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

October 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)	0.33	0.71	1.68	2.93	3.31	5.07
Fund Return (after fees, before sell spread)[1]	0.31	0.62	1.20	2.47	2.87	4.72
Fund Return (after fees and sell spread)[2]	0.31	0.65	1.07	2.43	2.84	4.71
RBA Cash Rate	0.02	0.06	0.43	1.08	1.31	3.02
Active return[3] (before fees and sell spread)	0.31	0.65	1.25	1.85	2.00	2.05
Active return[3] (after fees and sell spread)[2]	0.29	0.59	0.63	1.35	1.53	1.69
Bloomberg AusBond Banks Bill Index	0.01	0.03	0.51	1.35	1.59	3.28

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 0.12% (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 October 2020.

Performance & Market Commentary

The Fund performed well in October returning 0.31%, and 0.92% calendar-year-to-date (after I class unit fees). Positives over the month included coupon income and capital appreciation from our corporate bond exposures. Interest rate duration exposure of approximately 1.5 years was a modest detractor from returns as were our active currency positions, namely our long Norwegian krona, long Thai bhat and long Korean won positions versus the US dollar. Whilst we expect to maintain conservative portfolio positioning given our concern over longer-term growth, more recent events including announcement of a viable COVID-19 vaccine and a clear US election outcome make us more positive for the coming months. We expect to reduce our 'liquidity bucket' of cash and government-related securities from 10% toward 7% in the coming weeks as opportunities present.

Global bond markets remained relatively stable over the month, although US yields slightly rose. Corporate bonds 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 and the then looming US presidential election kept a lid on corporate bond performance.

Outlook & Portfolio Strategy

We remain concerned over further market turmoil and political divisiveness and will maintain conservative risk exposures. Penalty rates for holding cash have become too painful and we made use of select short-term commercial paper to maintain a relatively strong portfolio yield, while protecting against further market volatility. We have reduced but still maintain a degree of credit default protection and continue to hold interest-rate duration in the 1.6 to 2.0 year range. We remain concerned that a longer than anticipated lockdown could stress corporate solvencies further, driving us to be highly selective in deploying cash into new opportunities.

Whilst we remain biased for lower short-term rates, they have already been priced in and we have little conviction in the overall direction of interest rates or equities from where we stand today. While market talk of negative US rates is premature, low short-term rates are a given for the next 12 to 18 months at least. 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 will override supply concerns.

We remain 100% investment grade, strongly 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 COVID-19 affected regions. That said, we see wide dispersion within certain sectors, creating pricing anomalies that we will continue to exploit. 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 (~30%), and mortgage-backed (~20%) with the residual in cash. Geographically, we continue to maintain a roughly 2/3rds bias to Australian issuers, notably given they still offer better relative value compared to their international peers. Over time if the relative value position moderates we

will look for opportunities to reduce this. 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 continues to be protection of the portfolio from a further surprise sell-off in risk assets and a widening of corporate bond spreads.

A final note on fund sell spreads

The fund sell spread is currently 0.12%, 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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