

# 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 significantly for a second month in a row.
- US 10-year bonds traded in a 53 basis point band, ranging between a high point of 1.68% before closing the month at the low point of 1.15%.
- 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 corona virus 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

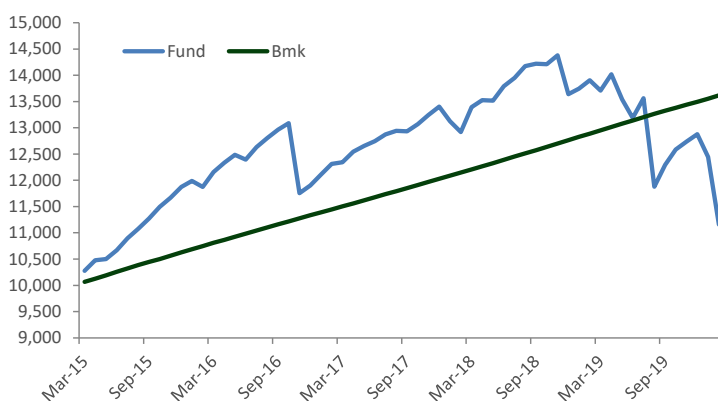
	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	-10.35%	-12.42%	-19.77%	-3.23%	2.21%	4.52%
Benchmark <sup>2</sup>	0.45%	1.33%	5.65%	5.95%	6.37%	6.75%
Retail <sup>3</sup>	-5.50%	-7.17%	-15.69%			
KiwiSaver <sup>3</sup>	-5.49%	-7.16%	-15.11%			

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<sup>1&2</sup>



## 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

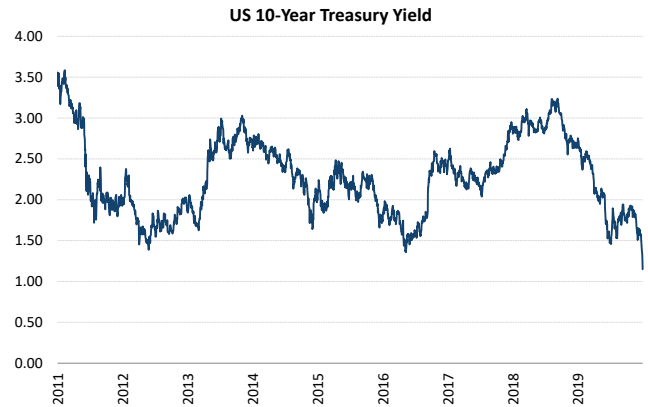
A ‘flight to safety’ saw significant falls in global bond yield with the US 10-year bonds falling from a high point of 1.68% before closing at the monthly low of 1.15%.

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 pricing in a fall in economic growth mainly resulting from lower service sector activity, lower trade and tourism numbers and dislocation of manufacturing supply chains.

The Federal Reserve has pointed to evolving risks facing the US economy and the central bank’s readiness to deploy tools and act as appropriate to support the economy. To be most effective and bolster confidence any central bank response should be globally co-ordinated.

It has to be said though that countering a sudden economic stoppage such as the one caused by the coronavirus is a lot harder for central banks than resolving a financial sudden stop.

To turn the corner, the global economy needs evidence of success in containing the spread of the virus and success in illness recovery and avoidance, best done via the creation of a new vaccine. As for financial markets, expect to see significant price and liquidity swings as investors digest the deepening economic and corporate damage on the one hand and central bank liquidity injections, and policy and health announcements on the other.



## 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. The large fall in 10-year US Treasury bond yield pushed the fund returns into negative territory over the month as 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. We expect income levels and volatility to be elevated in the months ahead. The speed and magnitude of yield changes in the US 10-year Treasury bond combined with the income received from selling options determines the total return of the Fund.

If volatility remains elevated for an extended period the income generating potential of the fund looks attractive however the frequency and cost of options being struck also determine the total return of the fund. Unfortunately, in recent times, the cost of options being struck has exceeded the income generated by 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

\$74.5m

#### Strategy Launch

October 2007

## Compliance

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

## Contact Us

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