

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 10-year US Treasury bond interest rates moved lower over the month, starting June at 2.13% reaching 2.18% before closing the month at 2.01%.
- The Federal Reserve Chairman Powell said the downside risks to the US economy have increased recently, reinforcing the case for lower rates.
- Equities in the US initially increased after Powell's comment and the yield on 10-year Treasury bonds fell under 2%.

Fund Highlights

- The fund lost value over June. Interest rates continued to fall as financial markets priced in rate cuts from the Federal Reserve over 2019. While any rate cuts occurring are still data dependent it seems likely the Fed will deliver lower rates to help support the economy. The fall in rates meant that a number of the fund's sold call options were struck resulting in a loss.
- The investment strategy of investing in NZ bank bonds and selling short term option contracts on 10-year US Treasury bonds remains unchanged.
- As a result of increased volatility in financial markets we have seen a sharp rise in the income the fund receives from selling short dated options on US Treasury Bonds.

Performance

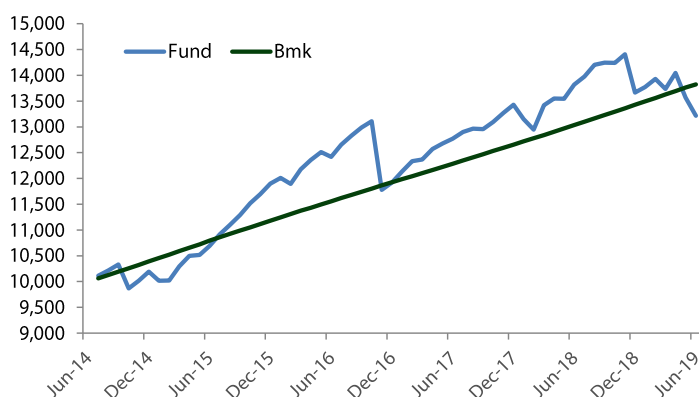
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-2.60%	-3.79%	-4.36%	2.09%	5.73%	8.57%
Benchmark ²	0.47%	1.46%	6.07%	6.16%	6.69%	6.85%
Retail ³	-4.27%	-2.66%	-4.95%			
KiwiSaver ³	-4.25%	-2.43%	-3.84%			

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, \$10,000 invested^{1, 2}



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 a higher income.

Objective

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

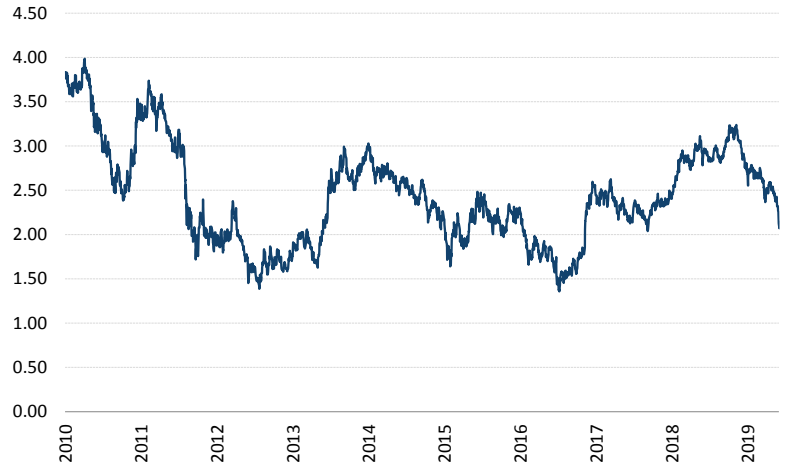
Market Commentary

Federal Reserve (Fed) Chairman Jerome Powell said the downside risks to the US economy have increased, reinforcing the case amongst policy makers for somewhat lower rates.

Cross-currents have re-emerged, with apparent progress on trade turning to greater uncertainty with incoming data raising concerns about the strength of the global economy. US companies seem to have recently become more concerned about the impact of trade tensions on their businesses and this is impacting the pace of business investment.

Inflation continues to be muted, the Fed seems to be of the view that lower rates would support economic activity, which would help to raise inflation and inflation expectations. The Fed has failed to convincingly hit its 2% inflation objective since 2012. In addition to this, inflation expectations have fallen and recently the Fed downgraded their forecast of price rises for 2019 to 1.5% from 1.8% in March. Meanwhile, the US economy is showing signs of slowing after a stronger than expected first quarter. Sales of new homes fell to a five month low in May while consumer confidence dropped in June to its lowest levels since September 2017. On the positive side unemployment remains near record lows. The US 10-year bond yield traded in a 21 basis point range over the month, moving between a high of 2.18% and a low of 1.97% before closing the month at 2.01%. The trading range is smaller than we have seen over recent months however follows on from steady falls in the yield on US Treasury bonds. US 10-year Treasury bonds have fallen from a high point of 3.25% in November last year to below 2% in June 2019.

US 10-Year Treasury Yield



Fund Commentary

The fund lost value over June. Interest rates continued to fall as financial markets priced in rate cuts from the Federal Reserve over 2019. While any rate cuts occurring are still data dependent it seems likely the Fed will deliver lower rates to help support the economy. The fall in rates meant that a number of the fund's sold call options were struck resulting in a loss.

With short term interest rates more likely to fall than rise the extent of any increase in longer term rates is also diminished. 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.

Income levels generated from selling options has increased as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets.

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 (incl GST)

Wholesale: negotiated outside of unit price
Retail: 1.22%, refer PDS for more details
KiwiSaver: 1.17%, refer PDS for more details. Fee waived until 30/9/2019

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

\$77.5m

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

This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme. This information is for the use of researchers, financial advisers and wholesale clients. 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 document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party. For full details on the fund, please refer to our Product Disclosure Statement on nikkoam.co.nz