Factsheet 30 June 2020

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund. The Nikko AM Option Fund (retail) and Nikko AM KiwiSaver Option Fund invest in units in the wholesale fund, which the commentary refers to.

Market Overview

- Interest rates on US 10-year Treasury bonds traded in a modest range over the month. Increases in yields have been viewed as a buying opportunity as infection rates continue to climb.
- June saw yields hit a high of 0.96% and a low of 0.62%. The historical low point in 10-year Treasury bonds was recorded in March this year when bonds traded at a yield of 0.31%.
- Markets continue to be focused on the economic and financial market impact of COVID-19. The impacts have been greater than anticipated as has the governmental and central bank response.

Fund Highlights

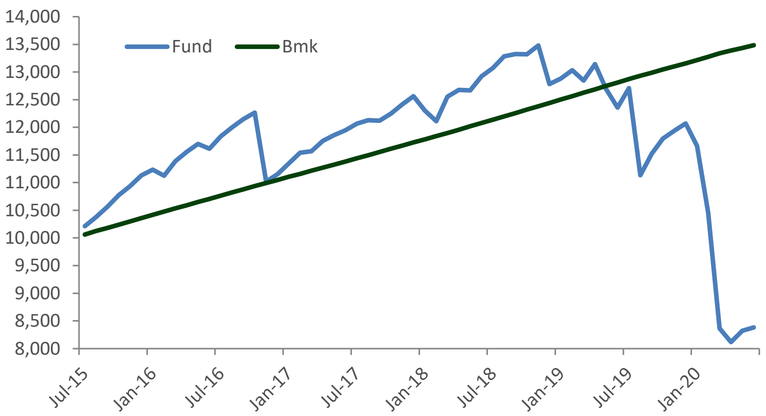
- The fund returned 0.24% over the quarter after a string of disappointing returns earlier in the year. Bond yields dropped to record lows in March however financial markets have subsequently been calmed by significant central bank and governmental support.
- Volatility has reduced as central bank and government spending programmes continue to support economies and financial markets. Income the fund receives from selling short-dated options has decreased over the month but still remains elevated compared to pre COVID levels.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	0.71%	0.24%	-32.17%	-11.13%	-3.47%	2.47%
Benchmark[2]	0.35%	1.10%	5.25%	5.81%	6.16%	6.68%
Retail[3]	1.58%	5.02%	-36.75%			
KiwiSaver[3]	0.73%	6.60%	-33.15%			

1. Returns are before tax and before the deduction of fees.
2. Benchmark: Bloomberg NZBond Bank Bill Index plus 4.0% per annum. No tax or fees.
3. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

Five Year Cumulative Performance, $10,000 invested[1&2]



Portfolio Manager

Fergus McDonald,

Head of Bonds and Currency

Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

Overview

The strategy invests in cash and fixed interest investments, and undertakes a leveraged trading strategy based on selling options on global government bonds.

This fund is a specialist investment strategy and is suitable only for experienced investors who have an investment time frame of three years or longer and are comfortable to accept short sharp periods of high volatility

The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every $1 in the fund, up to $6 of call options and $6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry date. Accordingly, the effective leverage of the fund is 6 times the value of the fund.

In times of increased interest rate volatility, it is likely the fund will receive a higher stream of income as new options sold will have a higher income.

Objective

The fund aims to earn a return of the benchmark before fees, expenses and taxes over a rolling three year period.

Market Commentary

Interest rates on US 10-year Treasury bonds traded in a modest range over the month. Increases in yields have been viewed as a buying opportunity as infection rates continue to climb.

June saw yields hit a high of 0.96% before closing on their monthly low of 0.62%. The historical low point in 10-year Treasury bonds was recorded in March this year when bonds traded at a yield of 0.31%.

The US bond market seems to be holding firm to its view that the revival of the American economy from the damage of the pandemic will be slow and fragmented. Ten-year US Treasury bond yields are barely changed from the end of March. Investors have pounced on any sell-off as a buying opportunity, keeping yields in check after they fell 125 basis points (bps) in the first quarter of 2020.

The grim outlook among bond investors is starkly contrasted with the positive outlook from equity investors. Share prices rose strongly on expectations for a rebound in business activity however optimism faded somewhat amid a surge of infections and moves by some states to delay re-openings. The end result is that Treasuries will likely remain a haven for investors seeking protection from the risk of another drop off in economic growth and another dose of central bank monetary accommodation.

The US labour market remains the area of most concern. June payrolls are expected to show an improvement on the rebound in hiring seen in May, however, the deep damage done to the labour market is likely to see the jobless rate at around 12.3%, down from the April peak but still highly elevated from the 3.5% seen in February. The Federal Reserve is likely to continue pumping stimulus into the US economy until jobs recover. In an interview Fed Chairman Powell said “we’re not even thinking about raising rates” and followed up by saying “we are strongly committed to using our tools to do whatever we can for as long as it takes”. Taking these comments at face value, unless an efficient vaccine is discovered over the next few months, we are not expecting a sustained rise in US interest rates any time soon.

Amid such a gloomy outlook, some investors are of the view that the Fed may follow other central banks and take rates into negative territory in an attempt to spur spending and investment. Powell acknowledged the speculation but said such a move was not being considered, although he stopped short of completely ruling out negative rates as a policy option in the future. With large scale fiscal and monetary policy stimulus required to support US economic activity and jobs for the foreseeable future interest rates are likely to remain low across all maturities and volatility in interest rate markets will moderate after the dislocation we have seen so far in 2020.

Fund Commentary

The fund returned 0.24% over the quarter after a string of disappointing returns earlier in the year. Bond yields dropped to record lows in March however financial markets have subsequently been calmed by significant central bank and governmental support.

The precise impact COVID-19 will have on economic activity is unknown, what we do know is the impact will be large and unfavourable. Earlier than anticipated opening up of economies from stringent lock downs is causing optimism to rise. Time will tell if this is the correct response as global infection rates continue to rise. Volatility has reduced as central bank and government spending programmes continue to support economies and financial markets.

Income the fund receives from selling short dated options has decreased over the month but still remains elevated compared to pre-COVID levels. If volatility remains at current levels the income generating potential of the fund looks attractive however the frequency and cost of options being struck also determines the total return.

Key Fund Facts

Distributions		**Estimated annual fund charges (incl. GST)**	
Wholesale fund:	generally does not distribute	Wholesale:	negotiated outside of unit price
Retail fund:	generally does not distribute	Retail:	1.22%, refer PDS for more details
KiwiSaver fund:	does not distribute	KiwiSaver:	1.15%, refer PDS for more details.

Hedging	**Buy / Sell spread**	**Strategy size**	**Strategy Launch**
Any foreign currency exposures are hedged to NZD within an operational range of 98.5% to 101.5%	0.00% / 0.00%	$60.0m	October 2007

Compliance
The wholesale fund complied with its investment mandate and trust deed during the month.

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