

# 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 NZ domiciled 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	1.21%	0.51%	0.70%
3 months	-8.21%	1.56%	-9.77%
6 months	-3.99%	3.20%	-7.18%
1 year	0.19%	6.66%	-6.46%
2 years (pa)	8.15%	7.13%	1.01%
3 years (pa)	8.21%	7.27%	0.94%
5 years (pa)	10.27%	7.11%	3.16%

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

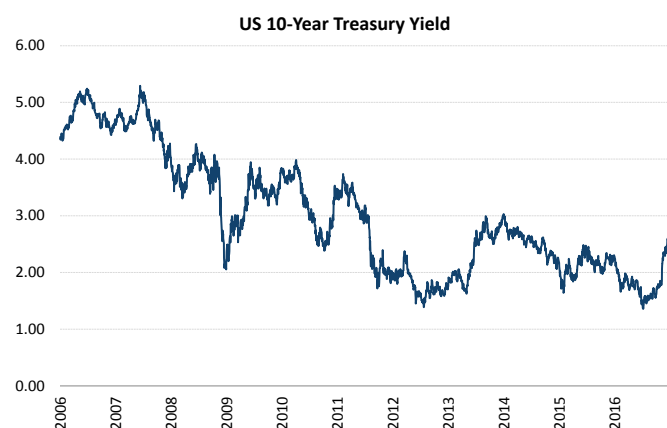
### Fund size

NZ\$173 million

### Compliance

The Fund complied with its investment mandate during the month.

### Commentary



The Option Fund returned 1.21% for December. It was pleasing the Fund had a positive month given the poor performance over the quarter as US interest rates moved much higher in yield through November following Donald Trump’s victory. The US 10-year interest rate remained relatively volatile in December spiking higher in yield by 25 basis points to 2.63% before unwinding most of the move and closing the year at 2.44%. The Fund coped much better with the volatility through the month given the options have now been reset around the new range of the US 10-year and premium income was much higher following the large moves in interest rates.

US interest rates increased significantly over the quarter with the US 10-year yield moving from 1.60% to 2.44%. Large interest rate movements over a short period of time is the primary risk the Option Fund is exposed to, however 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 return to trading more modestly and volatility stays elevated the Fund should trade well over the next 6 to 9 months.

There remains a fair amount of uncertainty around what the Trump presidency will mean for the US economy and the world in general, and we expect option premiums will remain elevated benefiting the Fund.

We have likely seen the low in longer-term interest rates in this economic cycle. The large move higher in interest rates has seen steepening yield curves, as longer-term interest rates rise on the transition from a very limited inflation outlook to the prospects of recovering inflation and growth which is a good thing. However there is now a lot of “positive sentiment” factored in with a higher and steeper yield curve. The market may want to see some more solid proof of improvement before taking yields higher, which could see some stability in interest rates or unwind of the move. There remains a lot of debt in the world and large areas of the global economy are still underperforming this should help moderate the pace of sustainable moves higher in interest rates.