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 2388.19
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.38yrs
Credit spread duration	1.33yrs
Average credit rating	A-
No of issuers	77
Yield to maturity	5.68%

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

April 2023

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)	0.43	1.35	2.40	1.75	2.08	4.46
Fund Return (after fees, before sell spread)[1]	0.40	1.25	1.99	1.33	1.63	4.10
Fund Return (after fees and sell spread)[2]	0.40	1.25	1.99	1.41	1.62	4.10
RBA Cash Rate	0.27	0.82	2.31	0.86	0.99	2.70
Active return[3] (before fees and sell spread)	0.16	0.54	0.08	0.89	1.09	1.76
Active return[3] (after fees and sell spread)[2]	0.13	0.44	-0.32	0.55	0.63	1.40
Bloomberg AusBond Bank Bills Index	0.30	0.83	2.37	0.81	1.11	2.91

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 April 2023.

Performance Commentary

The fund continues to deliver a robust performance, increasing by 0.40% (after class I unit fees) in the month and bringing returns in the calendar year-to-date to 1.73%. With the yield-to-maturity at over 5.5% largely unchanged and remaining close to decade highs, we would expect the strong performance seen so far this year to continue.

Volatility abated in April, with ranges in both rates and risk markets below what was seen in March. However, financial markets remain skittish around a potential broadening of global banking sector issues. Central banks continue to hike nonetheless, although the end of the tightening cycle draws closer as a possible slowing in the supply of credit from banks generally does some of the work in slowing aggregate demand. Activity data is already slowing under the weight of previous rate hikes (with corporate earnings growth similarly declining), but unemployment rates remain low and stable. Inflation data generally suggests that inflation may have peaked, but the decline is proving to be very gradual. We remain defensively positioned on both the rates and credit side accordingly.

Market Commentary

The month of April saw a reduction in volatility relative to that seen in March, across both risk and rates markets. Implied volatility measures such as the VIX for equities and MOVE index for bonds fell significantly with a peak in the VIX in March of 26.5 well above the peak of 19.0 in April. Observed ranges for US synthetic investment grade credit spreads in April was 7.2bps, well below the 20.3bps range of March. Similarly the monthly range in US 2 year yields fell to 46bps in April, down from 131bps in March. These were not isolated examples.

Economic data globally tended to exhibit some consistent patterns across the developed world. Inflation appears to be past its peak and declining, with the Australian quarterly CPI data showing inflation is no longer increasing, with yearly headline inflation falling for the first

time in almost two years from 7.8% in Q4 2022 to 7.0% in Q1 2023. However, the US inflation experience shows that the decline has been slow and remains inconsistent with the FOMC's inflation target, with the core PCE series at 4.6% in March, down less than a percentage point from the February 2022 high of 5.4%. Activity measures are showing signs of slowing, with one of the better leading indicators of the economy and risk sentiment in the Manufacturing ISM reading of 47.1 in April being below both the 50 breakeven line and the recent peak in March 2021 of 63.8. GDP itself was also soft, rising by just 1.1% annualised in Q1, continuing the sub-trend growth that began in 2022 when the US grew by just 0.9%. Labour markets remained resilient in this context, with unemployment rates not yet turning up in response to lower economic activity. In the US the 3.5% unemployment rate in March is below the 12-month average, while in Australia the same unemployment rate of 3.5% is in line with the stabilisation seen in the past six months.

With inflation moderating, albeit modestly, central banks moved closer to the end of their respective tightening cycles. The FOMC and ECB did not meet in April, but the RBA and BoC both paused. In contrast, the RBNZ hiked by 50bps as growth and inflation appeared to re-accelerate. Markets also took some additional future tightening out of central banks across the globe, in response to the US banking issues arguably reducing the supply of credit, doing some of the work for the central banks in reducing aggregate demand.

Portfolio Strategy

The portfolio remains defensively positioned in respect of both rates and credit. However the degree of defensiveness on the rates side was reduced on the view that the end of the tightening cycle is closer. Evidence that the cycle peak in yields is now behind us increased, given that the sharp drops observed in March did not retrace much by the end of April. As a result, we increased duration from around 0.25 years to around 0.4 years by month end.

The portfolio's physical spread duration remained at historical lows of <2yrs, with CDX protection further reducing it to a net spread duration of ~1.3yrs, resulting in the portfolio having a lower sensitivity to spreads than we have historically had (when spread duration was closer to 2.75-3yrs). Despite continued headlines around First Republic Bank, to which we have no exposure, the portfolio was able to post a strong return, with the high coupon continuing to provide a robustness which hasn't been seen for around a decade, and we remain cautiously optimistic, despite expecting a US recession in H2 2023/H1 2024.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~40%), corporates and REITs (~30%), and asset and mortgage-backed securities (<15%) with the residual in cash and liquids. Close to 90% of the portfolio is held in Australian & New Zealand names, and by currency <5% is held in non-AUD denominated securities.

Portfolio liquidity remains slightly above target with 'Level 1' liquidity at ~16%+ (cash, commercial paper, SSGA) and 'Level 2' liquidity at ~10%+ (<1yr investment grade). We are comfortable running liquidity slightly above target in 2023, as we believe this will provide the flexibility to buy discounted credit at very attractive levels as recession fears start to intensify in the back half of the year.

Outlook

With central banks' tightening cycles drawing to a close, our attention shifts to what's next. We think the key narrative to develop will be that economic activity will continue to moderate with a lag to the significant amount of rate hikes seen over 2022 and into 2023. Labour markets will eventually follow and weaken, but the pace and timing is unknown. With interest rates considered to be in restrictive territory, and inflation falling (albeit more slowly than some central banks would like), this is likely to see central banks cease the tightening cycle altogether. The moves to lengthen duration can therefore be viewed as looking to get back to a more normal setting for duration of around one year by the time central banks stop hiking, to provide a hedge against the credit exposures in the portfolio.

The move back to a more typical amount of spread duration - of something closer to three years - is likely further into the future. Risk markets continue to act like we're recovering from a recession we are yet to have! We see further moderation in earnings as the economy slows and this will eventually be reflected in risk markets. As such, we expect to remain cautiously positioned for some time as the evidence of an economic and earnings recession builds. Nevertheless, we remain positive on the outlook for stable and attractive portfolio returns as the yield to maturity bounces between a highly attractive 5.5-6.0%, providing a rich buffer to the uncertainty of the macro backdrop. Additionally, the heightened levels of available portfolio liquidity and volatility budget provide us the ability to pounce on opportunities in weakness, adding to our cautious optimism for returns in the period ahead.

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.