Kapstream Absolute Return Income Fund

Kapstream
—JANUS HENDERSON—

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 2018.24M
Distribution frequency	Quarterly
Management fee	0.41%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.6yrs
Credit spread duration	2.11yrs
Average credit rating	BBB+
No of issuers	74
Yield to maturity	5.29%

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

April 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)	0.27	1.19	7.59	5.26	3.71	4.71
Fund Return (after fees, before sell spread)[1]	0.25	1.10	7.13	4.82	3.27	4.34
Fund Return (after fees and sell spread)[2]	0.25	1.10	7.13	4.81	3.32	4.33
RBA Cash Rate	0.33	1.00	4.30	3.60	2.21	2.87
Active return[3] (before fees and sell spread)	-0.06	0.19	3.29	1.65	1.50	1.84
Active return[3] (after fees and sell spread)[2]	-0.08	0.11	2.83	1.21	1.12	1.46
Bloomberg AusBond Bank Bills Index	0.35	1.04	4.46	3.68	2.21	3.07

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 April 2025.

Performance Commentary

The fund added 0.25% in April, taking 12 month returns to 7.13% (after accounting for Class I unit fees). This was meaningfully above flat in extremely turbulent market conditions - a testament to the capital preservation objectives of the strategy. Adverse credit spread movements in response to rising recession fears broadly offset the carry in the portfolio in April. Kapstream, which had spare ammunition for such an occasion, took the opportunity to add risk at attractive levels. Rates duration added 22bps in the month, as yields at the front end of the yield curve fell on additional rate cuts being priced in. New active positions to take advantage of the volatility also added value. The yield to maturity finished April at 5.29%, which when combined with a 24bps increase in the portfolio's credit spread to swap, remains a solid base for absolute and relative-to-cash returns looking forward.

Market Commentary

'Liberation Day' in the US saw President Trump announce tariff rates well in excess of expectations and to a level that would represent the highest levels in over a century. The economic implications roiled financial markets. Equities, which were already 8% off their highs in anticipation of tariffs, fell an additional 15%. The implied volatility in equity markets, or VIX, rose from a low in March of 17% to an intraday high of 60%! This saw it share illustrious company over the past twenty years - including just one day during the post Japanese rate hike decline in its equity market in mid-2024, as well as for more extended periods such as following COVID period in 2020 and the Global Financial Crisis in 2008. US Credit spreads widened 25bps to 119bps accordingly. The US dollar fell notably, down 4.5% against the Euro. Bond yields fell dramatically, with US 2-year yields falling more than 40bps in three days. Then the back end of the US Treasury market began not functioning, with sellers driving the US 10 year yield up 30bps on April 7th. The bond market cracking more than the credit market and yields rising is unusual for a time of crisis. Possible explanations include an unwind of the optimism that marked the lead up to the new administration, or more serious an unwind of the US exceptionalism story that has been a feature of markets for many years now.

President Trump blinked first and walked back the timing and magnitude of increases for most countries. China's tariffs were increased but exemptions were carved out over following days. Markets responded by unwinding most of the price action over the preceding three sessions. The S&P 500 rebounded to finish the month largely unchanged, down just 0.8% (but are still down around 10% from the recent record highs). US credit spreads closed at 106bps, up 12bps on the month. US 2yr yields finished the month down 28bps to 3.60%, whilst 10-year yields declined 'just' 4bps to 4.16% in a notable steepening of the curve. Offshore markets largely followed suit, but with some notable exceptions. Front end yields outside of the US did not bounce back to the same degree in Australia and Europe. Australian credit spreads were also not marked significantly tighter in the second half of the month in line with offshore moves.

Outlook

The overused phrase that there is a greater than average degree of uncertainty seems appropriate at this juncture. The eventual rate of tariffs to be implemented remains unknown and subject to 'deals' being struck, making the economic impacts even harder to forecast. It's also not clear what the central bank reaction function will be: will higher inflation be the focus on the fall in activity and related rise in the unemployment rate? The timing of corporate tax cuts later in the year remains unknown.

If we had to outline our base case, the tariff increases, while significant, are not expected to cause a deep or protracted recession. The unemployment rate is set to rise, but arguably from a low level and not the sharp or double-digit style numbers you see in harsher times. Inflation will rise under the direct impacts of higher tariffs, but also with a possible supply side shock as Chinese shipments are reportedly almost halving already. We therefore see easing cycles in markets are largely overdone. On credit spreads, there may still be some room for recovery if the current issues subside. However, the recent episode highlight that headline risks remain high and future episodes are likely. Perhaps the highest conviction view for 2025 is therefore volatility-making active management and short-duration fixed income as relevant as ever.

Portfolio Strategy

The portfolios were active during this volatile period. Based on the above outlook, the widening in credit spreads saw us invest the excess liquidity reserved for opportunities such as this. On the rates side, several alpha positions were initiated and/or closed.

Credit carry continued to support returns in April whilst spread widening detracted from returns, overcoming the credit carry. The portfolio's spread duration increased as we added to new issues, we found attractive throughout the volatility with us buying first and then rotating out of less attractive credits as spread rallied back, resulting in a slight increase in spread duration.

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 potential of 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 midterm elections, with positive economic actions likely starting in the second half of 2025.

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

This month we participated in various financial and corporate deals, with the fund tending to buy credit during down equity days with credit exposure increasing towards the middle of the month, whilst often selling to rotate on up equity days towards the end of the month. 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 the possibility of short bouts of tariff induced volatility. The exposure has been skewed towards Australian credit because credit spreads were closer to their long-term averages compared to the significantly tighter spreads observed in the US before this sell-off. However, now opportunities are more balanced between USD and AUD credit and we were active in USD for short term trading opportunities over the month. Considering the sustained interest from yield-seeking high-net-worth and Asian investors, we anticipate that Australian spreads will likely move back 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 ~76% 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 with 'Level 1' liquidity at ~9% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~17% (<1yr investment grade paper). It was pleasing to see the high level of liquidity providing the flexibility to buy more attractive credits in the sell-off, which we utilised during April.

The previous stalling in core inflation globally had unfortunately seen us lighten up on duration heading into Liberation Day. However, pre-existing duration neutral positions such as curve steepeners in Canada and New Zealand performed strongly as the back end of the US become dysfunctional and rose sharply in yield. These positions, which had been on for some time, were therefore exited over the month. Short-duration positions at the front end of the US yield curve were implemented and exited for a reasonable profit. The divergence between Australian and US front-end yields also saw a bond yield differential trade entered. These positions helped add value over the month above and beyond the direct impact of falling yields at the front end. By design, Kapstream also avoided the sell off at the back end of yield curves globally, where influences other than near-term monetary policy play a greater role.