

# 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.

**Disclaimer** | This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme and the Nikko AM NZ Wholesale Investment Scheme. This information is for the use of researchers, financial advisers and wholesale clients. This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party.

### Performance (NZD gross returns)

|              | Fund    | Benchmark* | Excess  |
|--------------|---------|------------|---------|
| 1 month      | -10.16% | 0.52%      | -10.68% |
| 3 months     | -8.19%  | 1.57%      | -9.77%  |
| 6 months     | -5.83%  | 3.22%      | -9.05%  |
| 1 year       | 0.73%   | 6.74%      | -6.01%  |
| 2 years (pa) | 8.46%   | 7.20%      | 1.25%   |
| 3 years (pa) | 8.50%   | 7.29%      | 1.21%   |
| 5 years (pa) | 10.77%  | 7.12%      | 3.65%   |

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

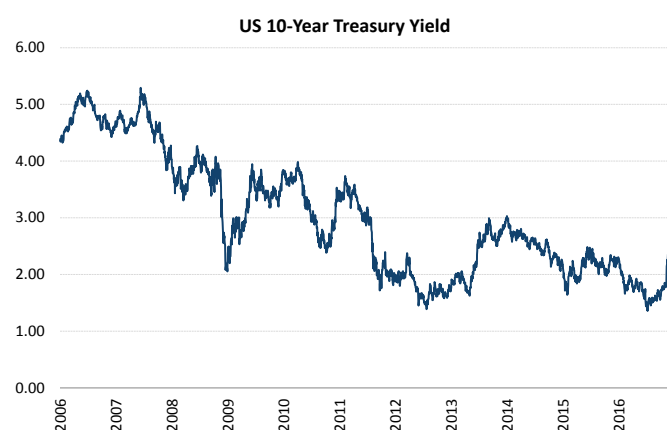
### Fund size

NZ\$169 million

### Compliance

The Fund complied with its investment mandate during the month.

### Commentary



The Option Fund performed poorly over November, falling in value by 10.16%. US interest rates increased significantly with US 10-year Treasury yields closing the month at 2.30% compared to a monthly low of 1.71% and an intra month high of 2.42%.

The majority of the moves occurred after Donald Trump’s victory on the 8th of November. Large interest rate movements over a short period of time is the primary risk the Option Fund is exposed to so a down turn is to be expected however it is disappointing to report a double digit decline. On the brighter side, with bond market volatility at elevated levels the income the Fund generates from writing options has increased significantly. Option premium income is currently approximately 2.5 to 3 times the levels received prior to Trump’s victory. If US Treasury bonds trade in a more modest monthly range than seen over November and volatility stays elevated the Fund should trade well over the next 6 to 9 months.

Rising inflation expectations were a key driver of financial markets in November, which saw a further sharp increase in global bond yields. Inflation data in the US continued to gain ground adding to expectations the US Fed would be tightening monetary policy in December. The shock election of Trump as the next US President fuelled those expectations and added to the global market sell-off. Trump’s policies included a major tax reform package and increased spending, including USD1 trillion on infrastructure, which would see a significant easing in US fiscal policy.

The US Fed kept policy unchanged at its November meeting, ahead of the election, but indicated that the case for a tightening had “continued to strengthen”.

We have likely seen the low in longer term interest rates in this economic cycle. US interest rates have jumped on an expectation of future growth and the market is pricing in higher inflation and growth levels, only time will tell if this expectation is justified.