Kapstream
— JANUS HENDERSON —

Kapstream Absolute Return Income Plus Fund

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 329m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%

Fund statistics

Interest rate duration	0.55 yrs
Credit spread duration	1.59 yrs
Yield to Maturity	6.75%
Average credit rating	BBB
Number of issuers	61

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

Daniel Siluk
Portfolio Manager

September 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)*	**-0.04**	**0.46**	**0.39**	**0.66**	**1.11**	**1.91**	**2.75**
Fund Return *(after fees, before sell spread)*[1]	-0.08	0.34	0.15	0.31	0.64	1.42	2.26
Fund Return *(after fees and sell spread)*[2]	-0.08	0.34	0.15	0.31	0.64	1.40	2.24
RBA Cash Rate	0.18	0.44	0.53	0.55	0.58	0.39	0.66
Active return[3] *(before fees and sell spread)*	**-0.22**	**0.03**	**-0.14**	**0.11**	**0.53**	**1.52**	**2.09**
Active return[3] *(after fees and sell spread)*[2]	-0.26	-0.09	-0.38	-0.24	0.06	1.01	1.58
Ausbond Bank Bill Index	0.15	0.42	0.49	0.51	0.52	0.38	0.75

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, 30 September 2022.

Performance commentary

The Fund returned -0.04% before fees in September, which represented capital preservation in an extreme fixed income bear market across rates and credit as yields continued to reset significantly higher. The largest contributor to returns was coupon income followed by CDX hedges, offset by yields increasing and some spread widening. While we have been in capital preservation mode, we continue to expect higher forward looking returns given the fund's yield to maturity is close to 7%, more than *double* compared to a year ago!

Portfolio strategy

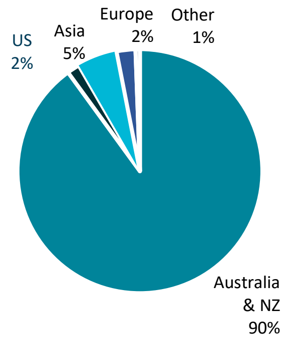
The Fund invested in financials in primary and secondary that met return hurdles to deploy cash into this uncertain environment. We remain concerned about the potential for a 2023 recession (or at least talk of it), and particularly for risk assets to fully price this earlier. This is driven by decelerating GDP, high inflation impacting consumers, aggressive and continued rate hiking, US dollar strength and a China and Europe led slowdown. As a result, we continue to hold CDX tactically at ~6% and keep the credit book short dated. Liquidity was maintained at the higher end of the range with Level 1 liquidity at ~13% (cash, commercial paper, SSGA) and Level 2 liquidity ~16% (<1yr investment grade).

The Fund currently yields 6.75% providing a strong tailwind for future returns. The yield was over 7% for the whole month but dropped 30bps+ on the last day of the month driven by the repayment of the Moula ABS a c10% yield investment at origination with a c3% position size. Physical spread duration ex SSGA increased 0.1yrs to ~1.5yrs and ~1.3yrs net of CDX. There is significant capacity to add attractive credits, largely due to the barbell strategy's success in limiting losses and providing liquidity at an opportune time. Repo exposure was stable at ~3%. Duration was steady going to 0.55yrs from 0.59yrs, given value driven by rates increasing. We continue to hold some of it in 'covered call' format, selling at the money receivers over NZ & Aus swaps to harvest elevated volatility against NZ and Aus swap exposure whilst we await the rates cycle to turn.

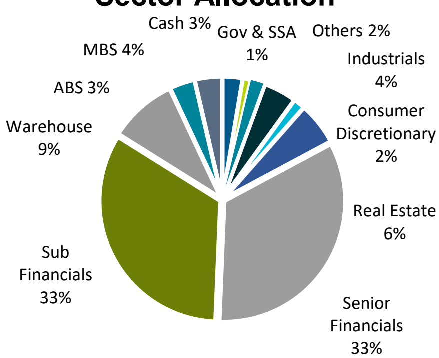
The average credit rating of holdings was stable at BBB. High yield was stable at ~19%, where holdings are typically BB-rated, short maturity bonds in the financial or securitised sectors where we have no concern around default risk. We continue to minimise or avoid exposure to the traditionally higher beta sectors such as commodities, energy, airlines and tourism. The portfolio is split across financials (~67%), corporates (~13%), and asset and mortgage-backed and warehouses (~16%) with the residual in cash and SSGAs. We have an ~90%/10% split between Australia/New Zealand and international issuers.

In rates, we have ~0.5yrs duration in the US and ~0.1yr duration in Australia & New Zealand. We believe there is merit in maintaining some level of duration as a hedge for the credit book, especially as short dated rates have increased significantly.

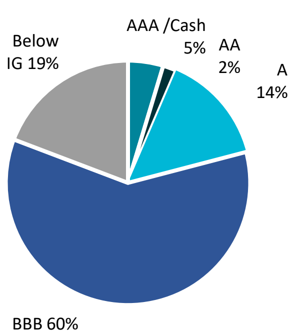
Geographic Allocation



Sector Allocation*



Credit Rating*



*Scaled to 100% for repo

Outlook

Global equities sold off with the S&P 500 falling 9.3%, ending cumulatively down ~25.5% from the highs. The VIX was up 5.8ppts to 31.6% and CDX widened 17bps to ~107bps. Increased central bank hawkishness saw bond prices soften as yields moved higher still, amidst a renewed deterioration in risk sentiment. The skittishness of markets was also highlighted by adverse market reaction to the UK Government's mini-budget. Credit spreads generally widened ~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. While broader risks have not changed - war in Ukraine and increased economic uncertainty in Europe, China's COVID-19 lockdowns and uneven recovery, central banks grappling to deal with an environment of persistent inflation and slowing growth.

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 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. 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. The smaller but still significant 30bp rise in Australian bond yields was due to the RBA Governor indicating that the pace of tightening may slow after the degree of tightening seen so far.

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.

We are still monitoring the situation in China as growth recovery is still very uneven and fragile. While the official Manufacturing PMI in September came in better than expected, rising from 49.4 to 50.1 compared to a consensus of 49.7, the Caixin Manufacturing PMI surprised to the downside, falling from 49.5 to 48.1. The official non-manufacturing PMI was also lower albeit still in expansionary territory, coming in at 50.6, down from 52.6. The currency weakened further against the USD, with CNY touching a close of 7.20, a level not seen since early 2008 as the FOMC's hawkish rate projections widened the interest rate gap further

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, the peak hawkishness concept for markets and a pivot from the central banks are likely to remain elusive. It's only at this point that moving duration to a longer-term average is advisable.

For more information, please contact Kapstream on 02 9234 0000
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