

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

- Volatility of the US 10-year bond declined from its recent highs, financial markets remained relatively stable through the latter half of November.
- With the US Federal Reserve indicating they are on hold and will be taking their direction from future developments it seems likely that the US 10-year bond could remain more constrained inside its recent trading range of 1.50 to 2% into year-end.

Fund Highlights

- The Fund had another strong monthly return as the US 10-year bond remained in a moderate range and no options were exercised during the month.
- Volatility has declined from its recent highs, but the income the fund receives from selling short dated options still remains supportive of generating good returns.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	1.19%	7.22%	-11.43%	2.71%	4.97%	6.42%
Benchmark ²	0.42%	1.28%	5.82%	6.02%	6.49%	6.79%
Retail ³	1.69%	6.49%	-12.50%			
KiwiSaver ³	1.70%	6.68%	-11.64%			

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

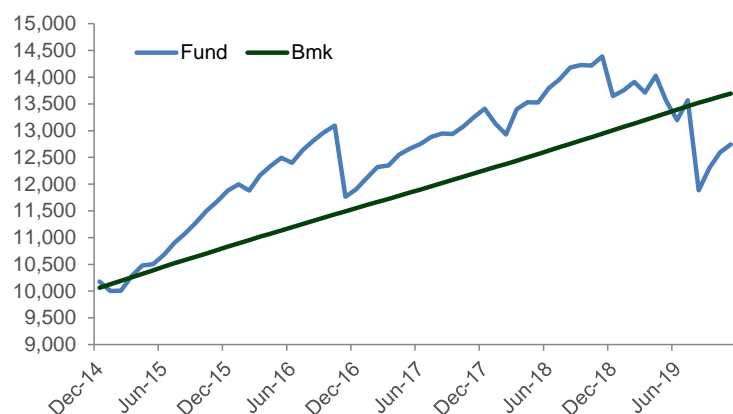
The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every \$1 in the fund, up to \$6 of call options and \$6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry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

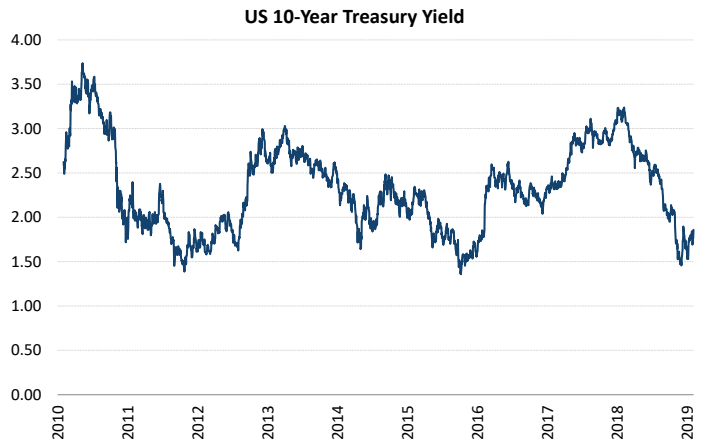
Five Year Cumulative Performance, \$10,000 invested^{1&2}



Market Commentary

The Option fund performed well over the month as the volatility of the US 10 year bond declined from its recent highs and financial markets remained relatively stable through the latter half of November. The US 10 year bond traded in a more constrained 25 basis point band, ranging between a high point of 1.94% and a low of 1.69% before closing the month at 1.78%. With the US Federal Reserve indicating they are on hold and will be taking their direction from future developments it seems likely that the US 10 year bond could remain more constrained inside its recent trading range of 1.50 to 2% into year-end. At the last rate cut in October Powell said he thinks monetary policy is “somewhat accommodative” which helps explain why Fed officials see themselves as in a holding pattern for the foreseeable future. Even if the Fed is 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 again. A more moderate trading range in the US 10 year bond should be supportive of returns for the Option fund while income levels for selling the options still remain higher than the average level received over the past year.

Over the past couple of months market sentiment has improved on the hope that US/China trade relations are thawing, however we remain mindful that it is unlikely in the near term that we will see a comprehensive agreement that results in a complete roll back of tariffs and a sustained improvement in US/China relations. Risk still remains that there may be some market disappointment. While uncertainty remains we expect that the pricing competition will remain robust between the buyers of the options we sell, and the income received should remain at a reasonable level supporting returns.



Fund Commentary

The Fund has produced quite strong returns over the past 3 months and option income levels have been good, however the past year has been a difficult one for the fund following a poor month in August when there were large moves in the US 10-year bond. The one year range 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 to current levels, around 1.78%.

Income levels generated from selling options has increased and remains above its medium term average 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, 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 (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

\$78.58m

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.