Kapstream
—JANUS HENDERSON—

Kapstream Absolute Return Income 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 (IG), absolute return-oriented global fixed income portfolio.

Fund Details

APIR code	HOW0165AU
Inception date	31 May 2007
Fund size	AUD 2025.50
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.94yrs
Credit spread duration	2.24yrs
Average credit rating	A-
No of issuers	73
Yield to maturity	5.77%

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

November 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)	0.52	1.83	7.59	4.31	3.09	4.68
Fund Return (after fees, before sell spread)[1]	0.48	1.72	7.11	3.88	2.64	4.31
Fund Return (after fees and sell spread)[2]	0.48	1.72	7.12	3.88	2.62	4.31
RBA Cash Rate	0.34	1.07	4.35	3.03	1.90	2.84
Active return[3] (before fees and sell spread)	0.18	0.77	3.24	1.28	1.18	1.84
Active return[3] (after fees and sell spread)[2]	0.14	0.65	2.77	0.85	0.72	1.47
Bloomberg AusBond Bank Bills Index	0.36	1.10	4.46	3.07	1.92	3.04

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, 30 November 2024.

Performance Commentary

The Fund added 0.48% in November, taking 12 month returns to 7.12% (after accounting for Class I unit fees). The primary driver of monthly returns was the consistent coupon income from the fund's credit holdings. Additionally, the fund benefited from movements in both bond yields and credit spreads, albeit the gains were modest. Our long duration positioning benefited the portfolio, with bond yields finishing the month lower despite the US election resulting in a Republican sweep. Credit exposures benefited from a compression in spreads globally, although widening pressure in Australia was seen later in the month on the back of significant primary issuance. Overall, the fund outperformed its cash benchmark for a seventh consecutive month in November, with yearly returns remaining well in excess of the RBA's 4.35% cash rate. The portfolio's yield to maturity saw a slight decrease, down 2bps to 5.77%, providing a strong basis for returns looking forward.

Market Commentary

The US election represented the key event risk for financial markets in November. Chances of a Republican president and House/Senate combination increased in late October, seeing equities and yields rise. This continued in the early part of November, as the chance became a reality. The prospect of additional expansionary fiscal policy saw rate cut expectations wound back, with the market pricing of the terminal rate rising to 3.75% and US two year yields rising to as high as 4.38%. The S&P500 breached the 6,000 level for the first time, with the same improvement in risk sentiment saw credit spreads compress both in the US and Australia.

However, the month did not continue as it started. Yields and equities came off these highs as news around Trump administration appointees saw some of the more extreme expectations around fiscal stimulus wound back. Equities came off their highs (only to rebound and finish at a record high) and spreads widened a touch off their lows. In Australia, the bounce in the last week of the month on new issuance indigestion saw the Bloomberg Ausbond Credit 0+ Index spread to swap out 2bps in November. Yields also gave back some of their gains and actually finished the month lower, as US Fed officials came out to suggest that a rate cut was still on track for the December meeting. US two year yields closed 2bps lower at 4.15%, with US ten year yields down 12bps in a surprise flattening of the yield curve (yield curves usually steepen in easing cycles and in environments where more government bonds need to be issued).

Fund Platform Availability

- AMP North, Wealthview, eWrap
- AMP PortfolioCare (Badge of Asgard)
- Asgard eWrap & Infinity
- Australian Money Market
- Australian Unity Lifeplan Investment Bond
- BT Panorama
- Centric Wealth (Findex)
- CFS Edge, FirstChoice & FirstWrap
- Clearstream/Ausmaq
- DASH
- Grow Wrap (Insignia)
- Hillross PortfolioCare (Badge of Asgard)
- HUB24
- Insignia – eXpand
- Insignia – Rhythm (private label HUB24)
- Insignia – Asset Administrator (BT Badge)
- Macquarie, Accumulator, Wrap IDPS and Super
- Mason Stevens
- Netwealth
- Praemium
- Powerwrap
- Oasis
- OnePath
- OneAnswer
- OneVue
- Platform Plus (Infocus)
- Voyage (Oasis Badge)
- Xplore Wealth

Yields elsewhere did not rise on this very US focused event risk and finished more significantly down in November. German yields fell on softening inflation and activity data, as well as ECB speak, with two year yields down 33bps. Markets are now pricing in a minimum of 25bps cuts from the ECB at its next four meetings, with chances of 50bps at each. UK yields were down around 20bps across the curve. Australian yields fell a reasonable amount as expectations of RBA cuts increased, with Australian three year yields down 11bps. Canadian two year yields were down a modest 4bps.

Outlook

Whilst the initial event risk related to the US election result is behind us, the uncertainty around what the result of the election means from here has not. Many questions remain, including the size of any fiscal stimulus, its impact on economic growth and inflation and whether it will stop the Fed from easing monetary policy all the way back to neutral. These questions are key in understanding whether the usual decline in bond yields and steepening of yield curves will continue as in previous cycles, or whether this cycle will be unusual in that the depth of the trend will be shallow. Forecasts of rate hikes in the US in 2025 have also resurfaced. Furthermore, there remain questions around what happens to economic activity outside the US. Tariffs may negatively impact other regions, such as Europe, which is already suffering with below trend economic activity. Threats of tariffs have also been raised for Canada and Mexico.

It’s also not all about the US election, with several other themes also still at play. Economic activity has slipped below trend in Europe, Canada and New Zealand, with central banks taking official interest rates back towards neutral and perhaps beyond. Yields may therefore continue their downtrend and curves steepen in these regions, decoupling from the usual relationship with the US. In contrast and despite sub-trend economic activity in Australia, inflation has remained stubbornly high, such that a rate cut from the RBA is not expected until well into next year. The year 2025 may therefore be when the official interest rate cycles diverge, after the starting points were synchronised by the pandemic. Active management that is global in nature will therefore be even more important than usual in such a world.

Portfolio Strategy

Portfolio positioning is not significantly different from historical averages, reflecting a number of the above uncertainties. This is unusual. Yields often move in the same direction as central banks, particularly at the front end of the curve where Kapstream tends to focus. The US election outcome has arguably disrupted this pattern by impacting how quickly or how far rates may fall from their restrictive settings. In credit, the risks of a global recession and therefore the need to be overly defensive have reduced, but spreads are at the bottom end of their range in many regions so being overly aggressive may not be prudent.

In terms of recent changes, duration positioning was recently increased in October from a little over half a year towards one year, after markets were seen to have taken yields too low in August. It remained at around one year in November, falling only modestly to 0.9 years. Kapstream continues to have the vast majority of its exposure outside the US, avoiding the election-related uncertainty, preferring regions where central banks have started easing and are still expected to take rates below neutral and below current market pricing. This includes Canada and mainland Europe, as well as New Zealand. Short duration positioning in Australia has been removed as near-term easing was largely removed.

Credit carry continued to support returns in November whilst spread compression played a smaller role as the Australian credit market suffered some indigestion in primary deals. The portfolio's physical spread duration was increased by c0.3yrs to c2.2 years as the red sweep made us more confident in stability in risk markets until at least the Trump inauguration on 20 January 2025. We expect that risk markets will continue to focus on the positives of potential tax cuts and de-regulation in the short term, and its focus will only shift to potential negatives upon inauguration when potential tariff induced trade wars, unpredictable executive orders and significant fiscal spending cuts reduce the earnings available for S&P500 companies and other negative effects as they become more visible. We also viewed the likely seasonality as a favourable time to add a controlled amount of risk as the year end often means negative net issuance over the holiday period which can lead to spread compression in January. Despite maintaining a fairly short dated book, we have captured strong credit spread compression compared to many short dated credit indices over the last year and were pleased to still outperform the local market in that respect. This month we participated in various financial and corporate deals.

The fund's high coupon is providing return stability not seen in nearly a decade, due to an above-average credit spread from shorter-term assets and an attractive cash rate. This makes us cautiously optimistic about future return prospects.

We plan to maintain our spread duration at around 2.0 - 2.2 years in the upcoming months, balancing our view that we expect the Republican victory to potentially extend the credit cycle, offset by fairly tight US credit spreads. The exposure has been 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. 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.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~64%), corporates and REITs (~20%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~81% 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, but we reduced it over the month given the red sweep, with 'Level 1' liquidity at ~9% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~18% (<1yr investment grade). We believe the high level of liquidity provides the flexibility to buy more attractive credits should there be a sell-off.

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