

Factsheet 30 November 2018

# NIKKO AM OPTION STRATEGY

Applies to: Nikko AM Wholesale Option Fund and Nikko AM Option Fund (retail) and Nikko AM KiwiSaver Option Fund

## Market Overview

- US long term interest rates moved higher during the month however closed November at lower levels.
- Short term interest rates are expected to rise again in December but the Federal Reserve may slow the rate of increases in 2019.
- There are signs US economic activity is slowing and trade tensions continue to create uncertainty.

## Fund Highlights

- The fund returned 1.2% in November as the US Treasury bond market traded in a narrow range.
- The investment strategy of investing in NZ bank bonds and selling short term option contracts on 10 year US Treasury bonds remains unchanged.
- The premium income received from selling option contracts has lowered from recent peaks as interest rate movements become more modest.

## Performance

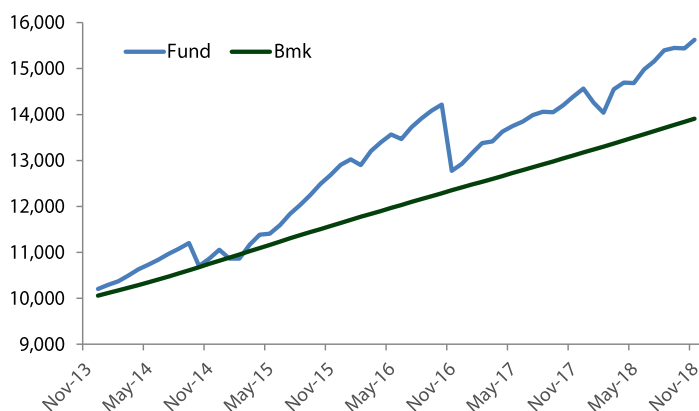
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	1.20%	1.46%	8.59%	7.21%	9.34%	10.46%
Benchmark <sup>2</sup>	0.49%	1.48%	6.08%	6.32%	6.82%	7.00%
Retail <sup>3</sup>	1.09%	1.15%				
KiwiSaver <sup>3</sup>	1.19%	1.47%				

1. Returns are before tax and before the deduction of fees

2. Benchmark: Bloomberg NZBond Bank Bill Index plus 4.0% per annum. No tax or fees.

3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any)

## Five Year Cumulative Performance<sup>1,2</sup>



## Portfolio Manager

**Fergus McDonald,**  
**Head of Bonds and Currency**



Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

## Overview

The strategy invests in cash and fixed interest investments, and undertakes a leveraged trading strategy based on selling options on global government bonds.

This fund is a specialist investment strategy and is suitable only for experienced investors who have an investment time frame of three years or longer and are comfortable to accept short sharp periods of high volatility

The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every \$1 in the fund, up to \$6 of call options and \$6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry date. Accordingly, the effective leverage of the fund is 6 times the value of the fund.

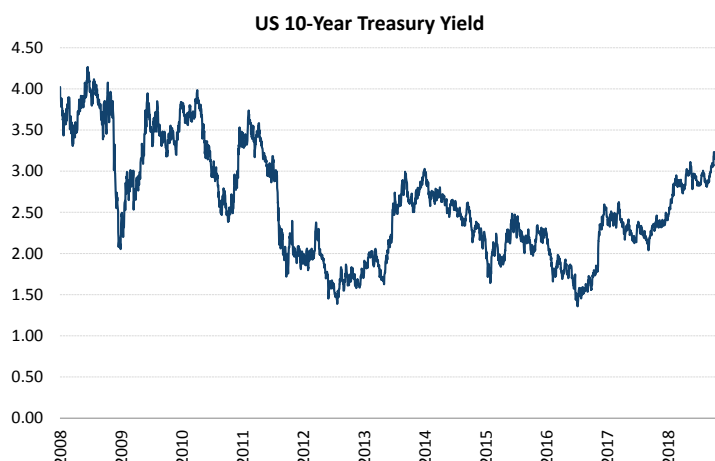
In times of increased interest rate volatility it is likely the fund will receive a higher stream of income as new options sold will have higher income.

## Objective

The fund aims to earn a return of the benchmark before fees, expenses and taxes over a rolling three year period.

## Market Commentary

The strength of the US economic expansion looks to be reducing however US central bankers are likely to continue to raise short term interest rates again in 2019, but to a lesser extent than previously indicated. It is important to note that the economy remains healthy although the prospects for further robust growth are diminished. We expect the Federal Reserve to increase rates one more time in 2018 and maintain the theme that further gradual increases in rates is consistent with a sustained expansion of economic activity, strong labour market conditions and inflation near their 2% medium term objective. The direction of short term interest rates in the US appears relatively predictable, however there is divergence in market views as to whether the long end of the yield curve should be higher or lower in yield. The US growth expansion is at record tenure and equity markets are also at high levels. Recent turbulence in equity markets, in some way caused by rises in interest rates, are a further sign the Federal Reserve will tread carefully when planning any moves in monetary policy settings in the new year. Uncertainty surrounding the Trump administration’s trade policy and how the implementation of it will impact individual companies, industries and global growth levels continues to keep investors nervous. Volatility in bond markets has been relatively contained but US 10 year bonds have until recently been making moves to push higher in yield. Higher levels of Treasury bond issuance to fund the expanding US fiscal deficit is widely expected and is an additional reason for investor disquiet. It remains to be seen if investors will see these higher yields as attractive buying opportunities or if rates drift higher over the next twelve months. The US 10 year bond yield traded in a 26 basis point range over the month , moving between a low of 2.99% and a high of 3.25% before closing on the November lows at 2.99%.



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## Fund Commentary

The Option Fund had a reasonably clean month with income being much higher than the cost of having options struck. Most of the option contracts sold by the fund have now been reset to provide a reasonable buffer for future interest rate movements and we look forward to the fund returning to a more normal level of monthly returns. Typically we receive higher levels of premium income when yields are moving higher. If current levels of volatility are maintained, income generated by the fund should remain at satisfactory levels however the speed and magnitude of yield changes in the US 10 year Treasury bond will continue to determine the total return of the fund in the months ahead.

## Key Fund Facts

### Distributions

Wholesale fund: generally does not distribute  
Retail fund: generally does not distribute  
KiwiSaver fund: does not distribute

### Estimated annual fund charges

Wholesale: negotiated outside of unit price  
Retail: 1.20%, refer PDS for more details  
KiwiSaver: 1.15%, refer PDS for more details. Fee waived until 31/3/2019

### Hedging

Any foreign currency exposures are hedged to NZD within an operational range of 98.5% to 101.5%

### Buy / Sell spread

0.00% / 0.00%

### Strategy size

\$77.6m

### Strategy Launch

October 2007

## Compliance

The Fund complied with its investment mandate and trust deed during the month.

## Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com

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