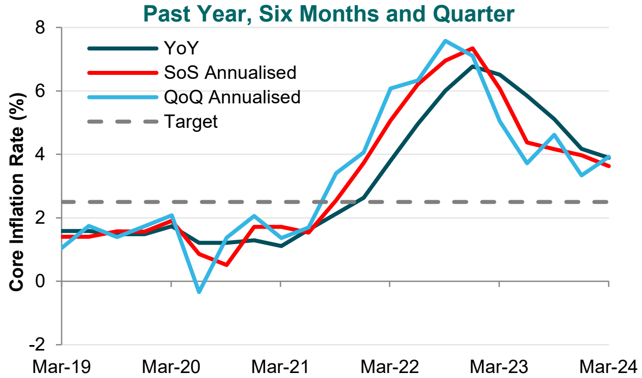
May 2024

The 'Higher For Longer' Club welcomes the RBA (and why this is good for fixed income)

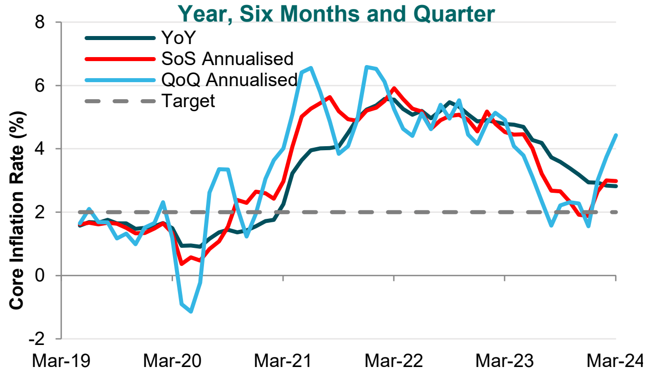
The economic outlook remains uncertain and the process of returning inflation to target is unlikely to be smooth with the RBA outlining a set of forecasts and commentary that implied the likelihood of Australian rates being on hold until well into 2025. The pace of decline in inflation, or whether it is declining at all, has been called into question, the chart below highlighting that shorter frequency measures of inflation over the past three and six months are no longer significantly below the yearly rate. We believe that inflation-focused central banks will not ease policy from the currently restrictive setting if inflation stabilises meaningfully above target.

Australian Annualised Core Inflation Over the Past Year, Six Months and Quarter



Source: Bloomberg, Kapstream

US Annualised Core Inflation Over the Past Year, Six Months and Quarter

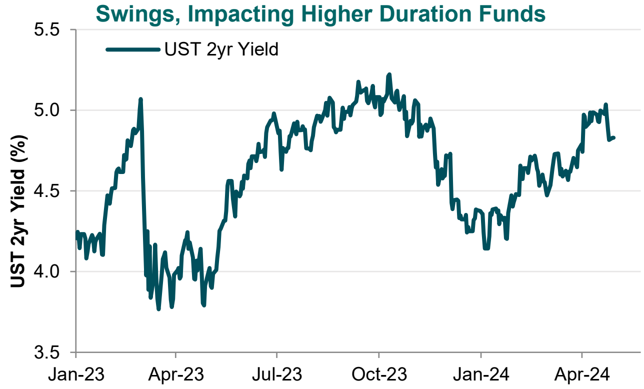


Source: Bloomberg, Kapstream

Whilst higher rates for longer may be harmful for borrowers, it is a boon for fixed income investors as it continues to drive a higher running yield. As an example, the yield to maturity as at 30th April 2024* on our flagship fund (Kapstream Absolute Return Income Fund) is at near decade highs of 6.31%, and at 7.05% for our higher octane fund (Kapstream Absolute Return Income *Plus* Fund). Furthermore, both exhibit class-leading low volatility among peers, being low duration and therefore exhibiting a lesser sensitivity to the ups and downs in bond yields that we've seen over the past year.

Rate cut expectations in Australia and the US have therefore been pushed back and bond yields this year have sharply reversed the declines of late 2023 as a result.

Bond Yields have Exhibited Significant Swings, Impacting Higher Duration Funds



Source: Bloomberg

However, not all developed markets are created equal. While the pandemic saw economies contract and central banks ease monetary policy in a somewhat synchronised fashion, economies and central banks will also begin to diverge as more time passes. Inflationary decline in Europe and Canada is not stalling as seen in the US and Australia, and is approaching the target rate in each region. We therefore expect the European Central Bank and the Bank of Canada to ease policy in coming months as a result, before any similar such move from the US Federal Reserve or the RBA. This has seen us shift the bulk of our duration exposures to European and Canadian markets, where the front end of the curve is likely to shift lower as their easing cycles get under way. Not being limited to just one or two markets and actively seeking the best opportunities globally is therefore expected to yield additional return to investors.

If a competitive return without the headache of undue volatility is what you're after, in a fund that has the freedom to look globally for compelling investment ideas, then please get in touch with us at www.kapstream.com.

*Yield to maturity (YTM) is not a forecast, and is not a guarantee of, the future return of the Fund. The Funds actual return will depend on a range of factors, including fluctuations in the value of the Fund's securities held from time to time. This material has been prepared by Kapstream Capital Pty Limited (ABN 19 122 076 117 AFSL 308870) (Kapstream), the investment manager of the Kapstream Absolute Return Income Fund & Kapstream Absolute Return Income Plus Fund (the Funds). Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (Challenger Group) and is the responsible entity of the Funds. Other than information which is identified as sourced from Fidante in relation to the Funds, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Funds Target Market Determination and Product Disclosure Statements (PDS) available at www.fidante.com should be considered before making a decision about whether to buy or hold units in the Funds. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. Any projections are based on assumptions which we believe are reasonable but are subject to change and should not be relied upon. Kapstream and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, Kapstream and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the Banking Act 1959 (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (Challenger ADI) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund(s) are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.