

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

- Interest rates on US 10-year Treasury bonds were volatile over the month but less so than previous months. Rates remain low as investors continue to fret about lower economic growth and trade issues.
- US 10-year bonds traded in a 36 basis point band, ranging between a high point of 1.86% and a low of 1.5% before closing the month at 1.69%.
- The Fed cut short term rates again and began debating how deep this cycle of interest rate cuts should be.

Fund Highlights

- 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 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 | 2.40% | -7.18% | -11.43% | -1.28% | 5.03% | 6.64% |
| Benchmark ² | 0.43% | 1.34% | 5.89% | 6.05% | 6.54% | 6.80% |
| Retail ³ | 1.80% | -8.06% | -13.01% | | | |
| KiwiSaver ³ | 1.81% | -7.88% | -12.09% | | | |

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

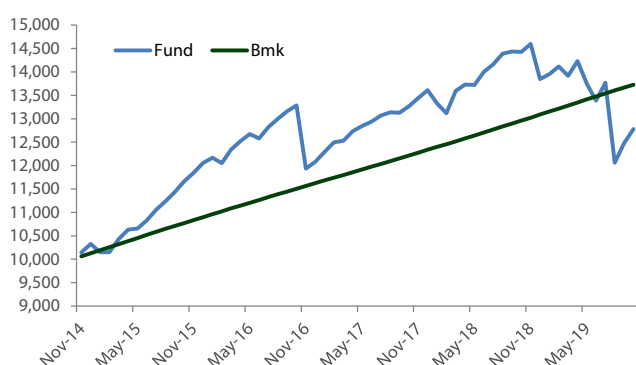
The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every \$1 in the fund, up to \$6 of call options and \$6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry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

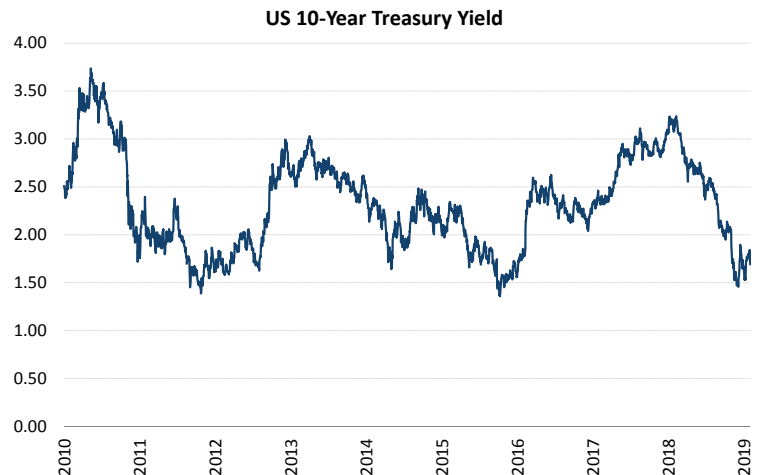
The US Federal Reserve cut rates again in October but removed a line from their post-meeting statement that had previously said they would “act as appropriate” to sustain the US economic expansion, signalling they are probably happy with their actions to date and don’t envisage further easing for now.

In his press conference, Fed Chairman Jerome Powell elaborated on the decision and cited improvement in the balance of risks to the economic outlook, in particular improvements in the outlook for the US-China trade war and the Brexit negotiations. Even if the Fed has finished easing for now Powell stressed they are nowhere near contemplating rate hikes again suggesting the Fed would need to see rising and persistent inflation before considering raising rates. Investors latched on to those remarks, sending equities higher and long term interest rates lower.

With the latest cut under their belts Powell said he said he thinks monetary policy is “somewhat accommodative” which helps explain why Fed officials see themselves in a holding pattern for the foreseeable future. Accommodative monetary paired with improving global risks would suggest their job is done for the time being.

US 10-year bonds traded in a 36 basis point band, ranging between a high point of 1.86% and a low of 1.5% before closing the month at 1.69%. This trading range is smaller than we have seen in recent months, it seems longer term interest rates are finding a floor as investors become more optimistic that the start of a resolution to the US/China trade is close or at least not escalating further.

As mentioned in previous commentaries, with short term interest rates now stable, it is likely the extent of any sustained increase in longer term rates is 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.



Fund Commentary

The fund returned 2.40% over the month. 10-year US Treasury bond rates remain low as investors continue to fret about low economic growth, low levels of inflation and unhelpful global trade tensions. The fall in US rates 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 before increasing somewhat to current levels.

Income levels generated from selling options has increased over recent months 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 the frequency and cost of options being struck will also determine the total return of the fund.

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

\$77.44m

Strategy Launch

October 2007

Compliance

The wholesale 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 retail and KiwiSaver funds, please refer to the relevant Product Disclosure Statement on nikkoam.co.nz.