KAPSTREAM
A JANUS CAPITAL Group Company

Monthly Report

Kapstream Absolute Return Income Fund

April 2017

Performance	Month (%)	3 Months (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	Inception (%) p.a.
Portfolio (gross)[1]	0.20	1.19	3.96	3.93	4.96	5.77
50% Bloomberg AusBond Bank Bill Index & 50% Bloomberg AusBond Composite 0-3 Yr Index	0.23	0.59	2.18	2.58	2.73	3.80
Active return (gross)[2]	-0.03	0.60	1.78	1.35	2.24	1.97

1. Gross returns exclude impact of ongoing management fees. No allowance is made for tax.
2. Numbers may not add due to rounding
3. Benchmark performance includes the RBA Cash Rate until 31 January 2014.

Portfolio Commentary

Your Fund returned 0.20% in April, and 3.96% over the 1-year period. Bond yields rallied toward post US election lows as a “risk-off” theme dominated market sentiment through most of April. The “no” Congresssional vote on US healthcare changes – signaling further political gridlock combined with subdued US economic data and concern over French elections controlled market emotion leading to month-end. However, further clarity around US tax reform and Macron’s likely victory in French elections allowed risk markets to rally and bond yields to rise at month-end. Australian 10-year government bond yields ended the month at 2.60%, down 0.10% from March. Likewise, US 10-year Treasuries yielded 2.35% at month-end, down 0.05%.

US Congress avoided a government shutdown (at least through September), agreeing on a compromised FY2017 budget while Macron won a decisive victory in the first round of French elections. Equity markets moved toward new record highs at month-end, with the Australian ASX up 1.04% and US S&P up 1.03%.

Markets continue to price in high probabilities for two more US rate hikes in 2017. In contrast, Australian markets price in virtually no probability of a 2017 rate hike and a small probability of one 0.25% cut.

Outlook

We retained a more conservative focus, as we remain uncertain of Trump administration policies. In a market characterized by greater volatility we expect to continue to minimise low risk/return trades such as our interest rate (duration) position. Given our expectations for much economic policy being geared toward more growth and inflation, we will maintain very small duration positions.

As policy focus moves away from immigration toward economic platforms, we remain concerned that increasing trade barriers and ending existing trade treaties will both raise inflation and lower US economic growth. We believe the Trump economic package will be revealed much later in 2017 which will cause continuing short-run volatility as markets price in rumor and innuendo.

More recent economic data lead us to remain neutral to the 2 more rate hikes over 2017. We view March’s 98,000 weak payrolls number to be an aberration, believing 7+ years of stable and steady jobs growth will likely continue. Wage pressures remain a concern, with average hourly earnings at 2.7%. Nonetheless, we expect the Fed to tread carefully, given Brexit concerns, European banking volatility, and slower Asian growth.

We believe the ECB will continue to struggle with the effectiveness of its quantitative easing programme, currently at €60 billion/month in sovereign and corporate bond purchases. We expect 2017 European growth and inflation to continue underperform expectations amidst structural rigidities in labour and product markets, particularly in Peripheral regions. Despite low growth, low inflation and easy monetary policy, we have found bond opportunities limited given low/negative yields and too great risks associated with higher-yielding investments. We expect to continue to avoid Europe, given uncertainty surrounding the Brexit campaign, low yields and limited corporate profitability, particularly with the uncertainty surrounding Brexit.

We continue to hold a positive view on investment grade credit in Australia, largely due to attractive real yields and robustness of issuers compared to other developed markets. Our portfolios continue to have material exposure to Australia, currently about 60% of our holdings.

Favoured holdings remain

1) the banking sector due to attractive yields and greater liquidity, and
2) infrastructure-type assets such as airports and toll roads which offer attractive yields, systemic importance, monopolistic businesses, high regulation and quality underlying collateral.

Globally, we like systemically important, highly rated Asian issuers such as government-related energy, telecom and banking entities and the US 'too-big-to-fail' banks, whose bonds should be supported by an increasingly robust regulatory environment focused on less risk taking and greater capital requirements.

We have maintained the fund's "liquidity bucket" of government-related and cash instruments at our target, back to our long-run average, taking advantage of attractive corporate issuance opportunities.

In managing fixed income portfolios, there are better risks to take:

- We expect corporate profitability to remain strong, aided by less regulation and lower taxes. We will continue to hold high-quality, investment-grade issuers. These corporate bonds currently yield approximately 3.2%.
- We expect the US to remain the main engine of global growth providing strong support for the US dollar vs. the rest of the world. We intend to continue to take long US dollar positions vs. a basket of Asian currencies and vs. the Euro.
- We expect US rates will underperform the rest of the world as US recovery continues. We will maintain positions which benefit from narrowing US vs. Australian and New Zealand rates.
- We still see risks in Europe. The European Central Bank will eventually increase the size of its Quantitative Easing programme, particularly as banking risks increase. However, we find little value in Europe given the low and negative yield environment.

Contact Details

Courtney Chute - Portfolio Manager, Kapstream Capital | Tel 02 9234 0009 | email: Courtney.Chute@kapstream.com

The information has been prepared on the basis that the Client is a wholesale client within the meaning of the Corporations Act 2001 (Cth), is general in nature and is not intended to constitute advice or a securities recommendation. It should be regarded as general information only rather than advice. Because of that, the Client should, before acting on any such information, consider its appropriateness, having regard to the Client's objectives, financial situation and needs. Any information provided or conclusions made in this report, whether express or implied, do not take into account the investment objectives, financial situation and particular needs of the Client. Past performance is not a guide to future performance. Neither Kapstream Capital (**"Kapstream"**) (ABN 19 122 076 117 AFSL 308 870) nor any other person guarantees the repayment of capital or any particular rate of return of the Client portfolio. Except to the extent prohibited by statute, Kapstream, or any director, officer, employee or agent of Kapstream, do not accept any liability (whether in negligence or otherwise) for any errors or omissions contained in this report.