Kapstream Absolute Return Income Fund

Kapstream — JANUS HENDERSON —

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 2048.57M
Distribution frequency	Quarterly
Management fee	0.41%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.56yrs
Credit spread duration	2.06yrs
Average credit rating	BBB+
No of issuers	74
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

March 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)	0.35	1.53	7.56	5.12	3.58	4.72
Fund Return (after fees, before sell spread)[1]	0.32	1.42	7.08	4.67	3.14	4.34
Fund Return (after fees and sell spread)[2]	0.32	1.42	7.09	4.67	3.34	4.34
RBA Cash Rate	0.34	1.03	4.36	3.50	2.14	2.87
Active return[3] (before fees and sell spread)	0.01	0.50	3.20	1.62	1.44	1.85
Active return[3] (after fees and sell spread)[2]	-0.02	0.39	2.73	1.18	1.19	1.48
Bloomberg AusBond Bank Bills Index	0.35	1.07	4.46	3.56	2.15	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, 31 March 2025.

Performance Commentary

The Fund added 0.32% in March, taking 12 month returns to 7.09% (after accounting for Class I unit fees). Monthly returns were in line with the cash benchmark, despite a significant deterioration in risk sentiment as tariff-related uncertainty plagued financial markets. The related widening in credit did negatively impact performance in the month, broadly offsetting the benefits from the credit carry in the portfolio. Rates also contributed positively given our focus on the front end where yields fell, despite longer-dated yields rising in many regions around the world in March. Annual returns remain close to their highest levels in over a decade and well in excess of a declining cash rate, with the yield to maturity of 5.42% maintaining a strong basis for returns looking forward.

Market Commentary

Policy uncertainty was again the key driver of financial markets over March. The threat of tariffs (and reciprocal tariffs), combined with a potentially related softening in US economic data, saw US equity markets finish the month of March down 8.7% from the latest record highs posted in February. To put this into perspective, this takes us back to levels seen in September 2024. Credit spreads widened in sympathy with sentiment, with the US Bloomberg Corporate Agg Average OAS index out 7bps (and 15bps over the past two months) to 94bps. European Credit spreads also widened 7bps in February but are only out 7bps over the past two months as defence spending plans supported economic growth expectations. Australian credit spreads to swap performed similarly, with the Bloomberg Credit Index out 7bps to +88bps. The disparity relative to historical ranges remains - US spreads are still 31bps inside their historical median whereas Australian spreads are in line.

Central Banks have arguably tougher decisions looming. Inflation appeared to have stabilised in recent months at an above trend rate in many regions, namely the US, Canada and Europe. This calls into question the depth of easing cycles that were underway, reducing the risk of below neutral monetary policy settings. Tariffs pose at least a one-off upward shift to inflation, with risks of second round impacts. However, markets and central banks are (correctly) focused more on the negative growth implications from disposable spending being sapped, combined with the detrimental impacts of higher uncertainty. This is why markets moved to price in more rate cuts over the month despite the inflationary impacts of tariffs, with US 2-year yields down 11bps in March. Front end yields outside the US generally moved by less, with German 2 year yields actually rising 2bps as the significant increase in fiscal expenditure dragged German 10-year yields up 33bps in the month to 2.74%.

Outlook

Financial market volatility in response to policy uncertainty will remain a feature over the year as a whole. A speedy resolution around tariff arrangements does not mean that the response of economic actors is clear or minor. For example, we suspect that part of the weakness in Q1 US economic activity reflects a bring forward of activity into Q4 of last year. Markets appear to be extrapolating this weakness beyond Q1, with the weakness in soft data being seen as circumstantial evidence supporting the idea. This is not known. Furthermore, the negative impacts of trade policy, combined with the negative employment impacts from efficiency savings is also well known, whereas the tax cuts that have been promised are not as yet on the radar. These are expected to be strongly supportive for economic growth later in the year, which could provide something of a floor to how far the current risk off move may extend.

Rates markets are not immune to the uncertainty surrounding the future path of global economic growth in the presence of a trade war. However, we feel that this has overshadowed the stabilisation of inflation above target even before the impact of tariffs impacts the balance between demand and supply. We had previously expected many regions to move rates below neutral, supporting an extended cycle in bond yields. Our conviction around this in areas such as Europe and Canada have therefore diminished. The year of the bond will therefore have to wait for another year, or the next recession. In that context, the benefit of longer-duration funds diminishes and the flexibility of funds to pivot away from lazily capturing medium term up-trends in price and towards the alpha generated from relative value trading will be even more apparent.

Portfolio Strategy

Positioning did not change significantly in the presence of the policy certainty outlined above. In the rates space, duration positioning was lightened around 0.2 years in aggregate to 0.55 years. This reflects a declining conviction in the monetary policy easing cycles outlined above, with exposures in Canada and Europe reduced modestly. Our conviction around lower yields in New Zealand remains in place. More broadly, yields falling towards the bottom of recent ranges is also supportive of having duration a little lighter than is usually the case, in what we continue to expect will be a sideways range over the course of this year. Active foreign exchange trades in the form of US dollar weakness also made a modest contribution to returns in March.

Credit carry continued to support returns in March whilst spread detracted slightly overcoming the credit carry. The portfolio's physical spread duration increased slightly as we added to new issues, we found attractive throughout the volatility.

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

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, focusing 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, especially given the Trump Administration will likely need a strong economic tailwind leading into the 2026 mid-term elections, with economic actions likely starting in the second half of 2025.

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 - 2.5 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 (~65%), corporates and REITs (~15%), 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 and fairly stable with 'Level 1' liquidity at ~13% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~16% (<1yr investment grade paper). We believe the high level of liquidity provides the flexibility to buy more attractive credits should there be a sell-off.