

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

- The US Federal Reserve cut interest rates for the first time in more than a decade in July.
- US 10-year Treasury bond interest rates were stable over the month - trading in a 19 basis point range, opening and closing the month at 2.01%.
- Federal Reserve Chairman Powell said downside risks to the US economy have increased, reinforcing the case for lower rates and that the overarching goal is to sustain the US economic expansion.

Fund Highlights

- The fund returned 2.84% for the month. Interest rates moved in a modest range after recent large falls as financial markets continued to price in rate cuts from the Federal Reserve.
- 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 market we have seen the rise in the income the fund receives from sell short dated options on US Treasury Bonds being maintained.

Performance

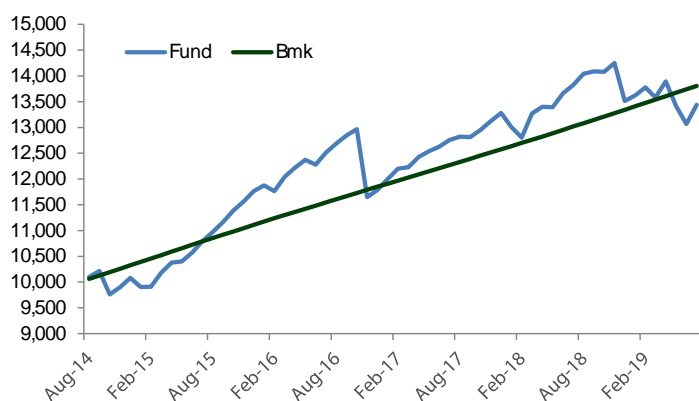
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale1	2.84%	-3.27%	-2.79%	2.40%	6.09%	8.28%
Benchmark2	0.48%	1.46%	6.04%	6.14%	6.66%	6.84%
Retail3	2.18%	-3.45%	-3.91%			
KiwiSaver3	2.30%	-3.22%	-2.77%			

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.

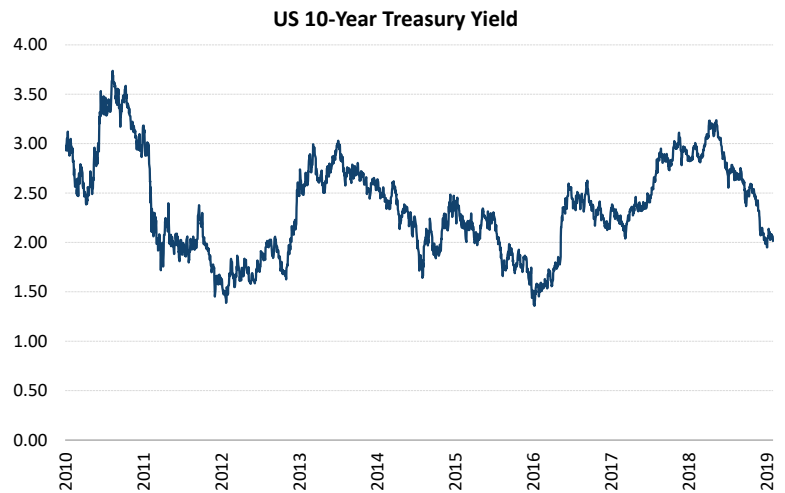
Objective

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 likes to tell reporters that the Fed has one over-arching goal: to sustain the economic expansion. The focus at present is the improvement in the jobs market which in the Fed’s view has started to reach communities at the edge of the workforce. Powell is recently reported as saying “It’s just so important for us to continue that process for a couple of years”

That means keeping the economy growing at or ideally above its long run cruising speed of about 2%, and running a strong labour market by holding unemployment down at levels many economists think is unsustainable. Cutting rates is one thing the Fed can do to help achieve its goals and help the people who have been left behind in the economic expansion. The Fed started down this track by cutting short term rates for the first time in more than a decade by 0.25%. This move disappointed some, including President Trump, who were looking for deeper cuts, but may not be the last cut in this easing cycle. Trade tensions between the US and China do not look like reducing in the short term and will remain a source of uncertainty in global trade and growth outlooks. Lower interest rates looks like the path of least resistance.



Fund Commentary

The fund returned 2.84% for the month. Interest rates moved in a modest range after recent large falls as financial markets continue to price in rate cuts from the Federal Reserve. While additional rate cuts are still data dependent it seems likely the Fed will deliver further rate cuts to help support the economy.

The US 10-year bond yield traded in a 19 basis point range over the month, moving between a high of 2.14% and a low of 1.95% 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 2.0% in July 2019. Income levels generated from selling options has increased as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets. If volatility remains elevated for an extended period the income generating potential of the fund looks attractive.

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

\$80.55m

Strategy Launch

October 2007

Compliance

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

Contact Us

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