Factsheet 31 March 2023

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 over March, carrying on the theme of the first quarter of 2023. Markets continued to worry about inflation - how long it would stay high for and the future path of monetary policy.
- Restrictive monetary policy should keep 10-year US Treasury yields high however the Fed has begun to reduce the size of hikes to mitigate downside risks to the economy. The problem is that inflation is still high and not falling quickly enough for the Fed officials.
- Complicating the outlook for interest rates was the turmoil in the US and European banking sector. This saw bank failures and risk management policies questioned. In some cases, the rapid rise in interest rates was the catalyst for the collapse causing some to think Central Banks may reduce or even end their tightening cycle. In our opinion, the Fed will be wary of unwarranted loosening of financial conditions as this would hurt efforts to achieve price stability.

Fund Highlights

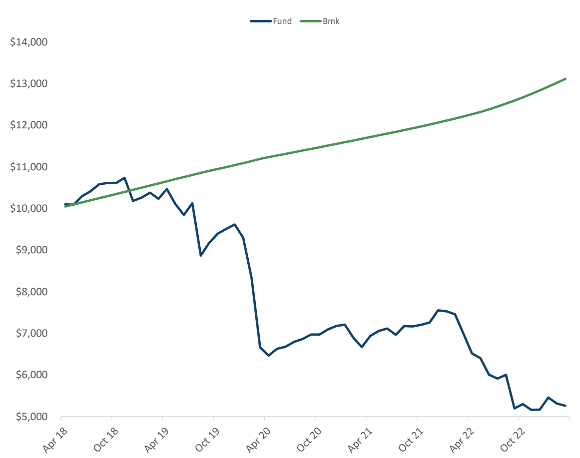
- After a strong start to the year the fund gave back some of the gains made in January. Bond yields reached a high of 4.09% early in March and March also saw the quarter's low at 3.28%.
- Bond yields moved through a number of option strike levels over the month creating losses in the fund greater than the income generated from selling options on Treasury bonds.
- Income and volatility levels remained at high levels as central bank policy settings, data releases and banking sector risks kept markets on edge.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Wholesale[1]	-1.05%	1.79%	-24.72%	-7.58%	-12.06%	-2.21%
Benchmark[2]	0.74%	2.14%	7.38%	5.42%	5.57%	6.21%

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.

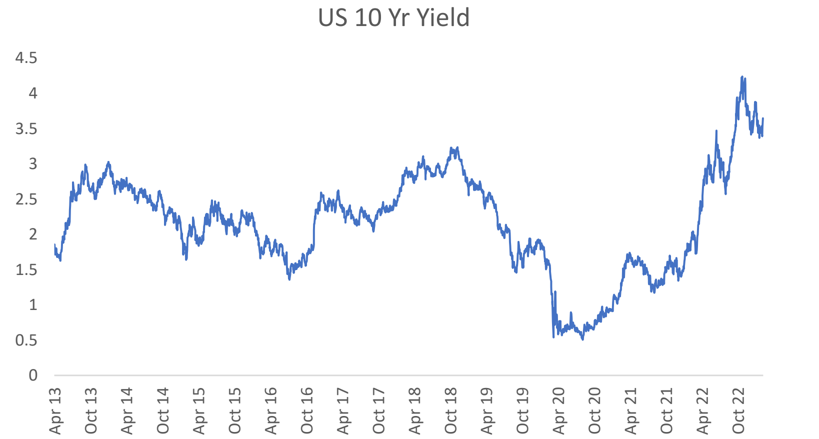
Objective

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 officials continue to stress the need to lower inflation even as they keep an eye on the fallout from the collapse of Silicon Valley Bank and other turmoil in the banking sector over the past month. Statements from various Fed spokespeople stressed that policy makers will not shrink from their responsibility to restore price stability despite banking strains.

The Fed raised their policy benchmark rate to a range of 4.75% to 5% at their March meeting from near zero in March 2022. Forecasts released at the same time show the 18 officials expect rates to reach 5.1% by the end of the year, according to their median projection. This implies one more 0.25% hike.



Inflation remains too high and the services sector excluding housing has yet to slow down despite the aggressive interest rate increases over the past twelve months. Wages are growing at a faster rate than what is consistent with the Fed's 2% inflation target even though wage gains have moderated recently. So, in the Fed's mind more work needs to be done to bring the services side of the economy back into balance however we may be moving into the early stages of a disinflationary process however we are not there yet.

Although the Fed has a dual mandate of promoting price stability and maximum employment the Fed remains focused on high inflation because the job market seems to be doing okay. If at some point attention needs to be paid to one side of the dual mandate then that will be done, and it is the price stability component that continues to need fixing.

An additional point to watch is how much credit tightens as a result of the banking issues experienced over March. A shift to tighter credit conditions could be especially painful for small businesses however Fed officials still seem confident of delivering a soft landing for the US economy.

Fund Commentary

After a strong start to the year the fund gave back some of the gains made in January. Bond yields reached a high of 4.09% early in March and March also saw the quarter's low at 3.28%. This gave a wide 91 basis point range, mostly occurring as the banking issues unfolded.

Bond yields moved through a number of option strike levels over the month creating losses in the fund greater than the income generated from selling options on Treasury bonds.

Income and volatility levels remained at high levels as central bank policy settings, data releases and banking sector risks kept markets on edge however we are seeing signs that volatility levels may decline after the recent bout of bond market turbulence.

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** $29.5m	**Strategy Launch** October 2007

Compliance

The wholesale fund complied with its investment mandate and trust deed during the month, except that an error has been identified where the value of specific options were incorrectly accounted for in the net asset value of the fund on certain days. The matter was resolved before 31 March with affected clients being notified directly and the impact to the fund and clients (that transacted) being restored to their rightful position, this was completed during the month of March 2023.

Contact Us

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