Kapstream
— JANUS HENDERSON —

Monthly Report - Class I Units

Fund Objective

The fund aims to provide a superior stream of income and capital stability over the medium term while aiming to outperform its benchmark through market cycles.

Fund Application

Investors seeking to enhance their overall fixed income returns with a higher yielding, predominantly investment grade (IG), absolute return-oriented global fixed income portfolio.

Fund Details

APIR code	HOW0165AU
Inception date	31 May 2007
Fund size	AUD 4,057m
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.42yrs
Credit spread duration	2.65yrs
Average credit rating	A
No of issuers	95
Yield to maturity	1.30%

Fund Guidelines

Target return	cash plus 2-3%
Target volatility	less than 1.5% annualised
Duration limits	-2 to +2 years
Credit quality	>85% investment grade

Steve Goldman
Portfolio Manager

Dan Siluk
Portfolio Manager

August 2021

Performance (%)	1 month	3 months	1 year	3 years p.a.	5 years p.a.	Annualised since inception
Fund Return (before fees and sell spread)	0.05	0.37	1.90	2.49	2.85	4.86
Fund Return (after fees, before sell spread)[1]	0.02	0.27	1.47	2.04	2.40	4.51
Fund Return (after fees and sell spread)[2]	0.02	0.27	1.55	2.01	2.39	4.50
RBA Cash Rate	0.01	0.03	0.13	0.69	1.01	2.85
Active return[3] (before fees and sell spread)	0.04	0.34	1.77	1.80	1.84	2.01
Active return[3] (after fees and sell spread)[2]	0.01	0.24	1.42	1.32	1.38	1.65
Bloomberg AusBond Banks Bill Index	0.00	0.01	0.04	0.84	1.22	3.08

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 August 2021.

Performance Commentary

The fund returned a modest 0.02% in August (after I class unit fees). Coupon income was the primary driver of returns, with mild spread compression also contributing positively over the month. The main detractor of returns was swap-spread widening in Australia, where a 5-7 basis point widening across the curve cost the portfolio about 10 basis points. The interest rate component of the portfolio's corporate assets are typically hedged by selling government bond futures, which naturally makes us long swap spreads. Our currency positions, of being long USD vs. CAD, GBP, JPY and EUR added 1 basis point to returns as the USD strengthened.

Market Commentary & Outlook

Despite cases of COVID-19's Delta-variant continuing to grow in nations with high vaccination levels, rates of death and hospitalisation remain low and so risk assets were broadly supported. The S&P 500 was up 2.9%, the 7th consecutive positive month. Australia's S&P/ASX 200 was up 1.9%, extending its stretch of monthly gains to 11 months. Volatility trended lower with the VIX down 1.8 points to 16.5. Credit spreads were tighter, with both North American and Australian IG CDS indices contracting marginally to 46.2 and 58.3 respectively, close to the tights on the year.

Key data prints in the US, namely payrolls and inflation, continue to be robust. Non-farm payrolls came out at +943k relative to expectations of +870k, this saw unemployment drop to a post-pandemic low of 5.4%, down from 5.9% the prior month. Meanwhile, headline inflation for the month was a strong 0.5%, as expected, with an annual rate tracking at 5.4%, modestly above expectations of 5.3%. The details showed a slowing in the transitory elements of the inflation basket, namely used cars, hotels and recreation. However, global shipping, transportation and storage costs (excluding fuel) continue to be high which speaks to the supply-chain constraints caused by COVID-19 and this in our view will lead to

persistently higher inflation over the short term. The much anticipated Jackson Hole speech by Fed Chair Jerome Powell confirmed conditions have been met for a tapering of the balance sheet to begin in the coming months, so the key focus will now shift to interest rate hikes where a clear distinction has been communicated to the market that tapering does not represent a tightening of financial conditions. We expect the Fed to maintain rates at or near zero for the next couple years with uncertainty as to the direction of inflation leading to volatility further out the curve. Rates were higher and steeper over the month with 2-year +2.5 basis points to 0.21% and 10-year +8.7 basis points to 1.31%.

In Australia, tightening of restrictions and ongoing lockdowns due to the spread of COVID-19's Delta-variant, particularly in New South Wales and Victoria, are weighing on investor sentiment. Business Conditions saw its largest monthly fall since the depths of 2020’s COVID-19 crisis, down 13.5pts to 11, while Business Confidence is now in negative territory, down 18.5pts to -8, in the red for the first time since September 2020. Earlier in the month the RBA met and retained the current composition of monetary policy; rates at 0.1% and QE purchases at a rate of A$5bn per month. Doves were left disappointed as the RBA did not indicate they were prepared to delay a tapering of asset purchases to $4bn per month in mid November. This suggests that the RBA believes the current mix of monetary policy settings is sufficiently loose and that any loss of economic activity through lockdowns will rebound quite quickly in subsequent months. Rates were little changed with 3-year down half a basis point to 0.237% and 10-year down 2.6 basis points to 1.16%.

The Bank of England also maintained unchanged policy settings, however, Governor Bailey delivered a hawkish statement in acknowledging a “modest tightening” of settings will be required “to be consistent with meeting the inflation target sustainably”. This tables a concern other MPC members also hold, which is that inflation may not be as transitory as the other central banks are implying (or hoping!). Bailey raised expectations for near-term inflation to 4% and forecasting a return to 2% in three years time. The European Central Bank did not meet in August however we have noted an uptick in hawkish commentary from Governing Council members who believe it is time to begin discussions on how to transition away from emergency stimulus as inflation and growth both rise across the region. The German 10-year was up 8 basis points to -0.38%.

In Asia, the Bank of Korea hiked rates by 25 basis points to 0.75%. Governor Lee was fairly dismissive of COVID-19 downside risks and instead chose to focus on potential financial imbalances and prolonged negative real rates as being harmful for markets and economy activity, as his rationale for hiking. In China, the partial shutdown of its major shipping port in Ningbo-Zhoushan (the third largest cargo port in the world) due to a COVID-19 Delta outbreak highlights the precarious nature the virus continues to hold over global supply chains. Such a shutdown only serves to further delay the transitory inflation narrative in ensuring transportation and storage costs remain elevated. Chinese data continues to print on the softer side; retail sales, industrial production and manufacturing PMIs all printing below expectations. We note that China appears to be entering a period of economic adjustment as it adapts to a new political and economic paradigm and while they have used policy tools, both monetary and fiscal, effectively in the past, such cultural and political shifts make policy changes more difficult going forward.

Portfolio Strategy

The portfolio maintained a yield-to-maturity of 1.3%, which at 120 basis points above the RBA's cash rate we believe provides us with a strong tailwind for returns going forward. This is towards the high end of our historical range during a non-stressed period, driven by an attractive off-index idiosyncratic pipeline. We rotated into attractive securitised and T2 investments, taking profits on tight senior financials and corporates. We continue to run a barbell strategy preferring shorter dated BBB credits over longer dated A credits given their similar spread and lower losses in a sell-off. Credit spread duration and average maturity were little changed over the month at 2.65 years and 2.77 years respectively. August is traditionally a quiet month for new issuance in the US as their summer holidays draw to a close, this theme permeates into the Australian corporate bond market where primary markets also completely dried up. Credit spread volatility was low, supported by accommodative policy and a quiet month for turnover. We anticipate the pipeline for new issuance to expand quite dramatically through September, and expect to see additional activity next month.

One area where we have been conducting additional research is in the US Loan space, as a relative value trade against High Yield. At a broad market level, the major USD Loan funds can yield north of 5%, and with High Yield Credit Default Swap Indices cost of carry

well below 3% throughout this calendar year and volatility stable, we believe we can find an attractive risk adjusted return structure, to enhance portfolio returns without adding undue risk.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~33%), corporates (~44%), and asset and mortgage-backed (~15%) with the residual in cash and liquids. Geographically, we have a roughly 70/30 split between Australian and international issuers.

In rates, we reduced duration from 0.6 years at the end of July to 0.4 years at the end of August. At a country level, the breakdown is 0.3 years Australasian duration and 0.1 years US duration. The reduction in duration of approximately 0.2 years primarily came from the 10 year part of the US curve. Whilst we believe central banks will keep rates on hold, ensuring the front end of yield curves is little changed, this promise to maintain rates near the effective lower bound could result in a return to markets pricing in modest levels of inflation, albeit at a slower pace than witnessed in the first quarter of this year. Hence 10yr US Treasury yields in the 1.2-1.3% range are too low by our reckoning and we expect rates to be higher by year end, in the 1.5-1.6% range.

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