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 2017.36 |
| Distribution frequency | Quarterly |
| Management fee | 0.40% |
| Buy/sell spread | Please contact us for latest spreads |

## Fund Statistics

| | |
|---|---|
| Interest rate duration | 1.03yrs |
| Credit spread duration | 2.09yrs |
| Average credit rating | A- |
| No of issuers | 73 |
| Yield to maturity | 5.66% |

## 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

## December 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) | 0.57 | 1.68 | 7.22 | 4.45 | 3.18 | 4.69 |
| Fund Return (after fees, before sell spread)[1] | 0.53 | 1.56 | 6.75 | 4.01 | 2.73 | 4.32 |
| Fund Return (after fees and sell spread)[2] | 0.53 | 1.56 | 6.75 | 4.01 | 2.72 | 4.32 |
| RBA Cash Rate | 0.37 | 1.08 | 4.39 | 3.15 | 1.97 | 2.85 |
| *Active return[3] (before fees and sell spread)* | 0.20 | 0.60 | 2.84 | 1.30 | 1.21 | 1.85 |
| *Active return[3] (after fees and sell spread)[2]* | 0.16 | 0.48 | 2.37 | 0.86 | 0.75 | 1.47 |
| Bloomberg AusBond Bank Bills Index | 0.38 | 1.12 | 4.47 | 3.19 | 1.98 | 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, 31 December 2024.

## Performance Commentary

The fund added 0.53% in December, taking 12 month returns to 6.75% (after accounting for Class I unit fees). Coupon income remained the key driver of returns, with market movements doing little to disturb this in December. Australian credit spreads were marginally wider (to swap) as global risk sentiment softened, but security selection more than offset this to see credit positioning make a modest positive contribution in the month. Yields were generally higher across the developed world, but much less so at the front end of the curve where Kapstream tends to focus. Additionally, our exposures to regions such as New Zealand and Canada, where front end yields actually fell, meant that the portfolio was protected from a negative contribution from duration. Overall, the Fund outperformed its cash benchmark for a ninth consecutive month to finish 2024, with yearly returns ending well in excess of the RBA's 4.35% cash rate. The portfolio's yield to maturity fell 11bps to 5.66%, remaining high by historical standards and continuing to provide a strong basis for absolute and relative-to-cash returns looking forward.

## Market Commentary

December was a mixed month in terms of sentiment. Equities and credit finished the year with a softer tone, after the strong post-US election gains seen in November. The S&P 500 fell 2.5% in December, erasing a portion of the 5.7% increase over November. US equities had a fantastic year in 2024, finishing up 23.3% and adding to the 24.2% increase in 2023. While the implications of the US election result is the current area of focus, it is useful to remember that these gains began well before November. The US avoiding recession was instead a more significant influence, after history suggested that the significant tightening cycle, we saw would likely have derailed the economy.

This pullback in risk sentiment over December predictably impacted credit markets. The Bloomberg US Agg Corporate average OAS rose 3bps to 80bps, after compressing 7bps in November. Nonetheless, this series remained near the bottom of the 74-618bps range for the past 25 years. Australian credit spreads to swap similarly widened in the month, with the Bloomberg Ausbond Credit 0+ index bid asset swap spread rising 1bp to 87bps. However, in contrast to the US situation, Australian credit spreads are closer to the average of the past 10 years of 89bps than the bottom of the 57-140bps range. The concerns around Australian credit spreads being tight from a longer-term valuation perspective is nowhere near as extreme.

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## 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

In rates markets, bond yield movements in December were varied depending on the part of the curve and the region. In the US (which often sets the tone elsewhere in bond land) yields rose strongly at the back end of the curve. Expectations of monetary policy easing have been pared back, reinforced by an upwardly revised set of Fed forecasts that suggested that the Fed would only ease by 50bps in 2025 and the same again in 2026, to take the Fed Funds rate to closer to 3%. Financial markets are more sceptical and have a terminal rate of around 4%, with expectations that Republican fiscal spending will support growth and potentially raise inflation. Combined with increased US Government debt issuance expectations, which are particularly influential at the back end of the curve, this saw US ten-year yields rise 40bps in the month to 4.57%, far eclipsing the 9bps increase in US two-year yields 4.24%.

Bond markets elsewhere followed the US, but to a lesser degree. Long end yields generally rose, in line with the US. Front end yields fell in New Zealand and Canada as concerns about economic activity increased, with front end yields in Australia also falling on a dovish turn in RBA commentary. In contrast, front end yields in Europe and the UK rose more so than in the US, as expectations of an aggressive easing cycle were pared back. This highlights what we expect to be a key theme into 2025 - divergence in yield movements across countries.

## Outlook

The outlook for 2025 has a different set of uncertainties compared to those at the beginning of 2024. Questions over when the global easing cycle would begin and fears of a possible recession given previous monetary policy tightening, are no longer as prominent as they were. Instead, questions about the impact of US fiscal easing and whether monetary easing cycles will extend further from here have become key. Yields have not followed their usual historical pattern of declining after the first easing accordingly, as it's unclear whether official interest rates will move all the way back to neutral let alone beyond.

We remain optimistic about returns in 2025. Yields remain high by the standards set over the past decade and provide a strong support for expected returns. Credit spreads, while at the bottom end of the range in some regions, are not so across all regions. The risks of a sharp widening due to a global recession have also fallen given the resilience exhibited in 2024 and with the expectations of fiscal stimulus in the US. In the rates space we still expect cash rates to fall, particularly so outside the US where the same fiscal stimulus is not a factor and economies are weaker. We therefore continue to emphasise the benefits of a globally focused investment process that is able to capture these elements, as we see the biggest opportunities and conviction in regions such as Europe, Canada, New Zealand and Australia.

## Portfolio Strategy

Portfolio positioning remains around historical averages, by design, reflecting the above outlook. Changes were minimal over the month of December.

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 December, rising back 0.1 years to 1.0 year over the month. Kapstream continued to have the majority of its exposure outside the US, avoiding the fiscal-spending related uncertainties after the US election. Instead, there is a preference for regions where central banks have started easing and are still expected to take rates below neutral and below current market pricing. Canadian and NZ exposures benefited the portfolio in December, whereas the European position detracted.

Credit carry continued to support returns in December whilst spread compression played a smaller role as the Australian credit market continued to digest the primary overhang from November. The portfolio's physical spread duration reduced slightly as we took profits on some positions.

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We expect that risk markets will continue to focus on the positives of potential tax cuts and de-regulation in the short term. Its focus will only shift to potential negatives upon inauguration when potential tariff induced trade wars, unpredictable executive orders and significant fiscal spending cuts uncertain impact on S&P500 companies as they become more visible.

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 are closer to their long-term averages compared to the significantly tighter spreads observed in the US. 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, unless disrupted by an unforeseen macro event.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~63%), corporates and REITs (~20%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~78% 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 ~10% (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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