Factsheet 30 April 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

- Interest rates on US 10-year Treasury bonds traded in a more modest range than we have seen in recent months as the initial reaction to the economic shock caused by COVID-19 subsided. Within the month yields hit a high of 0.78% and a low of 0.54%. The historical low point in 10-year Treasury bonds was recorded last month when bonds traded at a yield of 0.31%.
- Markets continue to be focused on the economic and financial market impact of COVID-19. The impacts have been greater than anticipated, as has the governmental and central bank response.

Fund Highlights

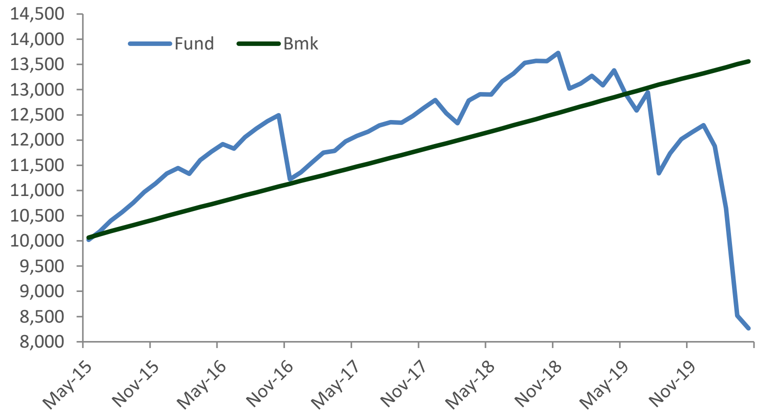
- The fund stabilised over April after a number of difficult months.
- The precise impact COVID-19 will have on economic activity is unknown, what we do know at this stage is the impact will be large and unfavourable.
- Volatility and uncertainty has increased and we are seeing a corresponding increase 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]	-2.96%	-30.41%	-38.24%	-11.62%	-3.74%	1.55%
Benchmark[2]	0.39%	1.31%	5.53%	5.91%	6.28%	6.72%
Retail[3]	1.91%	-34.59%	-42.01%			
KiwiSaver[3]	3.16%	-31.28%	-38.80%			

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

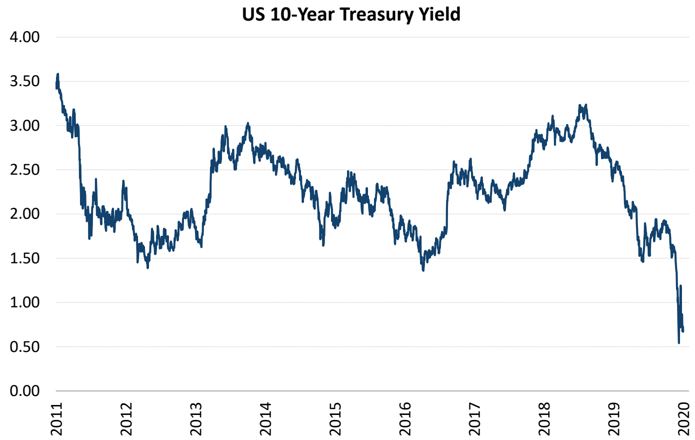
The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every $1 in the fund, up to $6 of call options and $6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry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



Bond yields dropped to record lows in March but financial markets have since been calmed by significant central bank and governmental support.

As the economic significance of closing international boarders, quarantining and social distancing became more apparent we saw a 'flight to safety' and large scale bond buying by risk-adverse investors and central banks.

After trading as high as 1.94% in January 2020, yields plummeted to an intraday low of 0.31% on the 9th of March. Even in the depths of the GFC bond yields didn't fall to this extent with the previous low point being close to 1.3%, however the excitement wasn't over with just yet. Within a matter of days yields climbed back to 1.27% as the prospect of large scale bond issuance from most governments around the global weighed heavily on investor's minds. Large government stimulus packages will need to be funded and the first port of call is to issue more bonds. The question of who would buy all these new bond was answered when central banks embarked on a range of new Quantitative Easing programmes which include large scale bond purchase schemes.

Investor nerves were soothed by the large step up in Quantitative Easing programmes around the globe resulting in less volatile and stressed markets over April.

Federal Reserve Chairman Jerome Powell said the coronavirus has brought the economy to an abrupt halt and it was uncertain how long the slowdown would last. The Fed held rates near zero and has pledged to keep them there until the nation was back on track. He went on to say that the economy may need more support from all of us if the recovery is to be a robust one. He emphasised several times the importance of fiscal policy to help what central banks are doing and highlighted the plight of those who are losing their jobs. Recent US labour data indicated a jobless rate of 22%, this is the worst since the Great Depression and more than twice the 10% peak seen in 2009. With the labour market hurting this badly it is difficult to see a time when the Fed will start to reverse their low interest rate stance.

Fund Commentary

The fund stabilised over April after a number of difficult months. With volatility reducing from the extreme levels seen in prior months the fund returned to a more normal level of return.

The precise impact COVID-19 will have on economic activity is unknown, what we do know at this stage is the impact will be large and unfavourable. Even though governments and central banks are providing unprecedented levels of stimulus and support it is unlikely economic activity will return to pre-virus levels quickly. In this environment interest rates are expected to stay low.

Income levels generated from selling options has increased over the past few months .The income earning capacity of the fund remains well above its medium term average as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets. This elevated income will over time help restore the value 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 will also determine the total return.

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	Strategy size	Strategy Launch
0.00% / 0.00%	$55.2m	October 2007

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

Contact Us
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