Kapstream Absolute Return Income Plus Fund

Kapstream
— JANUS HENDERSON —

Monthly Report – I class units

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 542m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%/0.2%
Interest rate duration	0.92yrs
Spread duration physical	2.14yrs
Yield to Maturity	6.18%
Average credit rating	BBB+
Number of issuers	66

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

December 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)*	**0.64**	**1.95**	**8.69**	**8.69**	**5.80**	**4.30**	**4.40**
Fund Return *(after fees, before sell spread)*[1]	0.60	1.83	8.19	8.19	5.32	3.81	3.90
Fund Return *(after fees and sell spread)*[2]	0.60	1.83	8.18	8.18	5.31	3.79	3.90
RBA Cash Rate	0.37	1.08	4.39	4.39	3.15	1.97	1.81
Active return[3] ***(before fees and sell spread)***	**0.27**	**0.88**	**4.30**	**4.30**	**2.65**	**2.33**	**2.58**
Active return[3] *(after fees and sell spread)*[2]	0.23	0.75	3.80	3.80	2.16	1.82	2.08
Ausbond Bank Bill Index	0.38	1.12	4.47	4.47	3.19	1.98	1.90

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 December 2024.

Performance commentary

The Fund returned 0.64% before fees in December, and the rolling one-year return was a very solid 8.69%. The primary returns driver was the consistent coupon income. Additionally, the fund benefited from modest movements in credit spreads. Over the year the main driver of returns was carry and credit spread compression, with a modest detraction from duration. The yield to maturity of 6.18% provides a strong basis for returns looking forward.

Portfolio strategy

The portfolio's physical spread duration reduced 0.24 years to 2.14yrs, as we rebalanced risk after an active November in new issuance. This was despite participating in some attractive higher yielding new issues. We plan to maintain our spread duration at around 1.8 - 2.2 years in the upcoming months as the Republican victory will likely extend the credit cycle given an expectation of the reduction in US corporate taxes to 15%. This will continue to 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 increased 2% to ~17%, in typically BB-rated short maturity assets. The portfolio is split across financials (~63%), corporates (~11%), and ABS/MBS and warehouses (~16%), with the residual in cash and SSGAs. We have a ~80%/20% split between Australia/New Zealand and international issuers.

Portfolio liquidity remains solid, with 'Level 1' liquidity at ~14% (cash, commercial paper, SSGA), up from 11% as we rebalanced. 'Level 2' liquidity reduced to 12% from ~17% (<1yr investment grade) as a bond matured. 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.

Rates duration reduced marginally to 0.92yrs from 1.06yrs. We continue to have the vast majority of our 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 Germany(0.31yr), Canada (0.28yr) and the US (0.28yrs) as well as New Zealand (0.06yr). Duration positioning in Australia was roughly flat at -0.01yr.

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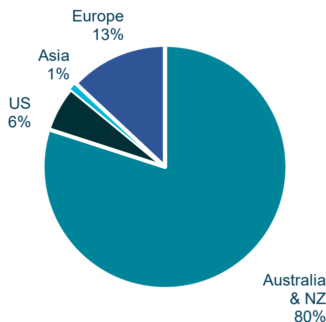
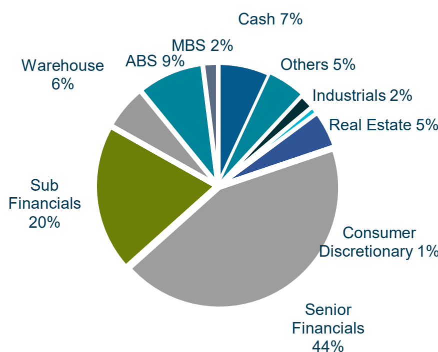
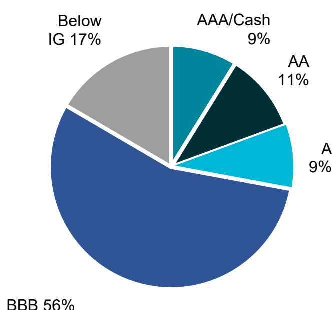
Geographic Allocation



Sector Allocation



Credit Rating



Outlook

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.

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 skeptical 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.

The 2025 outlook presents new uncertainties, shifting focus from the timing of a global easing cycle and recession fears due to past monetary tightening to the effects of US fiscal easing and the potential for further monetary easing. Unlike historical trends, yields haven't decreased post-easing, with uncertainty around whether interest rates will return to neutral.

Optimism for 2025 remains, supported by high yields over the past decade and varied credit spread conditions across regions. The risk of recession seems reduced, bolstered by 2024's resilience and anticipated US fiscal stimulus. Expectations are for cash rates to drop, especially outside the US, where fiscal stimulus is less likely 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.

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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