

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 Prescribed 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.

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	0.95%	0.52%	0.43%
3 months	3.61%	1.58%	2.03%
6 months	6.10%	3.24%	2.86%
1 year	13.85%	6.82%	7.03%
2 years (pa)	15.26%	7.26%	7.99%
3 years (pa)	12.56%	7.30%	5.26%
5 years (pa)	14.10%	7.13%	6.98%

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

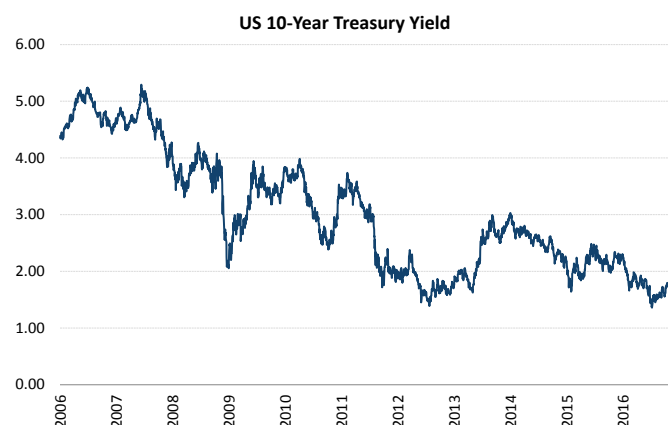
Fund size

NZ\$188 million

Compliance

The Fund complied with its investment mandate during the month.

Commentary



The Nikko AM Wholesale Option Fund gained 0.95% over October. This return compares favourably to the negative returns generated by many equity and bond markets around the globe.

Central Banks held short term rates steady over the month, however a bond sell-off occurred as economic data revealed improvements in key economies. The improved data flow resulted in markets growing increasingly uneasy over the duration of easy monetary policy settings. Financial markets priced in greater odds of a December US interest rate rise and speculated over the future of the European Central Banks asset purchase programme. Global bond yields have been drifting higher since July, but more aggressive selling saw yields higher over the month. German rates were 0.28% higher and 0.50% higher in the UK. US 10-year rates were 0.28% higher over the month, rising from 1.6% to 1.88% before closing at 1.83%.

Rising inflation expectations in the US and increasing conviction the Fed would deliver a second rate hike in December played a role in the US bond market sell-off.

US politics was front of mind in October. While a change in President is an important event in the political life of America we believe any economic impact will be much more subdued. It is unhelpful that the role of the Federal Reserve is becoming more politicised and is perhaps another reason why the Fed seems sensitive to limit the impact of policy changes on financial markets.

We believe 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.

If future rate movements are modest we believe the environment will remain favourable for the Option Fund, especially when viewed in the context of a modest return outlook from other sectors of financial markets.