

Factsheet 31 January 2020

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 the US 10-year Treasury bond fell over the month.
- US 10-year bonds traded in a 43 basis point band, ranging between a high point of 1.94% before closing at the monthly low of 1.51%.
- While the Fed remains on hold, markets are focused on the economic and financial market impact of the Coronavirus.

Fund Highlights

- The fund posted a negative return over the month as bond yields dropped significantly as the implications of the Coronavirus became more apparent.
- The lasting impact the Coronavirus will have on economic activity is unknown and this uncertainty is reflected in lower global interest rates and share markets.
- Volatility has increased from its recent lows and we are seeing a corresponding increase in the level of income the fund receives from selling short dated options.

Performance

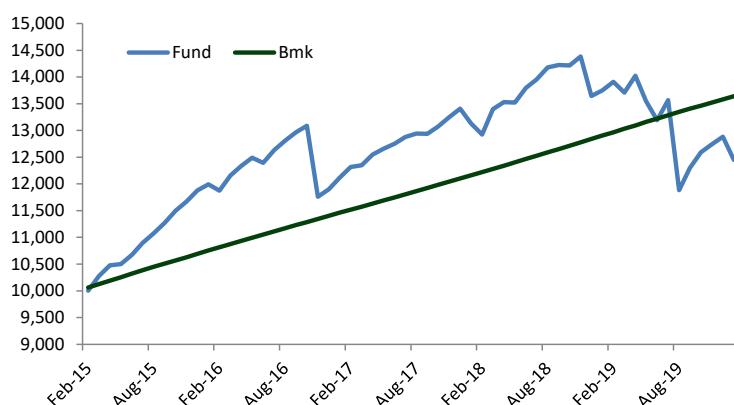
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale ¹	-3.37%	-1.14%	-9.46%	0.91%	4.48%	5.86%
Benchmark ²	0.44%	1.30%	5.69%	5.97%	6.40%	6.76%
Retail ³	-2.54%	-0.11%	-10.24%			
KiwiSaver ³	-2.56%	-0.10%	-9.56%			

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

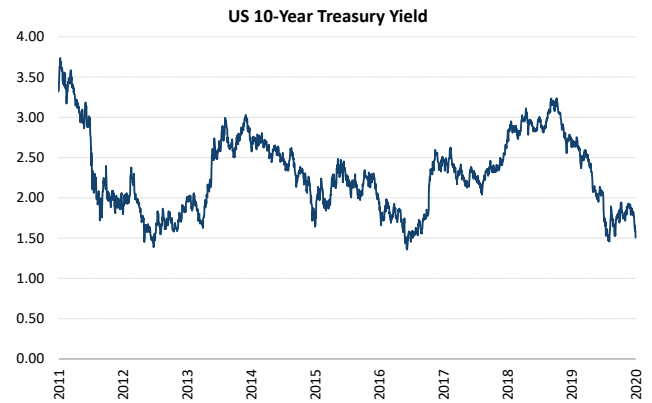
The fund aims to earn a return of the benchmark before fees, expenses and taxes over a rolling three year period.

Market Commentary

A ‘flight to safety’ saw significant falls in global bond yield with the US 10-year bonds falling from a high point of 1.94% before closing at the monthly low of 1.51%. The lasting impact the Coronavirus will have on economic activity is unknown and this uncertainty is reflected in lower global interest rates and share markets. Markets are already pricing in a fall in economic growth mainly resulting from lower service sector activity and also from lower trade and tourism numbers, however this pricing could be reversed if the worst fears of the spread of the virus do not materialise.

Federal Reserve Chairman Jerome Powell commented that the outbreak of the Coronavirus will likely hit the Chinese economy and could spill wider, but it was too early to judge what impact it would have on the US.

Against the backdrop of the widening virus crisis the Fed kept its key interest rate unchanged and continued to signal monetary policy would stay on hold for the time being while also stressing the need for US inflation to reach 2%. Officials kept the target range of the benchmark federal funds rate at 1.5% to 1.75% and called the stance appropriate to support sustained expansion of economic activity. The market is currently pricing in that the Fed will need to cut at least once in 2020 especially if the Coronavirus takes hold outside of China. The stable to lower outlook for short term interest rates is likely to limit any sustained movement in longer term interest rates. If current levels of volatility are maintained, income generated by the fund should remain at satisfactory levels. 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 posted a negative return over the month as bond yields dropped significantly as the implications of the Coronavirus became more apparent. Bond yields traded through a number of call option strikes and volatility increased. Income levels generated from selling options increased over the past month and year. It 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 but as mentioned above 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

\$77.9m

Strategy Launch

October 2007

Compliance

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

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