FAQ: Gyrostat Absolute Return Income Equity Class - Class A Units

Investment Manager: Gyrostat Capital Management Advisers Pty Ltd (Gyrostat)

Retiree income with downside protection

Volatility is our friend – risk managed investing

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1. Why did Gyrostat develop the Gyrostat Risk Managed Equity Fund (**Fund**)?

The Fund was developed to meet retiree financial risk management needs.

There have been 10 years of Government retirement income reviews in Australia to encourage the development of capital protected retiree income products.

The Financial System Enquiry, commissioned by the Australian Government concluded in their final report:

> *"The retirement phase of superannuation is underdeveloped and does not meet the risk management needs of many retirees."*

The various reviews have listed the criteria to be satisfied as follows: regular income, capital protection, no lock in periods for investors, transparent pricing, strong counterparty and no credit default risks.

We believe that Gyrostat meets all these requirements.

Gyrostat has consistently delivered income to investors and delivered 45 consecutive quarters with no losses exceeding its pre-defined 3% risk tolerance

Returns are designed to increase with market volatility including large market falls and deliver regular income through the complete investment cycle.

Risk managed investing has **downside protection** always in place (dynamically managed as per global best practice).

Gyrostat is a risk managed investing specialist.

2. Who is in the Gyrostat team and what is their background?

The Gyrostat team has extensive experience domestically and globally, as investors, as non-executive directors, and as senior management in funds management, private equity, industry, investment banking, financial services law and equity research.

The senior management team consists of Craig Racine, David Barwise, Leo Tang and Peter Keating.

The organisation has been very stable:

- Craig Racine and Leo Tang from inception – December 2010
- Peter Clifton and Andrew Smith from 2014
- David Barwise from 2018
- Peter Keating from 2021

Key skills are as follows:

Craig Racine:	investment, business development
Leo Tang:	investment, systems, IT
Peter Keating:	investment operations, finance
Peter Clifton:	governance, strategy
Andrew Smith:	compliance, strategy
David Barwise:	legal, compliance

3. What is the product positioning of the Fund?

The Class A Units aim to deliver **regular and stable retiree income with downside protection**.

The strategy aims to deliver a stable source of income by investing in high dividend paying stocks (largely Australian) and overlaying derivative strategies that will (a) provide a floor on the capital value of the investment and (b) provide opportunistic upside when warranted by market conditions.

The strategy looks and feels like a fixed income strategy as it provides:

- liquidity (for a portion of the allocation);
- a stable and reliable source of income; and
- an offset to losses incurred in adverse equity market conditions (sequencing draw-down risk)

Retiree investment portfolio considerations:
Gyrostat should be considered as an integral component of a diversified portfolio aimed at enhancing a retiree's fixed income. We believe it adds value, as the Class A units may generate positive returns in a market crash which is a diversifying offset to any credit strategy that is likely to underperform in this scenario.

4. What are the expected returns of the Class A units under different market conditions?

Expected returns are based upon stock price changes, option pricing, and dividends.

In falling markets, profits are achieved from options trading as these profits exceed losses on stock. Our portfolio structure always has more bought puts than underlying assets – as a result we can meet our 'hard' risk criteria and sell any additional put options on market falls (providing a source of income for distributions). This is what happened in February and March 2020 when banks fell 50% and dividends were nil, yet we had a record year and met our distribution targets.

In rising markets, profits are achieved from stock price gains exceeding falls in the value of the options protection. In some instances, bought call options also generate additional profits.

In stable markets, returns depend upon the frequency of market re-sets (i.e. stock price realized volatility +/-3% approximately during the period, and the number of gaps[1] at the open in stock price.) The higher the volatility, the higher the returns.

5. What are the approaches to financial risk management? What is best practice?

A summary of the risk management approaches is as follows:

- Vary asset allocation between stocks and bonds (diversification)
- Buy underlying asset, write call options (Buy-write income funds)
- Long/short funds (market neutral, 130/30)
- Buy underlying asset, using a predictive approach to sell futures contracts at some times
- Buy underlying assets, buy put options at selected times using predictive approaches
- Buy put options and hold cash (volatility as an asset class)

[1] Gaps occur when the price of a stock, or another asset, opens above or below the previous day's close with no trading activity in between

- Dynamic risk managed protection overlays: buy underlying assets, buy put options (always in place 'hard' risk parameter) – the Gyrostat approach

Gyrostat has reviewed the five global papers on dynamic risk managed protection overlays and two best practice key themes emerge:

- Structure protection between 'core' and 'tail' protection
- Use Dynamic Downside Protection, not buy and hold protection

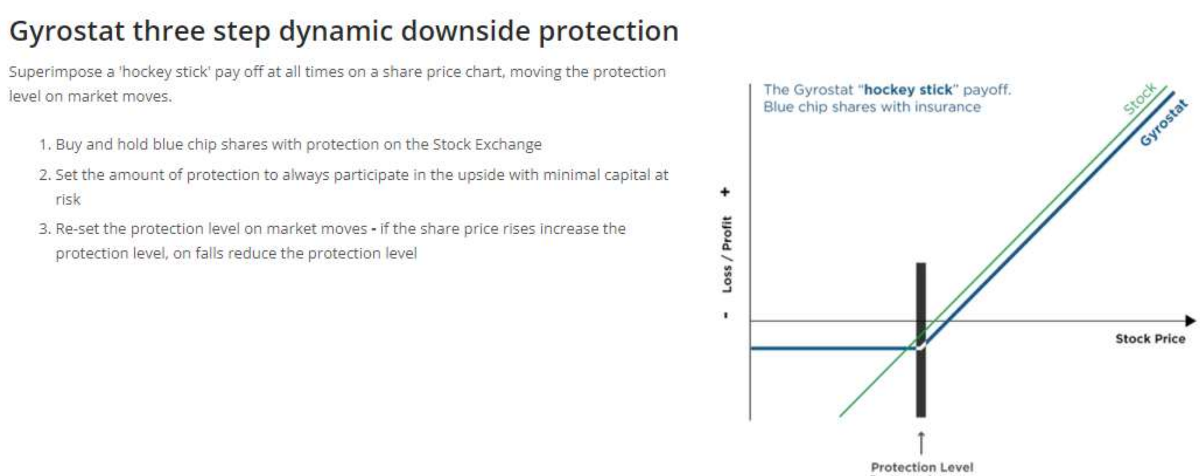
These best practice key themes are incorporated in our investment methodology for the Fund.

A more detailed explanation designed for asset consultants/investment committees is as presented by Mark Spitznagel:
https://www.youtube.com/watch?v=gGpt8VNpCxw

6. How does Gyrostat construct its Portfolio?

There are 3 steps in our risk management investment approach:

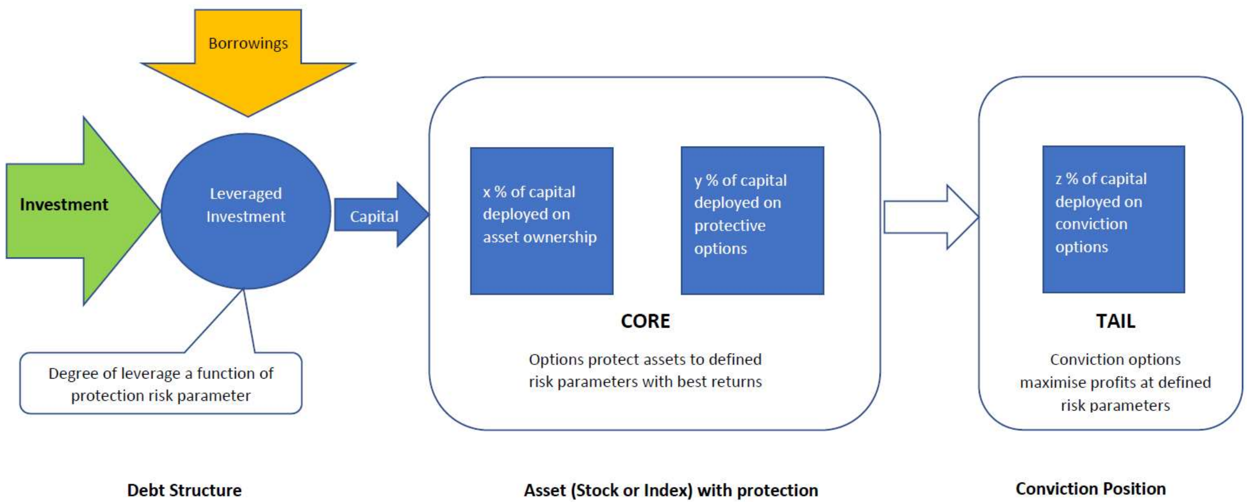
a. **Buy** stock [approx. 95% capital deployed in stock]
b. **Set** risk management overlay exchange traded options [approx; 5% capital]
c. **Re-set** dynamic risk managed overlay with market moves



At any point in time the portfolio holds about 15 "positions. A "position" is comprised of an exposure to a stock complemented by a derivatives' overlay. The components of each position are actively traded to keep the derivatives overlay in line with the underlying stock.

A quantitative/qualitative screening is applied to the eligible securities to determine which are then entered into to support a position. The quantitative/qualitative screens bias the selection to names that provide attractive valuations but are unlikely to exhibit a “value” trap. The screens include using forward earnings estimates in a residual income model (fundamentally based) as well as a variety of technical price driven signals (relative market performance, performance over time, resistance levels). A qualitative assessment of the business is undertaken to mitigate value traps.

Gyrostat Investment Risk Return Variables



Gyrostat uses proprietary software to identify options series with the greatest profit potential for a defined cost, exploiting differing levels of implied volatility in the options market.

Finally, seasonality in the dividend flows and in market conditions are also applied. Stock positions are entered into and hedged to ensure that the loss of any one position is no more than 3% over one quarter.

Additionally, calls are either bought or written depending on market conditions.

It is important to note that the overlay is not a set and forget strategy. Rather, it is actively monitored and trades follow large market or stock specific moves. Hence trading is intensified around corporate events. The strategy achieves its highest returns on market ‘gaps’ from the previous days close to market open. These represent major opportunities for the Fund. With ‘hard’ protection always in place and limited capital at risk across all price ranges, there are no requirements for stop losses.

7. How can sequencing risk be protected in retiree's portfolio construction?

Sequencing risk is the risk that the order and timing of investment returns are unfavourable, resulting in less money for retirement. Major market falls are a regular and hazardous feature of the investment cycle. Most corrections of > 30-50% occur within 6-12 months and typically within an 8 year cycle. We believe sequencing risk can be addressed through appropriate portfolio construction, in particular the adoption financial risk managed approaches, such as the application of dynamic risk managed risk protection overlays as utilised by Gyrostat.