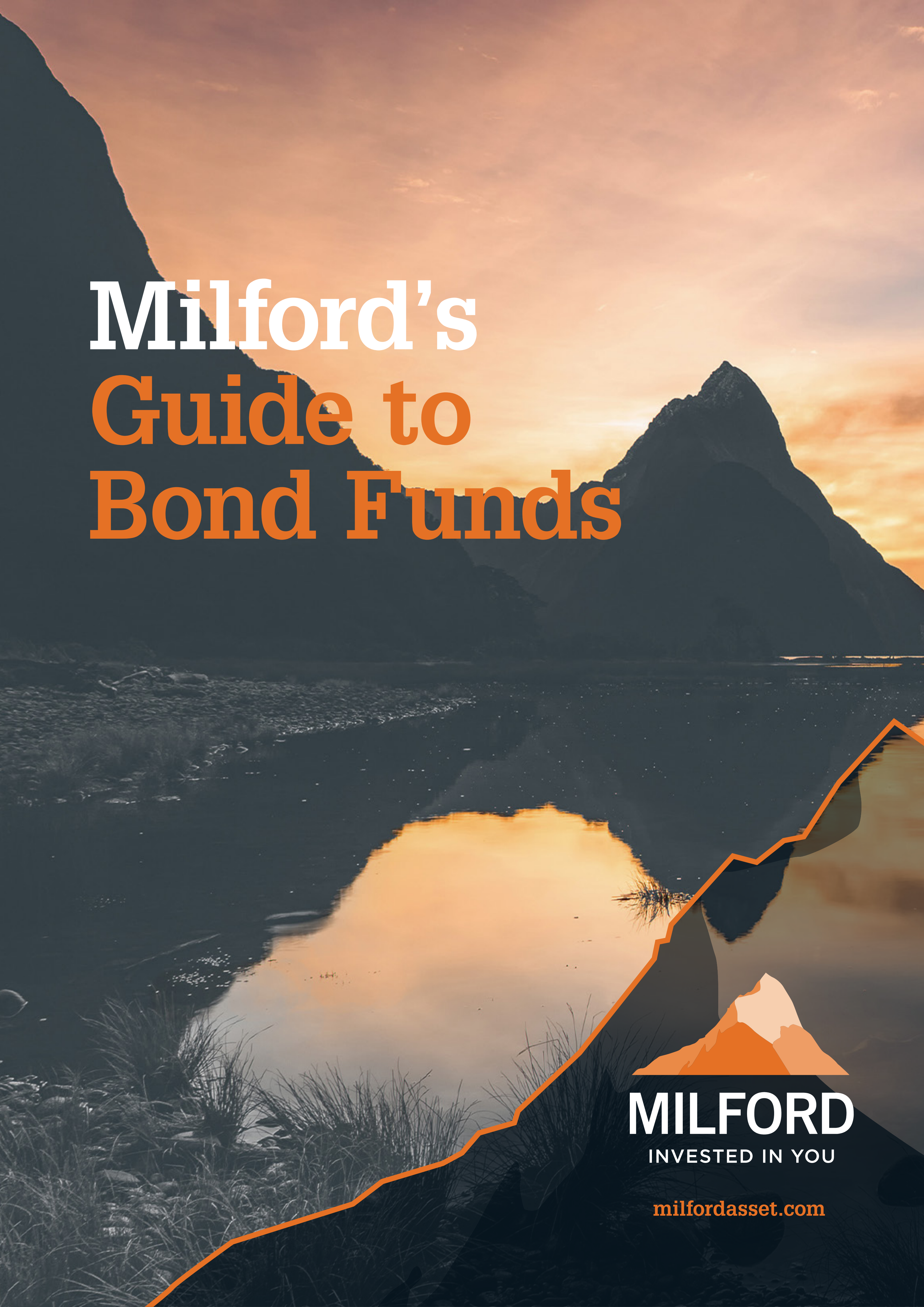

Milford's Guide to Bond Funds

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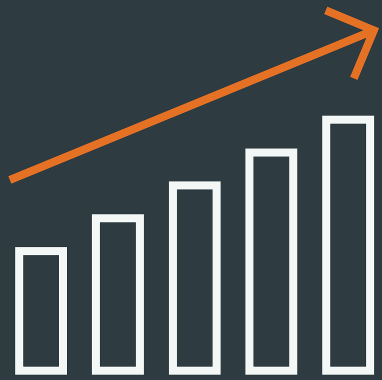
Are you thinking of investing in the Milford bond funds?



With returns on bank savings accounts and term deposits at historic lows, more and more people are looking at alternative ways to get their money earning for them. One such alternative approach is investing in bonds either directly or through a managed bond fund.

A bond fund can offer you benefits as you look to build a diversified investment portfolio with your risk spread across different types of investments.

Milford offers two bond funds: the Trans-Tasman Bond Fund and the Global Corporate Bond Fund.

What is a bond?

Bonds are used by governments (government bonds) and companies (corporate bonds) to borrow money from investors. When you buy a bond you are lending money to the government or company that issued it. In return, the bond issuer undertakes to give you regular interest payments (‘coupons’) and the original amount (‘principal’) back at the end of a defined period (‘maturity’).

What do the Milford bond funds invest in?

Milford bond funds invest primarily in corporate bonds. It is important to note Milford’s two bond funds themselves have different risk profiles, with the Trans-Tasman Bond Fund having a slightly lower risk profile than the Global Corporate Bond Fund. Please refer to the Product Disclosure Statements available on the Milford website for further details.

Why bonds and not shares?

One of the reasons some investors prefer bonds over shares is that, in the event of a company’s insolvency, bondholders rank for repayment ahead of the company’s shareholders. In recognition of this preferred position, however, the returns from bonds will generally be lower than returns available to shareholders. On the other hand, bond returns are typically more stable than returns from shares.

Why invest in a bond fund?

Diversification

Many investors diversify among a wide variety of assets classes, from shares and bonds to property and alternative investments (such as commodities). Diversifying across a range of asset classes can help to cushion the risk of negative returns from one particular type of investment.

Milford's bond funds further enhance diversification by investing in a wide range of individual bonds issued by multiple borrowers across different industries and geographies, with a mix of maturities and interest rates. One of the principal advantages of a bond fund over direct bond investment is that a bond fund is exposed to a portfolio of bonds, therefore minimising the impact of loss from a single bond in the portfolio.

Professional management

By investing in a bond fund, an investor also gains the benefit of investing in a portfolio of bonds selected by a professional manager. Milford assesses the quality of each bond issuer, the bond's terms, and its relative value compared with other available bonds. Milford also invests in bonds traded on local and international markets that are not easily accessible by individual investors.

Milford actively manages its bond portfolios by buying and selling bonds to manage the funds' risk exposures, including interest rate and issuer credit risk.

Why invest in a bond fund?

Income

The Milford bond funds provide investors with a regular income via a quarterly distribution. Clients can choose to have this distribution either paid to their bank account or re-invested back into the fund.

Liquidity

Units in Milford's funds are able to be bought and sold daily*. This offers greater flexibility to add to or exit your investment compared to term deposits where investments are fixed for a term.

Lower volatility return

The Milford bond funds aim to produce a positive return that exceeds the relevant benchmark over the fund's recommended investment timeframe. The funds aim to achieve a more stable return compared with funds invested in shares. However, it should be noted that month-to-month returns will fluctuate and can be negative at times.

PIE fund tax status

Investing in the Milford bond funds can be a tax efficient way to invest in bonds for investors on the top tax rate, with a maximum Prescribed Investor Rate for investing in funds of 28%.

* Withdrawal requests will generally be processed and units withdrawn using the closing unit prices for that business day. We will generally aim to make the withdrawal payment three business days after the day used for the unit price.

The risks of investing in bond funds

Just like other types of funds, there are risks with investing in bond funds. Prices of the funds can rise and fall and there is the possibility that you may not get back the original amount you invested. Below we highlight the main risks involved with investing in bond funds, and the approach we take to managing those risks.

Default risk

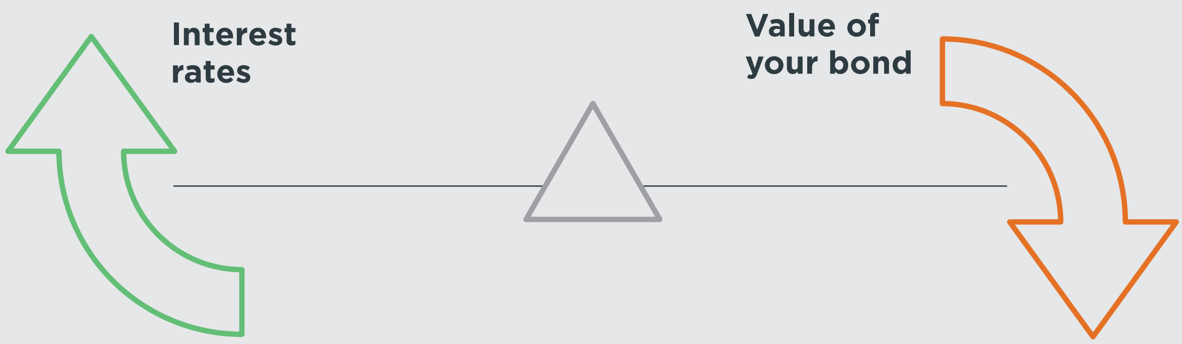
Every bond carries some risk that the issuer will “default”, or fail to fully repay its obligations at maturity. The Milford investment team assesses each bond and its issuer before investing, as well as monitoring the portfolio on an ongoing basis to minimise exposure to default risk.

Interest rate risk

The price of bonds typically moves in the opposite direction to interest rates – and the same applies to bond funds.

This can mean if prevailing interest rates increase, the bond fund’s price will fall to compensate for the now more attractive rates available from new bond issues. If prevailing interest rates fall, however, the opposite outcome will likely result.

When managing its bond funds, Milford uses a number of tools to actively manage the interest rate exposure relative to the funds’ benchmarks.



The risks of investing in bond funds

Mark to market risks

The price of the bond fund is determined by the prices of the underlying bonds. Bonds are typically traded on secondary markets where prices can change daily. This is a key difference to a term deposit which cannot be bought or sold during its term. Factors that can affect bond and bond fund prices include:

- financial market conditions
- changes in market interest rates (or expectations for interest rates), and
- positive or negative economic news or news specific to the issuer of a bond

Irrespective of changes in interest rates, the price of a bond can change to reflect factors including changes in market perceptions of the riskiness of the bond issuer.

Bond Fund investing in a low interest rate environment

Typically, a bond fund offers a lower but more stable rate of return compared to shares. Furthermore, a bond fund can offer a higher rate of return than term deposits or cash at the bank. The risks associated with bonds are, however, higher than with term deposits and returns will likely be more volatile. In addition, in the present environment with interest rates at historically low levels, you should be aware there is the increased possibility of low or even negative returns that may reduce the value of the capital you invest.

Glossary

Bonds

A security, usually issued by a company or government (or council) to borrow funds from investors. The issuer of the bond undertakes to pay investors a fixed rate of interest over a set time period and repay the initial amount borrowed at the end.

Corporate Bonds

Bonds issued by a company. They are also known as 'credit' and can offer higher interest rates than bonds issued by governments to compensate for the typically higher risk than government bonds.

Coupon

The regular interest payments paid to the holder of a bond.

Credit Rating

An independent assessment of an issuer's ability to repay its debts. Standard & Poor's, Fitch and Moody's are the three most prominent credit rating agencies.

Fixed Income Securities

Another name for bonds, but also other securities such as loans which undertake to pay regular interest payments and repay the initial investment at maturity.

High-Yield Bonds

Fixed income securities with a credit rating below 'investment grade'. These bonds have a higher risk of default than better quality issuers and offer higher yields to compensate for the additional risk.

Investment Grade Bonds

Fixed income securities with a moderate-to-strong credit rating signifying the issuer has relatively low risk of default.

Maturity

The length of time until the initial investment amount of a fixed income security is due to be repaid to the holder of the security.