Factsheet 30 June 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. Optimism for a strong economic recovery remains as vaccine programmes are rolled out, and monetary and fiscal stimulus remains strong. The market continued to see buyers emerge as the recovery induced spike in inflation is seen as transitory.
- Yields reached a high of 1.64% in June, a shade lower than the 1.69% high point in May and the peaks of 1.74% seen in April and 1.77% in March. June's low point for yields was 1.35% giving a modest 17 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 over the quarter.

Fund Highlights

- The fund gained 0.8% in June as bond yields continued to trade in a narrow range. Yields have stabilised around current levels after having experienced 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 and longevity 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]	0.78%	6.69%	6.54%	-11.59%	-5.12%	1.05%
Benchmark[2]	0.35%	1.07%	4.31%	5.16%	5.55%	6.31%

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.

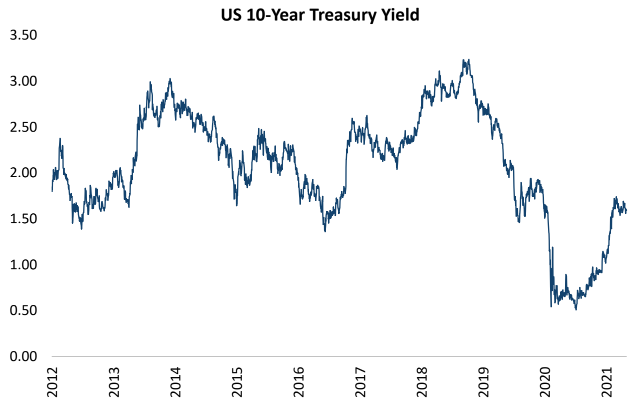
In times of increased interest rate volatility, it is likely the fund will receive a higher stream of income as new options sold will have a higher income.

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, and monetary and fiscal stimulus remains strong. The market continued to see buyers emerge 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 further period of low short-term rates is likely to limit how high longer-term US rates will go, even though the Fed is now closer to raising rates than previously thought.



The Fed Chair Jerome Powell said inflation had picked up but should move back toward the US central bank's 2% target once supply imbalances are resolved. Even though the Fed sees the near term lift in inflation as transitory Fed officials did surprise the market when their forecasts showed they had pulled forward their expected timing and pace of interest rate rises from the current near zero level while also kicking off discussion of when to taper asset purchases from their current $120 billion monthly pace.

The Fed's quarterly predictions showed 13 of 18 officials favoured at least one rate increase by the end of 2023, versus seven in March. Eleven officials saw at least two rate hikes by the end of that year. In addition, seven of them saw a move as early as 2022, up from four. The projections also showed that officials sense of risk and uncertainty around their inflation forecasts moved higher. Powell continued to sound optimistic on the outlook for employment saying, "job gains should pick up in coming months as vaccinations rise, easing some of the pandemic related factors currently weighing them down."

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As the US economy recovers from the COVID inspired recession and the Democrats freer hand to enact their stimulatory policies it is possible longer-term bonds trend higher in yield. We believe however that upside in yields will be modest as we have already seen a significant increase in long bond yields and short term interest rates will likely remain low compared to historical levels even if they move off levels close to zero. 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 gained 0.8% in June as bond yields continued to trade in a narrow range. Yields have stabilised around current levels after having experienced 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 and longevity of the US economic recovery and the resulting inflationary impact will likely keep bond market volatility and option income levels at attractive 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. 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** $40.7m	**Strategy Launch** October 2007

Compliance

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

Contact Us

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