Kapstream
—JANUS HENDERSON—

Monthly Report

Kapstream Absolute Return Income Fund

July 2021

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)	0.28	0.43	1.99	2.61	2.96	4.89
Fund Return (after fees, before sell spread)[1]	0.25	0.33	1.57	2.15	2.52	4.53
Fund Return (after fees and sell spread)[2]	0.25	0.33	1.64	2.12	2.50	4.53
RBA Cash Rate	0.01	0.02	0.14	0.73	1.04	2.86
Active return[3] *(before fees and sell spread)*	0.27	0.41	1.85	1.88	1.93	2.02
Active return[3] *(after fees and sell spread)*[2]	0.24	0.31	1.51	1.39	1.47	1.66
Bloomberg AusBond Banks Bill Index	0.00	0.01	0.05	0.89	1.26	3.10

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 0.07% and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate).
Source: Fidante Partners Limited, 31 July 2021.

Performance & Market Commentary

The fund performed well in July returning 0.25% (after I class unit fees). At a higher level, while coupon income remained the primary driver, interest rate exposure of about 0.6 years' duration was also positive for returns, driven principally by our Australian yield curve positioning of being long 10-year rates vs. 3 and 5-year rates. Corporate positions slightly detracted as corporate bond spreads marginally widened, although coupon income more than offset this. Our currency positions, of being long USA vs. CAD, GBP, JPY and Euro, were neutral for returns as the US dollar remained stable over the month.

Global and Australian yields fell over the month, the 5-year Australian government bond yield falling 0.24% to reach 0.59%, and 10-year yields falling 0.35% to reach 1.18%. Growing COVID-19 cases, a likely longer Sydney and wider national lockdown renewing prospects for the RBA to walk back its eventual tapering plans.

However, RBA policy so far remains unchanged, with cash rates and 2-year bond yields anchored at 0.10% and AUD5bn in weekly bond purchases expected to continue until at least September, despite Q3 growth headwinds as lockdowns continue and COVID-19 cases increase.

Outlook & Portfolio Strategy

While we remain optimistic on global recovery, increasing COVID-19 cases (notably the spread of the delta variant) and vaccine resistance will continue to weigh on global economies. We expect greater levels of vaccination to eventually allow for re-opening of businesses and to permeate to additional pockets of global economies, but this will take longer than markets currently anticipate. As demonstrated in Sydney, the effects of the pandemic will remain with us throughout 2021 and 2022, as the border remains closed through at least the first quarter of 2022. Although we expect a temporary spike in inflation, persistently high inflation is not a story for the longer-run, given it will take many years to reach full employment globally. Whilst Australian unemployment returned to pre-pandemic levels, the eventual return of foreign workers will keep a lid on wage inflation and overall inflation in the longer-run, keeping a cap on overall interest rates.

As telegraphed, we have maintained low cash levels given penalty short-term rates. Strong consumer balance sheets, fiscal expansion and expectations for solid employment data (once wider distribution of vaccines takes effect) add to our more optimistic outlook. In the US, the ability for Democrats to pass budget legislation including greater COVID-19 relief programs mean both fiscal and monetary stimulus will be running on all cylinders, at least in the shorter-run. More recent bond rallies and increasing rate volatility have caused us to reduce interest-rate duration to the 0.6 year range.

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-to-7 year bonds remain attractive given their yield advantages over cash rates and prospects for 'roll-down' gains or yields falling as these bonds move closer toward maturity.

We remain 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 (~45%), corporates (~30%), and mortgage-backed (~15%) with the residual in governments and 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 2020 turmoil in markets began. For the coming period our main goal will remain protecting the portfolio from a sell-off in risk assets and corporate bond spreads.

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