Factsheet 30 April 2021

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund.

Market Overview

- US 10-year Treasury bond yields eased back from their recent high point. Optimism for a strong economic recovery remains as vaccine programmes are rolled out, lock downs ease, and additional government stimulus measures are announced. Even with this rising tide of optimism the market has seen buyers emerge at current levels.
- US yields reached a high of 1.74% in April a shade lower than the 1.77% peak seen in late March. April's low point for yields was 1.53% giving a modest 21 basis point yield range over the month.
- The Fed sees short term rates staying low through to 2024 to help the economy and especially the labour market recover.

Fund Highlights

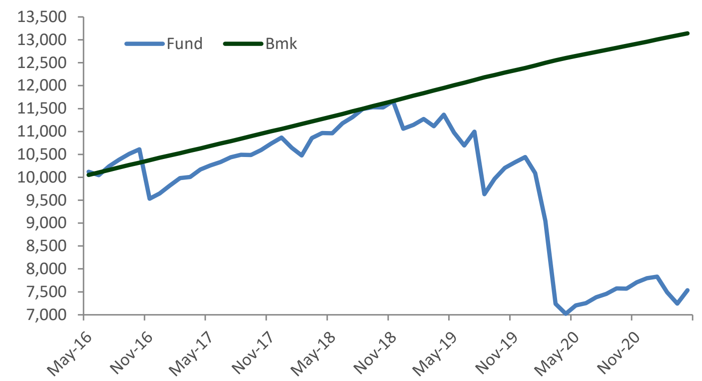
- The fund returned over 4% in April as bond yields settled in a narrower range than recent months. Yield movements have stabilised around the 1.7% mark after having a large increase so far in 2021.
- Income and volatility levels have stabilised around elevated levels from those seen over most of the past year.
- Uncertainty surrounding the strength of the US economic recovery and the inflationary impact will likely keep bond market volatility and option income levels elevated and remain at attractive levels compared to many investment alternatives.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	4.04%	-3.75%	7.32%	-11.76%	-5.50%	1.09%
Benchmark[2]	0.35%	1.06%	4.29%	5.25%	5.62%	6.38%

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.

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.

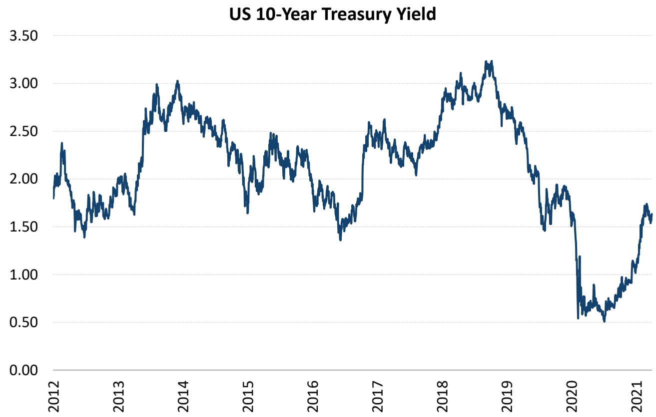
In times of increased interest rate volatility, it is likely the fund will receive a higher stream of income as new options sold will have a higher income.

Objective

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

Market Commentary

US 10-year Treasury bond yields eased back from their recent high point. Optimism for a strong economic recovery remains as vaccine programmes are rolled out, lock downs are reduced and additional government stimulus measures continue to be announced however the market has seen buyers emerge as interest rates in other markets remain low in comparison to the US. Bond investors remain concerned the Federal Reserve may allow the economy and inflation run too hot for too long before reducing stimulus, with this in mind it is possible the next move is higher in longer term interest rates. The magnitude of further rises in the long end is however likely to be moderated by stability in shorter term interest rates.



Yields reached a high of 1.74% in April a shade lower than the 1.77% peak seen in late March. April's low point for yields was 1.53% giving a modest 21 basis point yield range over the month. Yields have moved a long way from the historical low point in 10-year Treasury bonds of 0.31% recorded in March 2020, this may help explain some of the buying support around these current elevated levels.

The Fed sees short term rates staying low through to 2024 to help the economy and especially the labour market recover. They are expecting a significant economic recovery to occur in 2021 however any associated rise in inflation is expected to be temporary, the market however, is not so convinced that the rise in inflation will be temporary in nature.

The Fed has projected economic growth of 6.5% in 2021, this follows a 2.4% contraction in 2020 as a result of the pandemic. Inflation is seen ending 2021 at 2.4% before drifting back to 2% the following year. Fed Chair, Jerome Powell said prices would rise due to very low readings from last year dropping out of the annual numbers along with some pressure from pent up spending and supply chain bottlenecks. He remains confident the lift in inflation will be temporary and the reasons for a long period of low US inflation will reassert themselves and keep inflation in check. Powell did add however that if this prediction proved incorrect the Fed had the tools to tackle unwanted inflation and would use them.
Late in April the Federal Reserve upgraded their assessment of the US economy but they reiterated they were not yet ready to consider scaling back pandemic support. After holding its key interest rate near zero and maintaining a $120 billion a month of asset purchases the Fed said "amid progress on vaccinations and strong policy support, indicators of economic activity have strengthened" however they went on to say that the risks to the economic outlook remain and they soften their language in dropping the term "considerable risks".

As the US economy recovers from the COVID inspired recession and the Democrats have a freer hand to enact their stimulatory policies it is possible longer term bonds continue to trend higher in yield however we believe upside to yields will be more modest than we have seen recently as the Fed remains committed to keeping interest rates low. If the interest rate movements on US treasury bonds are moderate or trend higher or lower over time the fund should be able to generate acceptable returns over the coming year.

Fund Commentary

The fund's returned over 4% in April as bond yields settled in a narrower range than recent months. Yield movements have stabilised around the 1.7% mark after having a large increase so far in 2021. Income and volatility levels have stabilised around elevated levels from those seen over most of the past year. Uncertainty surrounding the strength of the US economic recovery and the inflationary impact will likely keep bond market volatility and option income levels elevated and remain at attractive levels compared to many investment alternatives. 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. If the incidence of large yield movements over a short time period remains modest the fund is well placed to provide an acceptable level of returns once again.

Key Fund Facts

Distributions	**Estimated annual fund charges (incl. GST)**		
Hedging Any foreign currency exposures are hedged to NZD within an operational range of 98.5% to 101.5%	**Buy / Sell spread** 0.00% / 0.00%	**Strategy size** $38.9m	**Strategy Launch** October 2007

Compliance

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

Contact Us

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