nikko am
Nikko Asset Management

Factsheet 30 September 2021

NIKKO AM OPTION STRATEGY

Assets are held in the Nikko AM Wholesale Option Fund.

Market Overview

- US 10-year Treasury bond yields pushed higher over September with the high point reached close to quarter end.
- Yields reached a high of 1.56% in September as the prospect of the Fed starting to taper bond purchases became more evident. September's low point in 10-year yields was 1.26%, giving a 30 basis point yield range over the month. Yields have moved a long way from the historical low point of 0.31% recorded in March 2020 however remain below the 2021 highpoint of 1.77% reached in March.
- The Federal Reserve is moving closer to when they may start reducing massive support for the US economy, although Chair Jerome Powell continues to say there is some way to go, the timeframe is shortening.

Fund Highlights

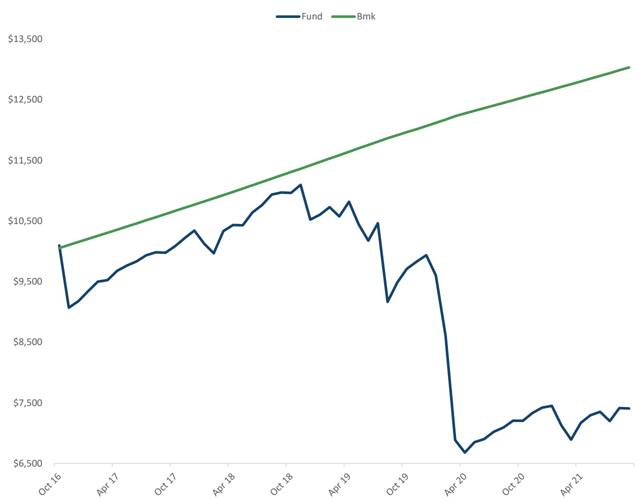
- The fund posted a negative return in September as bond yields lifted sharply at quarter end. This rate rise has partially reversed in early October which restored value to the fund in the new month, however the mark-to-market movements resulted in a negative result for September.
- Income and volatility levels have been stable over the past month however we are seeing short periods of market activity that are keeping markets on edge.
- Uncertainty surrounding the strength and longevity of the US economic recovery, the resulting inflationary impact and the Fed's response will likely keep bond market volatility and therefore option income at attractive levels compared to many other investment alternatives.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	-0.12%	0.72%	2.77%	-12.27%	-5.83%	3.90%
Benchmark[2]	0.35%	1.08%	4.33%	5.02%	5.44%	6.25%

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.

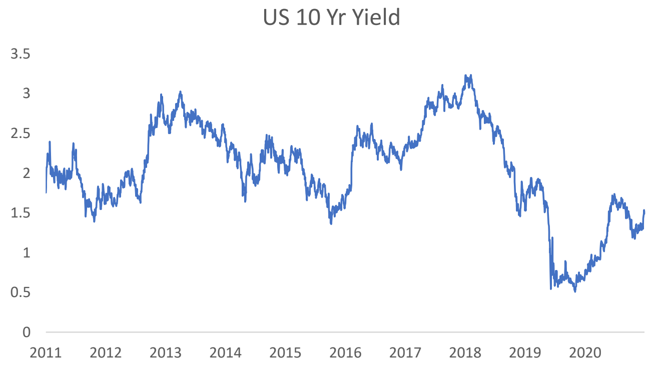
In times of increased interest rate volatility, it is likely the fund will receive a higher stream of income as new options sold will have a higher income.

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 Chairman, Jerome Powell said the central bank could begin scaling back asset purchases as soon as November and complete the process by mid 2022, after officials revealed a growing inclination to raise rates next year. Powell explained the Fed's first steps to withdrawing emergency pandemic support for the US economy could come as early as the November 2nd to 3rd FOMC meeting. At this stage Federal Reserve bond buying programme would need to be complete before any cash rate hikes would be considered.



Powell confirmed he didn't expect the Fed to begin rate increases until after the completion of the tapering process. Published data suggests Fed officials are evenly split on whether or not it will be appropriate to begin raising the fed funds rate as soon as 2022. At the June meeting the median projection of officials indicated no rate increases until 2023. So, we are seeing fed officials becoming more hawkish. Complicating the picture somewhat is that Powell's term as Fed Chair expires in February 2022 and in the US fall, President Biden will decide whether to nominate him again for another four-year term.

The US unemployment rate fell to 5.2% in August, well below the April peak of 14.8%, however it is still well above the 3.5% rate that prevailed in February 2020, just before the pandemic struck. Fed officials have said they expect to keep the Fed fund rate near zero until labour market conditions have reached levels consistent with their assessment of maximum employment.

Inflation, according to the Fed's preferred measure, was 4.2% in the 12 months to July, well above the central bank's 2% target. Many Fed officials have said they expect inflation to return to 2% after temporary supply chain disruptions resulting from the pandemic have been resolved, although several have also cited the rapid price increase as a reason to begin raising rates next year. The longer it takes for supply chains to return to normal the greater the risk inflation becomes entrenched, forcing the Fed to respond in a more forceful manner.

As the US economy recovers from the COVID inspired recession and stimulatory monetary and fiscal policies remain in place for it is possible longer term bonds trend higher. We believe, however, that any upside in yields will be modest as we have already seen a significant increase in long bond yields over the past year and short-term interest rates will likely remain low compared to historical levels even when they move off levels close to zero. If the interest rate movements on US treasury bonds are moderate or trend in either direction the fund should be able to generate acceptable returns over the coming year.

Fund Commentary

The fund posted a negative return in September as bond yields lifted sharply at quarter end. This rate rise has partially reversed in early October restoring value to the fund after the monthly close, however the mark-to-market movements resulted in a negative result for September. Income and volatility levels have been stable over the past month however, we are seeing short periods of market activity that are keeping markets on edge. Uncertainty surrounding the strength and longevity of the US economic recovery, the resulting inflationary impact and the Fed's response will likely keep bond market volatility and option income 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 will also determine the total return.

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** $43m	**Strategy Launch** October 2007

Compliance

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

Contact Us

www.nikkoam.co.nz | nzenquiries@nikkoam.com