# FUND PERFORMANCE UPDATE

October 2013

## Nikko AM Shenton Income Fund

## Highlights

- The Fund gained 0.79% in October and 1.16% on a year-to-date basis.

- In October, Asian credits rallied on protracted US debt ceiling dispute. 10-year US Treasury (UST) yields declined to around 2.55% as market participants anticipated a further delay in the tapering of the quantitative easing (QE) program. Declines in risk-free rates resulted in the tightening of credit spreads. In October, Asian high-grade and high-yield gained 2.11% and 2.17% respectively. Meanwhile, the rally in most Asian bonds since September was largely driven by short covering from investors who were previously underweight the region. However, the rally appears to be losing steam given the rise of 10-year UST yields towards the end of the month.

- With the transition of Fed Chairman in January and debt ceiling deadline in February, we expect the US QE tapering program to take place only in late 1Q 2014. The volatility in risk-free rates should remain contained for the rest of 2013, which will support credits. Nevertheless, in our opinion, the credit spreads are not likely to tighten substantially given the current supply overhang. Meanwhile, with the broader outlook for higher rates, we maintain a slight underweight on duration for the portfolio. Also, we are taking profit on Singapore government bonds and underweight the Singapore benchmark in terms of duration, while reducing our duration underweight in Malaysia. In terms of Asian currencies, we retain a cautious view based on our expectation that USD will appreciate over a broader terms when the US economy starts to improve.

## Performance Review

| | Currency | Performance | | |
|---|---|---|---|---|
| | | October 2013 (% change) | Year-to-Date (% change) | Since Inception (annualised) |
| Nikko AM Shenton Income Fund (Net of fees) | SGD | 0.79 | 1.16 | 4.58 |
| Nikko AM Shenton Income Fund (Net of fees and charges[1]) | SGD | -4.25 | -3.90 | 4.37 |

*Source: ©2013 Morningstar, Inc. & Nikko Asset Management Asia Limited as of 31 October 2013. 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.*

***Note:** With effect from 2 January 2013, there will be no benchmark against which the Fund's performance is measured as the Fund will be managed on an absolute return basis.*
*Since inception: 31 January 1989*

***Fund posted returns of 0.79% in October***

The Fund gained 0.79% in October, benefiting from the market expectation that the US Government shut-down and debt ceiling postponement would push back the start of the QE tapering towards 1Q 2014. The relieve rally resulted in UST yields easing off by another 10 basis points (bps) for the month to close at 2.55%, pulling along the Asian yield curves. In particular, this benefited the Indonesian and India bond markets, while the Asian credit market staged a strong rally and Asian currency rebounded.

# Market Review

## Asian Credits

***Asian credits rallied on protracted US debt ceiling dispute***

With the political debate on the US debt ceiling being postponed to February 2014, UST yields moved lower as market participants began to anticipate a further delay in the tapering of the QE program. Weaker than expected US economic data releases buttressed this view. The 10-year UST yield decline from around 2.61% to around 2.55%. As volatility for risk-free rates declined, risk sentiments turned for the better resulting in the tightening of credit spreads. In October, Asian high-grade returned 2.11% as spreads tightened by 14bps. Asian high-yield also rallied, gaining 2.17% for the month.

***Higher risk segments outperformed***

Higher risk segments of the market outperformed. Within the high-grade space, these segments include Indian corporates, and long-dated Indonesian and Philippines sovereign issues. 10-year Indian corporates spreads compressed by approximately 30 to 60bps. As expectations for a delay of the QE program tapering continued to build, concerns over fundamental challenges took a back seat. This led to a rally in UST and tightening in spreads which resulted in price gains of around 5 to 7 points for the 30-year Indonesian sovereign issues. Despite already trading at lofty valuations, long-dated Philippines sovereign issues also traded unchanged to around 3 points higher. In the high-yield space, Indonesian corporates also rallied. Indonesian coal mining bonds gained by up to 2.5 points. Long-dated Chinese property related bonds gained by around 2 points.

***New issuance rose sharply but was reasonably well absorbed***

As sentiments improved, new issuances continued strongly in October after picking up in September. 19 new high-grade issues amounting close to USD 10bn were issued in the primary market. High-yield primary issuance also gathered pace with 11 new issues totaling around USD 3.9bn. The surge of new issuance across both high-grade and high-yield was reasonably well-absorbed with negligible impact on secondary spreads.

## Asia Rates & FX

***US government partially shut down for 16 days***

US political leaders had failed to reach an agreement on budget legislation for fiscal year (FY) 2014, resulting in a federal government shutdown (the 18th government shutdown since 1976). After about two weeks of further negotiation, the Republicans and Democrats agreed on a deal on 16 October 2013, putting the government shutdown to an end. The agreement includes a continuing resolution that will fund ongoing "discretionary" government programs at roughly the same rate as in FY 2013 until 15 January 2014 and temporarily lifted the Treasury's debt ceiling until 7 February 2014. The Federal Open Market Committee's (FOMC) statement towards the end of October removed the reference to tighter financial conditions and stated that the central bank would await more evidence of sustainable economic progress before adjusting the pace of its securities purchases.

***Monetary Authority Singapore (MAS) kept Foreign Exchange policy unchanged***

During the policy meeting in October, MAS maintained its modest and gradual SGD NEER appreciation policy, in line with market expectations. In its assessment of growth, the MAS expects gradual recovery in global economies despite lingering uncertainties and expects Singapore to grow at 2.5%-3.5% in 2013 and broadly the same in 2014. Also, the MAS highlighted the ongoing pass-through of rising costs from higher COE premiums and tight labor markets as key inflationary sources going forward. In addition, MAS expects 2013 headline inflation to be at the upper end of 2%-3% range with core inflation at 1.5%-2.0%.

***Malaysia announced its fiscal budget for 2014***

During the month, Prime Minister Najib announced the country's fiscal budget for 2014, with a lower deficit target from 4.0% to 3.5% of GDP in 2013. Growth is forecast at 5.0%-5.5% in 2014, led by private investment, from an estimated 4.5%-5.0% in 2013. Importantly, a highly anticipated goods and services tax (GST) will be implemented effectively from 1 April 2015 at the rate of 6%. Basic food, transport, medical charges and residential property will be exempted from GST, while lower income households will be given one-off cash assistance of RM 300 to cushion impact. Also, the corporate tax rate will be cut by 1% to 24%, while personal income tax will be reduced by 1%-3% when GST starts. With the GST implementation, existing sales and services tax will be abolished. Overall, the public debt to GDP ratio is expected to rise to 54.8% in 2013, just shy of the 55% debt ceiling, from 53.3% in 2012.

***Thailand released 4Q 2013 Monetary Policy Report***

The Bank of Thailand released its 4Q 2013 Monetary Policy Report and lowered its 2013 GDP growth forecast to 3.7% from the previously estimated of 4.2% in July. Reasons for growth downgrade are weaker domestic growth as well as the fading of stimulus and tighter credit conditions. Also, exports are projected to be weaker and will continue to be a drag on growth. The central bank expected 2013 inflation at 2.2% and rising modestly to 2.4% in 2014. Also, core inflation is expected to remain firmly within the target range of 0.5%-3.0%, averaging 1.0% in 2013 and 1.2% in 2014.

***Moody’s upgraded Philippines to investment grade***

In October, Moody's upgraded the Philippines’ credit rating from Ba1 to Baa3 and assigned a positive outlook to the rating. With this upgrade, the country has now officially achieved investment grade recognition from all three major rating agencies. Moody's cited the country's robust economic performance, ongoing fiscal and debt consolidation, political stability, and strong governance to be behind the upgrade.

## Asset Allocation

| Bond Asset Classes | Weight % |
|---|---|
| Investment Grade | 20.72% |
| High Yield | 14.36% |
| Asian Local Currency | 49.18% |
| Convertible bonds | 7.20% |
| Cash | 8.54% |

*Source: Nikko Asset Management Asia Limited as at 31 October 2013*

## Market Outlook & Strategy

***Constructive on credits towards the end of the year; valuations fair***

The base case for the commencement of the tapering of the QE program has shifted to the first quarter of 2014. The volatility in risk-free rates should remain contained as we enter into the final 2 months of 2013. This should be supportive of credits. However, we hold the view that credit spreads are unlikely to tighten appreciably in the last 2 months given the supply overhang. Nonetheless, a moderate pace of new issuance is unlikely to derail the market unless fund outflows pick up appreciably. High-grade and high-yield corporate spreads are currently trading close to their historical mean levels. While spreads are not strikingly cheap, the decent “all-in” yields for high-grade and high-yield at 4.3% and 7.6% respectively are sufficiently decent in relation to fundamentals.

***Portfolio duration remains underweight***

Given the broader outlook for higher rates, we maintain a slight underweight on duration for the overall portfolio. Since September, the rally in most Asia bonds in our view was largely driven by short covering from investors who were previously underweight the region. This rally appears to be losing steam especially given that 10-year UST yields had breached below 2.5% on a few occasions in October but bounced back up thereafter. Tactically, we are taking profit on Singapore government bonds and underweight the Singapore’s benchmark in terms of duration given the market strong correlation to UST. Also, we think that the fiscal budget announced in Malaysia is in the right direction, and if implemented smoothly, should help to consolidate the country’s fiscal position over a longer term. In addition, the bond supply for next year is expected to be more conducive, and as such, we are reducing our duration underweight in Malaysia.

***Retaining a cautious view on Asia currencies***

We remain cautious on Asia currencies given our expectation that USD will appreciate over a broader term when the US economy starts to improve and expectation of QE tapering to resume again. In the interim, we expect US economic data to drive USD performance and Asia currencies. Selectively, we expect North-Asia currencies such as Chinese Yuan and Korean Won to be more resilient attributed to their stronger external balances. Also, we remain negative on the Indonesian Rupiah and Indian Rupee given their current account deficits.