Kapstream

—JANUS HENDERSON—

Kapstream Absolute Return Income Fund

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 2717mil
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.55yrs
Credit spread duration	2.08yrs
Average credit rating	A-
No of issuers	91
Yield to maturity	5.32%

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

Dan Siluk
Portfolio Manager

Dylan Bourke
Portfolio Manager

August 2022

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)	0.29	-0.05	-0.78	0.77	2.00	4.48
Fund Return (after fees, before sell spread)[1]	0.26	-0.15	-1.19	0.33	1.56	4.12
Fund Return (after fees and sell spread)[2]	0.26	-0.15	-1.18	0.30	1.55	4.12
RBA Cash Rate	0.16	0.31	0.41	0.36	0.79	2.69
Active return[3] (before fees and sell spread)	0.14	-0.36	-1.18	0.42	1.21	1.79
Active return[3] (after fees and sell spread)[2]	0.10	-0.46	-1.58	-0.05	0.75	1.43
Bloomberg AusBond Bank Bills Index	0.15	0.33	0.37	0.36	0.95	2.90

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 2022.

Performance Commentary

The fund returned a positive 0.26% (after class I unit fees) in August, weathering well the headwinds of a sharply rising yield environment and a deterioration in risk sentiment globally. US two-year yields rose 60bps in the month to close at 3.50%, as a hawkish tone from FOMC Chair Powell saw hikes re-priced into the near term and a portion of the cuts in 2023 taken out. Risk markets generally gave back all of their gains in the first half of the month, with the S&P 500 finishing lower and synthetic credit spreads wider in the US and Europe. Normally this backdrop would have been negative for performance. However, the fund's Australian credit exposures benefitted with a lag from the compression seen elsewhere in July, with the Bloomberg Ausbond Credit 0+ index spread to swap series narrowing by 8bps in August. Furthermore the synthetic hedge protection in place in the form of CDX IG benefited from a 12bps widening in the month, leading to a reversal of what was seen in the preceding month when the credit exposures and the synthetic hedge both negatively impacted performance. Carry was also significantly beneficial and is likely to remain so going forward, with the yield to maturity for the portfolio increasing further to finish the month at over 5%.

Market Commentary & Outlook

As widely anticipated, there was no pivot from Federal Reserve Chairman Jay Powell at the annual Jackson Hole meeting of central bankers. The commitment to fighting inflation with forthcoming rate hikes was maintained, as was the warning that rates may stay in restrictive territory for longer in order to make sure inflation is contained. Some 68bps of tightening is now priced in for the September FOMC meeting, indicating around a three-in-four chance of another 'unusually large' 75bps move. The market has also moved to take out one of the two 25bps rate cuts that had been priced in for 2023.

Interestingly, most of the moves in market pricing occurred in the week leading up to the Jackson Hole speech, with a somewhat more muted reaction to the hawkish messaging on the day itself. US 2-year yields closed the month 60bps higher to just below 3.50%, a level

not seen since 2007. US 10-year yields also surged back up to 3.20%, up 55bps on the month. It wasn't all about the Federal Reserve though, with surging natural gas prices in Europe pushing up inflation and ECB rate hike expectations. This includes a possible 75bps move at its September meeting. German 2-year yields rose 92bps in the month to 1.20%, the highest level since 2011. Inflation in the UK hitting double figures to be at the fastest pace since 1981 saw UK 2-year yields up 131bps in August. Not all the central bankers speaking out of Jackson Hole were hawkish though, with the Bank of Japan talking about the need for more evidence of supportive wage and inflation expectations before tightening policy. The Reserve Bank of New Zealand's Orr also hinted at being near the end of the cycle, with consumption showing the necessary signs of slowing in response to previous rate hikes.

It was a tale of two halves for risk markets. The extension of the rally seen in equity markets in July through to the middle of August made many question whether this was more than just a bear market rally. The S&P 500 rose some 19% off its early June lows, with the US Corporate Aggregate index spread to bond tightening nearly 30bps to bottom out at 131bps on August 16th. However, the rising expectation of a hawkish messaging from Jackson Hole saw this gradually reverse, with equities closing down on the month and physical credit widening spreads back out to +140bps (although this was still narrower than the previous month's close). The reversal in the synthetic space was more notable, with US investment grade CDX closing the month 12bps wider. European synthetic indices posted an even larger move, being out 19bps to +119bps on the sharply upwardly revised rate expectations profile. In contrast, both Australian physical and synthetic credit spreads narrowed in the month, reflecting the usual lags this market can exhibit in response to the previous month's compression seen elsewhere across the globe.

Looking forward, the bigger picture questions around peak inflation and peak hawkishness remain as yet unresolved. There is a growing view that we may have seen the peaks in yearly inflation in the US, but not so in Europe as energy prices spiral. The RBA does not expect Australian inflation to peak until Q4 of this year, which would not be confirmed until next year at the earliest. Until there is greater evidence of the peaks in inflation having been formed, if not some 'clear and convincing' evidence of some moderation, the peak hawkishness concept for markets and a pivot from the central banks is likely to remain elusive. It's only at this point that moving to capture the additional carry that bonds offer is advisable, as well as being more likely at that point to show the diversification benefits in a broader portfolio sense that has been usual practice in recent decades.

Portfolio Strategy

We continue to remain defensively positioned until the peak in official interest rates is more clearly established. Until this terminal rate is known with more certainty and the global theme of peak hawkishness is behind us, there remains the risk of further sell offs in both rates and risk markets. As such, our rates and credit exposures remain well below historical averages, which has served us well in protecting the portfolio from the sharp declines seen in fixed income and other asset classes.

Rates duration was again little changed in August. We have resisted the temptation to add additional duration despite the higher carry on offer, staying at around half a year's duration in the portfolio. Like many in the market, we were expecting the tone from Jackson Hole to remain hawkish relative to current market pricing, where the terminal rate at the end of July was considered too low and cuts in late 2023 thought to be too soon. We also see the September FOMC meeting as having a reasonable chance of a 75bps move, with the accompanying rate forecasts from the FOMC itself as likely as requiring an upgrade. We therefore see caution continuing to be warranted, even if current market pricing of a terminal rate of 3.75-4.00% is a considerable upgrade relative to a month ago.

We continued to position defensively, using the Aussie credit rally as an opportunity to reduce physical credit spread duration from ~2.2yrs to 2yrs (ex. SSGA). Given the reduced physical exposure we removed some of the CDX credit protection position, from ~13% to ~7%. We are balancing concerns about the Fed's ability to guide the global economy through an inflation and rate hiking induced slowdown vs the difficulty of ascertaining the bottom in any bear market.

We continue to buy selectively but mainly on a switch basis. In particular we are buying short dated TLAC and T2 bonds currently given very wide spreads. Our ability to buy is possible as a result of the more acute barbell-shaped strategy we've pursued in the portfolio for some time to limit losses and provide liquidity at opportune times. This approach (1) underweights longer dated A-rated credits and overweights shorter dated lower rated credits (mainly BBB-rated), assets with similar carry but less spread compression providing greater resilience in sell-offs, and (2) invests in a small bucket of higher spread assets to subsidise an overweight position in highly liquid assets, which provides the ammunition to add cheap new credits.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~40%), corporates and REITs (~34%), and asset and mortgage-backed securities (<15%) with the residual in cash and liquids. Approximately 80% of the portfolio is held in Australian & New Zealand names, and by currency around 90% of the portfolio is held in AUD-denominated securities.

Unless otherwise specified, any information contained in this publication is current as at the date of this report and is provided by Fidante Partners Limited (ABN 94 002 835 592, AFSL 234668) the issuer of the Kapstream Wholesale Absolute Return Income Fund (ARSN 124 152 790) (Fund). Kapstream Capital Pty Limited (ABN 19 122 076 117, AFSL 308870) is the investment manager of the Fund. It should be regarded as general information only rather than advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain the relevant Product Disclosure Statement (PDS) relating to the Fund and consider that PDS before making any decision about the Fund. A copy of the PDS can be obtained from your financial adviser, our Investor Services team on 13 51 53, or on our website www.fidante.com.au. If you acquire or hold the product, we and/or a Fidante Partners related company will receive fees and other benefits which are generally disclosed in the PDS or other disclosure document for the product. Neither Fidante Partners nor a Fidante Partners related company and our respective employees receive any specific remuneration for any advice provided to you. However, financial advisers (including some Fidante Partners related companies) may receive fees or commissions if they provide advice to you or arrange for you to invest in the Fund. Kapstream Capital, some or all Fidante Partners related companies and directors of those companies may benefit from fees, commissions and other benefits received by another group company.