

Nikko AM Wholesale Option Fund

Fund manager

Nikko Asset Management New Zealand Limited (Nikko AM NZ).

In New Zealand we actively manage around NZ\$5 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

To invest the portfolio in the authorised investments such that the portfolio earns a gross return of Bloomberg NZBond Bank Bill Index plus 4.0% per annum over a rolling three year period before fees.

Benchmark

Bloomberg NZBond Bank Bill Index plus 4.0% per annum (from 1 July 2016)

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

The Fund vehicle is a Portfolio Investment Entity (PIE) which is priced daily. Investors elect their own Portfolio Investor Rate. Information is provided to the IR and investors on an annual basis.

Distributions

Generally does not distribute but may do so at Nikko AM NZ's discretion.

Currency management

All premium income is converted into NZD upon receipt and any currency margin deposits are hedged to NZD within an operational range of 98.5% to 101.5%.

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: 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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Performance (NZD gross returns)

	Fund	Benchmark*	Excess
1 month	1.39%	0.53%	0.86%
3 months	2.57%	1.62%	0.95%
6 months	7.87%	3.29%	4.58%
1 year	15.65%	6.91%	8.74%
2 years (pa)	12.07%	7.39%	4.68%
3 years (pa)	12.84%	7.32%	5.52%
5 years (pa)	15.09%	7.15%	7.94%
10 years (pa)	11.14%	8.50%	2.64%

* S&P/NZX Bank Bills 90 Day Index plus 4.0% per annum prior to 1 July 2016

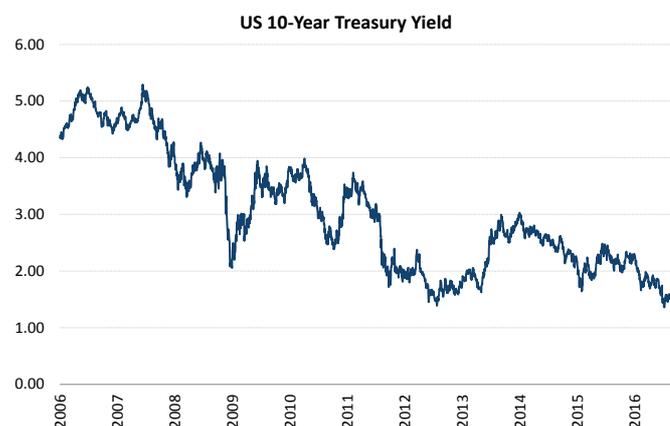
Fund size

NZ\$186 million

Compliance

The Fund complied with its investment mandate during the month.

Commentary



The Nikko AM Wholesale Option Fund performed well over August, gaining 1.39%. This return compares favourably to the return generated from cash and bond markets as the low nominal yields on fixed income assets begins to constrict returns from these sectors. Income generated by the Option Fund by writing options on US Treasury bonds is not significantly impacted by low bond yields and we anticipate Fund returns will continue to outperform more traditional fixed income investment strategies over the year ahead.

US 10 year bonds traded in a narrow 18 basis point range over the month. Bond yields started the month at 1.47% and closed at 1.58%. The intra month low was 1.45% and the high point was 1.63%. Due to the narrow trading range, bond yields stayed within the option bands established by the Fund and resulted in an acceptable month of performance. A low level of volatility in markets at present has led to option premium income being lower than average but still high enough to generate an attractive level of return.

The Federal Reserve seems to be inching closer to their second rate rise, the first seeming an age ago in December 2015. A September hike is possible, however, a December 2016 move seems most likely to us as this will be after the November Presidential election. The US economy is steadily improving and we believe the Fed needs to protect their credibility by raising rates soon. While a move in rates in 2016 is probable, the Fed will be careful not to unsettle markets and therefore forward guidance on future moves is likely to indicate only a modest and slow increase.

The yield movement on longer dated Treasury bonds is likely to be muted even if short term rates rise as investors' global search for yield will ensure the demand for relatively high yielding US bonds remains strong.

We continue to believe this environment remains favourable for the Option Fund, especially when viewed in the context of a modest return outlook from other sectors of financial markets.