



### 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 1986.84
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

### Fund Statistics

Interest rate duration	1.2yrs
Credit spread duration	1.86yrs
Average credit rating	BBB+
No of issuers	72
Yield to maturity	6.19%

### 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

### May 2024

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)	0.72	1.56	6.29	2.90	2.53	4.56
Fund Return (after fees, before sell spread) <sup>1</sup>	0.68	1.45	5.83	2.48	2.09	4.20
Fund Return (after fees and sell spread) <sup>2</sup>	0.68	1.45	5.83	2.48	2.08	4.19
RBA Cash Rate	0.36	1.08	4.25	2.32	1.57	2.79
Active return <sup>3</sup> (before fees and sell spread)	0.35	0.48	2.04	0.59	0.96	1.77
Active return <sup>3</sup> (after fees and sell spread) <sup>2</sup>	0.32	0.38	1.58	0.16	0.50	1.40
Bloomberg AusBond Bank Bills Index	0.37	1.10	4.32	2.32	1.59	2.99

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, 31 May 2024.

### Performance Commentary

The Fund demonstrated strong performance in May, adding 0.68% (after accounting for class I unit fees). Performance was supported by the high yield to maturity of the portfolio, which remained near decade highs at 6.19% at the end of the month. There was also a tailwind from improved risk sentiment, with the equities generally up solidly and credit spreads compressing in the month. While bond yields varied across regions, the extension in duration ahead of the coming easing cycle globally positively contributed in May. Over the past 12 months, net performance has risen to 5.83%, to be 158bps above the RBA cash benchmark (after accounting for class I unit fees). Before fees performance has risen back to be within the 2-3% return objective and is strong relative to peers.\* At the same time, volatility remains low at below the 1.50% limit and compared with other fixed income funds.\*\* Correlations with other fixed income indices and asset classes are generally below 0.2 over most time frames.\*\*\*

### Market Commentary

The improvement in risk sentiment was the dominant market theme in May. After a dip in April, the uptrend in asset prices since late 2022 resumed. The ongoing strength in earnings, supported by a US economy that is not just avoiding recession but showing solid growth, continued to provide a tailwind to risk assets. The S&P 500 was up 4.8% in May and is now up almost 30% from the lows in late 2022 and set fresh record highs. Credit spreads have narrowed in tandem. US physical credit, as measured the Bloomberg US Credit Aggregate, fell by 2bps to 85bps in May, down from 165bps in late 2022. This index now sits towards the bottom of its 76bps to 618bps range since 2000. Australian physical credit spreads (in the form of the Bloomberg Ausbond credit 0+ index OAS) narrowed an even larger 8bps to 130bps in May, with the greater compression partly reflecting that Australian spreads are closer to the historical average of 131bps. The larger move therefore partly reflects some catch up to the moves seen offshore.



The uptrend in asset prices also seems to be resisting the 'higher for longer' theme that appears appropriately priced into fixed income markets for now. Bond yields were little changed over the month of May and were mixed depending on the region. Yields fell in the US - down 16bps at the 2yr part of the curve where our exposures tend to be concentrated, as core inflation figures over the month showed a modest decline. In contrast, German 2yr yields were 6bps higher in the month as the market re-assesses the path of easing from the ECB with the preliminary core CPI inflation figure for May unexpectedly rising by 0.2pps to 2.9%. Other markets, such as Australia, saw a very limited change in yields over the month. Given the rise on the higher for longer theme earlier in 2024, bond yields therefore still sit towards the upper end of the largely sideways range of the past two years.

### Outlook

The improvement in risk sentiment has one significant threat to dodge: a global recession under the weight of the significant monetary policy tightening in recent years. While economic activity has slowed below trend in most developed markets, US economic activity (historically more correlated with risk markets) has remained stubbornly strong. What is behind this US exceptionalism? Much looser fiscal policy is the most commonly cited influence, as well as the benefit to consumer spending from excess savings being drawn down. This has seen the chances of a near-term recession in the US fall from around a two-in-three chance a year ago to around a one-in-three chance presently.

The outlook for rates markets has significant and two-sided risks. If inflation fails to continue its downtrend and stabilises above central bank targets, we may not only see high for longer for monetary policy but even higher for even longer! In this scenario the central banks may see monetary policy as not restrictive enough (in contrast to the currently held opposite view). This is not our base case, but still a risk of driving higher bond yields. Even if inflation were to decline at a pace slower than the central banks are currently forecasting, then a delay in rate cuts could see bond yields rise and duration positions suffer. However, with the repricing of this higher for longer theme into markets in 2024 the hurdle to beat is now lower. Inflation only need show a resumption of the downtrend for it to be in touching distance of target. Central banks would likely look to ease policy off its currently restrictive stance in that setting. This highlights just how important near term inflation outcomes are to fixed income fund performance looking ahead.

### Portfolio Strategy

Exposures in the portfolio were largely unchanged over May, with developments not affecting the key macro themes underpinning our positioning.

Duration positioning was little changed, at around 1.2 years, slightly beyond the historical average amount of duration in the portfolio. The mix remains more weighted towards Europe and to a lesser extent Canada, where the central banks are expected to begin their easing cycles on the back of inflation falling towards target. We still maintain an exposure to the US for the same reasons, albeit that the conviction around when the Fed will begin easing has reduced as the progress on inflation has stalled. We continue to see little chance of a move in official rates in Australia so are largely neutral that region.

The portfolio's physical spread duration increased slightly to ~1.86yrs, while retaining lower sensitivity to spread change than we have historically targeted. We took advantage of primary issuance that offered good carry, attractive new issue concession and had a strong potential for spread compression, such as the NAB 2039 transaction. Despite the flow of new deals, we saw further credit spread compression. Spread performance in the portfolio continued to add to returns over the month and calendar-year-to-date period and slightly outpaced the compression in broader Australian credit indices, evidencing positive security selection.

The high coupon continues to provide a return robustness which hasn't been seen for around a decade. The quality of this coupon is strong given it is comprised of a higher than average credit spread, despite being focused on shorter dated assets. Given this high coupon we remain cautiously optimistic. Additionally, as the odds of a soft landing (rather than hard landing) in the US continues to increase given strong GDP and unemployment data, we expect to hold spread duration around 1.8-2yrs over the coming months in Australian credit, as home market credit spreads remain around long term averages in comparison to the US where credit spreads are significantly tighter against averages. In the absence of a hard landing globally, we expect Australian spreads will continue to follow the US lead and move towards the lower end of historical ranges.

In terms of asset allocation, the portfolio can be split across three major 'buckets': financials (~60%), corporates and REITs (~25%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~85% of the portfolio is held in Australian & New Zealand names, and by currency <5% is held in non-AUD denominated securities.



Portfolio liquidity remains high, with 'Level 1' liquidity is at ~10% (cash, commercial paper, SSGA) and slightly above the high end of the range for 'Level 2' liquidity at ~21% (<1yr investment grade), as a few bonds matured and we selectively redeployed proceeds into attractive new issuance. We believe the high level of liquidity provides the flexibility to buy attractive credits or take advantage of a better entry point should there be a sell-off.

*\* Kapstream's flagship and plus funds have placed in the top quartile of Lonsec's combined investment universe (for diversified and unconstrained fixed income funds) over the past 1, 3 and 5 years as at January 2024.*

*\*\* Kapstream has ranked in the bottom quartile for volatility over 1, 3 and 5 years in the Morningstar as at April 2024.*

*\*\*\* Kapstream has calculated the monthly return correlation with the Australian based indices used in APRA's annual performance test for the Australian superannuation industry.*

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](http://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.