

Factsheet 30 April 2023

# NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund.

## Market Overview

- US 10-year Treasury bond yields continued to trade in a volatile fashion over April however yields on 10 year US Treasury bonds ended the month at similar levels to the beginning.
- Restrictive monetary policy should keep 10 year US Treasury yields high however the Fed has reduced the size of hikes to mitigate downside risks to the economy, they may now have reached the end of their tightening cycle. The problem for the Fed is that inflation is still high and not falling quickly.
- Complicating the outlook for interest rates is the turmoil in the US regional banking sector, with casualties continuing to mount.

## Fund Highlights

- The fund delivered a strong return over April. Bond yields reached a high of 3.64% over the month and traded at a low point of 3.25% before closing April at 3.42%
- Even though bond yields moved through a 39 basis point range, bond yields closed the month at similar levels as the start.
- Income and volatility levels remained at high levels as central bank policy settings, data releases and banking sector risks kept markets on edge.
- The option exposure in the portfolio has reduced.

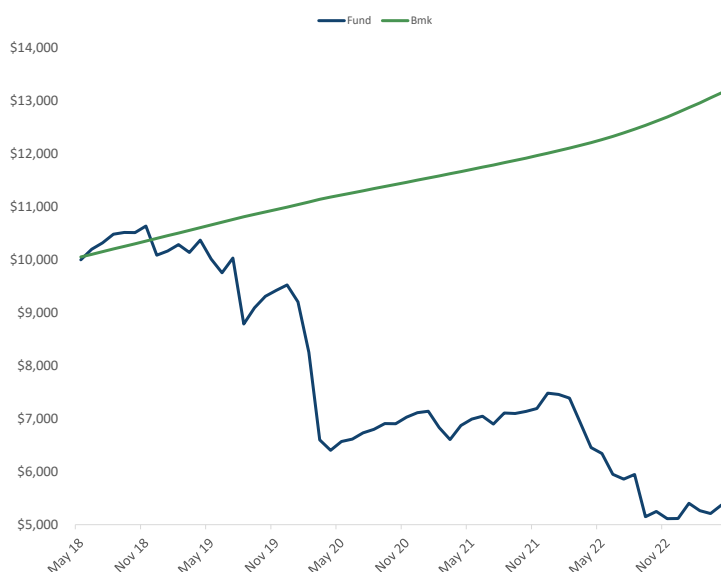
## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale <sup>1</sup>	3.09%	-0.64%	-16.81%	-5.70%	-11.70%	-2.07%
Benchmark <sup>2</sup>	0.73%	2.16%	7.71%	5.55%	5.62%	6.22%

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.

## 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

The Federal Reserve is dropping hints that the end of the interest rate cycle may be nearing even though it wants to maintain some wiggle-room in case inflation stops slowing. The Fed raised rates by 0.25% at their latest meeting and suggested it may be the final move in the most aggressive tightening campaign since the 1980s as economic risks mount. Significantly, they are no longer saying “we anticipate further increase” however they will continue to be driven by incoming data.

The increase lifted the Federal fund’s rate to a target range of 5% to 5.25%, from nearly zero early last year. Whether that rate will prove high enough to bring inflation back to the Fed’s 2% target will continue to be monitored however the Fed officials’ outlook for inflation does not support interest rate cuts. So, the Fed expects to keep rates at restrictive levels for some time yet.

Policy makers resolve to ensure inflation continues to decelerate even if this is at the cost of rising unemployment and creating a degree of stress in the banking system. Tighter credit conditions for households and business are likely to weigh on economic activity however the Fed remains hopeful the US avoids a recession or if one occurs that it is mild. Officials noted that wage increases have been moving down and job openings have declined but have not been accompanied by rising unemployment as yet, however rising unemployment is likely as the year progresses.



### Fund Commentary

The fund delivered a strong return over April. US 10-year US bond yields reached a high of 3.64% over the month and traded to a low point of 3.25% before closing April at 3.42%. Even though bond yields moved through a 39 basis point range, bond yields closed the month at similar levels as the start.

Income and volatility levels remained at high levels as central bank policy settings, data releases and banking sector risks kept markets on edge however the market predominately traded within the option fund ranges and the incidence of option being struck was low. The option exposure in the portfolio has reduced as the fund nears its closing date.

Key Fund Facts			
<b>Distributions</b>	<b>Estimated annual fund charges (incl. GST)</b>		
<b>Hedging</b>	<b>Buy / Sell spread</b>	<b>Strategy size</b>	<b>Strategy Launch</b>
Any foreign currency exposures are hedged to NZD within an operational range of 98.5% to 101.5%	0.00% / 0.00%	\$30.5m	October 2007

### Compliance

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

### Contact Us

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