Nikko Asset Management

Factsheet 31 May 2021

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund.

Market Overview

- US 10-year Treasury bond yields continued to ease back from their recent high point.
- Yields reached a high of 1.69% in May, a shade lower than the 1.74 % peak seen in April and, the March peak of 1.77%. May's low point for yields was 1.55% giving a modest 14 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 current levels.
- The Fed continues to see 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.

Fund Highlights

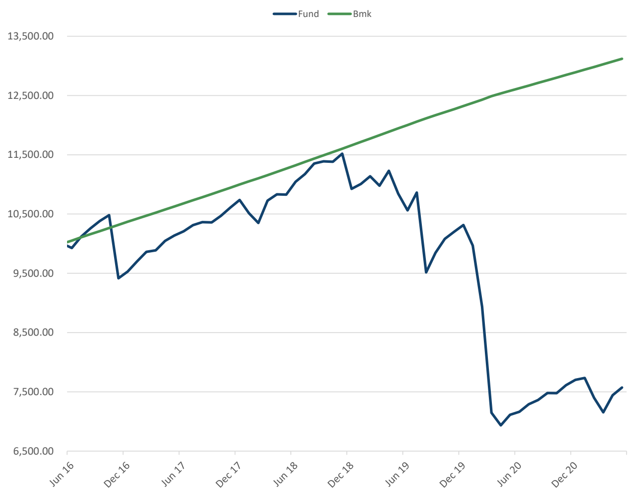
- The fund's unit price gained close to 1.75% in May as bond yields settled in a narrower range than recent months. Yield movements have stabilised around current levels after having a large increase so far in 2021.
- Income and volatility have reduced from elevated levels however remain similar to those seen over most of the past year.
- Uncertainty surrounding the strength of the US economic recovery and the resulting inflationary impact will likely keep bond market volatility and option income levels 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]	1.75%	2.34%	6.47%	-11.23%	-5.40%	1.21%
Benchmark[2]	0.36%	1.07%	4.30%	5.21%	5.58%	6.33%

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.

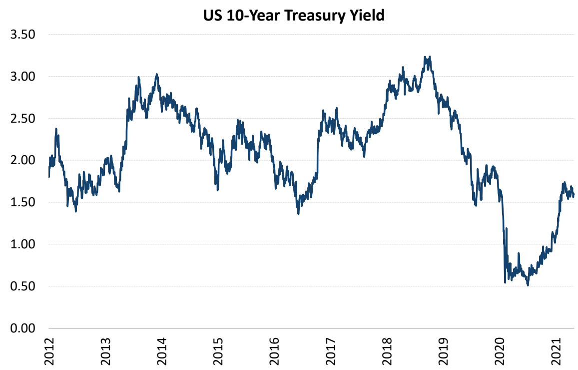
The fund uses a leveraged trading strategy and the impact of interest rate volatility is magnified by the use of leverage. For every $1 in the fund, up to $6 of call options and $6 of put options can be sold. The options are sold in pairs, each comprising a call and a put option with the same expiry 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 continued to ease 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. The market has seen buyers emerge at current levels as the recovery induced spike in inflation is seen as transitory and US interest rates remain high compared to many other parts of the world. A prolonged period of low short-term rates is also likely to limit how high longer-term US rates can go.

Fears of higher inflation have unsettled some investors amid rising commodity prices, some Fed critics argue its easy policies combined with massive US fiscal stimulus risk overheating the economy. The Fed concedes inflation is likely to move beyond 2% in the short term but argue longer run inflation expectations remain well anchored at levels that will achieve the Feds longer run goals. Maximising employment opportunities for the most impacted sectors of the community continues to be a major focus of the Fed. They will want to see improvement in the employment of minorities and are likely to wait to see the impact of the September expiry of additional unemployment benefits, before contemplating their next steps to reduce economic stimulus. The Black unemployment rate rose in April to 9.7% and overall unemployment ticked up to 6.1%.

Ten-year yields reached a high of 1.69% in May a shade lower than the 1.74 % peak seen in April and the March peak of 1.77%. May's low point for yields was 1.55% giving a modest 14 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 current levels.

Bond investors remain concerned the Federal Reserve may allow the economy and inflation to 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, if this does occur the magnitude of further rises in the long end is likely to be moderated by stability in shorter term interest rates. In addition 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 may trend higher in yield however we believe upside to yields will be modest as we have already seen a significant increase in long bond yields and, the Fed remains committed to keeping short term interest rates low.

Fund Commentary

The fund's unit price gained 1.75% in May as bond yields settled into a narrower range than recent months. Yield movements seem to have stabilised around current levels after increasing significantly in 2021. Income and volatility have reduced from elevated levels however remain similar to those seen over most of the past year. Uncertainty surrounding the strength of the US economic recovery and the resulting inflationary impact will likely keep bond market volatility and option income levels 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** $40.3m	**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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