Kapstream
— JANUS HENDERSON —
Monthly Report

Kapstream Absolute Return Income Fund

April 2020

Performance	Month (%)	3 Months (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	Since Inception[1] (%) p.a.
Fund Return (before fees and sell spread)	-0.36	-1.42	1.39	2.91	3.10	5.10
Fund Return (after fees, before sell spread)[1]	-0.38	-1.58	0.89	2.45	2.66	4.75
Fund Return (after fees and sell spread)[2]	0.32	-1.88	0.58	2.35	2.60	4.73
RBA Cash Rate	0.01	0.11	0.86	1.29	1.49	3.13
Active return[3] (before fees and sell spread)	-0.37	-1.53	0.53	1.62	1.61	1.97
Active return[3] (after fees and sell spread)[2]	0.31	-1.99	-0.28	1.06	1.11	1.60
Bloomberg AusBond Banks Bill Index	0.05	0.22	1.12	1.62	1.80	3.40

Past performance is no guarantee of future results. After fee returns are inclusive of 0.41% annualised total expenses for class I units. Fund inception date 31 May 2007. No allowance is made for tax. Numbers may not add due to rounding. 1) For a continuing investor the actual return experienced based on the NAV performance of the Fund, after accounting for management fees. 2) The return experienced by a redeeming investor, based on the exit price performance of the Fund which accounts for the end of period sell spread of 0.30% (see additional note on sell spreads at the end of this report), and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate).
Source: Fidante Partners Limited, 30 April 2020.

Portfolio Commentary

The Fund returned -0.38% in April and -0.96% calendar-year-to-date (after management fees but excluding the impact of any sell spread cost* charged only to redeeming investors). The Fund's credit default protection was the largest detractor following a month-end bond rally as risk appetites returned. Positives over the month included our corporate bond exposure, albeit Australian corporates lagged the wider global market. The portfolio's interest rate exposure, currently at 1.1 years' duration, aided returns as yields fell. Currency positions, generally long USD versus Asian currencies, slightly detracted from value.

* Note on sell spreads below.

Outlook & Portfolio Strategy

We remain concerned over further market turmoil and will maintain conservative risk exposures. We have increased our cash exposure to approximately 11% of the Fund through selling corporate bonds over the past two months. We will maintain high credit default protection and hold interest-rate duration in the 1.1 years' range. Cash and liquidity remain our number one priority. While corporate bond yields look very attractive from a fundamental perspective given the sell-off, the new liquidity premium for these securities make us reluctant to buy over the shorter term. We also remain concerned that a longer than anticipated lockdown could stress corporate solvencies even further. We will await further information before increasing risk positions.

US policymakers delivered their first phase of massive fiscal support. The US Federal Reserve delivered on monetary policy, quantitative easing and a wide-ranging set of programs meant to support both financial markets and the wider economy. Whilst we remain biased for lower short-term rates, they have already been priced in and we have little conviction in overall direction of interest rates or equities from where they stand today. While market talk of negative US rates is premature, low short-term rates are a given for the next 12-18 months. We are not believers in the consensus view for a steeper yield curve as massive deficits fuel record Treasury bond issuance. Lessons from Japan and Europe demonstrate longer-term deflation risks override supply concerns.

Bond market liquidity is improving. We have used improving liquidity to increase cash and remain fortunate in not feeling compelled to make major portfolio changes. We remain 100% investment grade, biased toward shorter dated (<5yr) issues, and with a continued avoidance of more volatile or higher beta sectors (such as commodity, energy, gaming, tourism and autos) as well as the worst affected regions. We maintain only a modest exposure to China (and only in USD-denominated quasi-sovereign issuers), and otherwise nothing in emerging markets. Our portfolio can be simply split across three major 'buckets'; financials (~1/3rd), corporates (~1/3rd), and mortgage-backed (~20%) with the residual in cash. Geographically, we have maintained a roughly 2/3rds to 1/3rd split between Australian and international issuers (the latter divided between the US and developed Asia). We have no greater concern today with default risk across any portfolios we manage as we did before the turmoil in markets began.

For the coming month our main goal will remain protecting the portfolio from a further sell-off in risk assets and widening corporate bond spreads.

A final note on fund sell spreads

Consistent with improving bond market conditions and heightened Fund liquidity the sell spread was further reduced during the period to 0.30%. This spread exists solely to protect unitholders from the impact of higher trading costs that the whole fund would otherwise face in meeting requests from the few investors who on any given day wish to withdraw any of their investment. It is not a manager fee, rather a mechanism that pays directly back into the Fund to ensure only withdrawing unitholders meet the currently elevated transaction costs of a withdrawal. Markets remain volatile and liquidity conditions change on a daily basis. While we all look forward to an eventual return to normalcy, the sell spread currently remains in place as necessary protection for unitholders from the adverse environment we all face. Please stay abreast of current sell spread levels which are published as a Continuous Disclosure Notice on our Responsible Entity's website at https://www.fidante.com/investment-managers/kapstream-capital.

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