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 450m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%
Interest rate duration	0.52yrs
Spread duration physical	1.93yrs
Yield to Maturity	6.33%
Average credit rating	BBB+
Number of issuers	63

Fund guidelines

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

Platforms

- AMP North (Class A)
- Asgard Infinity
- BT Panorama
- Insignia - Asset Administrator (Badge BT)
- Netwealth

Dylan Bourke
Portfolio Manager

Daniel Siluk
Portfolio Manager

August 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)*	**0.87**	**2.75**	**5.63**	**8.72**	**5.04**	**3.91**	**4.15**
Fund Return *(after fees, before sell spread)*[1]	0.83	2.63	5.30	8.22	4.55	3.43	3.66
Fund Return *(after fees and sell spread)*[2]	0.83	2.63	5.30	8.22	4.55	3.41	3.65
RBA Cash Rate	0.35	1.07	2.90	4.30	2.67	1.73	1.67
Active return[3] ***(before fees and sell spread)***	**0.52**	**1.68**	**2.73**	**4.42**	**2.36**	**2.18**	**2.48**
Active return[3] *(after fees and sell spread)*[2]	0.48	1.56	2.40	3.91	1.88	1.68	1.98
Ausbond Bank Bill Index	0.38	1.11	2.95	4.39	2.70	1.75	1.76

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, 31 August 2024.

Performance commentary

The Fund returned 0.87% before fees in August, and the rolling one-year return was a solid 8.72%, outperforming last month's strong one-year return. The key driver remains the additional carry we have built in via short-dated credit exposures. This was accompanied by a significant benefit from our duration exposure, as bond yields fell sharply across the world in anticipation of the upcoming US Federal Reserve easing cycle. Our conviction on the outlook for 2024 remains strong given the fund's yield of 6.33%.

Portfolio strategy

The portfolio's physical spread duration dropped back below 2yrs, to 1.93yrs, as we took profit on some of the investments we made in primary. Despite maintaining a fairly short-dated book, our asset allocation overweighting T2 and mezzanine securitised continues to allow us to capture very strong credit spreads. Given the potential for volatility over the next few months, we plan to maintain our spread duration towards the lower end of the range of 1.8 to 2 years, and possibly even shorter in the upcoming months. This will be skewed towards Australian dollar credit as credit spreads in AUD are closer to their long-term averages compared to the significantly tighter spreads observed in the US.

The average credit rating of holdings remained at BBB+. We shifted some of our regional credit exposure from Australia to Europe, particularly in the T2 space, taking advantage of attractive new deals in AUD from offshore issuers. High yield exposure was stable at ~17%, in typically BB-rated short maturity assets. The portfolio is split across financials (~64%), corporates (~7%), and ABS/MBS and warehouses (~19%), with the residual in cash and SSGAs. We have a ~85%/15% split between Australia/New Zealand and international issuers, reflecting opportunities in primary markets.

Portfolio liquidity remains solid, with 'Level 1' liquidity at ~19% (cash, commercial paper, SSGA) as we sold some investments that have performed well and thanks to inflows. 'Level 2' liquidity was slightly lower, at ~14% (<1yr investment grade). 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.

Rate duration was reduced to 0.52yr from 1.04yr. Duration was mainly cut in the US (0.18yr down from 0.42yr) as we viewed that the sharp move earlier in the month to be overdone. We also reduced duration in Australia (-0.18yr from 0.0) as we believe rate cut expectations have become too elevated in light of stubborn inflation. Elsewhere, we maintained our position in New Zealand (0.05yr) , Canada (0.15yr) and Europe (0.31yr)

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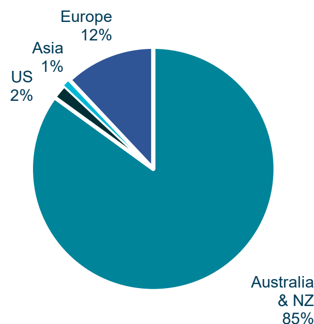
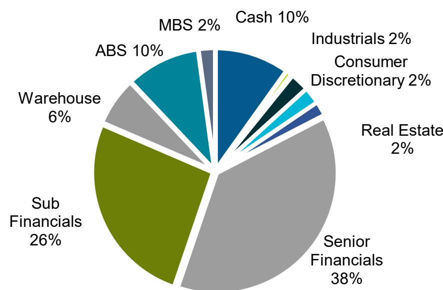
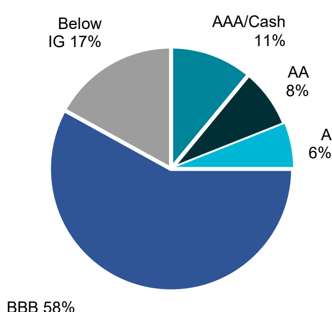
Geographic Allocation



Sector Allocation



Credit Rating



Outlook

August was a turbulent month for financial markets. Concerns of a hard landing in the US on some softer labour market data coincided with some leverage unwinds due to the Bank of Japan hiking rates at the end of July. As a result, risk sentiment soured globally, with the S&P500 down almost 10% from the fresh record highs the month earlier. Credit spreads widened accordingly, from a low of 48bps mid-July for CDX IG, to as high as 66bps in early August. The implied volatility on US equities in the form of the VIX index spiked from the teens to as high as 66, a level only surpassed during the peak of the pandemic and GFC periods.

However, risk markets generally recovered by the end of the month. Fears of a hard landing were wound back and the Bank of Japan came out and said that additional rate hikes were unlikely during periods of volatility. Equities finished the month modestly higher and CDX IG spreads went back down to 49bps. The VIX index also closed the month at 15, lower on the month. Australian credit spreads, which usually lag offshore moves, were an exception, with the Bloomberg Australian Corporate Average ASW out 4bps to 91bps at end August.

Unlike risk markets, yields went in largely one direction. Soft payrolls data saw expectations of a September easing firm and FOMC Chairman Powell confirmed that the time had come for the easing cycle after the annual Jackson Hole meeting of central bankers. US 2-year yields fell 34bps over the month to finish at 3.92%, as the end point for the easing cycle moved from around 3.40% to 3.05%. US 10-year yields fell a smaller 13bps over the month to 3.90%, seeing the inversion of the US yield curve all but disappear.

Yields elsewhere followed the US lead, but to a lesser and varying degrees. The Reserve Bank of New Zealand began their easing cycle on recession fears, with NZ 2-year bond yields down 24bps over the month. Australian 3-year bond yields were down 20bps in August, with an 80% chance of a cut by the end of the year priced (which was pushed back on by the RBA Governor). German and Canadian 2-year yields were down a lesser 14bps and 12bps respectively, possibly reflecting that these central banks had already seen significant yield declines as the central banks had already begun their easing cycles.

The economy will continue to drive the outlook for risk and rates markets. In particular, the prospects for the US economy and whether it will experience a hard landing will drive US equity markets, which has an unduly large influence on risk sentiment elsewhere. We see the fears of a hard landing as overdone for now. There has been a notable softening in the labour market but from a very strong starting point - the unemployment rate of 4.3% is still quite low by historical standards. US GDP growth remains relatively firm and while it may soften further, the evidence of a sharp increase in the unemployment rate remains scant.

The economy will also increasingly drive central banks, now that inflation has mostly returned towards target in most regions. The US is widely expected to be added to the central banks that have begun easing in September. Australia remains an outlier: inflation has not fallen as much and is arguably stalling at just under 4%, way above the 2-3% target band. We believe rate cut expectations have therefore become too elevated, with a cut not expected until the middle of next year. That being said, yields, even in Australia, will follow the global lead to a degree. In the regions where the unemployment rate is rising rapidly, a move into easy territory may yet see yields fall further, as a move to neutral settings is all that is priced at present.

We believe that there will continue to be uncertainty in 2024, reinforcing the importance of active investment, in conjunction with strong bottom-up analysis to help avoid tail risks. 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 6-7%, 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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