Kapstream Absolute Return Income Plus Fund

Kapstream
— JANUS HENDERSON —

Monthly Report – I class units

KANGANEWS AWARDS 2018 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2019 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2021 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR

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 333m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%

Fund statistics

Interest rate duration	0.52 yrs
Credit spread duration	1.9 yrs
Yield to Maturity	5.32%
Average credit rating	BBB
Number of issuers	68

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

April 2022

Performance (%)	1 month	3 months	6 months	calendar year to date	1 year	3 years annualised	since inception annualised
Fund Return *(before fees and sell spread)*	**0.03**	**0.04**	**0.64**	**0.30**	**2.14**	**2.53**	**2.96**
Fund Return *(after fees, before sell spread)[1]*	-0.01	-0.07	0.41	0.15	1.67	2.03	2.47
Fund Return *(after fees and sell spread)[2]*	-0.01	-0.07	0.41	0.15	1.67	2.01	2.46
RBA Cash Rate	0.01	0.02	0.05	0.03	0.10	0.38	0.59
Active return[3] *(before fees and sell spread)*	**0.02**	**0.02**	**0.59**	**0.27**	**2.04**	**2.15**	**2.37**
Active return[3] *(after fees and sell spread)[2]*	-0.02	-0.09	0.36	0.12	1.57	1.63	1.86
Ausbond Bank Bill Index	-0.02	-0.01	0.01	0.00	0.02	0.40	0.70

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, and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate). Source: Fidante Partners Limited, 29 April 2022.

Performance commentary

The Fund returned 0.03% before fees in April. Despite being below the target return, it is one of the strongest amongst peers demonstrating robust capital preservation and resilience, notably when compared to conventional indices such as the Ausbond Credit 0+ and Ausbond Composite 0+ indices which fell -1.34% and -1.49% respectively. The largest contributor was coupon income. Rate duration of 0.52yr and swap spread duration of 0.4yr detracted as rates sold-off, and spreads driven by broader risk-off moves also slightly detracted.

Portfolio strategy

The Fund only added the Athene new issue A$ 5yr ASW +190 A rated deal being the only deal to meet the hurdles to deploy into the tepid environment. Internal concern about the potential for a 2023 recession (or at least talk of it), and particularly for risk assets to price this earlier are starting to occupy our thoughts. This is driven by decelerating GDP, high inflation impacting consumers, aggressive rate hiking and a likely China slowdown induced by lockdowns. As a result, we have added CDX again starting in mid April bringing it to 10% at an average of 76bps. Level 1 liquidity was stable at a still conservative level of ~12.4% (cash, semis, commercial paper, SSGA) and Level 2 liquidity ~18.0% (<1yr investment grade).

The Fund currently yields over 5%, providing a strong tailwind for future returns. Physical spread duration ex SSGA was stable at ~1.8yrs and ~1.3yrs net of CDX. There is still capacity to add attractive credits which is possible due to the barbell strategy's success in limiting losses and providing liquidity at an opportune time. This strategy overweighs short-dated, lower-rated credits in tight spread environments (assets with equal carry but less spread compression potential providing greater resilience to sell-offs) and invests in a small bucket of less-liquid, high-spread assets to subsidise an overweight position in liquid assets. Duration increased from 0.37yrs to 0.52yrs, which is still low, as we believe there will be continued volatility in rate markets, due to persistent concerns about inflation. Repo exposure was stable at ~3%.

The average credit rating of holdings was stable at BBB. High yield was stable at c23%, where holdings are typically BB, short maturity bonds in the financial or securitised sectors where we have no concern around default risk. We continue to minimise or avoid exposure to the traditionally higher beta sectors such as commodities, energy, airlines and tourism. Our portfolio is split across financials (~63%), corporates (~16%), and asset and mortgage-backed (~18%) with the residual in cash and SSGAs. We have an 86%/14% split between Australia/New Zealand and international issuers.

In rates, we have ~0.2yrs Australasian duration and ~0.3yrs US duration for a total portfolio duration of ~0.5yrs. We believe there is merit in maintaining some level of neutral duration as a hedge for the credit book, especially as short dated rates have increased significantly.

Outlook

Global risk assets suffered with S&P 500 -8.8%, the VIX was up 12.8ppts to 33.4% and CDX widened +16bps to 83bps. Global rates continued to rise briskly with UST 2yrs +38bps. While broader risks have not changed - war in Ukraine and increased economic uncertainty in Europe; China's COVID-19 lockdowns and subsequent slowing data; central banks grappling to deal with an environment of persistent inflation and slowing growth - investors have begun to price in greater chance of monetary policy mistakes leading to increased probability of a hard landing and/or recession. Add to the mix first quarter earnings news in the US, which despite being quite strong, came with forward looking forecasts revised lower by many companies, particularity volatile mega-cap and big-tech names, adding to the softer risk sentiment.

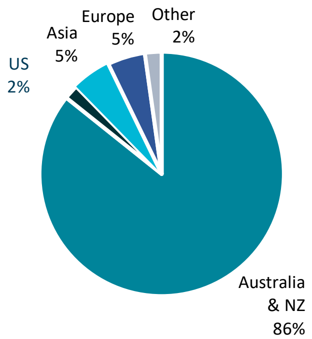
US economic data was mixed, unemployment and underemployment fell to cyclical lows of 3.6% and 6.9% respectively and while the ISM various gauges of manufacturing and services data fell and were lower than expectations, they remain at high levels. Q1 GDP was -1.4%, driven largely by lower net exports (imports exceeding exports). An import surge tied to solid consumer demand suggests growth may return over subsequent quarters and does not signal an imminent recession. Meanwhile, quarterly wage data, in the Employment Cost Index, showed a record +1.4% which will fuel the inflation narrative going forward, adding to pressure on the Fed's inflation-fighting credibility. Headline CPI continued to accelerate printing 8.5%. Many FOMC members now believe rates will need to be raised beyond neutral to combat inflation. While there was no April FOMC meeting, they did convene early May and hiked rates by 50bps, with another 50bp of hikes priced for each of the June and July meetings. Given that elevated realised inflation and inflation expectations over the longer term remain anchored at around 3%, we believe the Fed will continue its aggressive hiking path throughout the year, increasing rate volatility. US rates sold off with 2yr +38bps to 2.71%, while 10yr rose +60bps to 2.94%.

Russia's ongoing invasion of Ukraine continues to weigh on investor sentiment across Europe, as well as impacting food and energy prices globally. Emmanuel Macron's victory in the French national elections provided some political certainty which was viewed positively by markets. Meanwhile, the ECB failed to present the market with a firm plan as to when their asset purchase program will unwind, sending the Euro lower. Member commentary points to readiness in raising rates, however, ECB President Lagarde remains circumspect saying "if I raise interest rates today, it is not going to bring the price of energy down". German 2yr yields rose 34bps 0.26%, while the 10yr rose +39bps to 0.94%.

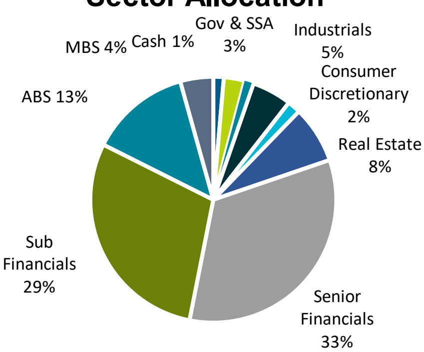
Australia economic data broadly underperformed expectations. Home loans fell as higher mortgage rates charged by the banks has slowed the pace of house price growth, even seeing declines in some capital cities. Fewer jobs than anticipated were created and the unemployment rate remained at an albeit low level of 4.0%, narrowly missing expectations of 3.9%. Headline CPI was 5.1% with strong price increases in non-tradeables (services) inflation signalling that there is momentum driven by higher wages and demand, not just the supply-induced disruptions relating to China and Ukraine. While the RBA did not alter policy rates in April, it was the inflation data and expectations of wage inflation remaining elevated that led to a 25bp increase in the policy rate to 0.35% early May. Governor Lowe, no longer "patient", has communicated the Board's flexibility to raise rates based on data "over coming months". Australian 3yr yields rose +37bps to 2.71%, while the 10yr rose +29bps to 3.13%.

In Asia, China saw a slowing of manufacturing and non-manufacturing PMI, in particular the latter which has been impacted mostly by growing infections leading to city-wide lockdowns across the country. Stimulus measures thus far have been insufficient to deal with the slowdown. In Japan, the focus was on currency markets as the JPY declined sharply, one of the weakest performers in the G10, -6.6% against the USD, having fallen -5.8% in March. A source of the currency performance was the BOJ who reaffirmed their highly accommodative monetary policy settings, saying they will buy unlimited quantities of JGBs in order to defend their yield curve control target. BOJ's Governor Kuroda's commitment to overshooting inflation remains unchanged.

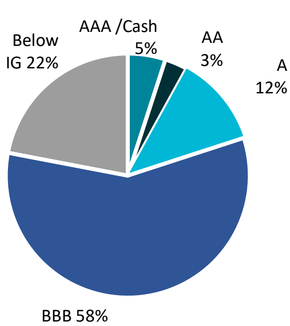
Geographic Allocation



Sector Allocation*



Credit Rating*



*Scaled to 100% for repo