FUND PERFORMANCE UPDATE

September 2014

Nikko AM Shenton Asia Bond Fund

Highlights

- The Fund returned -0.23% in September. During the month, Asian currencies depreciated against the USD, while performances of Asian bonds were mixed.

- In its September Federal Open Market Committee (FOMC) statement, the US Federal Reserve (Fed) renewed its pledge to keep interest rates near zero for a considerable time after its quantitative easing (QE) program ends in October. However, the US Fed indicated it could raise borrowing costs faster than expected when it starts moving. Meanwhile, Bank Negara Malaysia (BNM) maintained its benchmark overnight policy rate but signalled further tightening may be needed to ensure financial stability. On the other hand, Philippines central bank raised both its policy rate and the rate on its special deposit accounts (SDA) to curb inflation. Elsewhere, the Thailand Public Debt Management Office (PDMO) announced the government's fund raising plan for the FY2015, with an intention to raise THB 705bn in FY2015.

- We expect Thai bonds to be well-supported as growth in the country remains sluggish and an accommodative monetary stance is required. The recent sell-off in Indonesia bonds due to political concerns had pushed yields higher. As the bond supply concerns have eased, we expect Indonesia bonds to be well sought-after going forward. In Malaysia, long-term fiscal consolidation plans and implementation of the Goods and Services Tax in 2015 will bode well for Malaysia bonds. Meanwhile, we underweight Singapore and Hong Kong bonds on expectations of a rising US Treasuries (UST) yields. We are also underweight in Philippines bonds on the back of sticky inflation and ongoing monetary tightening cycle.

Performance Review

	Currency	Performance		
		September 2014 (% change)	Year-to-Date (% change)	Since Inception (annualised)
Nikko AM Shenton Asia Bond Fund (Net of fees)	SGD	-0.23	3.33	1.36
Nikko AM Shenton Asia Bond Fund (Net of fees and charges[1])	SGD	-5.22	-1.83	0.79
Benchmark (HSBC Asian Local Bond Index (ALBI)) [2]	SGD	0.13	5.50	N/A

Source: ©2014 Morningstar & Nikko Asset Management Asia Limited as of 30 September 2014. All returns are calculated on a NAV-NAV basis and assuming all dividends and distributions are re-invested if any. Past performance is not necessarily indicative of future performance.

[1]Takes into account sales and realization charges, where applicable.
[2]Benchmark started on 1 Oct 2011
Since inception: 1 Aug 2005

The Fund retreated in September on USD strength

The Fund fell 23 basis points (bps) in September. During the month, Asian currencies depreciated against the USD as the rising UST yields and rising USD/JPY lent support to rally in USD. Performances of Asian bonds were mixed in September. Specifically, Singapore and Indonesia bonds were mostly weaker in the month, while Malaysia and Thailand bonds remained firm.

Market Review

Few changes in September FOMC statement but more hawkish interest rate projection

Contrary to market expectations, the US Fed maintained its guidance in the September FOMC statement that short-term interest rates will remain near zero for a "considerable time" after the end of its QE program and reiterated that there remains “significant underutilisation” of labour resources. However, despite maintaining the dovish tone in the statement, interest rate projections by FOMC members pointed to a faster pace of rate increases. The FOMC now expects a rate of 1.25% to 1.5% as at end-2015 and an interest rate of 2.75% to 3% by the end of 2016. The US Fed also revised down both its growth and unemployment rate forecasts. Specifically, GDP forecast for 2014 was reduced from 2.2% to 2.1%. Similarly, growth for 2015 is forecasted at 2.8% instead of 3.1%. For unemployment, it now expects a little below 6% by the end 2014 and 5.5% for 2015.

BNM pauses on monetary tightening but kept future plausibility of tightening open

At the September Monetary Policy Committee (MPC) meeting, BNM left its benchmark overnight policy rate unchanged at 3.25%, after raising rates in July. While its policy statement was more dovish on growth and inflation than previously, the central bank continued to leave the prospect of further tightening open. According to the concluding paragraph in the policy statement "further adjustment to the degree of monetary accommodation may be taken depending on how new information will affect the assessment on the balance of risks". It was indicated that the MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth, inflation and financial imbalances.

Bangko Sentral ng Pilipinas (BSP) tightens policy to curb inflation pressures

In September, the BSP raised its policy rate (reverse-repo rate), repo-rate and SDA rate by 25bps in September to 4.0%, 6.0% and 2.5% respectively, while leaving the reserve requirement rates unchanged at 20%. The central bank also increased its 2014 inflation forecast from 4.3% to 4.5% and 2015 inflation from 3.74% to 3.8%. The BSP highlighted that the balance of risks to the inflation outlook continues to lean toward the upside, with price pressures emanating from the possible further increases in food prices as a result of tight domestic supply conditions, as well as from pending petitions for adjustments in utility rates and potential power shortages. The Monetary Board believes that the continued favourable prospects for domestic demand, as evidenced by the stronger GDP growth in the second quarter, allow some scope for a further adjustment in policy rates.

Thailand announces 2015 financing plans

Thailand’s PDMO has announced the government’s fund raising plan for the FY2015 (October 2014 to September 2015). The PDMO intends to raise THB 705bn in FY2015 with THB 445bn via issuance of loan bonds, inflation linked bonds and amortising and THB 260bn via loans, savings bonds and promissory notes. Given the total maturities of THB 279bn in FY2015, net issuance is lowered by 14% at THB 166bn compared to THB 194bn for FY2014. With the objective of enhancing liquidity of the benchmark bonds, the PDMO will be re-issuing bonds instead of creating new benchmark series in FY2015.

Market Outlook & Strategy

Positive on Thailand, Indonesia and Malaysia bonds

We remain broadly positive on ASEAN bonds, expecting them to be resilient even in the event of US Fed’s tightening. Meanwhile, we expect Thailand bonds to be well supported as growth in Thailand remains anaemic and an accommodative monetary stance is required. Elsewhere, the recent sell-off in Indonesia bonds due to political concerns had pushed yields higher, and is now offering attractive yields to investors. Given that bond supply concerns have eased, we expect Indonesia bonds to be well sought-after going forward. In Malaysia, long-term fiscal consolidation plans and implementation of the Goods and Services Tax in 2015 will bode well for Malaysia bonds. We do not expect BNM to embark on aggressive tightening and monetary policies will likely be data-dependent going forward.

Remain underweight in Singapore, Hong Kong and Philippines

Given that Singapore and Hong Kong bonds are highly correlated to USTs, we remain underweight in Singapore and Hong Kong bonds on expectations that the UST yields is likely to rise. We are also underweight in Philippines bonds on the back of sticky inflation and ongoing monetary tightening cycle.

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