# Kapstream

— JANUS HENDERSON —

Monthly Report – I class units

# Kapstream Absolute Return Income Plus Fund

## Fund objective

The fund aims to provide a superior stream of income and capital stability over the medium term while aiming to outperform its benchmark through market cycles.

## Fund application

Investors seeking to enhance their overall fixed income returns with a higher yielding, predominantly investment grade, absolute return-oriented global fixed income portfolio.

## Fund details

| | |
|---|---|
| Inception date | 16 August 2018 |
| Fund size | AUD 430m |
| Distribution frequency | Quarterly |
| Management fee | 0.45% p.a. |
| Buy/sell spread | 0%/0.2% |

## Fund statistics

| | |
|---|---|
| Interest rate duration | 1.07yrs |
| Spread duration physical | 2.01 yrs |
| Yield to Maturity | 6.98% |
| Average credit rating | BBB |
| Number of issuers | 59 |

## Fund guidelines

| | |
|---|---|
| Target return | cash plus 3-4% |
| Target volatility | <3% annualised |
| Duration limit | -2 to +2 yrs |
| Credit quality | >75% investment grade |

**Dylan Bourke**
Portfolio Manager

**Daniel Siluk**
Portfolio Manager

## June 2024

| Performance (%) | 1 month | 3 months | calendar year to date | 1 year | 3 years annualised | 5 years annualised | since inception annualised |
|---|---|---|---|---|---|---|---|
| **Fund Return** *(before fees and sell spread)* | **0.78** | **2.01** | **3.60** | **8.04** | **4.61** | **3.73** | **3.94** |
| Fund Return *(after fees, before sell spread)*[1] | 0.74 | 1.89 | 3.37 | 7.54 | 4.12 | 3.24 | 3.49 |
| Fund Return *(after fees and sell spread)*[2] | 0.74 | 1.89 | 3.37 | 7.54 | 4.13 | 3.22 | 3.43 |
| RBA Cash Rate | 0.33 | 1.08 | 2.15 | 4.25 | 2.43 | 1.62 | 1.60 |
| **Active return[3]** ***(before fees and sell spread)*** | **0.45** | **0.93** | **1.46** | **3.79** | **2.18** | **2.11** | **2.34** |
| Active return[3] *(after fees and sell spread)*[2] | 0.42 | 0.81 | 1.22 | 3.30 | 1.70 | 1.60 | 1.84 |
| Ausbond Bank Bill Index | 0.35 | 1.08 | 2.18 | 4.37 | 2.44 | 1.64 | 1.69 |

**Past performance is no guarantee of future results.** Net of fee returns inclusive of 0.4632% annualised total expenses. No allowance is made for tax. Numbers may not add due to rounding. 1) For a continuing investor the actual return experienced based on the NAV performance of the Fund, after accounting for management fees. 2) The return experienced by a redeeming investor, based on the exit price performance of the Fund which accounts for the start and end of period sell spread level, and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate). Source: Fidante Partners Limited, 30 June 2024.

## Performance commentary

The Fund returned 0.78% before fees in June, and the rolling one-year return was 8.04%. Coupon income, rates duration and slight spread tightening driven by an overweight to T2 all contributed to the strong performance. Our conviction on the outlook for 2024 remains strong given the fund's yield of 6.98%.

## Portfolio strategy

While we are cautiously optimistic about the prospects of short-term investment-grade credit, buoyed by the high coupon, our outlook becomes more cautious when considering longer-term credits, given the current indications of risk which are the significant losses incurred by Norinchukin, a domestic systemically important bank in Japan; defaults within AAA-rated Commercial Mortgage-Backed Securities (CMBS) in both the US and Europe; and the increasing popularity of more extreme political candidates globally. Under normal circumstances, any of these factors could trigger a 10% drop in equity markets, but the current optimistic market has partially or completely ignored these issues.

As such, we maintained a short-dated credit book. Level 1 liquidity increased to 12.3% (cash, commercial paper, SSGA) due to matured / called bonds and as we took profit on outperforming primary deals. Level 2 liquidity was at ~16.9% (<1yr investment grade). We did not have any CDX hedging.

The Fund's yield to maturity of 6.98% will continue to provide a strong tailwind for future returns. Physical spread duration ex. SSGA decreased to ~2.0yrs from ~2.3yrs for the reasons detailed above. We plan to maintain our spread duration towards the lower range of 1.8 to 2 yrs. This will be skewed towards Australian credit because credit spreads in Australia are closer to their long-term averages compared to the significantly tighter spreads observed in the US. There was no repo exposure.

The average credit rating of holdings was stable at BBB. High yield exposure was stable at ~17%, in typically BB-rated short maturity assets. We continue to avoid exposure to companies with material default risk and / or vulnerable to a downturn in the economy. The portfolio is split across financials (~67%), corporates (~9%), and ABS/MBS and warehouses (~21%), with the residual in cash and SSGAs. We expect ABS/MBS and warehouses to reduce in the coming months towards the soft internal limit of 20%. We have a ~90%/10% split between Australia/New Zealand and international issuers.

Rate duration decreased slightly by 0.11yr to 1.07yr. The mix remains more weighted towards Europe (0.52yr) and to a lesser extent Canada (0.17yr) where the central banks have begun their easing cycles on the back of inflation falling towards target. We still maintain an exposure to the US (0.27yr) for the same reasons, while we remain largely neutral in Australia (0.04yr) and continue to hold a small 0.07yr position in New Zealand.

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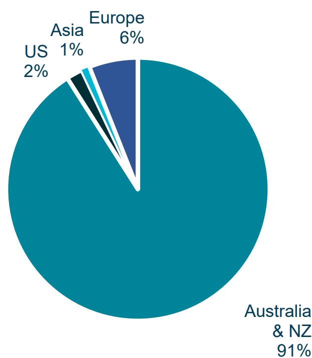
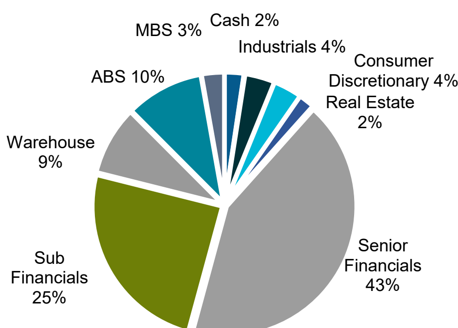
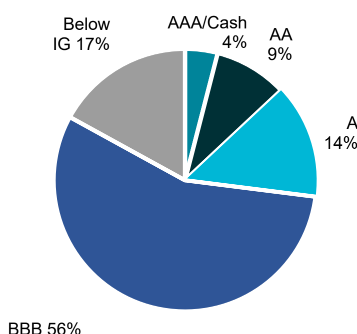
## Geographic Allocation*




## Sector Allocation




## Credit Rating*




## Outlook

The key global concern to rise in June was the announcement that France would go to an election, which would likely result in the current government coalition losing the majority in Parliament, increasing political uncertainty at best and raising odds of a larger budget deficit at worst, should the Rassemblement National (far right party), which gathered over 30% of the votes in the first round on 30th June, gain the majority of seats. The spread between French and German 10-year Government bond yields widened from around 50bps to 80bps, close to its widest level in over a decade but still well below the ~200bps level seen during the European debt crisis in 2011. European credit spreads also widened more than their global peers, out 11bps (Bloomberg Pan European Agg Corporate) over the month and wider by 16bps at the wides intra-month. The contagion spread somewhat to US credit spreads, which were out by a smaller amount of 9bps, although other influences such as dealer repositioning ahead of quarter and financial year end were also present. However, spreads remain quite low by historical standards. CDX widened by 4bp.

Above-expectations inflation outcomes also present a threat to fixed income returns. This was most evident in Australia, where warnings from the RBA that disinflation may be stalling were combined with above-expectations May inflation data. Markets are pricing in hike chances and pushing out the timing of rate cuts. The prospect of rate hikes has pushed up bond yields in Australia in June, when they fell elsewhere. Australian physical credit spreads (in the form of the Bloomberg Ausbond credit 0+ index OAS) sold off by 4bp accordingly.

Yields fell outside of Australia for two reasons: the easing cycle began in Europe and Canada, while US inflation data came out below expectations. Core inflation in both Europe and Canada had fallen to 2.9%, less than a percentage point from target and still declining. This saw the central banks begin to ease back on how restrictive monetary policy needs to be. In the US, a below-expectations inflation number, amidst a backdrop of continued falls in the yearly rate, also sets up a path for rate cuts from the Federal Reserve later in the year. For these reasons bonds generally rallied and took yields lower in the month.

Whilst trends were favourable over June as a whole, some clouds loom on the horizon, in particular the higher inflation outcomes seen in Australia. In Europe and Canada, where the easing cycle has already begun, above-expectations CPI data have called into question whether inflation is still falling. This may see rate cuts occur at least at a slower pace in these regions, if not stall.

While inflation was taking a lower turn in the US, there were also signs that the economy may be softening. Jobless claims have begun to trend higher, despite the strong payrolls employment outcomes in recent months. Consumer spending has also been softening over the course of the year. The US election later in the year is likely to see promises of fiscal spending which may provide the economy a boost, but of course the election outcome contains other risks for the economy and markets. Should the US economy falter, then risk markets could suffer. Spreads being at low levels also cautions against being overly exposed to credit markets, but recession fears do not appear imminent for now.

We believe the uncertainty in 2024 will continue to reinforce the importance of active investment in conjunction with strong analysis, as passive index portfolios may face painful tail risks such as defaults, leading to increased fundamental differentiation and dispersion of returns. Our portfolio held no exposure to US regional banks, Credit Suisse, or AT1 bonds in 2023 or 2024, which we have historically avoided due to their equity-like volatility during crises.

Our philosophy is to run a 'sleep-at-night' portfolio, quickly selling investments with any concerns to minimise potential price impacts, and we expect the attractive yield to generate a meaningful return for investors. Nevertheless, we remain positive on the outlook for stable and attractive portfolio returns, as the yield to maturity bounces around 7%, providing a rich buffer to the uncertainty of the macro backdrop. Additionally, the elevated levels of available portfolio liquidity and volatility budget provide us with ample ability to pounce on any opportunities, reinforcing our cautious optimism for returns in the period ahead.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