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 2660mil
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.52yrs
Credit spread duration	2.06yrs
Average credit rating	BBB+
No of issuers	91
Yield to maturity	5.88%

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

September 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)	-0.14	-0.01	-0.97	0.73	1.92	4.45
Fund Return (after fees, before sell spread)[1]	-0.17	-0.11	-1.38	0.29	1.48	4.09
Fund Return (after fees and sell spread)[2]	-0.17	-0.11	-1.37	0.26	1.47	4.08
RBA Cash Rate	0.18	0.44	0.58	0.39	0.81	2.68
Active return[3] (before fees and sell spread)	-0.32	-0.45	-1.55	0.34	1.12	1.76
Active return[3] (after fees and sell spread)[2]	-0.35	-0.55	-1.95	-0.13	0.66	1.40
Bloomberg AusBond Bank Bills Index	0.15	0.42	0.52	0.38	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, 30 September 2022.

Performance Commentary

Another challenging month for markets saw the fund register a modest decline of -0.17% (after class I unit fees) in September. Increased central bank hawkishness saw bond prices soften as yields moved higher still, amidst a renewed deterioration in risk sentiment. The skittishness of markets generally was also highlighted by adverse market reaction to the UK Government's mini-budget. Credit spreads generally widened between ~15-20bps across many regions and ~5-10bps in Australia. Yields rose extensively across the world with UK bond yields up ~120-130bps, US yields up ~60-80bps and Australian yields generally up a smaller ~30bps or so. Intra-month highs and ranges were even larger than what these moves suggest, reflecting the impact of the Bank of England's response to the mini-budget towards the end of the month. Despite the support from higher carry across the portfolio and from being defensively positioned, this was insufficient to fully overcome such a negative backdrop.

On the topic of carry, the yield to maturity of the portfolio rose more than 50bps to ~5.9% at the end of September, a considerable improvement on the ~1.5% level seen just 12 months earlier. This development prompted our thought piece for the month, where we bid farewell to TINA (There Is No Alternative to equities) and said *'Hello (again) CINDY'* (Credit Is Now Delivering Yield). Please visit our website for the full article.

Market Commentary & Outlook

Total returns across a range of asset classes posted another negative month in September. Increased Central Bank hawkishness in the fight against inflation was again the major contributor, leading to sharp rises in yields and declining risk sentiment on the resulting softer economic growth outlook. The market's adverse reaction to the fiscal measures announced in the UK mini-budget were another major contributor to the volatility seen in the month.

Relative to tightening cycles over the past few decades, the amount of tightening undertaken by central banks globally in September was nothing short of remarkable. The Swedish

Riksbank hiked by 100bps, US Federal Reserve, European Central Bank and the Swiss National Bank all hiked by 75bps, while the Bank of England, Reserve Bank of Australia, Bank of Canada, and Norges Bank all hiked by 50bps. The rise in inflation has been a global phenomenon, with supply side pressures from the pandemic proving more persistent than originally thought and demand side pressures arising from the amount of stimulus introduced in response. This year has seen this stimulus being taken away, with a clearly-stated intention of moving into restrictive territory quickly to prevent higher inflation and inflation expectations from becoming entrenched.

Bond yields have had to move quickly to keep pace with the speed of rate hikes, with September being no exception as terminal rates were again revised higher. This was most evident in the UK, with the fiscally loose mini-budget seeing the Government's borrowing rates and expected official interest rates from the Bank of England rise dramatically. Yields in the 2-10yr part of the curve generally finished 120-130bps higher over the month, with intra-month highs considerably above this until the Bank of England responded by delaying QT and re-introducing bond purchases. UK 30-year bond yields fell by more than 100bps on the day of that announcement alone, helping to support the pension funds that have these longer-dated bonds on hand as collateral. Even in the US there was a 60-80bps increase in yields across the curve, as the US Federal Reserve indicated an increase in the expected terminal rate of close to 100bps to 4.50%-4.75% on the back of stronger-than-expected inflation figures. Australian bond yields increased by a smaller, but still significant, 30bps or so in September, as the RBA Governor indicated that the pace of tightening may slow after the degree of tightening seen so far.

With the Central Banks so committed to fighting inflation, the impact of more restrictive policy on the economic outlook saw risk markets deteriorate. Equities experienced significant falls, with the S&P 500 declining 9.3% in September. Credit markets followed suit, but arguably less than what the fall in equities historically may have suggested, with spreads widening by 15-20bps across the US and Australian physical credit space. Even commodities markets were impacted by the lower growth outlook, with West Texas Intermediate oil price futures showing an 11.2% decline in the month to be more than 35% off their highs for the year.

Portfolio Strategy

Given the September trends outlined above have been themes for much of this year, we remain defensively positioned on both the rates and credit front. The uncertainty of exactly where the terminal rate is likely to be in this cycle for all central banks has prevented us from moving back towards more normal exposure levels. This has helped protect the portfolio from the worst of the sharp declines seen across the broader fixed income universe.

On the rates front we saw significant upgrades to terminal rates for almost all Central Banks in September. As such we held rates duration of around half a year, below the historical average exposure of around one year. To date we have not been unduly keen to more fully incorporate the increasingly attractive benefits that higher yields offer, until it becomes clearer that we are close to the end of tightening cycles globally. Given the size of the increases in September outlined above, it is evident that we are not there yet.

On the credit front we continue to position defensively, holding physical credit spread duration around 2yrs (ex. SSGA), gently reducing over the passage of time. We maintained CDX credit protection at ~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 fixed rate financial bonds in primary given attractive new issue concessions and wide spreads. Fixed rate financial bonds have continued to perform well driven by strong buying technicals from middle markets and high net worth buyers in Australia and Asia. 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 (~32%), and asset and mortgage-backed securities (<15%) with the residual in cash and liquids. Approximately 85% of the portfolio is held in Australian & New Zealand names, and by currency around 91% of the portfolio is held in AUD-denominated securities.

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