

Factsheet 30 September 2019

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund. The Nikko AM Option Fund (retail) and Nikko AM KiwiSaver Option Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- The interest rate on US 10-year Treasury bonds remained volatile impacted by the possibility of partial resolution of the US - China trade impasse.
- US 10-year bonds traded at 1.43% over the month, close to the GFC low of 1.37% before closing the month at 1.67%.
- The Fed's overarching goal of sustaining the US economic expansion remains intact, they may cut rates further but not by too much as the US economy remains strong relative to the rest of the world.

Fund Highlights

- The Fund gained 3% over the month however the past year has been a difficult one for the fund.
- 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 rise in income the Fund receives from sell short dated options on US Treasury Bonds. We are hopeful this increase will be maintained and leads to the fund generating higher than average returns over the months ahead.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	3.48%	-6.78%	-13.54%	-1.75%	3.58%	6.75%
Benchmark ²	0.43%	1.40%	5.96%	6.09%	6.58%	6.82%
Retail ³	2.87%	-7.72%	-14.68%			
KiwiSaver ³	3.03%	-7.44%	-13.68%			

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)

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

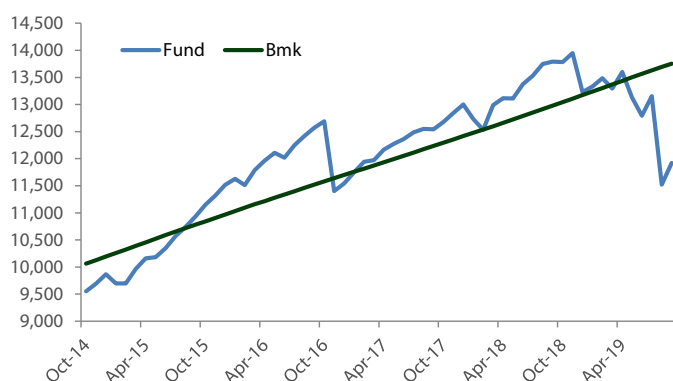
The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every \$1 in the fund, up to \$6 of call options and \$6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry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

Five Year Cumulative Performance, \$10,000 invested^{1&2}

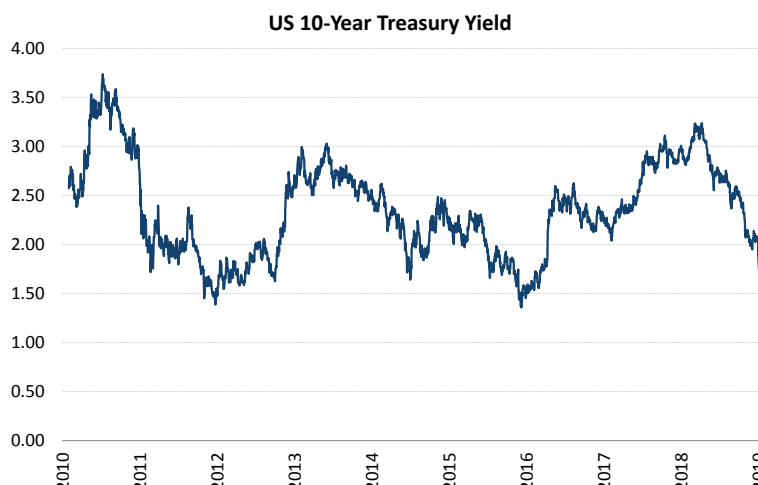


Market Commentary

Federal Reserve policy makers lowered interest rates for a second time this year with Chairman Jerome Powell saying that moderate policy moves should be sufficient to sustain the US economic expansion. 'We took this step to help keep the US economy strong in the face of some notable developments and to provide insurance against ongoing risks' Powell was recorded as saying after the Fed cut its benchmark rate by 0.25% to a range of 1.75% to 2.00%. Treasury bond yields increased on the news as Powell made it clear that policy makers did not expect to need a series of deep rate cuts.

The door has been left open for a more extensive sequence of cuts if the economy takes a turn for the worse and more stimulus is needed however officials stressed that this was not their expected outcome. Fed officials reconfirmed to act as appropriate to sustain the economic expansion.

Global growth has been hit by uncertainty over US trade policy, fanning fears of a global recession. The US is not immune from these fears and the uncertain outlook is keeping US rates under downward pressure.



Fund Commentary

The Fund gained 3.48% over the month however the past year has been a difficult one for the fund. Ten year US Treasury bond rates fell close to their Global Financial Crisis low points as investors fretted about lower economic growth and trade issues. While additional rate cuts to short term rates 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 47 basis point range over the month, moving between a high of 1.9% and a low of 1.43% before closing the month at 1.65%. The large fall in rates we have seen over the past year may have come to an end, at least for the time being. The fall has been significant with US 10 year Treasury bonds falling from a high point of 3.25% in November last year to a low of 1.43% in September 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 but as mentioned above the frequency and cost of options being struck will also determine the total return of the fund. 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 (incl GST)

Wholesale: negotiated outside of unit price
Retail: 1.22%, refer PDS for more details
KiwiSaver: 1.17%, refer PDS for more details.

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

\$76.24m

Strategy Launch

October 2007

Compliance

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

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