KANGANEWS AWARDS 2017 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
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Kapstream
—JANUS HENDERSON—
Monthly Report

Kapstream Absolute Return Income Fund

November 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)	0.52	1.09	1.97	2.99	3.38	5.07
Fund Return (after fees, before sell spread)[1]	0.48	0.99	1.48	2.53	2.93	4.73
Fund Return (after fees and sell spread)[2]	0.50	1.04	1.37	2.50	2.91	4.72
RBA Cash Rate	0.01	0.05	0.39	1.04	1.28	3.00
Active return[3] *(before fees and sell spread)*	0.51	1.04	1.58	1.95	2.10	2.07
Active return[3] *(after fees and sell spread)[2]*	0.49	0.99	0.98	1.46	1.63	1.71
Bloomberg AusBond Banks Bill Index	0.01	0.03	0.44	1.31	1.56	3.26

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 0.15% (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, 31 March 2020.

Performance & Market Commentary

The Fund performed well in November returning 0.48%, and 1.40% calendar-year-to-date (after I class unit fees). Positives over the month included coupon income and capital appreciation from our corporate bond exposures. Our interest rate duration of approximately 1.6 years was a modest detractor from returns. Our active currency positions, namely a long Norwegian krona position (versus the USD) aided returns whilst our long Thai baht and Korean won vs. the US dollar was a slight negative for returns. More recent events including announcement of a viable vaccine and a clear US election outcome make us more positive, and accordingly we have reduced our 'liquidity bucket' of cash and government-related securities from 10% to 7%.

Global bond markets remained relatively stable over the month, although US yields slightly rose. Corporate bonds, particularly in Australia, outperformed as investors sought higher yields in a low interest rate environment. Improving global data, including payrolls and retail sales aided risk appetites, but the recent surge in COVID-19 cases kept a lid on market bullishness.

Outlook & Portfolio Strategy

We have become more optimistic on global recovery, perhaps seeing global GDP return to pre-COVID-19 levels by Q3 2021, the primary driver being good news on the vaccine front. As telegraphed over the prior month, we have reduced cash levels given penalty rates for holding cash, combined with our more optimistic growth outlook. A clear US election outcome (despite current noise), strong consumer balance sheets and solid employment data add to our more optimistic outlook. The apparent appointment of Janet Yellen as Treasury secretary is a large positive, indicating better coordination between the government and the Federal Reserve. However, stronger than anticipated COVID-19 reinfection rates, new lockdowns and the resulting negative impact to businesses in Europe and the US, and a likely Republican-held Senate reducing the likelihood of meaningful US fiscal stimulus will continue to make us cautious in the months ahead. We will maintain lower credit default protection and continue to hold interest-rate duration in the 1.6 to 2.0 year range. Democrats winning the two Georgia Senate seats could lead to a positive surprise for US fiscal stimulus while further virus spread and risks to the approval, acceptance and distribution of a viable vaccine could lead to a negative surprise. We will await further information before further increasing risk positions.

Whilst we remain biased for lower short-term rates, they have already been priced in. Low short-term rates are a given for the next 12 to 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 combined with central bank purchases override supply concerns. Nonetheless 3-7 year bonds remain attractive given their yield advantages over cash rates, and also prospects for 'roll-down' gains or yields falling as these bonds move closer toward maturity.

Bond market liquidity continues to improve toward pre-COVID-19 levels. We remain 100% investment grade, biased toward shorter dated (<7yr) 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 (~40%), corporates (~34%), and mortgage-backed (~19%) 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). Again, we have no greater concern with default risk across any portfolios we manage as we did before the turmoil in markets began.

For the coming period our main goal will continue to be protecting the portfolio from a further sell-off in risk assets and corporate bond spreads.

A final note on fund sell spreads

The fund sell spread was reduced from 0.12% to 0.10% over the month, reflecting lower but still moderately elevated market transaction costs in fixed income securities. Sell spreads exist 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 that ensures only withdrawing unitholders meet the still modestly elevated transaction costs of a withdrawal. Please stay abreast of current sell spread levels which are published as a Continuous Disclosure Notice on our Responsible Entity's website https://www.fidante.com/investment-managers/kapstream-capital.

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