Kapstream Absolute Return Income Plus Fund

Kapstream
— JANUS HENDERSON —

Monthly Report – I class units

KANGANEWS AWARDS 2018 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2019 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2021 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2022 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2023 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR

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 460m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%
Interest rate duration	0.67yrs
Spread duration physical	2.08yrs
Yield to Maturity	6.26%
Average credit rating	BBB+
Number of issuers	62

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

September 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)*	**0.93**	**2.90**	**6.60**	**9.21**	**5.28**	**4.08**	**4.25**
Fund Return *(after fees, before sell spread)*[1]	0.89	2.78	6.24	8.70	4.79	3.59	3.76
Fund Return *(after fees and sell spread)*[2]	0.89	2.78	6.23	8.70	4.79	3.58	3.75
RBA Cash Rate	0.36	1.10	3.27	4.35	2.79	1.79	1.71
Active return[3] ***(before fees and sell spread)***	**0.56**	**1.79**	**3.33**	**4.86**	**2.49**	**2.29**	**2.54**
Active return[3] *(after fees and sell spread)*[2]	0.53	1.67	2.96	4.36	2.00	1.79	2.04
Ausbond Bank Bill Index	0.36	1.11	3.32	4.41	2.82	1.81	1.80

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 September 2024.

Performance commentary

The Fund returned 0.93% before fees in September, and the rolling one-year return was a solid 9.12%, the highest one-year return since inception. The strong run of outcomes in the past several months reflects a continuation of solid risk sentiment and central bank rate cut induced declines in bond yields. Credit spreads modestly add to performance and carry, again, contributed solidly to returns. Duration made a meaningful contribution as the US Federal Reserve began its easing cycle with a 50bp rate cut, supporting further reduction in bond yields over the month.

Portfolio strategy

The portfolio's physical spread duration inched up to 2.08yrs, as we saw some opportunities in primary. For example, we invested in the new ANZ NZ AT1 transaction, as we viewed the concession as very attractive and expect APRA's directive to phase out AT1s to be very supportive. Spread on the bond rallied over 40bp since pricing. However, 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, skewed towards Australian dollar credit. Barring a severe global downturn and considering the sustained interest from yield-seeking high-net-worth and Asian investors, we anticipate that Australian spreads will likely play catch-up to the US by moving towards the lower end of their historical ranges.

The average credit rating of holdings remained at BBB+. High yield exposure was fairly stable at ~16%, in typically BB-rated short maturity assets. The portfolio is split across financials (~71%), corporates (~8%), and ABS/MBS and warehouses (~17%), with the residual in cash and SSGAs. We have a ~85%/15% split between Australia/New Zealand and international issuers.

Portfolio liquidity remains solid, with 'Level 1' liquidity marginally lower at ~17% (cash, commercial paper, SSGA) as invested in attractive primary deals. 'Level 2' liquidity was fairly stable, at ~15% (<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.

After rates positioning was aggressively cut in August, reflecting our view that markets had moved too quickly to price in an easing cycle, positioning did not change materially in September. The negative carry from long positions is now significant at potentially 10bps per month - a high hurdle to clear. We continued to hold very little exposure to Australia (0.01yr) where the central bank has clearly indicated that cuts are not likely until 2025. Positioning only edged up slightly by 0.15 years to 0.67 years in September. The mix is spread across the US (0.17yr), Europe (0.30yr), Canada (0.14yr) and New Zealand (0.04yr), where we expect market pricing to move towards pricing in an easing cycle below neutral.

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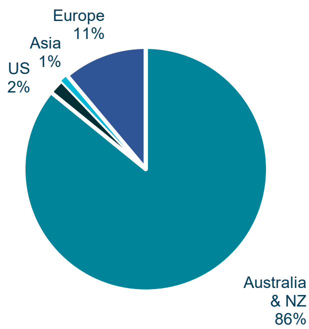
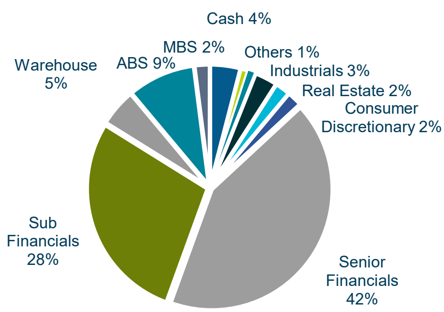
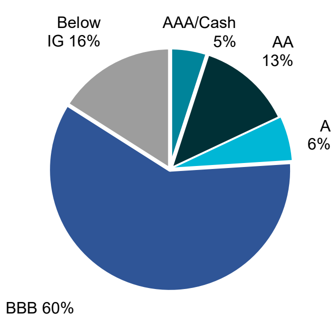
Geographic Allocation



Sector Allocation



Credit Rating



Outlook

Themes in markets for the past few months continued uninterrupted in September. Risk sentiment generally improved as recession fears subsided, while yields fell as the global easing cycle gets more and more priced in. However, risks and exceptions remain.

In the absence of clear indicators of a recession in the US, economic and earnings expectations are supporting risk sentiment. US GDP growth for Q2 was revised up slightly in September to a strong 3.0% annualised pace, well above the historical average of around 2%. Early forecasts for Q3 show a similarly strong rate of change. Payrolls growth has subsequently remained strong and continues to average more than 100k per month. However, the unemployment rate continues on an upward trajectory despite slipping 0.1ppt to 4.2% in September. The S&P 500 rose 2.0% in September, posting new record highs. Credit spreads similarly compressed, with the US credit aggregate index in 4bps to 90bps in the month and quite close to the post-GFC lows of 80bps. Outside of the US, growth is generally below trend and unemployment rates are rising, but risk markets aren't reflecting these conditions and are taking their lead from the US. For example, Australia has seen below trend GDP growth since the end of 2022, but the Bloomberg Australian Corporate 0+ average spread to swap was stable in September at 90bps.

Bond yields fell significantly as the easing cycle continues to get priced in. The US Federal Reserve finally began its easing cycle, starting off with an above-expectations 50bp move. Not only has confidence increased that inflation will return to target, but the labour market has simultaneously weakened relative to their forecasts. Combined with the fact that official interest rates were more than 250bps above neutral, the Fed chose a more aggressive path back to more neutral settings. Markets have therefore been vindicated with what has been a much quicker and deeper easing cycle, shifting the average cut per meeting to above 25bps and the terminal rate down to neutral of around 3%. This resulted in a sharp drop in bond yields, with US 2-year yields down 28bps to 3.64%. The US 10-year yield fell a smaller 12bps, leading to a steepening of the curve into positive territory for the first time since mid-2022. Yields fell similar or greater amounts in Europe, NZ and Canada on domestic macroeconomic reasons. However, Australian yields were largely unchanged with inflation stubbornly high and the Governor stating that imminent cuts were unlikely.

In most regions, the focus has moved away from the start of the global easing cycle to its pace and depth. The Fed's 50bp start to its easing cycle was a departure from that in Canada, Europe and New Zealand, where 25bps was the initial move. This has seemingly opened the way to larger cuts inside and outside the US, seeing terminal rates fall towards neutral in most regions. Currently, the US economy remains resilient, weathering the significant tightening measures implemented by the Fed to combat inflation without severe distress. However, should the situation shift, leading to a recession, credit markets could face significant challenges, especially with spreads near historically low levels, heightening the risk. Yet, the potential impact of a recession varies. If economic growth stays robust while the unemployment rate slowly increases, prompting upward revisions in the Fed's unemployment projections, we would likely see a further drop in official rates and bond yields, without a sell-off in risk markets. Conversely, a more significant downturn in growth, such as a move into negative territory, would probably lead to a decline in both bond yields and risk sentiment. For the moment, these outcomes seem to be continually deferred to a later date or dismissed altogether.

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.