Kapstream Absolute Return Income Plus Fund

Kapstream
— JANUS HENDERSON —

Monthly Report – I class 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

Inception date	16 August 2018
Fund size	AUD 372m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%

Fund statistics

Interest rate duration	0.42 yrs
Credit spread duration	1.94 yrs
Yield to Maturity	3.31%
Average credit rating	BBB
Number of issuers	67

Fund guidelines

Target return	cash plus 3-4%
Target volatility	<3% annualised
Duration limit	-2 to +2 yrs
Credit quality	>75% investment grade

Dylan Bourke
Portfolio Manager

Steve Goldman
Portfolio Manager

November 2021

Performance (%)	1 month	3 months	6 months	1 year	calendar year to date	annualised since inception
Fund Return *(before fees and sell spread)*	**0.07**	**0.39**	**1.31**	**2.96**	**2.44**	**3.16**
Fund Return *(after fees, before sell spread)*[1]	0.03	0.28	1.08	2.48	2.01	2.67
Fund Return *(after fees and sell spread)*[2]	0.03	0.28	1.08	2.64	2.16	2.65
RBA Cash Rate	0.01	0.02	0.05	0.10	0.09	0.65
Active return[3] *(before fees and sell spread)*	**0.06**	**0.37**	**1.26**	**2.86**	**2.35**	**2.51**
Active return[3] *(after fees and sell spread)*[2]	0.02	0.25	1.03	2.54	2.07	1.99
Ausbond Bank Bill Index	0.01	0.01	0.01	0.02	0.02	0.79

Past performance is no guarantee of future results. Net of fee returns inclusive of 0.4632% annualised total expenses. 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 start and end of period sell spread level (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 November 2021.

Performance commentary

The Fund returned 0.07% before fees in November. The fund delivered just below its cash plus 3-4% target range over the trailing twelve-month period driven by a stronger November 2020 dropping out. The largest contributor over the month was coupon income. The 0.42yr duration also marginally contributed as rates rallied. However, AUD swap spreads widened 17bps which the portfolio was exposed to by being long fixed rate bonds and hedging by selling futures. Additionally, credit spreads widened detracting from performance. Historically swap spread widening has tended to revert back to less elevated levels over a few months, so we are hopeful it will form a return tailwind over coming months.

Portfolio strategy

The fund rotated into attractive new issues, maintaining the yield over 3%, while spread duration increased to 1.94yrs. We believe the spread over the cash rate should provide a strong tailwind for returns going forward. Duration was maintained around 0.4yrs, as we believe there will be continued volatility in rate markets, due to persistent concerns about inflation. We run a barbell strategy, preferring short-dated, lower rated credits given their expected resilience in a sell-off and concerns over credit spreads at relatively tight levels. Repo exposure was nil.

The fund's recent purchases included market leaders in the financial, securitised and corporate sectors. The average credit rating of our holdings was reduced to BBB from BBB+ driven by buying short dated BBB T2. High yield stayed fairly stable at 19.7%. High yield holdings are typically BB-rated, short maturity bonds in the financial or securitised sectors where we have no concern around default risk. We minimise or completely avoid exposure to the traditionally higher beta sectors such as commodities, energy, airlines and tourism.

Our portfolio can be simply split across three major 'buckets'; financials (~47%), corporates (~23%), and asset and mortgage-backed (~18%) with the residual in cash and liquids. Geographically, we have an 88%/12% split between Australia/New Zealand and international issuers. Over the coming months, we expect to maintain the yield on the portfolio, as we continue to add from a very strong pipeline of investment opportunities.

In rates, we have ~0.2yrs Australasian duration and ~0.2yrs US duration for a total portfolio duration of ~0.4yrs. We believe there is merit in maintaining some level of neutral duration as a hedge for the credit book.

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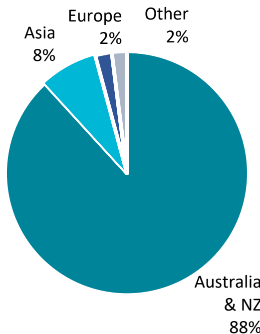
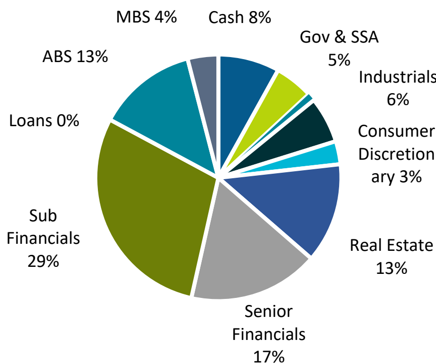
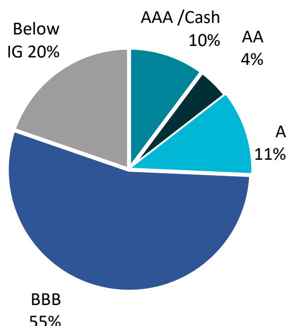
Geographic Allocation



Sector Allocation



Credit Rating



Outlook

In global markets, risk assets sold off with equities down globally, CDX widened 5.5bps and the VIX spiked 11% to 27%. Credit spreads in the US widened 10bps, with AUD spreads being fairly stable except for T2 which widened 6bps. Global rates rallied, particularly in the long end. Swap spreads tended to widen with Australian swap spreads being particularly affected widening c17bps, reflecting the withdrawal by hedge funds after being stopped out in violent rate moves last month as well as continued paying pressure from mortgage holders and corporates fixing their interest rates.

In the US, the Federal Open Market Committee announced tapering of asset purchases at a pace of USD 15bn per month being 10bn in Treasuries and 5bn in Agency Mortgages. FOMC members started to talk about the prospect of a faster taper and this led to the market pricing rate hikes sooner. Federal Reserve Chair Jerome Powell chose to “retire” the term “transitory” to describe inflation. While Powell described inflation as still being clearly connected with the pandemic, the fact that is has spread more broadly was evidenced with the data; November releases of Consumer Price Inflation (CPI) of 6.2% and the FED’s preferred measure Personal Consumption Expenditures of 5.0%, both at levels not seen in decades, led the market to believe the pace of taper will be accelerated at the December meeting. The 2-year US Treasury rose 6.8 basis points to 0.565% while the 10-year fell 10.8 basis points to 1.44%.

In Australia, the Reserve Bank of Australia formally discontinued its Yield Curve Control (YCC) target, effectively removing the guidance associated with a first hike in 2024. The RBA highlighted two main reasons for the end of YCC, i) a fundamental improvement in the economy and an earlier than expected return to its inflation target and ii) operational challenges around additional purchases of government bonds, having already owned a significant proportion of outstanding bonds across the Australian Commonwealth Government Bond curve. We believe it is this latter reason which will lead the RBA to also taper purchases under its Quantitative Purchases (QE) program at a more rapid pace, which will be reviewed in February. Governor Lowe did attempt to strike a dovish tone, ruling out 2022 rate hikes which market pricing had begun to suggest. On the data front, the employment report was weaker than anticipated, a hangover from recent lockdowns, but this is set to improve in the coming months. Business Conditions and Confidence numbers reflected improving sentiment, while current account surplus surged to a record high for Q3. The yield on the 3-year Australian Government Bond fell 36 basis points (having risen 91 basis points in October) to close the month at 0.865%, while the 10-year fell 40 basis points to 1.69%.

In Europe, the European Central Bank continues to stick to its stance of highly accommodative monetary policy. ECB President Lagarde warned that conditions to start raising rates “are very unlikely to be satisfied next year” and Vice President de Guindos noted that inflation will slow next year, “without a doubt”. Relative to US and other developed market central banks, this divergent policy stance led to the EURUSD hitting a 16-month low of 1.1186. German 2-year rates fell 15 basis points to -0.74%, close to its lows on the year of -0.79% seen in August. Meanwhile, in the UK, the Bank of England (BoE) voted to keep its policy rate at 0.1%, surprising market participants who had anticipated a 15 basis point hike in response to more concerning language from BoE officials in recent months around the persistence of inflation. Officials noted that the Omicron strain has the potential to blow off track the view by policymakers that the economic recovery is mature. 2-year UK Treasury yields fell 22.6 basis points to 0.48% while the 10-year fell a similar magnitude, down 22.5 basis points to 0.81%

In China, we saw some improvements to headline economic data with both retail sales and industrial production rebounding. CPI and Producers Price Index (PPI) were above market expectations. PPI at 13.5% annualised is at levels last seen in the early 1990s. Despite the solid economic data, the Peoples Bank of China (PBoC) downgraded China’s economic outlook, perhaps a sign of uneasiness as the pandemic continues to dictate the global economic recovery. Evergrande’s issues remain unresolved, debt restructuring the most likely path out for the embattled property developer.

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