

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	0.26%	0.50%	-0.24%
3 months	3.74%	1.50%	2.24%
6 months	-4.77%	3.08%	-7.86%
1 year	1.55%	6.42%	-4.86%
2 years (pa)	9.60%	6.91%	2.69%
3 years (pa)	8.52%	7.20%	1.31%
5 years (pa)	10.12%	7.07%	3.05%

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

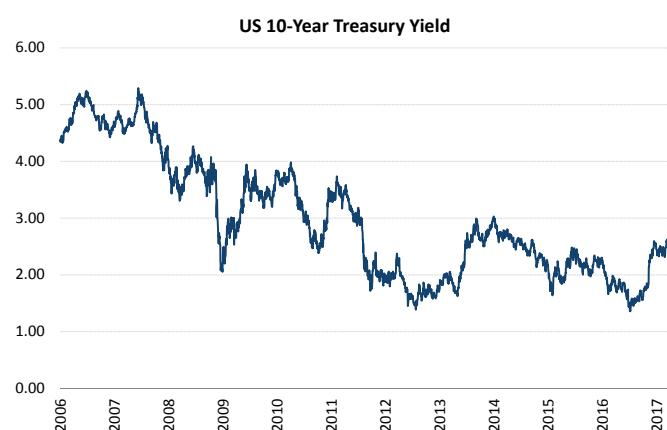
Fund size

NZ\$177 million

Compliance

The Fund complied with its investment mandate during the month.

Treasury yield



Fund Performance

The Option Fund returned 0.26% over March. The US 10-year Treasury bond traded to a high of 2.63% and an intraday low of 2.35% over the month before closing at a yield of 2.39%. The month's performance was negatively impacted by the Fund protecting against a larger increase in bond yields than eventuated, however a modest monthly return was still generated. Income that the Fund received from writing options continues to be at the lower end of historical income levels but should provide the basis for an acceptable level of performance over the months ahead.

Market Commentary

Much of the focus over the past month was on the Federal Reserve's guidance towards a March increase in the Fed Funds Rate. A 25 basis point increase was expected and delivered. This rate rise was the third in this cycle and the forecasts surrounding the announcement were largely unchanged, with the Fed having no particular concern about the inflation outlook. The yield on US 10-year bonds peaked at 2.63% immediately prior to the FOMC rates meeting and subsided immediately after. After the rate rise US politics took centre stage. President Trump's healthcare bill to unwind Obama-Care did not proceed due to the lack of support within the Republican Party. This bill was expected to deliver over \$340b in savings over the next decade to help offset the costs of future tax cuts. Financial markets took the view that the prospects for meaningful US fiscal stimulus had diminished. Trump's failure to pass the healthcare bill highlighted the gridlock often seen in Washington and the difficulty that Trump's administration will have in fully achieving their policy agenda. With the magnitude of US economic stimulation being dimmed, bond yields look to remain within recent trading ranges.