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	0.72%	0.49%	0.23%
3 months	3.26%	1.50%	1.76%
6 months	7.12%	3.02%	4.10%
1 year	2.85%	6.31%	-3.46%
2 years (pa)	9.29%	6.69%	2.60%
3 years (pa)	8.49%	7.10%	1.39%
5 years (pa)	10.13%	7.03%	3.10%

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

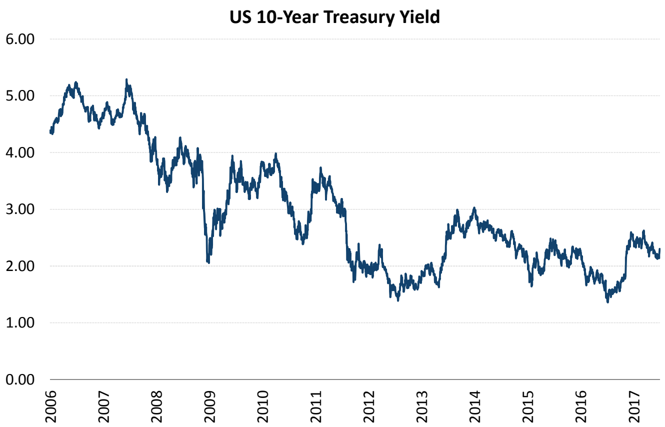
Fund size

NZ$178 million

Compliance

The Fund complied with its investment mandate during the month.

Treasury yield



Fund Performance

The Option Fund returned 0.72% over June. For most of the month interest rate movements in longer term US Treasury bonds were modest with the rate on the 10-year bond moving between 2.21% and 2.13%, and premium income reflected this low level of volatility. We have taken some leverage off at the lows in yields and volatility. At the end of the month global central banks came out in a co-ordinated effort to tell the market that inflation was reappearing and a normalisation of rates was forecast. Bonds sold off globally, and the US 10-year bonds ended the month at 2.31%, moving up 16 points in four days. Option premium has subsequently increased as a result of the bond sell off.

Market Commentary

The US Federal Reserve hiked the funds rate range to 1.0-1.25% and outlined a path of balance sheet reduction. We expect any unwind of the balance sheet will be gradual as to not unsettle financial markets. We expect this to be affirmed by the FOMC meeting minutes that are due out in the first week of July.

Much of June saw US rates being exceptionally stable, with very little market-moving data points or surprises. US Q1 GDP was revised up from a disappointing initial result, lending support to future US Fed hikes. The big movement in longer term bonds at the end of the month was the result of coordinated statements from the European Central Bank and the Bank of England, and to a lesser degree the US Fed. In a nut shell the Central Bankers have said that they see inflation reappearing, and monetary conditions normalising in due course. This was all likely in response to a global market that did not appear to believe this to be the case, as evident in the recent global bond rally. As a result of this global bonds have sold off, and global yield curves steepened out to the long end.

Political risk continued to weigh on investor sentiment in the US. With Trump fighting fires on many fronts, market optimism that was once very evident had begun to wane. There are serious questions over policy goals in light of messy healthcare reform, and other issues reflecting badly on the administration's ability to push its agenda.