Factsheet 31 August 2022

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund.

Market Overview

- US 10-year Treasury bond yields continued to trade in a volatile fashion as the market fluctuated between worrying about inflation and worrying about the Federal Reserve's aggressive tightening policy's impact on economic growth.
- Hawkish Fed statements, inflation concerns and the likelihood of an elevated period of a restrictive policy stance drove bond yields to a high of 3.16%. Earlier in the month investor concerns about a slowing economy saw 10-year yields trade at a low of 2.51%.
- Multiple rises in the Fed's Fund Rate over 2022 and into 2023 looks to be a certainty as the US faces elevated inflation and a strong labour market however the speed of rate rises may slow if economic data remains soft, however the Fed does need to win the inflation battle.

Fund Highlights

- The fund's value increased over August as bond yields remained volatile and income levels were high.
- Income and volatility levels remain at attractive levels as we continue to see central bank statements, data releases and geo-political events keep markets on edge.
- Uncertainty surrounding inflation and economic growth levels will likely keep bond market volatility and option income high. The elevated level of option premium income will benefit the fund and help insulate it from losses should large, short-term movements in bond yields continue.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	1.48%	-6.25%	-16.34%	-12.20%	-9.08%	0.02%
Benchmark[2]	0.57%	1.62%	5.34%	4.86%	5.31%	6.12%

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

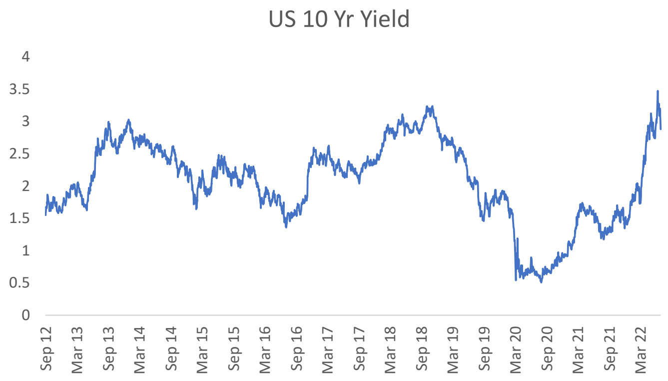
The fund aims to earn a return of the benchmark before fees, expenses and taxes over a rolling three-year period.

Market Commentary

Federal Reserve Chair Jerome Powell signalled the US Central Bank is likely to keep raising interest rates and leave them elevated for a while to stamp out inflation, he also pushed back against the idea the Fed would soon reverse course. He said "the historical record cautions strongly against prematurely loosening policy".

Restoring inflation to the 2% target is the central bank's overarching focus right now even though consumers and businesses will feel economic pain.

Another "unusually large" increase in the cash rate could be appropriate when officials gather in September however Powell stopped short of committing to one. The decision will depend on the totality of the incoming data and the evolving outlook.



Restoring price stability will take some time and requires the Fed using their tools forcefully to bring demand and supply into better balance. The Fed remains convinced that higher interest rates, slower growth and a softer labour market will bring inflation down, the question remains around how quickly this will occur and what economic damage is done along the way.

The July inflation print did come in lower, however a single month's improvement falls short of what the Fed will need to see before they are confident inflation is moving down. Looking beyond the current rate hike cycle, Fed policy makers will be trying to assess whether longer run inflation pressures will remain persistent. Supply chain costs may be shifting higher and the supply of labour could remain tight for years to come due to an aging population and limited migration. Powell commented that the labour market is clearly out of balance with demand for workers substantially exceeding supply. Unfortunately this seems to be a global issue rather than just focused on the US. It is clear that for a number of reasons markets are swinging from fearing inflation to having a growth scare. Only time will tell how severe the economic downturn will be however in the meantime uncertainty has grown and volatility looks likely to remain elevated for some months to come.

Fund Commentary

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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** $33.3m	**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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