

## Nikko AM Wholesale Option Fund

### Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM).

Nikko AM is Asia's premier global asset manager. In New Zealand we actively manage NZ\$4 billion of investments for a diverse group of clients, including superannuation schemes, charitable trusts, KiwiSaver scheme providers, corporations and local government along with providing services to financial intermediaries through wrap platforms.

We offer investment management services in domestic sectors (equities, fixed interest and cash) through our Auckland-based investment team and employ offshore managers to manage global sectors (global equities, global bonds and alternative investments).

### Fund launch

April 2007. A similar portfolio has been operated by Nikko AM since September 2003.

### Investment objective

A gross return of S&P/NZX Bank Bills 90-Day Index plus 4.0% per annum over a rolling three year period.

### Investment process

The Fund invests into cash deposits and bank bills with highly rated financial institutions. The assets are then used as collateral security for derivatives, in particular, selling options on long-term NZ, US, UK, Euro bloc or Australian government stock.

Most options are written for one month and provide the institutional purchaser with a payout if interest rates move by more than a prescribed margin in one particular direction. The Fund earns a premium for writing (selling) the options. The Fund will write options on government bonds with maturities between 5 and 15 years.

### Structure and taxation

The Fund vehicle is a Unit Trust and Portfolio Investment Entity (PIE) which is priced daily. Unit holders elect their own Portfolio Investor Rate. Information is provided to the IRD and unit holders on an annual basis.

### Distributions

At any date for any period fixed by the Manager

### Hedging policy

Assets and liabilities hedged to NZD at the discretion of the Manager. Hedging is based on the gross asset value of the Fund.

### Management fees and other charges

Investment management fees and performance fees will be negotiated separately with each investor and invoiced outside the Fund.

All Fund statutory and operating costs will be met directly by the Manager.

**Performance fee:** Any return in excess of NZ 90-day bank bill rate plus 4.0% per annum will be subject to a fee of 15% of excess payable to the manager on an annual basis. The Fund will not operate a high watermark approach. The performance fee is not in the unit price of the Fund - any performance fee will be negotiated separately with each investor and invoiced outside the Fund.

### Buy/sell spread

Nil

### Trustee

Public Trust

### Custodian

Public Trust as legal custodian, BNP Paribas Fund Services Australasia Pty Limited delegated as functional custodian.

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#### Selected investors only

Participation in the Fund is limited to persons or entities who are New Zealand resident, and:

(a) whose principal business is the investment of money; or

(b) who, in the ordinary course of and for the purposes of their business, habitually invest money;

and, consequently (or for other reasons) do not constitute "the public" for the purposes of the Securities Act 1978 (**Exempt Person**). Nikko AM will not therefore be required to produce a registered prospectus or an investment statement in relation to the proposed investment (such documents otherwise being required were this offer to be made to persons or entities that are not Exempt Persons), and such documents will not be produced accordingly. Investors in the Fund will be required to acknowledge their status as an Exempt Person as part of their subscription in the Fund. Investors in the Fund will also be required to undertake to Nikko AM that any transfers of interests in the Fund will only be to Exempt Persons.

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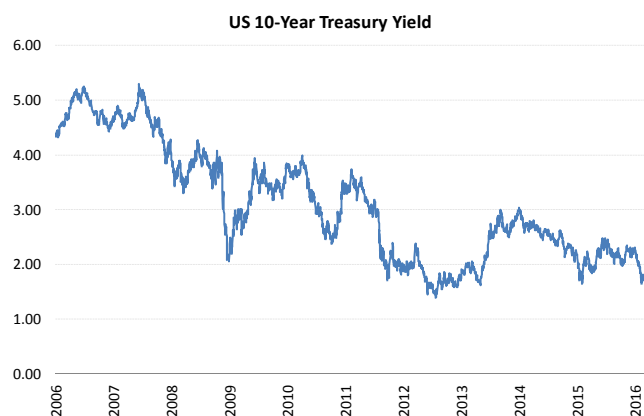
Performance (NZD gross returns)

	Fund %	Investment Objective %	Excess %
1 month	-0.96	0.57	-1.53
<b>3 months</b>	<b>1.72</b>	<b>1.74</b>	<b>-0.02</b>
6 months	7.21	3.51	3.70
<b>1 year</b>	<b>18.72</b>	<b>7.49</b>	<b>11.23</b>
2 years (pa)	11.55	7.60	3.95
<b>3 years (pa)</b>	<b>11.00</b>	<b>7.35</b>	<b>3.64</b>
5 years (pa)	8.85	7.18	1.67

Fund size

\$ 180 million

Commentary



The Nikko AM Wholesale Option Fund had a disappointing month, declining 0.96% in February. Yields on 10-year US Treasury Bonds have fallen significantly since the beginning of 2016 resulting in a number of the Fund's call options being exercised and subsequent losses being absorbed by the Fund. Yields fell from a high of 2.32% early in January to an intra-day low of 1.53% on 12 February.

Bond markets were well supported by expectations of further central bank easing. The Bank of Japan (BoJ) surprised markets by introducing a negative interest rate policy at the end of January and consequently Japan's 10-year rate went into negative territory. The 10-year JGB rate ended February at -0.06% helped by the BoJ's easing actions. As the implications of the world's third largest economy introducing negative rates were digested, a 'risk off' tone was adopted that saw equity markets plunge with the MSCI World Index down 7.5% in early February.

The ECB's President Dragi added to the 'bond rally' by indicating further stimulus would be forthcoming in Europe if it was required. This drove German yields lower, with their 10-year rate down 22 basis points over February to yield just 0.11%.

These global influences help explain why US 10-year Treasury yields ended lower at the end of February. With European bond rates heading towards new lows and Japanese rates negative, US rates remain relatively attractive, even when well below 2%. This led to the US bond market being well bid over the month despite stronger than expected US economic activity and inflation data. The US unemployment rate fell to 4.9%, while wage and price inflation data showed that inflationary pressures are increasing. Counteracting the impact of this stronger than expected data is investors continue to believe the US Federal Reserve will be cautious in terms of further monetary tightening over 2016.

Even though the Fund produced a negative return over February, we believe the environment remains sound for the Option Fund to generate acceptable returns over the months ahead.

Compliance

The Fund complied with its investment mandate during the month.