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 480m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%
Interest rate duration	1.04yrs
Spread duration physical	1.98yrs
Yield to Maturity	6.56%
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

October 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)*	**0.67**	**2.49**	**7.32**	**9.22**	**5.46**	**4.16**	**4.30**
Fund Return *(after fees, before sell spread)*[1]	0.63	2.37	6.91	8.71	4.99	3.67	3.81
Fund Return *(after fees and sell spread)*[2]	0.63	2.37	6.90	8.71	4.98	3.65	3.80
RBA Cash Rate	0.36	1.08	3.65	4.36	2.91	1.85	1.75
Active return[3] ***(before fees and sell spread)***	**0.31**	**1.41**	**3.67**	**4.86**	**2.56**	**2.31**	**2.56**
Active return[3] *(after fees and sell spread)*[2]	0.27	1.29	3.26	4.36	2.07	1.81	2.06
Ausbond Bank Bill Index	0.37	1.12	3.70	4.45	2.94	1.86	1.83

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 October 2024.

Performance commentary

The Fund returned 0.67% before fees in October, and the rolling one-year return was 9.22%, the strongest one-year return since inception. Physical credit spreads continued to compress and coupon income, again, also contributed strongly. Bond yields rebounded sharply in October, as financial markets unwound overly-aggressive rate cut expectations and as positioning shifted ahead of the US election, resulting in duration therefore detracting from performance. The now higher yield to maturity of 6.56% provides an even stronger basis for returns looking forward.

Portfolio strategy

The portfolio's physical spread duration decreased slightly to 1.98yrs, as we continued to take profit on longer duration bonds that had performed really well, while reinvesting into primary deals. We plan to maintain our spread duration at around 1.8 - 2.2 years in the upcoming months, which is a wider range dependent on the outcome of the US election, which in the case of a Republican victory would likely extend the credit cycle. This will be skewed towards Australian dollar credit where we see good relative value. 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 stable at ~16%, in typically BB-rated short maturity assets. The portfolio is split across financials (~71%), corporates (~7%), and ABS/MBS and warehouses (~17%), with the residual in cash and SSGAs. We have a ~81%/19% split between Australia/New Zealand and international issuers, with the slight shift towards the latter due to attractive primary opportunities.

Portfolio liquidity remains solid, with 'Level 1' liquidity fairly stable at ~16% (cash, commercial paper, SSGA). 'Level 2' liquidity was marginally higher, at ~18% (<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.

Reducing Rates duration in August significantly supported performance in October, as did the mix of where that duration was held, as yields increase about 50bps across the curve in Australia and the US. Furthermore, the exposure was only modestly weighted towards the US and with short duration exposures in Australia, but a far greater weight to Europe, Canada and New Zealand. After the yield increase in the month, we returned duration to the one year point at the end of October (1.04yr), continuing to add exposure as global easing cycles continue, with a skew towards Canada (0.35yr), Europe (0.35yr), the US (0.30yr) and New Zealand (0.07yr) and a slightly short position in Australia (-0.02yr).

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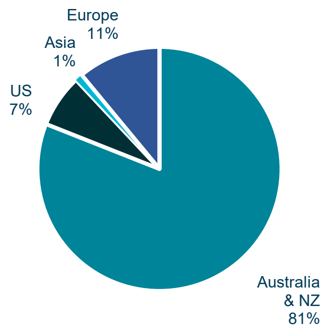
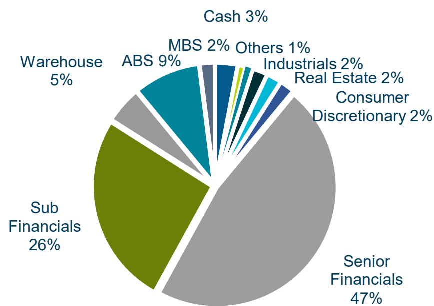
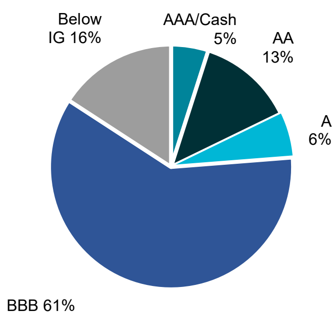
Geographic Allocation



Sector Allocation



Credit Rating



Outlook

Markets moved to price out a number of rate cuts that it had overly aggressively priced in back in July. At that time, the Federal Reserve was preparing for an outsized 50bps easing and rate hikes from the Bank of Japan were being taken out, after carry trade unwinds saw equities decline. Since then, inflation, economic growth and the labour market have all come in on the positive side of expectations, leading to a reassessment of how aggressively the US Federal Reserve would ease monetary policy. Furthermore, the Republicans improving chances in the weeks leading up to the election also had a positive impact on yields. These influences saw the terminal rate in the US rise from around 2.80% in early August to around 3.60% at month's end, with 2yr yields rising by a staggering 53bps in the month of October alone, to close at 4.17%. Australian front end yields rose a similar amount, with 3yr yields up 48bps to 4.02% as near-term rate cut expectations were dashed. However, other regions where central banks have already started easing had a much more muted reaction, with German 2yr yields up 27bps, Canadian 2yr yields up 16bps and NZ 2yr swap rates rising just 6bps.

Risk market themes were generally more balanced. Both US election candidates were seen as a positive for fiscal spending and economic activity, supporting the outlook for earnings. However, a very late re-assessment of a Harris victory saw all these gains eroded with the S&P 500 down 1% over the month. Synthetic credit indices were a touch wider in sympathy, with CDX IG ending the month 1bp wider at 54bps. However, physical credit spreads compressed noticeably, particularly in Australia. The Bloomberg US Corporate Aggregate series contracted 5bps to 84bps to be at the bottom of the post Global Financial Crisis range. Australian credit spreads were not as close to their historical tights, allowing a greater compression in the Bloomberg Ausbond credit OAS spread series of 13bps to 114bps.

The US election result represents the key near term risk to markets, but beyond that, the question is to what extent will it disrupt how far central banks will ease policy. Tariffs and tax cuts that boost demand could see inflation stop declining below trend or even increase, leading to the Fed retaining some restrictiveness in its policies. However, terminal rates are already pricing in this outcome. Furthermore, a continual rise in yields as was seen in 2016, when the Fed was tightening policy, is less likely when monetary policy is going the opposite way. More interesting perhaps is that these policies may see lower economic growth outside the US, leading to more rate cuts elsewhere. A global focus for active duration would allow these trends to be captured. For risk markets the fiscal spending promises significantly reduce the near-term prospects of a recession, taking away a key downside risk for declines in sentiment.

We believe that there will continue to be uncertainty for the next few months, 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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