the TOPIX climbing 2.13% and the Nikkei rising 3.03% on a month-on-month basis. Stock prices rose at the start of the month, buoyed by the strong US economic indicators and the weakening of the yen. The market subsequently took a downward turn amid growing concerns about the creditworthiness of a major Portuguese bank and Japan’s machinery orders in May which came in below market expectations. From mid- to end-month, there were some instances where stock prices weakened amid concern over the Israeli army's incursion into Gaza and the shooting down of a commercial airliner in eastern Ukraine. However, with the arrival of earnings season, stocks with strong earnings began to drive the market upward. Overall, 22 out of the 33 TOPIX sectors, including Non-ferrous Metals, Rubber Products, and Electric Appliances, saw month-on-month price increases. In contrast, the remaining 11 sectors, including Securities & Commodity Futures, Non-bank Financials and Insurance, saw price declines.

Market Outlook

Japanese equity market advanced on better-than-expected quarterly corporate earnings

Since the start of the year, the Japanese equity market has undergone a consolidation phase triggered by concerns over geopolitical risks and other external factors, as well as worries over the resilience of the Japanese economy following the consumption tax hike. However from late-May onward, stocks rebounded supported by positive sentiment in the overseas equity markets and as Japanese corporations began to adopt proactive shareholder return stances on the back of strong earnings. The limited impact of the consumption tax hike, which mostly remained within expectations, also boosted the market. In addition, we are seeing many companies with better-than-expected first fiscal quarter earnings (for the April-June quarter). We also expect further upward revisions of earnings and the adoption of more active shareholder return policies by Japanese corporations. Therefore, we continue to expect the upward trend in stock prices in the Japanese equity market.

The structural reforms implemented in response to financial crises and natural disasters have dramatically strengthened the earnings structures of Japanese firms. In the medium-term, significant changes are expected to take place in Japan's economy as a direct result of the government’s economic policies.

Therefore, we expect the recovery trend in corporate results to continue. In addition, stock prices will likely be revalued upward as the effects of government policies aimed at lifting the economy out of deflation become apparent.

Investment Strategy

Portfolio is characterised by low volatility and low correlation relative to the market

In principle, we managed the Fund based on an investment policy of making highly selective investments in companies with future dividend growth potential and higher projected dividend yield higher than the market average. In making stock selections, we adopt bottom-up company research, which focuses on the company's corporate competitiveness, cash flow generation ability, financial stability and company's policy on shareholder return. Therefore, we will invest in firms selectively that are able to grow their dividends over a medium- to long-term perspective. Given that many of the holdings are in stable growth stocks with strong earnings power and sound financials, the portfolio is characterised by low volatility and low correlation with the market. Currently, many of the Fund's holdings are in telecommunications firms, information services companies, general trading companies, precision equipment manufacturer, banks, automakers and chemical companies.

Capital to flow into high quality names with proactive shareholder return policy

The Japanese equity market has been in a consolidation phase since the start of 2014, but sentiment has started to improve from late May. The improvement can be attributed to the strong corporate earnings and as Japanese companies adopt a more proactive shareholder return stances. In this environment, we expect to see a sustained flow of investor capital into high-quality names with proactive shareholder return policy and high dividend yields. Therefore, in addition to the good downside protection capability demonstrated by the Fund during the market decline since the start of the year, we are confident that our investment strategy will be able to exercise its strengths and log positive returns amid the market upswing. At the same time, we expect many companies to announce upwards earnings revisions and dividend increases when they release their fiscal first half earnings results in October. As such, we believe there is a strong potential that this will increase investor interest in dividends.

Focus on names with ample cash reserves and strong earnings momentum

In terms of stock selection, we will seek out names with ample cash reserves and/or strong earnings momentum that have a great deal of room to increase their dividends. In particular, we will focus on names that are capable of maintaining sustained dividend growth. In the recent stock market development, we saw short-term earnings having a significant impact on price action. There are cases where price declines are caused by weak short-term earnings, despite the companies' strong mid-term growth potential. We view these companies offer investment opportunities, where we can invest in with valuation upsides from the realisation of the growth potential over the medium- to long-term.

As for portfolio weightings, we will make adjustments as necessary in response to changes in dividend yields that result from stock price fluctuation.

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