Kapstream

JANUS HENDERSON

Kapstream Absolute Return Income Fund

KANGANEWS AWARDS 2017 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
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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 (IG), absolute return-oriented global fixed income portfolio.

Fund Details

APIR code	HOW0165AU
Inception date	31 May 2007
Fund size	AUD 2054.37
Distribution frequency	Quarterly
Management fee	0.41%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.78yrs
Credit spread duration	1.97yrs
Average credit rating	A-
No of issuers	72
Yield to maturity	5.44%

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

February 2025

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)	0.56	1.75	7.81	4.86	3.18	4.72
Fund Return (after fees, before sell spread)[1]	0.53	1.63	7.34	4.41	2.73	4.35
Fund Return (after fees and sell spread)[2]	0.53	1.63	7.34	4.42	2.72	4.34
RBA Cash Rate	0.32	1.06	4.34	3.38	2.08	2.86
Active return[3] (before fees and sell spread)	0.24	0.69	3.47	1.48	1.10	1.86
Active return[3] (after fees and sell spread)[2]	0.21	0.57	3.00	1.03	0.64	1.48
Bloomberg AusBond Bank Bills Index	0.34	1.10	4.48	3.44	2.10	3.06

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, 28 February 2025.

Performance Commentary

The Fund added 0.53% in February, taking 12 month returns to 7.34% (after accounting for Class I unit fees). Monthly returns again exceeded the cash benchmark, supported by the income we've built into the portfolio as well as a drop in bond yields globally on tariff fears. US bond yields showed the biggest declines, as concerns over economic growth materialised amidst policy uncertainty. The RBA starting the easing cycle with a 25bps cut to 4.10% helped yields fall locally. Equities fell and credit spreads generally widened on tariff concerns, apart from in Australia where some catch up to global moves saw spreads tighten. Annual returns are now around their highest absolute level since 2013, despite the anticipated headline risk from the US again impacting markets towards the end of the month. This reflects the underlying higher level of official interest rates in Australia, combined with the additional spread actively incorporated into the product. The yield to maturity of 5.44% remains a strong basis for expected absolute returns, as well as returns relative to a declining Australian cash rate going forward.

Market Commentary

The changing of the guard in US politics continued to have the inevitable and market moving announcements relating to policy changes in February. President Trump's repeated threats of tariffs on China, Canada and Mexico initially dents sentiment, only for this to be unwound when the threats don't materialise. The negative impacts of tariffs on economic growth lower earnings expectations, which saw the S&P 500 finish the month down 1.4% (but a slightly larger 3.1% from its intra-month record highs). US credit spreads, such as the Bloomberg Corporate Aggregate average OAS, moved out 8bps to 87bps in sympathy, but remain near the lower end of the historic range. The deterioration over the month whilst notable, therefore needs to be put against the context of overall strength. Australian credit spreads such as the Bloomberg Ausbond Credit 0+Index (to swap) bucked the global trend in February by compressing 3.4bps to 81.4bps 'catching up' some prior months of US credit spread tightening. This still has Australian spreads sitting just inside the historical average of 89bps.

For more information, please contact Kapstream on 02 9234 0000
or info@kapstream.com or visit www.kapstream.com

The policy outlook posed a thorny problem for Central Banks and bond markets, as the negative impacts of tariffs on economic growth are accompanied by a positive direct impact on inflation. This comes at a time when core inflation globally is trending sideways, at a rate above central banks' targets. Nonetheless, the disruptive element from tariffs was clearly the dominant theme in February, seeing yields fall in the US in particular. US 2 year yields were down 21bps in the month to just below 4% and their lowest since late September. US 10 year yields were down a larger 33bps to 4.21%, flattening the curve. Most other countries followed suit, but to a smaller degree in the high single digits. Australia being an exception with the RBA starting it's easing cycle with a 25bps cut to 4.10%. This saw Australian 10 year yields fall an 'outsized' 14bps in February to 4.32%.

Outlook

The uncertainty around tariffs has impacted economic actors more than markets. A bringing forward of purchases into Q4 to avoid potential tariffs has left a hole in forecasts for US GDP in Q1. The Atlanta Fed GDPNow series now suggests quarterly GDP may be negative for the first time in three years. If the expectations of a greater than 2% decline as at the time of writing come to fruition, it would be the worst quarterly outcome since the COVID-impacted Q2 of 2020. Beyond the next quarter's GDP, the uncertainty about the policy regime will weigh on business investment and potentially consumption, particularly if large public sector job cuts are implemented. This represents a challenge to the broadly accepted narrative that Trump's presidency and the Republican clean sweep will be positive for the economy and risk markets. Kapstream remains cautiously optimistic but expect periods of volatility throughout the year as the economy and headlines ebb and flow.

For rates markets the uncertainty largely relates to how far the current easing cycle, and therefore bond yields, will extend. The impact of tight monetary policy may not have led to the recession that history and many may have suggested, meaning that below neutral interest rates may not be required. In addition, the stalling of inflation above target hints at the possibility that above-neutral rates may be needed, at least for a time. Given that many markets have a further reduction in monetary policy restrictiveness priced in, this raises the prospect of a more sideways range in bond yields in 2025 than we had previously envisaged. Kapstream foresees that higher conviction may therefore come from not from a generalised global decline in bond yields but looking at opportunities in specific regions. The ability to be global in focus and not beholden to the direction of just one region should therefore be a source of additional alpha over 2025.

Portfolio Strategy

Portfolio positioning did not change significantly over the month, reflecting that we had already moved to lighten active positioning in light of the expected volatility from US policy changes. Broadly speaking we are at the rare position of being at about average in terms of our rates and credit spread duration. We no longer expect a recession so don't want to be short risk exposures. However spreads globally are at the lower end of historical ranges, so being aggressively long may not be appropriate either. In rates only a modest number of further easings are expected - not the deep easing cycle that normally follows a tightening cycle. This is largely complete in many regions and arguably fully priced for the remaining portion.

As a result, rates duration positioning was largely unchanged over February. Overall duration positioning was increased marginally to around 0.8 years, remaining around the historical average of around one year. We no longer think that deep easing cycles from here are the most likely scenario, reflecting that much of the restrictiveness from monetary policy has already been removed. The mix also remains diverse in nature reflecting our increasingly global focus - with risk spread across the US, Europe, Canada, New Zealand and Australia - regions where we still expect rate cuts. This amount of duration no longer has the same amount of negative carry that it did a year ago and would still protect the portfolio should risk sentiment take an unexpected downturn.

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

Credit carry continued to support returns in February whilst spread compression was a decent contributor. The portfolio's physical spread duration reduced slightly as we took profits on some positions.

We are unsurprised that the market has shifted its focus to potential negatives after inauguration driven by potential tariff induced trade wars, unpredictable executive orders and significant fiscal spending cuts causing increased uncertainty for individual company earnings profiles. However, our focus is the opposite of the market, focussing on the likely longer term stronger earnings driven by 15% US corporate tax rates, and a likely boom in corporate investment in the US which will provide a solid underpinning for US earnings and global sentiment.

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 close to decade high coupon is providing higher return stability 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 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 and the ability for bouts of short tariff induced volatility. 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 (~64%), corporates and REITs (~20%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~80% 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 and fairly stable with 'Level 1' liquidity at ~11% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~19% (<1yr investment grade). We believe the high level of liquidity provides the flexibility to buy more attractive credits should there be a sell-off.