



# Kapstream Absolute Return Income (Class A) Fund

This report has been prepared for financial advisers only



**Superior**

May 2023

## INTRODUCTION

### Key Principles

SQM Research considers (but is not restricted to) the following key review elements within its assessment:

1. Business profile - product strategies and future direction
2. Marketing strategies and capabilities, market access
3. Executive Management / Oversight of the investment management firm
4. Corporate Governance / fund compliance / risk management
5. Investment team and investment process
6. Fund performance, investment style, market conditions, investment market outlook
7. Recent material portfolio changes
8. Investment liquidity
9. Investment risks
10. Fund/Trust fees and expenses

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**Report Date: 18 May 2023**

Star Rating*	Description	Definition	
4½ stars and above	Outstanding	<b>Highly suitable for inclusion on APLs</b> <i>SQM Research believes the Fund has considerable potential to outperform over the medium-to-long term. Past returns have typically been quite strong. Product disclosure statement (PDS) compliance processes are of a high-calibre. There are no corporate governance concerns. Management is extremely experienced, highly skilled and has access to significant resources.</i>	High Investment grade
4¼ stars	Superior	<b>Suitable for inclusion on most APLs</b> <i>SQM Research considers the Fund has substantial potential to outperform over the medium-to-long term. Past returns have tended to be strong. PDS compliance processes are high-quality. There are no material corporate governance concerns. Management is of a very high calibre.</i>	High Investment grade
4 stars	Superior	<b>Suitable for inclusion on most APLs</b> <i>In SQM Research's view, the Fund has an appreciable potential to outperform over the medium-to-long term. Historical performance has tended to be meaningful. PDS compliance processes are strong. There are very little to no corporate governance concerns. Management is of a high calibre.</i>	High Investment grade
3¾ stars	Favourable	<b>Consider for APL inclusion</b> <i>SQM Research concludes the Fund has a moderate potential to outperform over the medium-to-long term. Past performance has tended to be reasonable. Management is experienced and displays investment-grade quality. There are no corporate governance concerns, or they are of a minor nature.</i>	Approved
3½ stars	Acceptable	<b>Consider for APL inclusion</b> <i>In SQM Research's view, the potential for future outperformance in the medium-to-long term is somewhat uncertain. Historical performance has tended to be modest or patchy. Management is generally experienced and capable. SQM Research has identified weaknesses which need addressing in order to improve confidence in the Manager.</i>	Low Investment grade
3¼ stars	Caution Required	<b>Not suitable for most APLs</b> <i>In SQM Research's opinion, the potential for future outperformance in the medium-to-long term is very uncertain. Historical returns have tended to be disappointing or materially below expectations. PDS compliance processes are potential substandard. There are possible corporate governance concerns. Management quality is not of investment-grade standard.</i>	Unapproved
3 stars	Strong Caution Required	<b>Not suitable for most APLs</b> <i>In SQM Research's opinion, the potential for future outperformance in the medium-to-long term is unlikely. Historical performance has tended to be unacceptable. There may be some material corporate governance concerns. SQM Research has a number of concerns regarding management.</i>	Unapproved
Below 3 stars	Avoid or redeem	<b>Not suitable for most APL inclusion</b>	Unapproved
Event-driven Rating		Definition	
<b>Hold</b>		<i>Rating is suspended until SQM Research receives further information. A rating is typically put on hold for a period of two days to four weeks.</i>	
<b>Withdrawn</b>		<i>Rating no longer applies. Significant issues have arisen since the last report date. Investors should consider avoiding or redeeming units in the fund.</i>	

\* The definitions in the table above are not all encompassing and not all individual items mentioned will necessarily be relevant to the rated Fund. Users should read the current rating report for a comprehensive assessment.

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**SQM Rating** ★★★★★

*Superior. Suitable for inclusion on most APLs.*

Fund Description	
Fund Name	Kapstream Absolute Return Income Fund (class A units)
APIR Code	HOW0052AU
Asset Class	Global Fixed Income
Management and Service Providers	
Investment Manager	Kapstream Capital Pty Ltd
Responsible Entity	Fidante Partners Limited
Fund Information	
Fund Inception Date	31 May 2007
Fund Size	\$1,572 (as of March 2023)
Return Objective (per PDS)	Consistent income and capital stability over the medium to long term, with low volatility.
Internal Return Objective	Cash + 2-3% before fees
Risk Level (per PDS/IM)	Very low
Internal Risk Objective	>1.5% annualised volatility
Benchmark	RBA Cash Rate
Number of stocks/positions	196 (as of March 2023)
Fund Leverage	Nil
Portfolio Turnover	23%
Top 5 Holdings Weight	14%
Investor Information	
Management Fee	0.55%
TCR (Total Cost Ratio)	0.55%
Buy/Sell Spread	Buy 0.0% / Sell 0.07%
Performance Fee Rate	Nil
Minimum Application	\$10,000
Redemption Policy	Daily
Distribution Frequency	Quarterly
Investment Horizon	Three years
Currency Hedging Policy	Intention to be fully hedged but with the ability to take modest non-AUD currency positions

## Fund Summary

### Fund Description

The **Kapstream Absolute Return Income (Class A) Fund** ("the **Fund**") is a registered managed investment scheme open to retail investors.

The Fund aims to provide a steady stream of income and capital stability over the medium term while with an annualised volatility of less than 1.5%, while aiming to outperform its benchmark through market cycles. The investment approach incorporates both top-down global macro views and bottom-up risk analysis to create a portfolio with the potential to deliver higher returns than cash, with low volatility in the unit price.

The Fund is actively managed and invests in a portfolio of global credit and fixed income securities. The Fund employs a core and overlay approach. Core investments are predominantly short dated and investment grade credit securities. Interest rate and credit derivatives are used as overlays to actively mitigate credit and rate market risk and generate additional alpha.

The internal benchmark is the RBA Official Cash Rate + 2-3% p.a. before fees over rolling 3-year periods.

### Fund Rating

The **Kapstream Absolute Return Income Plus Fund** has achieved the following rating:

Star Rating	Description	Definition	Investment Grading
4.25 stars	Superior	Suitable for inclusion on most APLs	High Investment Grade

## SQM Research's View

### 1. People and Resources

#### About the Manager

Kapstream Capital Pty Limited ('Kapstream') was founded in Sydney in 2006. Kapstream is a specialist global fixed income manager with its principal office in Sydney and an associate office in Newport Beach, California. Kapstream focuses on managing low volatility, global, short duration fixed income portfolios with absolute return performance objectives for institutional and retail clients. As of December 2022, Kapstream manages A\$6.9 billion from its office in Sydney and a further A\$4.9 billion in USD and GBP portfolios from its associate office in Newport Beach. SQM Research notes the firm has a substantial parent group able to provide

financial and technical support. Kapstream has a good spread of clients comprising a range of high net worth individuals, family offices, institutional investors (including public and private pension funds, asset and private wealth managers), and retail clients.

#### Investment Team

The investment team comprises 14 finance professionals based in Sydney and Newport Beach, California. The two managing directors, Mr Daniel Siluk and Mr Dylan Bourke have hands-on involvement in investment decisions and have over 35 years of industry experience. They are supported by 12 highly experienced portfolio managers and analysts. The investment team has an average of 17.6 years of industry experience and, apart from four more recent hires, generally has a long tenure with Kapstream. The core team has worked together for a long time. All members of the investment management team are highly qualified. Members have appropriate academic qualifications and CFA designations.

In SQM Research's opinion, the team size is adequate, considering the number of securities held, the size of the portfolio and the requirements to implement the investment process effectively. SQM Research observes that investment experience and company tenure levels are high across the investment team. The investment management process and performance do not rely excessively on one person's skill, contacts and reputation, and there is a suitable backup for the key investment team members. SQM Research assesses key person risk to be low.

### 2. Investment Philosophy and Process

#### Investable Universe

Kapstream will invest in opportunities across the range of OECD countries and, to a limited extent, in emerging market countries. The Fund invests predominantly in investment grade global credit and fixed income securities. These include:

- Government & government-related bonds
- Corporate bonds
- Mortgage-backed & asset-backed securities
- Emerging market debt
- Convertible securities
- Cash & cash-related instruments
- Derivatives, including swaps, options, & futures.

### Investment Approach

Kapstream's investment approach exploits the inefficiencies in traditional bond fund portfolio management. Kapstream seeks to identify the strongest investment opportunities with attractive risk/reward characteristics consistent with the strategy's objectives. By adopting a benchmark-unaware, unconstrained approach, Kapstream can invest in the broadest array of fixed income instruments, both physical and derivatives, that are priced for greater return potential.

The Fund is actively managed. Kapstream's investment style combines top-down macroeconomic research and analysis, which considers broad interest rate, currency, and fixed income market trends, with bottom-up credit research and fixed income security selection.

### Research

Research comprises analysis of both the macroenvironment and security-level credit. The following factors are considered as part of the research process.

- For expected risk and return, in addition to fundamental default/downgrade risk, the expected credit return. For risk, consideration is given to the liquidity of the issuer's bonds, or if they are not available, similar bonds are assessed.
- For issuer-level credit risk, the credit rating assigned by agencies and internal paper ratings highlighting relevant financials, business overview, ESG and other relevant factors. The purpose is to assess the likelihood of downgrades/upgrades and defaults. An internal rating is assigned based on Moody's methodology if a credit investment is unrated.
- For security level risks, the size of the deal. Kapstream usually buys up to ~20 %, except for MBS/ABS mezzanine notes, where more extensive ownership increases liquidity.
- Top-down macro analysis is typically a risk management overlay whereby specific sectors and regions will be avoided until a positive view can be formed.
- Industry, sector, social or economic themes are considered in the credit and ESG assessments and monitoring updates.

In SQM Research's view, given the investment approach, the research effort (external vs internal, extent of market coverage, depth and breadth of analysis) is adequate regarding its ability to add value by security selection.

The research process comprises structured and logical steps to filter the wider investment universe down to a targeted research list. Macroeconomic views are systematically obtained and integrated into the research process. The research criteria align with the investment approach and objectives of the portfolio in terms of applying a systematic method of assessing both quantitative and qualitative issues. There is an ongoing peer review of the research analysts' output by the broader team to provide an appropriate reality check.

### Portfolio Construction

Being an absolute return focused strategy, the RBA Official Cash Rate is used as the benchmark, with a 2-3% performance target above this. No regard is given to the composition of any conventional fixed income index in the portfolio construction process.

Kapstream's absolute return approach seeks to capture a wide range of individual positions and trades, resulting in a diversified portfolio, balancing opportunities between income and growth, and focusing on capital preservation. In line with Kapstream's investment approach, portfolio construction is considered in two interconnected elements: 'core' holdings and a series of 'overlay' derivative alpha strategies, which together achieve the Fund's return objectives over the cycle while remaining within the volatility budget.

**Core holdings:** The aim of the core holdings is to provide capital preservation and income diversification. Typically, the portfolio will hold 100+ high quality and generally short-dated positions, of which 85% must be investment grade (rated BBB or higher). The core holdings can include a range of securities but will typically comprise the following:

- Cash & Money Market instruments
- Fixed rates notes
- Floating rate securities
- Mortgage and asset-backed securities.

Commensurate with the level of conviction and taking a conservative stance, Kapstream will act quickly to reduce and exit any position it believes represents a capital erosion risk to the portfolio or may become illiquid (if the expectation is that the asset be a liquid holding).



**Overlay:** The overlay portfolio component seeks to achieve two main objectives: risk mitigation and return enhancement.

- For risk mitigation, Kapstream employs a series of derivative strategies to hedge broader portfolio-level risks, such as manage interest rate duration or hedge away non-AUD currency risk.
- For return enhancement, Kapstream seeks to integrate multiple macroeconomic relative value strategies into the portfolio. The overlay portfolio is a collection of actively managed strategies primarily aimed at exploiting opportunities within global fixed income markets across rates, FX, and credit. Although higher risk/higher return trades may exist, the goal is to provide significant diversification and compensation for any risk taken.

A disciplined and structured process determines the active weights of securities and sectors in the portfolio. High level rates and credit allocation decisions will be predicated on the firm's macroeconomic view. They will offer what an optimal risk-adjusted return profile against the backdrop of prevailing market conditions is. Position sizes are determined by the portfolio managers, considering volatility, relative value, liquidity and the coupon paid. The Fund currently holds 176 positions in the portfolio. SQM Research notes that most positions are held at between 0% – 3.0% weight. Only ten are held above 3%

In SQM Research's opinion, the structure of the portfolio (in terms of the distribution of active weights, number of positions, sector concentration, etc.) is satisfactory for the strategy, given the objectives of the Fund, risk constraints and Kapstream's active investment style.

### Risk Management

Risk is monitored and managed through proprietary in-house and external quantitative risk systems and the judgment of the portfolio managers. The first measure of risk is based on interest rate duration exposure, credit duration exposure and FX exposure. Each of these is measured and monitored daily, firstly for the portfolio constraints and, secondly, for the investment targets. Risk levels are assigned to each trade depending on return expectations, size of the trade, correlation with other positions, entry and exit levels, mean reversion, best execution, and conviction level.

Kapstream has appropriate limits governing factors such as exposures to companies, credit quality, duration exposure, volatility targets, use of derivatives, leverage and currency risk. In SQM Research's opinion, the risk management

regime used by Kapstream is robust and will provide suitable capital preservation characteristics for the Fund.

SQM Research notes the risk management regime will have the following characteristics:

- There will be a trade-off between the extent of the portfolio constraints and the need for flexibility to implement the absolute return investment approach. i.e., limits are not too loose so as to be ineffective or too restrictive, thereby limiting Kapstream's ability to add value. In this regard, the quality of Kapstream's research and due diligence will be critical to the success of the Fund.
- The Fund can hold a moderate exposure to non-investment grade debt and the elevated risk that entails.
- Risk management considers credit quality and the companies' management quality. There is a good use of tools to monitor portfolio risk. The manager has identified the key influencers of performance in their investment process. The risk of these going wrong is being appropriately monitored and managed.
- A separate and independent risk management structure oversees all risk management activity. The overall risk management regime is robust regarding detail provided to investment decision-makers and management, timeliness and coverage.
- Volatility has been maintained below the 1.5% target limit.

## 3. Fund Characteristics

### Credit Quality

The Fund is distinguished by its high level of credit quality. The Fund has consistently held between 85-100% of assets in Investment grade (BBB or better) securities. SQM Research notes that 92% of the assets held are investment grade, with 8% in non-investment grade (BB or lower), or not rated.

### Duration

Duration risk is low. Most assets held by the Fund are short dated, with 35% of the portfolio assets having a maturity of less than one year and 69% less than three years. The portfolio has an average credit duration of 1.52 years.

The allocation between fixed and floating rate debt is actively managed to position the portfolio for the prevailing interest rate/inflation environment. Since its inception, the Fund has demonstrated a bias to floating rate securities, with about 60% in floating rate securities.

### Geographic Allocation

The Fund has been consistently heavily weighted towards Australian debt, which comprises 80% of NAV, with exposures to the US, UK/Europe, and Asia comprising only around 20%. The bias towards Australian securities reflects Kapstream's greater knowledge of the home market and access to deals, as well as generally higher spreads and the more stable rating profiles resulting from the high level of institutional investment. Kapstream only invests overseas where there is an appropriate 'rule of law', i.e., in hard currencies only (USD, EUR, GBP, NZD, SGD).

### Currency Management

Kapstream may hold up to 15% of the portfolio in non-AUD currency positions. Kapstream actively manages the Fund's currency exposure. The neutral position is to fully hedge any non-AUD exposure. Non-Australian dollar-denominated securities may be fully, partially or not hedged back to the AUD.

## 4. Performance & Risk

### Length of Track Record

The Fund has a history of 15.9 years.

### Return Objective

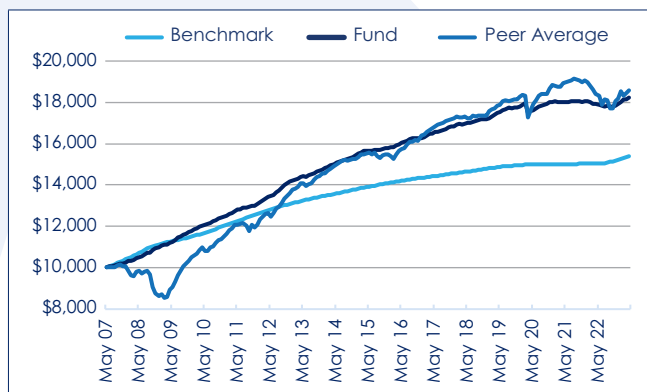
As stated in the PDS, the Fund's benchmark is the RBA Cash Rate.

Fund Performance to 30 April 2023 (% p.a.)							
Total Return	1-Month	3-Month	6-Month	1-Year	3-Year	5-Year	Inception
Fund	0.39	1.22	2.49	1.84	1.27	1.45	3.85
Benchmark	0.30	0.86	1.64	2.42	0.89	1.02	2.75
Peer Average	0.61	0.07	4.82	0.82	1.72	1.33	4.31
Alpha	0.09	0.35	0.85	-0.58	0.37	0.43	1.10

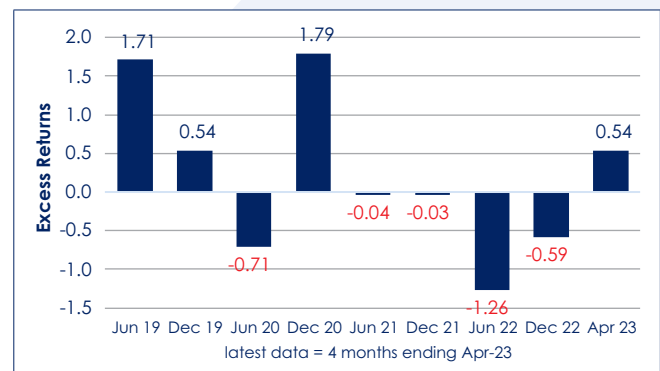
With dividends reinvested. Returns beyond one year are annualised. Return history starts Jun-2007

Benchmark: RBA Cash Rate Target

### Growth of \$10,000



### Fund Excess Returns %: Half-yearly (net of fees)





## SUMMARY

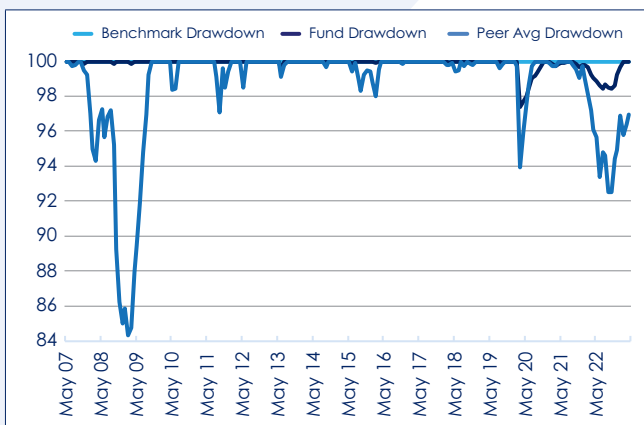
### Volatility

The Fund's volatility has been lower than that of the Bloomberg AusBond Bank Bill Index and lower than traditional bond funds. The Fund has also exhibited lower volatility than the peer group of fixed interest funds.

### Drawdown Experience

Given the fund's investment approach and objectives, drawdowns have been generally very low and in line with expectations. The Fund's drawdown profile has been substantially better than the peer average and the Bloomberg AusBond Bank Bill Index.

While the Fund experienced a drawdown in February 2020 during the Covid-19 crisis, the Fund improved its liquidity requirements which limited the impact of the fixed interest downturn that occurred in 2022 to around -1.5%, where fixed interest funds incurred drawdowns in the order of -6.5%. The Fund's capital preservation objective was achieved.



- A robust risk management regime is embedded throughout the credit assessment and portfolio construction process.

### Weaknesses of the Fund

- Limited geographic diversification, with 80% of the portfolio in Australian debt.
- The Fund has failed to achieve its internal performance benchmark of Cash + 2-3% on an annualised basis over the period since inception.

### Other Considerations

- The Fund is an absolute return strategy with no consideration given to the composition or performance of the Bloomberg AusBond Composite 0+Y TR Index. Investors should expect the Fund's performance to differ significantly from that of the Index from time to time.

### Key Changes since the Last Review

- This report is an inaugural review.

## 5. Strengths and Weaknesses

### Strengths of the Fund

- The investment team is highly experienced with strong track records.
- In contrast to the peer group, capital preservation was largely achieved in 2022-2023 in the face of a global bond market sell-off.
- Low volatility and low drawdowns compared to other fixed income funds.
- High credit quality with at least 85% of the portfolio in investment grade securities.
- Low exposure to interest rate risk.

## Investment Approach

### Philosophy

Kapstream has articulated an investment philosophy underpinning its core beliefs on managing money. The investment philosophy has reputable academic support and industry validation.

Kapstream observes that traditional global fixed income portfolios managed against conventional issuance-based benchmarks, which typically represent the largest and not necessarily the strongest issuers, lack alignment with investor goals and believes that the return attributes of higher quality fixed income securities and instruments can be effectively captured to drive defensive absolute return outcomes. Kapstream believes that by constructing actively managed globally diversified portfolios predominantly using these assets, it is possible to obtain consistent returns, and lowly correlated to other asset classes, and, when combined with an integrated risk management and hedging approach, provide for strong capital preservation.

### Strategy

Kapstream has articulated a clear investment strategy and has identified how it intends to add value. Kapstream's investment approach exploits the inefficiencies in traditional bond fund portfolio management. Kapstream seeks to identify the strongest investment opportunities with attractive risk/reward characteristics consistent with the strategy's objectives. By adopting a benchmark-unaware, unconstrained approach, Kapstream can invest in the widest array of fixed income instruments, both physical and derivatives, that are priced for greater return potential.

The strategy is designed to deliver its performance objectives in all normal market conditions consistently. The Fund is expected to perform more strongly at a time when interest rates are at a stable or falling point in their cycle and when credit spreads are stable or narrowing. Despite providing capital preservation to investors during the most recent calendar year, 2022 indicated the type of market conditions during which the strategy underperforms, characterised by rapidly rising interest rates and widening credit spreads.

### Investment Universe

The Fund predominantly invests in investment grade global credit and fixed income securities. These include:

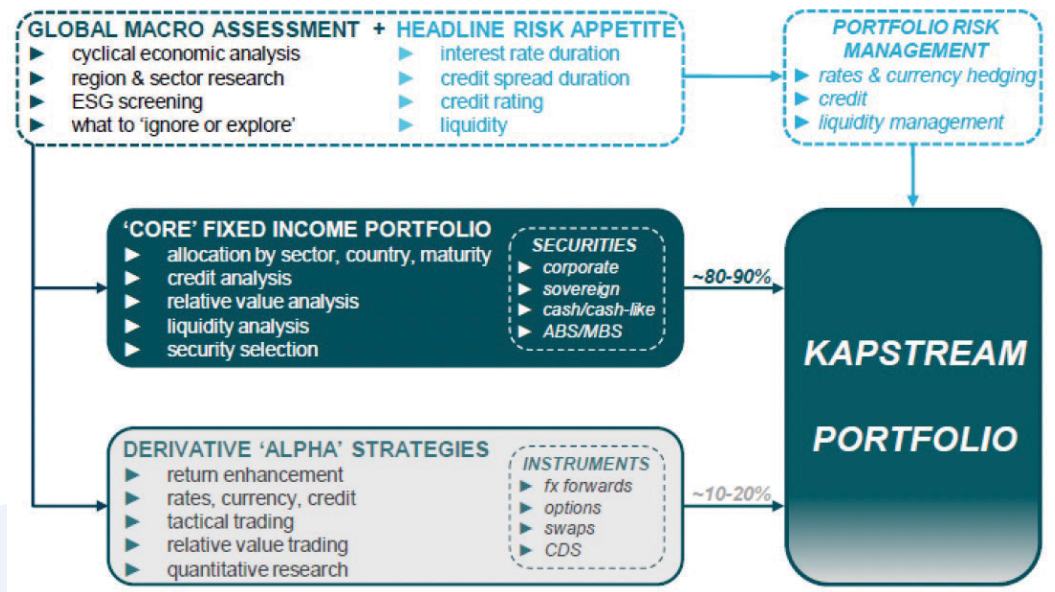
- Government & government-related bonds
- Corporate bonds
- Mortgage-backed & asset-backed securities
- Emerging market debt
- Convertible securities
- Cash & cash-related instruments
- Derivatives, including swaps, options, & futures.

Kapstream will invest in a range of OECD countries (typically the G10) and, to a limited extent, in emerging market countries. SQM Research believes the investment universe is appropriate for the Fund's investment objectives and risk expectations.

### Investment Style

The Fund is actively managed. Kapstream's investment style combines top-down macroeconomic research and analysis, which considers broad interest rate, currency and fixed income market trends, with bottom-up credit research and fixed income security selection.

## Investment Process



## Research

### Idea Generation

Kapstream uses a combination of external and internal research. The external research consists of broker research, as well as Moody's, S&P, Fitch, Corelogic, Sustainalytics and MSCI ESG. It also has access to parent Janus Henderson's credit research and Bloomberg.

The idea generation process revolves around identifying the key drivers of the investment in question and identifying when the assessment of those drivers changes. Credit ideas are generated from looking at new issues, secondary offers and New Issue Concessions. For AUD-denominated investments, Kapstream has visibility on all new issues and deals brought to market.

### Security Research

The following factors are considered as part of the research process.

- Forexpected risk and return, in addition to fundamental default/downgrade risk, the expected credit return is credit spread plus credit roll down (carry + credit roll down x spread duration). For risk, consideration is given to the liquidity of the issuer's bonds, or if they are not available, similar bonds are assessed.
- For issuer-level credit risk, the credit rating assigned by agencies and internal paper ratings highlighting relevant financials, business overview, ESG and other relevant factors. The purpose is to assess the likelihood of downgrades/upgrades and defaults.

If a credit investment is unrated, an internal rating is assigned based on Moody's methodology. Any subordination or security enhancements are considered and adjusted in line with Moody's methodologies.

- For security level risks, the size of the deal. Kapstream will usually not buy more than ~20%, except for MBS/ABS mezzanine notes, where bigger ownership increases liquidity.
- Top-down macro analysis is normally a risk management overlay whereby certain sectors and regions will be avoided until a positive view can be formed.
- Industry, sector, social or economic themes are considered in the credit and ESG assessments, as well as monitoring updates.
- Findings from meetings with company management are incorporated into valuations and filtered into views on fundamentals, ESG and relative value.

### ESG Considerations

Factors affecting long-term corporate sustainability, including labour standards and environmental, social and ethical (ESG) considerations, are incorporated into fundamental research, although they do not play a significant role in investment decisions. Most of Kapstream's investments are in countries with relatively good environmental, social and labour standards, so the investment risk associated with these factors is generally

low. Kapstream also evaluates ethical standards, but primarily as they relate to a company's corporate behaviour and not necessarily the ethical standing of the product or service they provide. Kapstream excludes companies or entities that generate 10% or more of their total sales from armaments and tobacco from its investment universe.

Fidante Partner's parent, Challenger Limited, is a member of the PRI Association (PRI), a promoter of responsible investment practices supported by the United Nations.

## Portfolio Construction

### Asset Allocation

Being an absolute return focused strategy, the RBA Official Cash Rate is used as the benchmark, with a performance target of 2-3% above this. No regard is given to the composition of any conventional fixed income index in the portfolio construction process.

Kapstream's absolute return approach seeks to capture a wide range of individual positions and trades, balancing opportunities between income and growth with a focus on capital preservation. The following types of fixed income strategies are considered and used in the Fund.

- Interest Rate Duration
  - Fundamentals: Over the coming ~6 months, how much does the US Fed have to hike, stay stable or cut, given US rates tend to move global rates (cut, neutral, +25 hike, +50bp, +75bps or more).
  - Technicals: Given the trending nature of US rates, a key determinant of rates duration is whether the US 2-year Treasury bond is trending down, sideways or up. The preference is to be longer when it is trending down, neutral when it is sideways and short when going up.
- Credit Spread Duration
  - Fundamentals: SP500 earnings forecast growth/decline rates, expectations for a recession, upgrade/downgrade rates and default rates.
  - Technicals: Central Bank tightening/loosening – rates direction & M2 growth rates, issuance expectations, dealer inventories.
  - Relative Value: spreads compared to history, spreads compared to other asset classes, New Issue Concessions, yields compared to other asset classes.

- Average Target Rating: The average target credit rating for the Fund is decided with reference to the risk tolerance of the investors in the Fund and will always be Investment Grade. The rating will likely range from BBB- to A+ over time.
- Credit Hedges: Various hedges are considered, with CDX being the main ones used, given it is the largest and most liquid credit instrument globally.
- Credit Sector/Country Rotation: To determine target sector/region/country exposure across the portfolios, the focus is at a high level with allocation decisions made between; Liquids, AU Financials, AU Corporates, Offshore Financials, Offshore Corporates, Subordinated Debt, REITs, Securitised Debt, ABS/MBS, and Warehouses.
- Currency: As a rule, a bond's currency of issue is considered a more important determinant than the country of risk. This is because different currencies have different levels of compensation for credit spread, different liquidity and different betas for the same credit risk.

In line with Kapstream's investment approach, portfolio construction is considered in two interconnected elements: core holdings and a series of overlay derivative alpha strategies, which together may achieve the Fund's return objectives of cash plus 2-3% over the cycle while remaining within the 1.5% volatility budget.

**Core holdings:** The aim of the core holdings is to provide capital preservation and income diversification. Typically, the portfolio will hold 100+ high quality and generally short-dated positions, of which 85% must be investment grade (rated BBB or higher). The core holdings can include a range of securities but will typically comprise the following:

- Cash & Money Market instruments
- Fixed rates notes
- Floating rate securities
- Mortgage and asset-backed securities.

Commensurate with the level of conviction and taking a conservative stance, Kapstream will act quickly to reduce and/or exit any position it believes represents a capital erosion risk to the portfolio or may become illiquid (if the expectation is that the asset be a liquid holding).

**Overlay:** The overlay portfolio component seeks to achieve two main objectives: risk mitigation and return enhancement.

- For risk mitigation, Kapstream employs a series of derivative strategies to hedge broader portfolio-level risks, such as to manage interest rate duration or to hedge away non-AUD currency risk.
- For return enhancement, Kapstream seeks to integrate multiple macroeconomic relative value strategies into the portfolio. The overlay portfolio is a collection of actively managed strategies primarily aimed at exploiting opportunities within global fixed income markets across rates, FX, and credit. Although higher risk/higher return trades may exist, the goal is to provide a significant level of diversification and compensation for any risk taken.

The portfolio construction process begins with the outputs of the regular portfolio manager meetings with respect to duration and credit positioning. It is then the role of the functional teams in rates/macro and credit to implement these decisions. The portfolio is holistically constructed, focusing on diversification and risk.

There is a disciplined and structured process that determines the weights of securities and sectors in the portfolio. High level rates and credit allocation decisions will be predicated on the firm's macroeconomic view and will offer what is an optimal risk-adjusted return profile against the backdrop of prevailing market conditions. Internal macroeconomic/asset allocation modelling tools are used to provide quantitative support to the portfolio construction process. These draw upon a range of economic data and market analysis while also factoring in individual and team opinions.

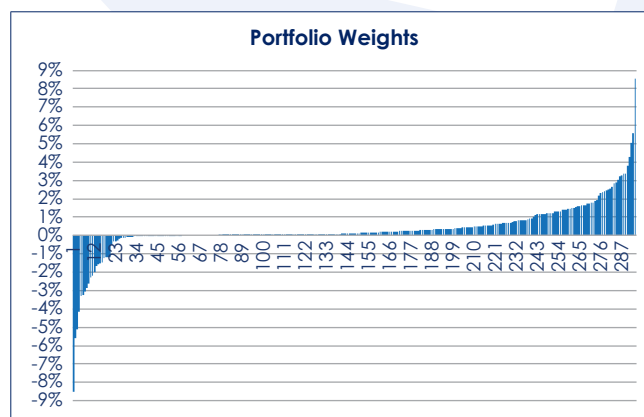
The table below shows the broad asset allocation ranges for the Fund.

Asset Class	Minimum	Maximum
Global fixed income securities (Investment Grade)	85%	100%
Global fixed income securities (Non-Investment Grade)	0%	15%
Cash	0%	100%

The Fund has the following maximum limits on sector exposures.

Sector	Limit
Mortgage Backed Securities	50%
Asset-Backed Securities	50%
Convertible Securities	25%
Emerging Markets	25%
Bank Loans	10%

Within the above limits, position sizes are determined by the portfolio managers, with consideration given to volatility, relative value, liquidity and the coupon paid. The Fund currently holds 176 positions in the portfolio. SQM Research notes that most positions are held at between 0% – 3.0% weight. Only ten are held above 3%.

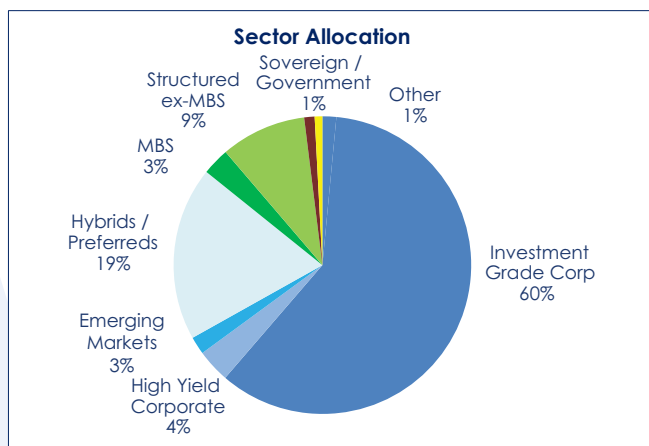


The outcome of the portfolio construction process is multiple macroeconomic strategies across each of the broad sector categories and exposure to a range of global markets. The number of strategies will vary across the market cycle, dependent on perceived risks and the number of opportunities.

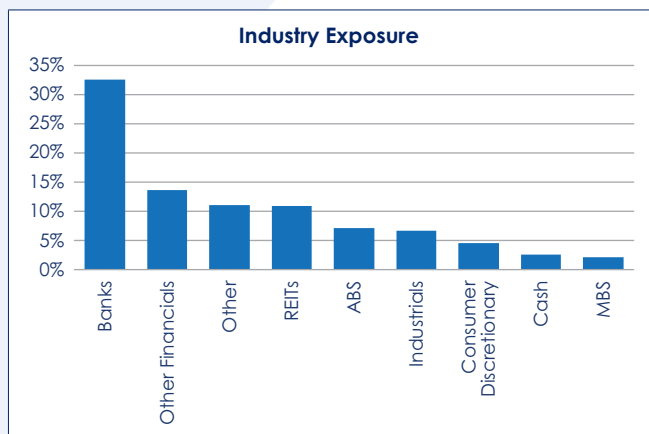


### Sector Allocation

The Fund's sector exposure is an outcome of the opportunity set within the investment universe. The current allocation to credit sectors is shown in the chart below.



In terms of industry allocations, the portfolio is well diversified. SQM Research notes that the Fund's investment criteria would tend to emphasise investments into Banks and other Finance sector industries, which together comprise 46% of the portfolio. Cyclical industries such as Energy and Mining would tend to be excluded.



### Liquidity

The purpose of liquidity is to allow the fund to be a liquidity provider for clients and the market without needing to sell bonds at unfavourable prices to achieve that liquidity. In setting the allocation to liquid assets, consideration is given to the Fund's obligations to provide daily liquidity to investors and factors in a worst-case liquidity provision based on the Fund's drawdown history. Different levels of liquidity are held, depending on the Portfolio Managers' views on expected liquidity needs and credit spreads and on current and future market liquidity.

- Level 1 & 2 assets (cash, TDs, government bonds, and investment grade bonds of less than 1 year maturity) will comprise 15%-30% of NAV depending on views on expected additional liquidity needs, credit spreads, as well as views on current and future expected market liquidity.
- Level 3 & 4 assets (Big 4 Banks senior debt, A, AA and BBB rated corporates, US bank senior financials and ABS/MBS) comprise the remainder, with ABS/MBS limited to less than 15%. To ensure adequate liquidity, bonds considered for investment require an issue size greater than \$250m.

SQM notes that following the Covid-19 liquidity problems, Kapstream structurally increased the required allocation to Level 1 & 2 assets, which benefitted the Fund in 2022-2023.

### Monitoring

An in-house portfolio holdings and analytics system contains all data pertaining to holdings and transactions and is updated daily. This system is used to monitor risk buckets, including:

- Rates: duration exposure by country, duration exposure by curve point
- Credit: sector, collateral, country, currency, rating exposures
- FX: net of hedging.

Additionally, daily performance and attribution reports are disseminated to all team members, showing return contributions from the four main components of a bond return - coupon income, shifts in the rate curve, shifts in the credit curve and FX.

### Sell Discipline

If a security is no longer considered a 'sleep at night' position, the holding in that security would be reduced and/or fully sold. Factors that may result in a review include:

- A deterioration in issuer fundamentals.
- An unexpected movement in price.
- A change to the market liquidity of a specific issue.
- A worsening of the sector or geographic setting in which an issuer operates.
- An unexpected or uncertain change to the regulatory environment affecting a specific issuer.
- A deterioration, failure to deliver on the initiative, or surprise change in the ESG attitude of an issuer.

## Risk Management

### Process

Risk is monitored and managed through a combination of proprietary in-house and external quantitative risk systems (Kapstream Analytics Portal, SimCorp Dimension, Bloomberg, FINCAD) and the judgment of the portfolio managers.

The first measure of risk is based on interest rate duration exposure, credit duration exposure and FX exposure. Each of these is measured and monitored daily, firstly with respect to portfolio constraints and, secondly, with respect to the investment targets. Risk levels are assigned to each trade depending on return expectations, size of the trade, correlation with other positions, entry and exit levels, mean reversion, best execution, and conviction level. Entry/exit and stop loss levels are set for each trade and are monitored to ensure profit targets are being met, as well as measure the sensitivity to the prevailing market conditions. Liquidity testing and scenario analysis are undertaken on a regular basis as part of routine reporting.

Kapstream utilises UBS Delta, an external system completely administered and operated by Janus Henderson, for ex-ante risk reporting, namely VaR and tracking error analysis. The analysis and reporting are updated monthly. Kapstream does not manage money according to results from the UBS Delta risk model. Instead, an in-house risk budgeting framework focused on interest rate duration by country and curve, and both the market risk and idiosyncratic risk of individual credit positions are used. This framework seeks to ensure no one position overwhelms the return or risk profile of the portfolio.

Detailed attribution analysis is carried out at the security level, enabling performance monitoring according to credit ratings, collateral type, sectors, interest rate types, etc., to assist portfolio managers in tracking the performance of various components and strategies implemented in the portfolio.

### Portfolio Constraints

The following risk constraints are applied to the portfolio.

Characteristics	Constraints & Limits
Max position size	10%
Max exposure to single company	Not specified
Max exposure to single sector	Not specified
Max exposure to single currency	+/- 15%
Minimum average portfolio credit rating	Investment Grade
Max Non-Investment Grade exposure	15%
Minimum issue size	\$250 million
Duration range	+/- 2 years
Final maturity	< 5 years
Ex-ante Volatility	Target 1%. Max 1.5%.
Fixed vs. Floating rate exposure	Not specified
Use of derivatives	Permitted
Use of leverage	Permitted

SQM Research notes the risk management regime will have the following characteristics:

- There will be a trade-off between the extent of the portfolio constraints and the need for flexibility to implement the absolute return investment approach. i.e., limits are not too loose so as to be ineffective, or too restrictive thereby limiting Kapstream's ability to add value. In this regard, the quality of Kapstream's research and due diligence will be critical to the success of the Fund.
- The Fund can hold a moderate exposure to non-investment grade debt, along with the elevated risk that entails.
- Risk management considers credit quality and the companies' management quality. There is adequate use of tools to monitor portfolio risk. The manager has identified the key influencers of performance in their investment process. The risk of these going wrong is being appropriately monitored and managed.
- There is a separate and independent risk management structure to oversight all risk management activity. The overall risk management regime is robust in terms of detail provided to investment decision-makers and management, timeliness and coverage.
- Volatility has been maintained below the 1.5% target limit.



## INVESTMENT PROCESS

### Use of Leverage

The Fund's constitution allows for borrowing. However, Kapstream will generally not borrow on behalf of the Fund except to provide liquidity for short-term cash flow needs or if emergency or extraordinary situations arise, through the use of matched repo transactions via one or more of the nine-strong repo counterparty panel. All leverage is to be covered by cash or cash equivalent securities, which are <1 year investment grade securities.

### Use of Derivatives

Derivatives are the primary tool used for managing risk across the portfolio. The Fund may invest in or obtain exposure to derivatives such as futures, options and swaps. Kapstream uses OTC swaps (both interest rate and credit default), exchange traded futures, options on both swaps and futures and foreign exchange.

The Fund's net derivative value will not exceed 10% of the net asset value of the Fund. Approximately 90% of derivative usage is for risk management purposes to enable the Fund to buy the best bonds but have the flexibility to manage the effect of interest rates or foreign currency movements. The remaining 10% is used to generate an additional return by taking active, conviction-based positions in interest rates (duration, yield curve and relative country value), credit (credit default swaps) and currencies (FX). Kapstream does not intend to gear the Fund by using derivatives.

### Currency Management

Kapstream actively manages the Fund's currency exposure. Non-Australian dollar-denominated securities may be fully, partially or not hedged back to the AUD. The neutral position of the portfolio is to fully hedge back any non-AUD exposure.

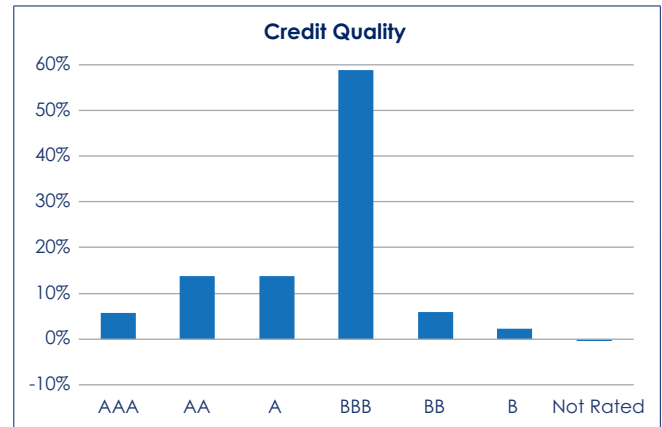
The Fund mandate allows for modest active currency positions as an alpha source where conviction exists. Kapstream may hold up to a maximum of 15% of the portfolio in non-AUD currency positions, which is comprised of direct investments into currencies and the portion of non-AUD denominated securities which are not hedged back to the AUD.

## Fund Characteristics

### Credit Quality

The Fund is distinguished by its high level of credit quality. The Fund has consistently held between 85-100% of assets in investment grade securities. The Fund's credit exposure as of the end of March 2023 is shown below. SQM Research notes that 92% of the assets held are investment

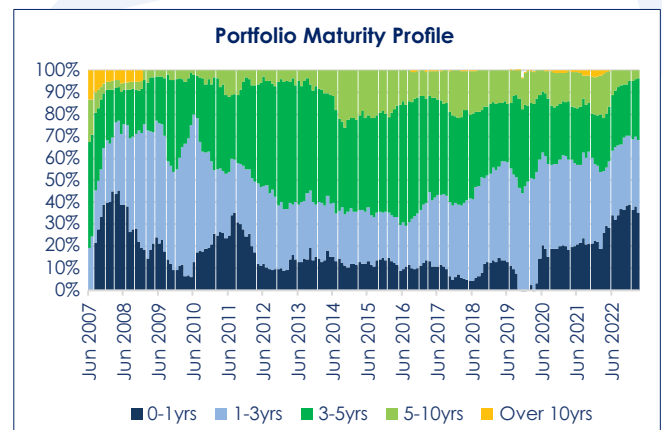
grade securities (BBB or better) with 8% in non-investment grade (BB or lower) or unrated securities. The manager has recently moved up the risk spectrum. The Fund's exposure to non-investment grade securities increased from 5% of NAV in early 2021 to around 8-10% by late 2021.



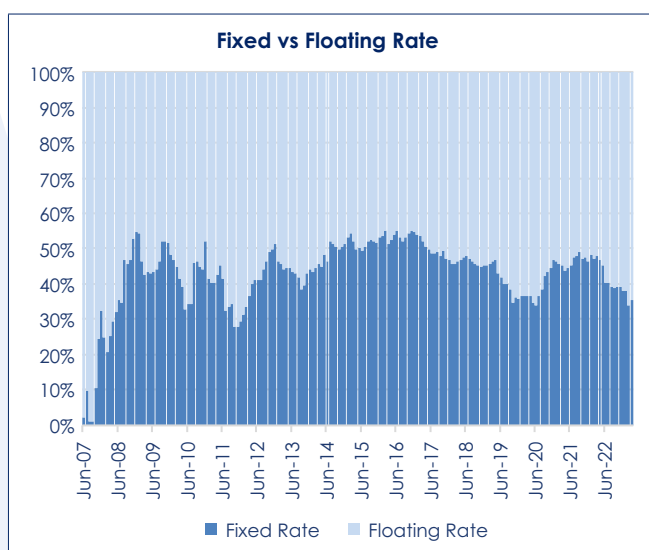
Until recently, the interest rate environment has been very benign. However, in times of deteriorating economic and/or credit conditions, lower quality credit instruments tend to be more volatile and price sensitive compared to higher quality credit. Sub-investment grade credit instruments carry a significantly greater default risk than those of higher credit quality due to the debt issuer's impaired ability to service the interest and repay the principal as and when its due. The Fund's relatively small exposure to non-investment grade credit will protect the Fund compared to other fixed interest funds that have gone further out the credit risk spectrum. SQM Research notes Kapstream has never suffered a default in its entire firm history.

### Duration Risk

Duration risk is low. Most assets held by the Fund are short dated, with half of the portfolio assets having a maturity of less than one year and 83% less than three years. The portfolio has an average credit duration of 1.4 years.

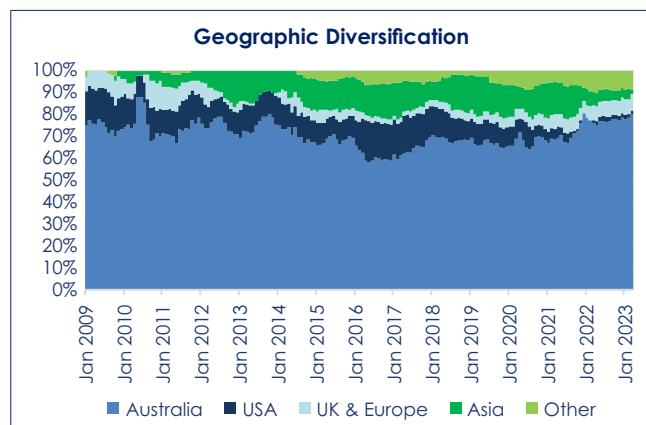


The allocation between fixed and floating rate debt is actively managed to position the portfolio for the prevailing interest rate/inflation environment. Since its inception, the Fund has demonstrated a bias toward floating rate securities. The floating rate exposure of 78% implies some capital protection in a rising interest rate and inflationary environment. SQM Research notes that commercial loans are typically floating rate and would have performed better in a rising interest rate environment.



### Geographic Allocation

Country allocations are unconstrained. The Fund has been consistently heavily weighted towards Australian debt. Close to 80% of the portfolio is held in Australian & New Zealand names, and by currency 100%+ is held in AUD-denominated securities. The bias towards Australian securities reflects Kapstream's greater knowledge of the home market and access to deals, as well as generally higher spreads and the more stable rating profiles resulting from the high level of institutional investment. Kapstream only invests overseas where there is an appropriate 'rule of law', i.e., in hard currencies only (e.g., USD, EUR, GBP, NZD, SGD).



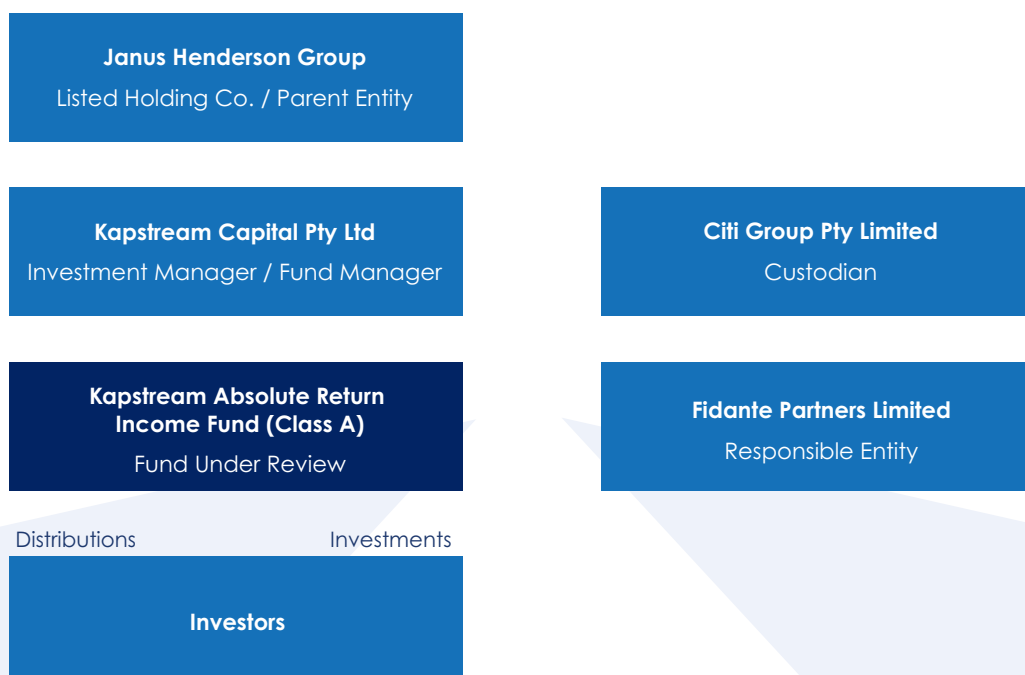
### Market Capitalisation

The Fund has no market cap bias, although it will invest only in listed companies with a market cap greater than US\$5 billion and EBITDA greater than US\$100m. While new issues are important, they are not essential for the Fund's strategy as it is not overly reliant on new issue concessions as significant contributors to returns.

### Turnover

Historical portfolio turnover over the past 5 years has been between ~25% to ~60%. Kapstream expects turnover to be at ~60% over the longer term. This can be impacted by flow activity, market liquidity and volatility, and new issue frequency. The average holding period has been around one year, with bonds sold as they make gains or start to trade tighter.

## Key Counterparties



### Parent Entity

Janus Henderson Group (JHG) is a global asset management group with principal offices in London and Denver and is dual-listed on the NYSE and ASX. JHG was formed in 2017 upon the merger of Janus Capital Group and Henderson Group. Kapstream has been owned by the Janus Henderson Group since 2017, operating continuously under its own AFSL as an autonomous subsidiary.

### Investment Manager

Kapstream Capital Pty Limited was founded in Sydney in 2006 and is a specialist global fixed income manager with its principal office in Sydney and an associate office in Newport Beach, California. Kapstream focuses on the management of low volatility, global, short duration fixed income portfolios with absolute return performance objectives, on behalf of institutional and retail clients. As of December 2022, Kapstream manages A\$6.9 billion from its office in Sydney and a further A\$4.9 billion managed in USD and GBP portfolios in collaboration with its associate team and office in Newport Beach, California. Kapstream has operated profitably since before 2010.

The firm launched the Kapstream Absolute Return Income Fund in 2007, and in 2018 launched the higher performance Kapstream Absolute Return Income Plus Fund. Kapstream also manages separately managed accounts on behalf of institutional clients in Australia and overseas.

SQM Research notes the firm has a substantial parent group able to provide financial and/or technical support. Since July 2015 Kapstream has operated as an autonomous 'boutique' subsidiary, initially of Janus Capital Group and – since their merger in May 2017 with Henderson Global Investors – now of Janus Henderson Investors. There are no concerns over the stability of the manager's or parent's position in the market. Kapstream has a good spread of clients comprising a range of high net worth individuals, family offices, institutional investors (including public and private pension funds, asset and private wealth managers), and retail clients.

## Governance

### Responsible Entity

Fidante Partners Limited (ABN 94 002 835 592, AFSL 234668) is the Fund's Responsible Entity. Fidante Partners is part of the Challenger Limited Group, an ASX-listed investment management firm. As Responsible Entity, Fidante Partners oversees the operation and management of the Fund.

### Custodian

Citi Group Pty Limited is the custodian for the Fund.

### Fund Administration

Fidante Partners has been the Administrator of both Kapstream funds since inception and provides fund administration, including investor-related services, administrative services, payment handling, and accounting services, including calculation of monthly NAV for the Fund.

### Management Risk

#### Compliance

As the Responsible Entity, Fidante has a risk management framework incorporating management, operational and financial controls. Fidante also maintains a risk register which is reviewed at least annually.

The compliance framework for personnel, policies and processes operates independently of the investment process. Kapstream adheres to the risk and compliance framework of the Janus Henderson Group. Kapstream maintains a documented Risk Management Policy embedded within its Compliance Manual. The Risk Management Policy contains a Risk Register which the Board reviews and signs off on annually. Kapstream is also within the scope of the Janus Henderson Group Internal Audit function. Internal audit findings are reported to both the Kapstream Board and to the JHI Australia Risk & Compliance team, and additionally, where fund related, will be provided to Fidante's Compliance Committee and through to the Fidante Board. The systems and processes in use to assure individual mandate compliance, portfolio monitoring and guideline adherence are robust and tested.

SQM Research views independence in an oversight body such as the Compliance Committee as a strong and favourable factor in Fund governance.

There have been no material regulatory, compliance or audit issues or regulatory actions against the investment manager. There have been no litigation issues involving the firm or its employees over the past three years.

Funds management businesses rely on the operational capabilities of key counterparties. A critical element is the ability of the Responsible Entity to monitor operational performance and to meet the regulatory and statutory responsibilities required. For any investment fund, there is a risk that a weak financial position or management performance deterioration of key counterparties could temporarily or permanently compromise their performance and competency. This can adversely affect financial or regulatory outcomes for the Fund or associated entities.

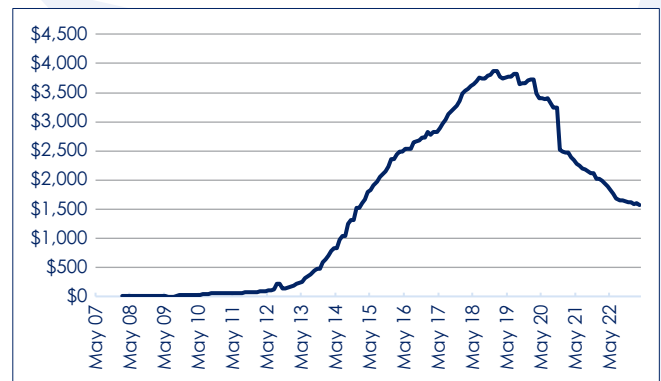
*Based on the materials reviewed, SQM Research believes that Kapstream and associated key counterparties are highly qualified to carry out their assigned responsibilities. Management risk is rated as low.*

### Business Strategy

#### Funds under Management

The Fund has approximately \$1,572 million in funds under management as of March 2023. The Fund experienced a significant decline in FUM during 2020, with FUM falling from approximately \$3,700 million to \$1,570 million.

#### FUM for Fund under Review (\$ million)



Kapstream does not set hard limits for the FUM it will accept into the strategy, given the dynamic nature of fixed income markets. The Manager will monitor the Fund for any degradation in performance as FUM grows and will review accordingly. Kapstream does not anticipate any liquidity constraints based on a larger FUM size, given the universe of investment grade/high yield and securitised bonds/warehouses is extremely large.

## Investment Team

Name	Responsibility / Position	Location	Years at Firm	Years in Industry
Daniel Siluk	Managing Director, Portfolio Manager	Sydney	14.0	20.0
Dylan Bourke	Managing Director, Portfolio Manager	Sydney	9.0	15.0
Robert Roszkowski	Portfolio Manager	Sydney	12.0	12.0
Priyank Shah	Portfolio Manager	Sydney	8.0	17.0
Pauline Chrystal	Portfolio Manager	Sydney	5.0	17.0
Mark Bayley	Portfolio Manager	Sydney	3.0	27.0
Courtney Chute	Portfolio Analyst	Sydney	11.0	16.0
Zeyu Gao	Quantitative Analyst	Sydney	2.0	2.0
Ben Zhong	Data Analyst	Sydney	1.0	25.0
Kris Bernie	Portfolio Manager	Sydney	1.0	25.0
Jason England	Portfolio Manager	Newport Beach	6.0	28.0
Jeremiah Lopez	Associate Portfolio Manager	Newport Beach	19.0	20.0
Addison Maier	Associate Portfolio Manager	Newport Beach	12.0	12.0
Vincent Ahn	Associate Portfolio Manager	Newport Beach	6.0	11.0
Average			7.8	17.6

### Team Structure

The investment team comprises 14 finance professionals based in Sydney and Newport Beach, California. The two managing directors, Mr Daniel Siluk and Mr Dylan Bourke, have hands-on involvement in investment decisions and, between them, have over 35 years of industry experience. They are supported by 12 highly experienced portfolio managers and analysts. The investment team has an average of 17.6 years of industry experience and, apart from four more recent hires, generally has a long tenure with Kapstream. The core team has worked together for a long time. All members of the investment management team are highly qualified. Members have appropriate academic qualifications and CFA designations.

All investment decision-making and research pertaining to the strategy is undertaken internally, and it is not reliant on any other resources within the wider Janus Henderson Group. That said, Kapstream may from time to time consider research provided by Janus Henderson.

The team consists of three broad functional areas: Rates/Macro, Credit and Data Analytics and Support. None of these groups operates independently of the other, given the investment process relies on the combination of rates and credit to achieve the return objectives. The portfolio manager role is hybrid in nature in that portfolio managers have research and trading responsibilities for the sectors and sub-asset classes they cover. The Credit portfolio manager role is also an integrated one where all Credit portfolio managers undertake analysis, trading

and portfolio construction responsibilities. Analysts are responsible for covering around 30-40 names each. Coverage in credit is based on sectors and geographies to build up specialisation. Analysts are not expected to 'cover the universe', given that a significant element of the firm's process is more macro-oriented, which filters the potential investible universe down to a manageable size.

An Investment Committee (comprising the team's three senior-most portfolio managers) has responsibility for firm-wide oversight of investment strategy, including research and portfolio leadership. The main role of the Investment Committee is to ensure the most relevant and topical subjects facing markets are discussed in appropriate detail and in a timely manner, with relevant application to portfolio construction and risk management.

In SQM Research's opinion, the team size is adequate, considering the number of securities held, the size of the portfolio and the requirements to effectively implement the investment process. SQM Research observes that the levels of investment experience and company tenure are high across the investment team. The team has some diversity of previous experience at different firms and has been exposed to different ideas and practices. The investment management process and performance do not rely excessively on the skill, contacts and reputation of one person, and there is a suitable backup for the key investment team members. In SQM Research's view, key person risk is assessed as low.



### Staffing Changes

Staff turnover within the investment team has been low. Two investment professionals departed in the last three years, and there have been four additions to the investment team in Sydney.

Departures			
Date	Name	Responsibility	Reason for Departure
01-Aug-22	Steve Goldman	Portfolio Manager	Retirement
01-Jul-20	Raymond Lee	Portfolio Manager/Head of Credit	Position Redundancy

Additions / Hires			
Date	Name	New Responsibility	Previous Position / Employer
01-Apr-22	Kris Bernie	Portfolio Manager	First Sentier
01-Feb-22	Ben Zhong	Data Analyst	APRA
01-Dec-20	Zeyu Gao	Quantitative Analyst	ANU School of Computer Science
01-Jul-20	Mark Bayley	Portfolio Manager	FIIG

Kapstream maintains a formal Succession Planning Policy, which considers key functions and identifies backups to those leading specific functions. The overall team-based approach, where all investment staff contribute to all portfolios, is also designed to reduce individual reliance.

### Meeting Schedule

Communication occurs in varying forms, from formal meetings to ad hoc discussions in response to current events, whether that be market-based data releases or announcements of new deals. Day-to-day portfolio construction decisions occur within functional areas; for example, the rates/macro team will decide upon things such as which tenor to roll NCDs and FX forward contracts, when to roll futures hedges, managing swap spread exposure, etc., whereas the credit team will make relative value decisions between issues and sectors.

The following formal meetings are conducted by Kapstream.

Meeting	Agenda	Frequency	Participants
<b>Portfolio Management Meeting</b>	Discussion on portfolio positioning in the context of market developments through the prior week and to consider news and developments forthcoming.	Weekly	Whole team
<b>Liquids and Hedging Meeting</b>	Determination of the amount and mix of 'Level 1' assets for liquidity purposes and Swap Spread exposure.	Monthly	Priyank Shah, Kris Bernie, others by invitation/choice
<b>Credit Asset Allocation Meeting</b>	Determination of the sector exposure across portfolios. The focus is at a high level with allocation decisions between; Liquids, AU Financials, AU Corps, Offshore Financials, Offshore Corps, Subordinated Debt, REITs, Securitized Debt and Warehouses.	Monthly	Credit group (Dylan Bourke, Pauline Chrystal, Mark Bayley, Addison Maier), others by invite subject-dependent)

SQM Research believes the practice of constant communication and the broad-based inclusion of team members in decision-making is a vital ingredient to the success of the process. Interactive peer review and collaboration across a tightly knit group of experienced investors will likely make the best use of their combined intellectual property and shared history.

## Remuneration and Incentives

### Remuneration

Kapstream aims to pay top-quartile salaries based on external compensation surveys and factoring in industry experience and seniority. Salaries are reviewed annually and adjusted according to progress and performance review outcomes, of which both individual and firmwide KPIs form part.

All staff within the firm are eligible for an annual variable compensation award in addition to salary. The variable compensation pool value is, in part, a function of firmwide revenues. Individual awards are based on individual performance and team and portfolio contribution. If awards are lower than an annually agreed threshold, they are paid fully as upfront cash. Beyond the annually agreed threshold, 60% is paid as upfront cash and 40% is deferred to vest in equal 'thirds' over the following three years. Deferred compensation is split equally between Kapstream funds and Janus Henderson Group shares. If a member of the team elects to leave the firm, they forego any deferred compensation.

### Equity Ownership

As a wholly owned subsidiary of Janus Henderson Group, the team do not own equity in Kapstream. Most staff hold material investments in Kapstream funds, creating an alignment of interest with clients. They have skin in the game.

*SQM Research believes access to firm equity and client-focused performance bonuses act as strong incentives for optimising staff engagement, retention and productivity. The intention (and SQM believes the effect) is to align staff performance with client and shareholder objectives. It focuses on the customers' needs and medium to long-term results.*



## Fees

Fees and Costs	Fund	Peer Avg
Management Fee (% p.a.)	0.55%	0.71%
Transactional Costs (% p.a.)	0.00%	–
Total Cost Ratio (% p.a.)	0.55%	0.86%
Performance Fee (%)	0.00%	14.25%
Buy Spread (%)	0.00%	0.10%
Sell Spread (%)	0.07%	0.10%

### Management Fee

The management fee is 0.55% per annum of the Fund's Net Asset Value (NAV), inclusive of any GST and net of any reduced input tax credits (RITCs). Management fees are calculated and accrued daily and paid monthly in arrears.

### Transactional and operational costs

The transactional and operational costs for the last financial year were 0.0% p.a. of NAV.

### Total fees and costs

The estimated total for management costs and net transactional and operational costs is estimated as 0.55% p.a. of the net asset value of the Fund.

### Overall Fees

SQM Research observes that Kapstream's 0.55% p.a. TCR is lower than the peer average of 0.86% p.a.

## Redemption Policy

The Fund is valued daily and offers daily applications and redemptions. The fund maintains suitable cash liquidity to meet expected redemption requests without freezing the fund.

## Distributions

The Fund aims to deliver consistent quarterly distributions with low volatility that reflect the coupon income being generated within the portfolio. The Fund pays distributions out of its smoothed medium-term expectation of income. This means distributions will generally be funded out of income, but capital can be utilised to maintain distribution consistency in the event of a short term drawdown for example. The manager's track record in paying distributions has been consistent in terms of frequency and quantum, although SQM Research notes distributions may be adjusted to assist in maintaining a smooth payment profile over a year.

Distribution Amount - cents per unit			
Distribution Date	Distribution CPU	Unit price* \$	Distribution %
Mar-21	0.34	\$1.211	0.28
Jun-21	3.10	\$1.208	2.57
Sep-21	0.39	\$1.181	0.33
Dec-21	0.42	\$1.173	0.36
Mar-22	0.50	\$1.165	0.43
Jun-22	1.19	\$1.151	1.03
Sep-22	0.84	\$1.140	0.74
Dec-22	0.83	\$1.135	0.73
Mar-23	0.83	\$1.144	0.73

Risk/Return Data to 30 April 2023							
Total Return	1-Month	3-Month	6-Month	1-Year	3-Year	5-Year	Inception
Fund	0.39	1.22	2.49	1.84	1.27	1.45	3.85
Benchmark	0.30	0.86	1.64	2.42	0.89	1.02	2.75
Peer Average	0.61	0.07	4.82	0.82	1.72	1.33	4.31
Alpha	0.09	0.35	0.85	-0.58	0.37	0.43	1.10
Metrics	1-Year	3-Year	5-Year	Inception			
Tracking Error (% p.a.) - Fund	0.91	0.86	1.45	1.11			
Tracking Error (% p.a.) - Peer Average	5.64	4.23	4.86	4.26			
Information Ratio - Fund	-0.64	0.43	0.30	0.99			
Information Ratio - Peer Average	0.51	1.01	0.70	0.03			
Sharpe Ratio - Fund	-0.47	0.49	0.23	0.77			
Sharpe Ratio - Peer Average	0.08	1.20	0.66	0.42			
Volatility - Fund (% p.a.)	1.12	0.93	1.50	1.22			
Volatility - Fund (% p.a.)	5.78	4.26	4.89	4.22			
Volatility - Benchmark (% p.a.)	0.32	0.36	0.29	0.55			
Beta based on stated Benchmark	2.64	0.99	1.36	0.94			

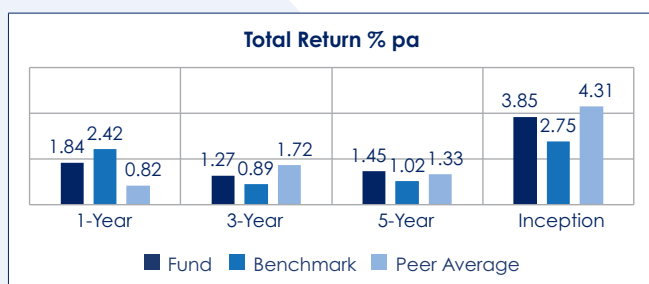
Dividends reinvested. Returns beyond one year are annualised. Return history starts Jun-2007

Benchmark: RBA Cash Rate Target

## Quantitative Insight<sup>1</sup>

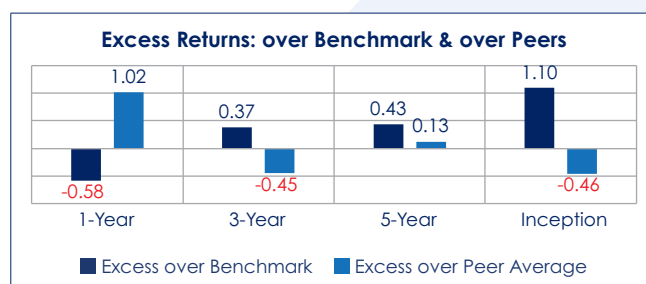
**Note:** Unless otherwise stated, all return and risk data reported in this section are after-fees and for **periods ending 30 April 2023**.

### Returns



The Fund has outperformed its benchmark on 81.7% of 1-yr rolling observations since its inception. The Fund has outperformed its benchmark on 94.9% of 3-yr rolling observations since its inception. SQM Research notes the Fund has underperformed both the Bloomberg AusBond Composite 0+Y TR Index and Bloomberg Global Aggregate TR (Hedged AUD) in the period since inception. However, over the past 12 months to April 2023, the Fund has outperformed these indices by a considerable margin.

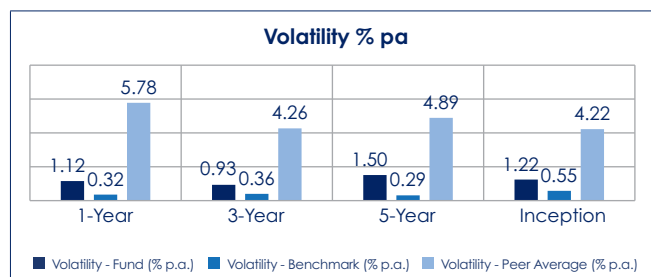
### Excess Returns (Alpha)



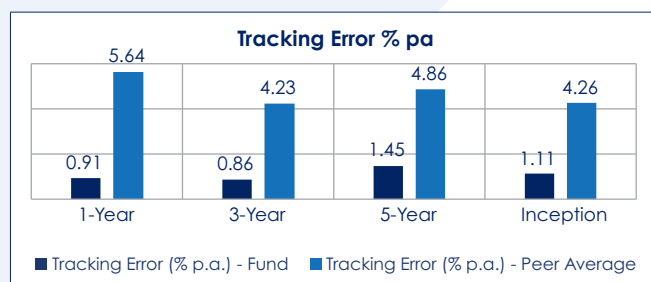
The return outcomes, as described above, are in line with the PDS objective and with SQM Research's expectations for the Fund relative to its volatility. In SQM Research's opinion, the RBA Cash benchmark is a low hurdle for an actively managed, absolute return, fixed interest fund that is incurring significantly higher levels of risk both in terms of volatility and potential drawdowns. SQM Research also notes that the Fund has failed to achieve its internal return objective of the RBA Cash Rate +2.3% p.a. before fees.

<sup>1</sup> Note: Sharpe and Information Ratios are not reliable comparison tools in periods where both the Fund and its peers/benchmark record a negative result

## Risk



The Fund's **volatility** (standard deviation of monthly returns) has tended to be significantly lower than peers but higher than its benchmark. As another perspective, the Fund's 3-year rolling volatility has varied from a low of 0.54% per annum to a high of 1.81% and averaged 1.01% over the rolling observations of the Fund's lifespan. Over this same time frame the peer group rolling volatility ranged from a low of 2.01% per annum to a high of 7.81% and averaged 4.12%.



The Fund's **tracking error** (standard deviation of monthly excess returns) has been consistently lower than peers. SQM Research has measured and reported tracking error in the tables above. Since the Fund's benchmark has almost no volatility, the tracking error readings add no new information to observations gained from studying volatility. Tracking error will be virtually identical to the Fund's volatility.

The risk outcomes as described above regarding volatility and tracking error are consistent with the PDS statements about risk and are in line with SQM Research's expectations for this Fund.

## Drawdowns

Drawdown Summary			
Drawdown Size (peak-to-trough)			
	Fund	Bench	Peers
Average	-0.42%	no data	-2.40%
Number	14	0	17
Smallest	-0.02%	+0.00%	-0.05%
Largest	-2.59%	+0.00%	-16.15%
Length of Drawdown (in months)			
	Fund	Bench	Peers
Average	3.9	no data	5.5

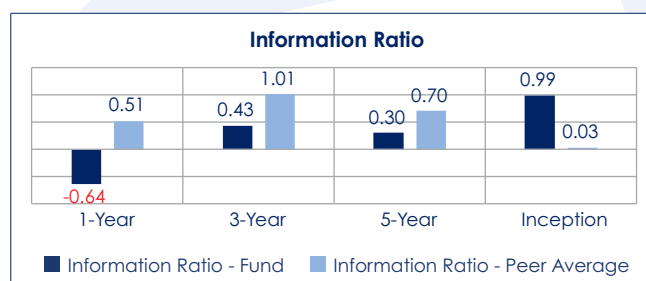
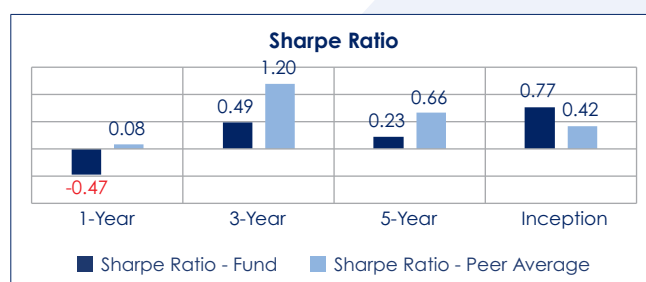
Length of Drawdown = time from peak to trough and back to the previous peak level

The benchmark has had zero drawdowns, as expected from inflation or cash-based indexes. The Fund's drawdown profile has been substantially better than the peer average.

## Upside/Downside Capture

	Downside Capture		Upside Capture	
	3 years	Inception	3 years	Inception
Fund	.	.	142.0%	139.6%
Peer Average	.	.	204.0%	160.1%

## Risk-Adjusted Returns



Over the longer term, the Fund's risk-adjusted returns (as measured by Sharpe and information ratios) have been materially better than the peer average, measured since inception. This has not been the case over the more recent 5 year period.

## Correlation of Fund to Asset Classes

Market	3 years	Inception	Market Indexes
Aust Bonds	+24.1%	+30.1%	Bloomberg AusBond Composite 0+Y TR
Aust Equity	+13.8%	+29.6%	S&P/ASX 300 TR
Global Bonds	+30.7%	+41.3%	Bloomberg Global Aggregate Hdq AUD
Global Equity	+9.2%	+17.7%	MSCI World Ex Australia NR AUD

## Correlation Key

Low	High	Description
0%	20%	low, weak
20%	40%	modest, moderate
40%	70%	significant, material
70%	90%	strong, high
90%	100%	substantial

Over the life of the Fund, the 3-year rolling correlation to Australian equities has ranged from a low of -16.06% to a high of 66.54% and averaged 29.68%. Over the same time frame, the peer group's 3-year rolling correlation has ranged from a low of 32.10% to a high of 76.20% and averaged 56.68%.

## Tail Risk

*(The analysis in the table below looks at the **tail risk performance relationship of the Fund to the ASX300**, a practice that SQM has set as common across asset classes in Fund reviews. This approach recognises that for the large bulk of financial planner clients, their key traditional asset class **risk** regarding **size** and **volatility** is to Australian equities. Exploring that relationship is useful regardless of the asset class of the Fund itself, as it is helpful to understand how a Fund has acted in times of Australian equity market stress in terms of softening or exaggerating the negative performance experienced at such times.)*

The table below details the **largest negative monthly returns** for the S&P/ASX 300 TR Index **since the inception of the Fund**. This is compared to the Fund's performance over the same months.

## Extreme Market Returns vs Fund Return Same Month

Index: S&P/ASX 300 TR		From May-14 to Apr-22		
Rank	Date	Market	Fund	Difference
1	Mar-20	-20.83%	-2.59%	+18.24%
2	Oct-08	-12.88%	+1.13%	+14.01%
3	Jan-08	-11.00%	+0.55%	+11.55%
4	Sep-08	-9.94%	-0.13%	+9.81%
5	Jun-22	-8.97%	-0.23%	+8.74%
6	Feb-20	-7.76%	+0.46%	+8.22%
7	Aug-15	-7.70%	-0.02%	+7.68%
8	Jun-08	-7.57%	+0.30%	+7.87%
9	May-10	-7.54%	+0.25%	+7.79%
10	May-12	-6.74%	+0.50%	+7.24%
Totals		-100.92%	+0.23%	+101.15%

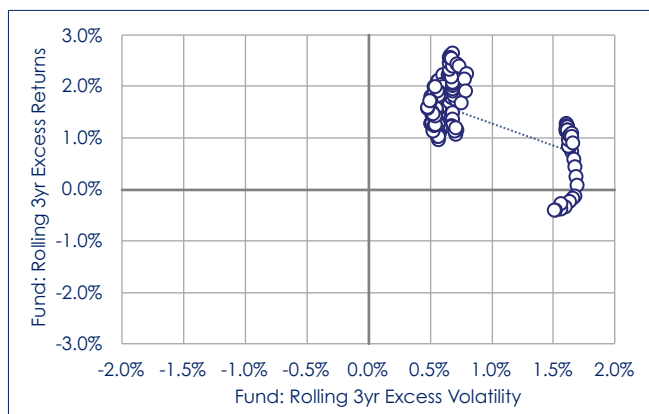
No. of Months			
Correlation	+73.7%	Positive Return	6
Capture	-0.2%	Outperform	10

The data in the table above indicate that the Fund displays substantial defensive characteristics in the face of extreme Australian equity tail risk.

## Snail Trail

The snail trail chart and tables below show the Fund's rolling 3-year excess returns and rolling 3-year excess volatility. There are 156 observations in total. The two tables below display the distribution of these observations and their overall frequency across the risk/return quadrants.

Snail Trail Distribution			
Frequency	Lo-Vol	Hi-Vol	Total
Hi-Return	0	148	148
Lo-Return	0	8	8
Total	0	156	156
156 rolling 3-year observations			
% of Total	Lo-Vol	Hi-Vol	Total
Hi-Return	0.0%	94.9%	94.9%
Lo-Return	0.0%	5.1%	5.1%
Total	0.0%	100.0%	100.0%



In assessing a snail trail it is important to note the following:

**Q1 upper left-hand quadrant** - higher return than the Fund's market index with lower volatility (less risk). This is the optimal position.

**Q2 upper right-hand quadrant** - higher return than the Fund's market index with higher volatility (more risk). This can often be a desirable position depending on the attractiveness of the Sharpe ratios produced in this zone. It is important to note that in the case of inflation or cash-style benchmarks, the Q1 top left-hand quadrant is unachievable as it is not possible to deliver lower volatility than what is virtually zero for the benchmark. In such cases, the Q2 zone is the optimal position.

**Q3 lower left-hand quadrant** - lower return than the Fund's market index with lower volatility (less risk). Less than ideal, and Sharpe ratios can assist in assessing the risk/return trade-off in this zone.

**Q4 lower right-hand quadrant** - lower return than the Fund's market index with higher volatility (more risk). The least desirable outcome.

#### Consistency

The more "bunched together" the cluster of dots, the more consistent is the performance. A second indicator of consistency is the trail's nomadic nature. Trails that roam across multiple quadrants over time are indicating **low consistency** in the Fund's risk-return profile. The quadrant that **contains the bulk** of the Fund's snail trail is likely to be more representative of the Fund's risk/return characteristics and identity.

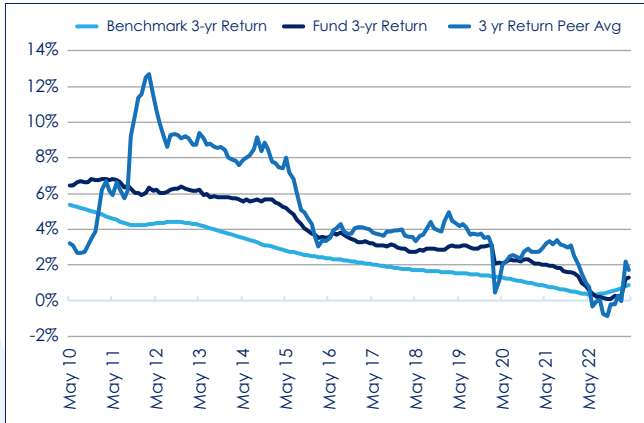
#### Annual Returns

Year	Fund	Benchmark	Peer Avg	vs. Bench	vs. Peers
2011	+5.01	+4.87	+4.79	<b>+0.14</b>	<b>+0.22</b>
2012	+8.22	+3.83	+12.71	<b>+4.39</b>	<b>-4.49</b>
2013	+4.13	+2.81	+7.07	<b>+1.31</b>	<b>-2.94</b>
2014	+4.71	+2.57	+4.91	<b>+2.14</b>	<b>-0.20</b>
2015	+2.40	+2.16	+1.28	<b>+0.23</b>	<b>+1.12</b>
2016	+3.01	+1.78	+5.85	<b>+1.24</b>	<b>-2.84</b>
2017	+3.55	+1.53	+5.33	<b>+2.01</b>	<b>-1.78</b>
2018	+2.02	+1.53	+0.75	<b>+0.49</b>	<b>+1.27</b>
2019	+3.46	+1.19	+5.08	<b>+2.27</b>	<b>-1.62</b>
2020	+1.40	+0.33	+3.10	<b>+1.07</b>	<b>-1.70</b>
2021	+0.03	+0.10	+1.37	<b>-0.08</b>	<b>-1.35</b>
2022	<b>-0.55</b>	+1.31	<b>-4.78</b>	<b>-1.86</b>	<b>+4.23</b>
Apr-23	+1.68	+1.13	+2.15	<b>+0.54</b>	<b>-0.47</b>

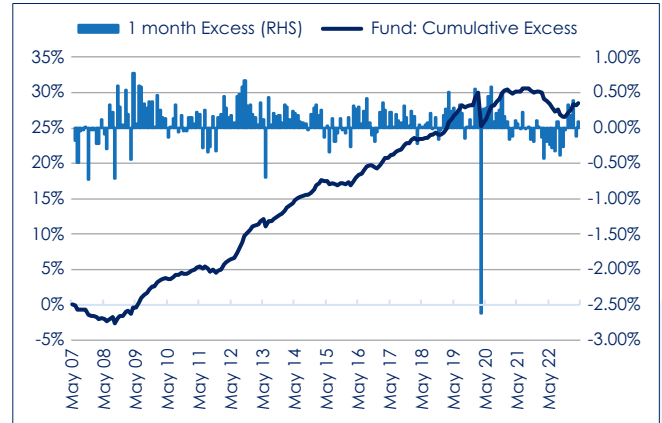
2023 data = 4 months ending Apr-23

## Return and Risk

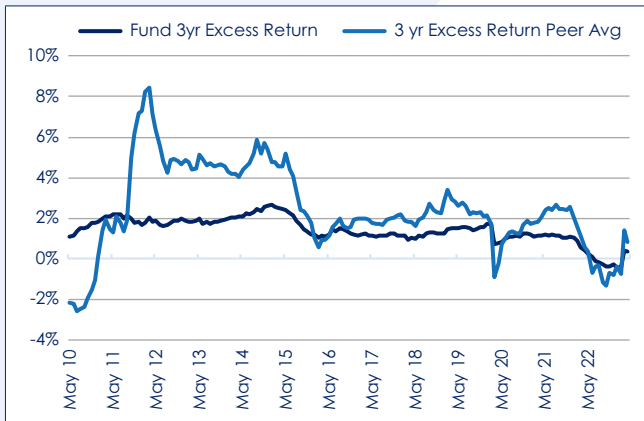
### Rolling Returns



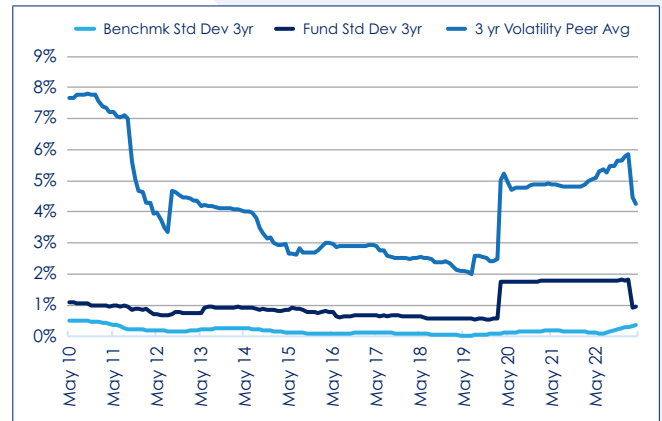
### Cumulative Excess Returns



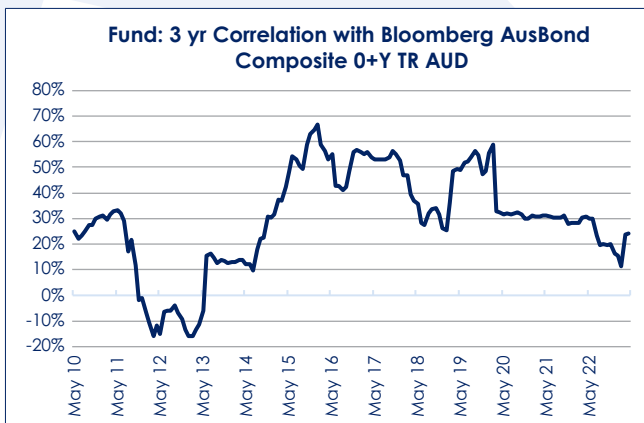
### Rolling Excess Returns



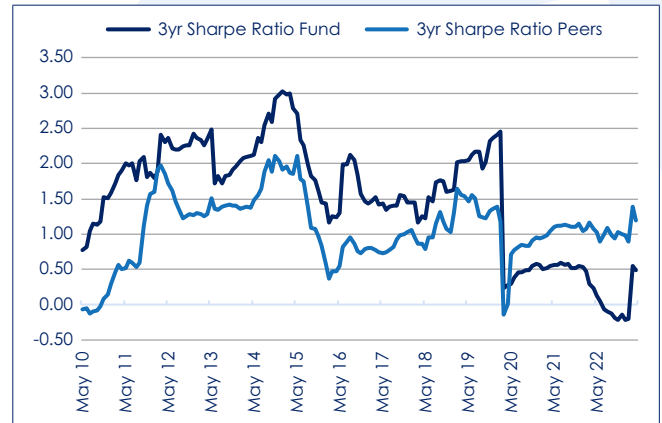
### Rolling Volatility



### Rolling Correlation

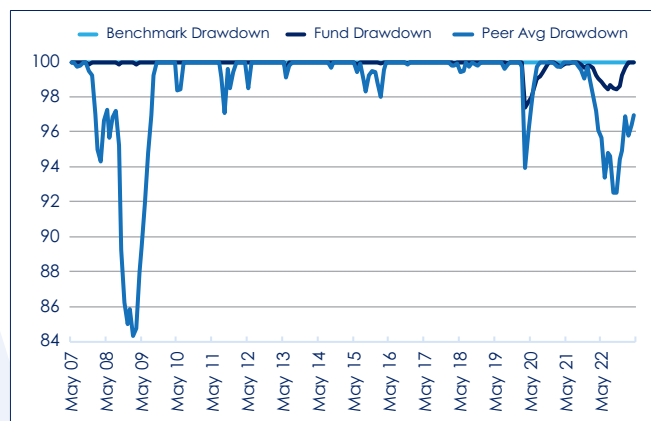


### Rolling Sharpe Ratio



## Return and Risk

### Drawdowns





**Drawdown**

A drawdown tracks the path of the Fund's accumulated NAV (with dividends reinvested). It is measured for a peak-to-trough decline and the subsequent recovery back to that previous peak level. The total return over that entire period is, of course, zero. The metric of interest, the drawdown itself, is quoted as the percentage change between the peak and the trough over that period. Funds typically have multiple drawdowns of varying size and length over their lifetime. The table above shows how many drawdowns have occurred and their average peak-to-trough size.

**Alpha**

SQM defines Alpha as the excess return compared to the Benchmark and is calculated as

$$\text{Alpha} = \text{Fund Return} - \text{Benchmark Return}$$

**A General Note on Distributions for Managed Funds**

The Responsible Entity of a Managed Fund will provide for a regular schedule of distributions, such as monthly/quarterly/semi-annual or annual. This is subject to the Fund having a sufficient distributable income. The official total distributable income available to pay to investors is determined for the period of that Fund's financial year. By distributing the net taxable income of the Fund to investors each year, a Fund itself should not be liable for tax on its net earnings.

If a Fund makes distributions more frequently than once over the financial year, those distributions will be based on estimates of the distributable income for that distribution period. The final amount of distributable income available for passing on to investors can only be calculated after the close of the financial year, based on the Fund's taxable income for that year.

If the total distributions a Fund pays out exceed total taxable income for that particular financial year, the excess amount may be treated as a return of capital rather than income. This will possibly have tax implications for the investor.

Due to the considerations outlined above, there may be periods in which no distributions are made or a Fund may make additional distributions. The performance of the Fund and general market conditions determine a Fund's ability to distribute income. Accordingly, there is no guarantee that a Fund will distribute in any distribution period.

**Total Cost Ratio (TCR)**

Managed Investment Schemes: The TCR for Managed Investment Schemes, Exchange Traded Products, and Investment Bond funds is an addition of the Investment Management Fees and Costs (including admin fees), Performance Fee Costs, and the impact of dollar-based fees.

Superannuation funds: The TCR for Superannuation and Pension funds is an addition of the Investment Management Fees and Costs (including admin fees), Performance Fee Costs, Administration Fees and Costs, the impact of dollar-based fees and a deduction of Super OTC Derivative Costs.

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