

GLOBAL FIXED INCOME & CREDIT OUTLOOK

February 2017

Recent Developments

Global Fixed Income

Global bond markets continue to wait for more detail around the US administration's policy platform. Europe should see growth accelerate, with our ongoing preference for peripheral Europe over the Euro. We remain cautious on the UK due to the Brexit uncertainty. US data continues to strengthen, while the outlook for emerging markets has improved, and the sell-off in Mexico expected to slow.

Global Credit

Global credit markets have started the year well, with Latam High Yield a key driver. Volatility is like to remain in Asia, while Japan and the US markets continue to look positive. Our focus this month centres around the impact of President Trump's agenda on the Chinese market, and the uncertain political situation in Europe.

Global Fixed Income

Current Views

	February 2017	
	FX	Duration
USA	OW	UW
Australia	OW	OW
New Zealand	N	OW
UK	UW	UW
Canada	N	N
Sweden	OW	N
Norway	OW	N
Euro	UW	UW
Japan	UW	N
Malaysia	N	N
Mexico	OW	N
Poland	N	N
Singapore	UW	OW
South Africa	N	OW

FX—Foreign exchange. OW—Overweight. UW—Underweight. N—Neutral.

Key Factors

- The Trump administration's lack of clarity around its agenda is continuing
- The US Federal Reserve is likely to raise rates at least twice in 2017
- Growth should accelerate in Europe, with the ECB continuing its QE program
- Short-term interest rates in Japan should favour the US dollar
- Outlook for emerging markets continues to improve, with ongoing resilience in Mexico

Developed Markets

With President Trump announcing that he will be releasing his tax plans in the coming weeks, we have shifted to a more cautious position on US duration. The risk is that President Trump announces a sizeable stimulus package, with the backing of the broad Republican base. This would raise fears that the US Federal Reserve would need to act more quickly than expected, and with markets only pricing in two or three rate hikes in 2017, we believe that markets are under-pricing the risks of this announcement.

In Europe, we see some acceleration in growth, with the ECB sticking to its QE program for now. There is a risk that it will struggle to keep longer-dated yields anchored. We favour peripheral Europe over the Euro, given strong Swedish growth and the positive outlook for oil prices that should support Norway. We remain cautious on the UK given the uncertainties surrounding leaving the EU, and most likely the single market in the process.

In Japan, we believe that short-term interest differentials will continue to dominate this cross in the short term, and so favour the US dollar.

The recent spike in iron ore prices has left the Australian dollar lagging in its wake. We are now overweight this currency in anticipation of some catch-up in the coming weeks.

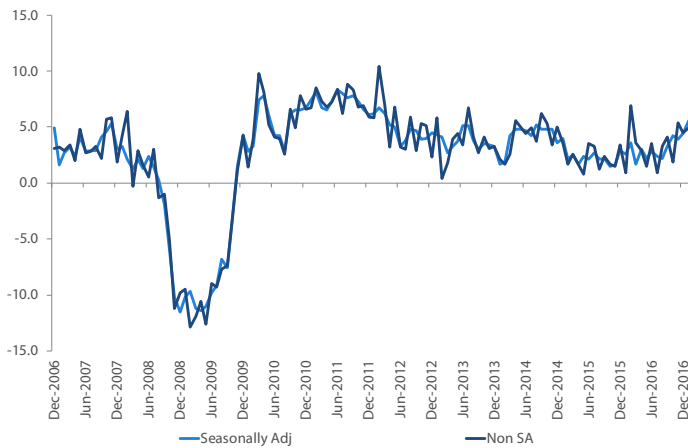
Emerging Markets

With the global growth outlook improving, the outlook for emerging markets has also improved, and we believe that they can make further gains over the coming months.

Mexico has been resilient after the initial post-election reaction, with its sell-off showing signs of exhaustion. We have thus shifted to an overweight position in anticipation of continued momentum.

Discussion Points

1) US data continues to strengthen, with confidence surveys moving sharply upwards. As the unemployment rate has dropped to historical lows, retail sales have started to trend higher. This raises the risk of the US Federal Reserve tightening interest rates more than currently expected.



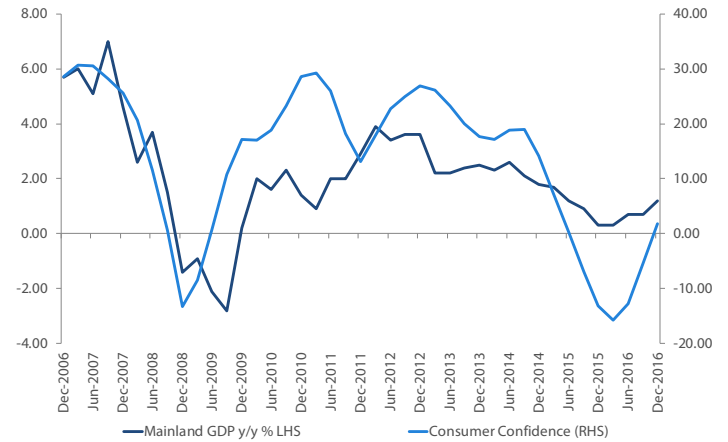
Source: Bloomberg

2) Although the Australian economy still appears to be soft, a significant gap has opened up between iron ore prices and the Australian dollar. This, along with our constructive view on Chinese growth, leaves us positive on the Australian dollar.



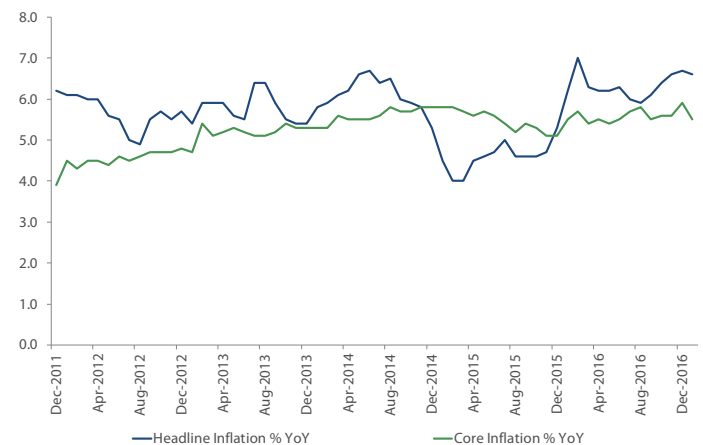
Source: Bloomberg

3) A more constructive outlook for global oil prices has also seen the outlook for the Norwegian economy improve. Its central bank is unlikely to maintain policy at such accommodative levels should this trend continues through 2017.



Source: Bloomberg

4) In South Africa, inflation data has started to roll over, led by core inflation. Real yields are attractive, given the still poor growth outlook, and this leads us to be overweight duration.



Source: Bloomberg

Global Credit

Key Views

Global credit markets performed well on a total return basis, both in High Yield and Investment Grade.

What appeared to outperform was high Beta, particularly High Yield in Latam, which seemed to drive the market. Some key themes that we will pay attention to in February are the Chinese market following Trump's victory, and the current political situation in Europe and its effect on credit markets.

Europe

The overall picture has not changed very much, with the current Macro environment continuing to be supportive for investment in European credit. However, it is worth noting that the current political situation in mainland Europe does present some concerns. We are paying close attention to the French presidential election and the chances of a Le Pen victory. In recent weeks we have seen underperformance in French credit spreads. On the Micro front, M&A yield volume is around 40-45% higher than the previous year, based on value. This isn't too detrimental, as most of these deals have been completed with cash.

On Technicals, new issuance continues to be healthy, with High Yield issuance looking like it is recovering from a very quiet January. High Yield is offering some promising value and we will continue to spend the majority of our time searching for bond investments in this space. There could potentially be a negative reaction to the ECB's decision to reduce its bond purchasing program, and the consequences that this may cause in the market, especially in the utility Investment Grade space.

Japan

We remain relatively positive on both the Macro and Micro level in Japan, and currently view it as a good environment in which to invest in Japanese credit. On the technical side, there is not much inventory or many new issues coming into the market. Valuations are quite poor, however it is worth noting that, if a new issue comes to the market, it still sells well. We are currently trying to keep our credit exposure high to ensure that we can attract excess spread in the low interest rate environment. We will try to purchase as much as possible in order to achieve this.

US

The US economy continues to look strong from a Macro, Micro and Valuation standpoint. The sector rotation trade into basic industries continues to dominate, given the resurgence in copper, iron ore and oil prices. High beta sectors have

performed well and we think that this will continue in the near term. In January, we saw almost record Investment Grade corporate issuances, where roughly USD 170bn was issued, which complemented continued strong demand. In the near term, we don't see much risk being passed onto the US. We are still waiting for President Trump's corporate tax reform, where if a border tax does not get passed, it looks likely that the Trump administration will aim to raise taxes by cutting corporate interest tax deductibility. This could heavily affect the overall issuance, and the tax shield generated in LBO and private equity transactions. We would suggest that this tax change will be the most significant event to happen to corporates in the coming months.

South America

Over the month, Latam was the strongest market across global credit markets. The overall story has not changed too much since last month on the Macro side, however in Colombia we saw a value added tax being introduced towards the end of last year and the start of this year. This has seen inflation creep higher in the short term and, in doing so, has caused the Central Bank to have a cautious view on interest rates. Mexico has reacted to President Trump's rhetoric through fiscal policy, which should increase inflation in the short term. This should also provide the catalyst for the Central Bank to raise interest rates, which will help to restore credibility. The increase in copper prices has also helped exporters like Chile and Peru. Valuation is becoming more of a problem, with Brazil being the only market above its 10-year average. This could be why it seems to be currently favoured by investors and we would argue that there is still value to be gained.

Australia

There has been very little volatility in the Australian market, despite there being major catalysts for there to be. The only thing that has been moving is credit spreads, which have been tightening. Financials performed strongly in January, with strong credit spread contraction. Observing the economy with greater scrutiny, you could argue that Australia is the lucky country. The housing market has been slowing but commodity markets have risen to the point where they are beginning to support the economy. We are also seeing a reasonable state of employment and a positive economic environment.

However, where credit markets are suffering in Australia is supply dynamics. We are seeing a lot of supply coming from financials, where we saw over AUD 4bn in issuance in January. Spreads are not being particularly helped by lines becoming illiquid, as people are becoming more cautious to trade them. We have seen general spread tightening, however it has been a tightening where financials have outperformed non-financials. Despite the securitised market looking attractive, valuations don't look very compelling for investors.

Asia ex Japan

Asian credit registered gains in January, as credit spreads tightened. Asian Investment Grade returned 0.76% and Asian High Yield corporates returned 1.32% - decent gains considering heavy primary supply and higher risk-free rates. At the Macro level, growth was stable in the region, however the jump in Chinese PPI (and in Indonesia and India) highlighted the emerging upside risks to inflation. On the Micro side, there were no big changes over the month but the Indian financial sector is weakening, and net losses are still rising.

With a focus on Technicals, the supply of new issues is expected to remain heavy in the coming month, following the Chinese New Year lull in early February. Although the supply of new issues was fairly high in January, the demand backdrop for Asian credit appears to be intact, as spreads have broadly tightened. In addition, inflows into emerging market hard currency bonds have started the year on a positive note.

Towards the end of the month, the Chinese central bank introduced a temporary 28-day liquidity facility to those large commercial banks that are considered to be primary liquidity providers on the interbank market. This was in anticipation of tighter liquidity ahead of the Chinese New Year holidays. A few days later, the PBoC increased the six-month and one-year MLF rates by 10bps each, to 3.1% and 2.95% respectively. This signaled its intent to keep a tight rein on leverage within the financial system.

Volatility is likely to remain, due to the US Federal Reserve remaining on a tightening path, uncertainty around the policies of the new US administration, and risk events like the upcoming elections in Europe. The myriad of factors, some conflicting, which have driven the direction of Treasury yields, are expected to remain. These include potentially higher yields due to reflationary policies from the Trump administration, to potentially lower yields from lower growth stemming from protectionist policies. With spreads at the tight end of the historical range, we remain cautious.

Discussion Points

Europe faces a period of heightened political risk through 2017, with the region facing elections in a number of key countries that could have an impact on global credit markets. The Netherlands is first, with its election on 15 March. Polls suggest that the right wing Freedom Party, led by Geert Wilders, could well win the largest number of seats. Wilders has campaigned on a pledge to 'de-Islamise' the Netherlands and is a controversial figure.

France then has its Presidential elections, with the first round on 23 April. Marine Le Pen from the National Front is widely expected to be one of the two candidates to reach the second round, which will be held on 7 May. Le Pen has also campaigned on an anti-immigration platform, while also advocating that France hold a referendum on Euro membership.

German elections will take place later in 2017, with Chancellor Angela Merkel facing the strongest opposition for some time.

Finally, there is the possibility of an early Italian election, where the anti-European Five Star party has undertaken measures to make it appear more mainstream and electable, potentially gaining a larger share of the vote. We will continue to watch this political situation closely throughout the year.

About the Global Fixed Income Team

Andre Severino

Co-Head of Global Fixed Income

Holger Mertens

Head Portfolio Manager, Global Credit, CFA

Steven Williams

Head Portfolio Manager, Core Markets

Raphael Marechal

Head Portfolio Manager, Global Emerging Markets

Simon Down

Senior Portfolio Manager, CFA

About Nikko Asset Management

Nikko Asset Management, together with its investment advisory affiliates, has 204 investment professionals around the world and approximately USD 170.6 billion in assets under management or supervision as of 31 December 2016. Nikko Asset Management strives to provide outstanding long-term performance, service and a comprehensive suite of investment management solutions to a diverse client base, which includes governments, institutions, corporations and private individuals worldwide. For more information, please contact us using the details below or visit our website at www.emea.nikkoam.com

Contact Us

Nikko Asset Management Europe Ltd

1 London Wall, London, EC2Y 5AD

Phone: +44 (0)20 7796 9866

Fax: +44 (0)20 7796 9816

Email: Emarketing@nikkoam.com

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor a guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association/Japan Securities Dealers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you.

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice.

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme and the Nikko AM NZ Wholesale Investment Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website www.nikkoam.co.nz).