Nikko AM NZ Wholesale Investment Scheme

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.

Performance (NZD gross returns)

	Fund	Benchmark*	Excess
1 month	1.67%	0.49%	1.18%
3 months	4.73%	1.51%	3.22%
6 months	-3.85%	3.10%	-6.96%
1 year	3.71%	6.49%	-2.78%
2 years (pa)	10.96%	6.99%	3.97%
3 years (pa)	8.87%	7.23%	1.64%
5 years (pa)	9.92%	7.08%	2.83%

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

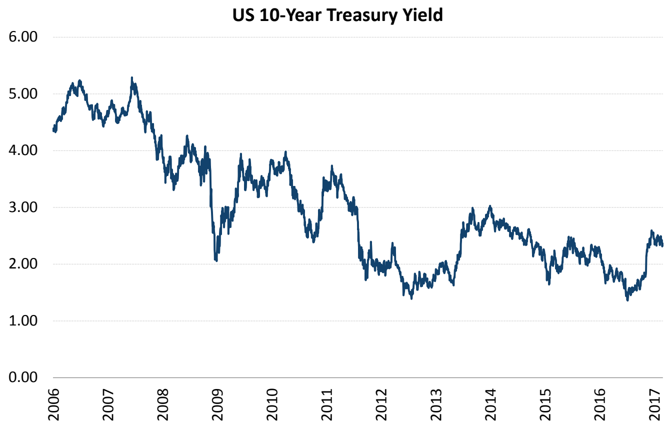
Fund size

NZ$178 million

Compliance

The Fund complied with its investment mandate during the month.

Commentary



The Option Fund returned 1.67% over February. The US 10-year Treasury bonds traded over a modest range over the past month. The 10-year rates traded to a low of 2.31% and a high of 2.52% before closing the period at 2.4% and closed 7 basis points lower than the start of the month.

The Fund coped well with this modest trading range however we are seeing some reduction in the income the Fund receives from writing options as bonds seem comfortable remaining in a 2.3% to 2.6% band.
The US Federal Reserve's monetary policy outlook remains the key market driver with signs the US economy is heating up. Some Federal Reserve members expressed the view at their February meeting that a further rise in the federal funds would be appropriate fairly soon. The unemployment reading of 4.7% is viewed by many as consistent with the Fed's maximum employment objective and business and consumer confidence levels are higher due to the expectations of economic stimulus to come.

Newly elected President Trump and his policy agenda also remains a focus for financial markets. While Trump teased about the prospect of a future 'phenomenal' tax package announcement the talk around Washington was of a fiscal minefield ahead.

Potential delays to the fiscal stimulus timetable seemed to have some impact on bond markets resulting in rates falling from recent highs. After the significant increase in global rates late last year investors seem less concerned further significant increases in bond yields is imminent.