

# 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	0.88%	0.50%	0.38%
3 months	2.79%	1.51%	1.28%
6 months	7.65%	3.04%	4.61%
1 year	1.37%	6.35%	-4.99%
2 years (pa)	9.79%	6.77%	3.02%
3 years (pa)	8.60%	7.14%	1.46%
5 years (pa)	10.65%	7.04%	3.61%

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

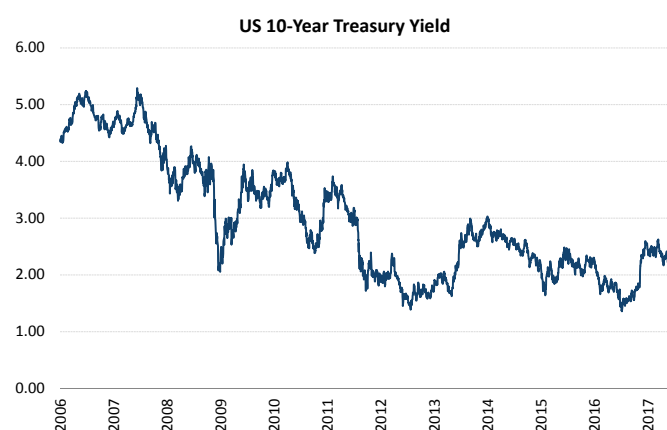
## Fund size

NZ\$180 million

## Compliance

The Fund complied with its investment mandate during the month.

## Treasury yield



## Fund Performance

The Option Fund returned 0.88% over May. Interest rate movements in longer term US Treasury bonds continues to be modest with the rate on the 10-year bond moving between 2.18% and 2.42% before closing the month at 2.20%. Income from writing option contracts on Treasury bonds remained low over the month, however yield movements were also low resulting in an acceptable level of returns for the Fund. We are expecting a low level of volatility to remain over the short term however, as the frequency of options being struck is also low the total return of the Option Fund should remain satisfactory.

## Market Commentary

Some softer US economic data including inflation indicators, created doubt about the future path of Fed rate hikes. FCMC minutes from their May meeting put June in the spot light for the next rate rise however further rate rises and the speed of them remains data dependent. Of particular interest is the economic slowdown seen in quarter one and whether this is an indication of the future trajectory of US economic growth.

Political risk also weighed on investor sentiment in the US market after investigations began into President Trump's link to potential Russian interference in the US election ramped up. With Trump fighting fires on many fronts, markets took the view that his pro-growth strategy was under threat and further delays were likely for any fresh policy initiatives.

The US Federal Reserve has mooted plans to unwind its balance sheet that ballooned in size over the GFC as quantitative easing helped restore confidence in the US financial markets. It is possible this process will begin in early 2018 and the eventual reduction of the Fed's balance sheet has the potential to influence long term interest rates over and above the impact of Fed funds rate changes. We expect any unwind of the balance sheet will be gradual and not designed to unsettle financial markets.

With economic outcomes and financial market impacts still uncertain we believe interest rate movements on long term US bonds will continue to be modest over the months ahead. If we are correct the returns of the Option Fund will continue to be satisfactory over the months ahead.