Kapstream Absolute Return Income Fund

ARSN 124 152 790

Annual report - 30 June 2018

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These financial statements cover Kapstream Absolute Return Income Fund as an individual entity.

The Responsible Entity of Kapstream Absolute Return Income Fund is Fidante Partners Limited (ABN 94 002 835 592). The Responsible Entity's registered office is:

Level 2
5 Martin Place
Sydney NSW 2000

Financial highlights

Financial highlights for Kapstream Absolute Return Income Fund ('the Trust') include the following:

Performance

The table below shows historical discrete annual return performance of the Trust for the past five years. Calculation of performance is after all fees, except any entry fees that have been deducted, and assumes that all distributions were reinvested during that year. The total return is the aggregate of capital growth and distribution returns.

	2018	2017	2016	2015	2014
	%	%	%	%	%
Class A					
Capital growth	**(0.29)**	(0.10)	0.37	0.42	1.55
Distribution of income	**2.98**	3.19	2.38	3.04	3.62
Total return	**2.69**	3.09	2.75	3.46	5.17
Class I					
Capital growth	**(0.40)**	(0.01)	0.35	0.03	1.33
Distribution of income	**3.37**	3.39	2.71	3.73	4.14
Total return	**2.97**	3.38	3.06	3.76	5.47

Effective 30 September 2017, the Wholesale class of units' name was formally changed to Class A and the Premier class of units' name was formally changed to Class I.

Consistent with the statements in the current product disclosure statement, future performance is not guaranteed. Investors should exercise care in using past performance as a predictor of future performance.

Indirect Cost Ratio (ICR)

The Indirect Cost Ratio (ICR) is the ratio of the Trust’s management costs over the Trust’s average net assets attributable for the year, expressed as a percentage. The ICR of the Trust for the past five years has been:

	2018	2017	2016	2015	2014
	%	%	%	%	%
Class A	**0.70**	0.70	0.70	0.70	0.70
Class I	**0.41**	0.41	0.41	0.41	0.41

Management costs include management fees and other expenses or reimbursements deducted in relation to the Trust, but do not include transactional and operational costs such as brokerage. Management costs are not paid directly by the unitholders of the Trust.

Financial highlights (continued)

Unit redemption prices

Unit redemption prices (quoted ex-distribution and exclusive of exit fees) are shown as follows:

	2018	2017
	$	$
Class A		
At 30 June	**1.2091**	1.2126
High during year	**1.2232**	1.2278
Low during year	**1.2091**	1.2126

	2018	2017
	$	$
Class I		
At 30 June	**1.0460**	1.0502
High during year	**1.0598**	1.0631
Low during year	**1.0460**	1.0488

Directors' report

The Directors of Fidante Partners Limited, the Responsible Entity of Kapstream Absolute Return Income Fund, present their report together with the financial statements of Kapstream Absolute Return Income Fund ('the Trust') for the year ended 30 June 2018.

Directors

The following persons held office as Directors of Fidante Partners Limited during the year or since the end of the year and up to the date of this report, unless otherwise stated:

T Bofinger (appointed 1 July 2018)
A Collins
A Murphy
I Saines
A Tobin
R Willis (resigned 30 June 2018)

Principal activities

The principal activity of the Trust during the year was to invest in accordance with the provisions of the Trust's Constitution.

There were no significant changes in the nature of the Trust's activities during the year.

The Asset Manager of the Trust is Kapstream Capital Pty Limited.

Review and results of operations

During the year, the Trust continued to invest funds in accordance with target asset allocations as set out in the current product disclosure statement which continues to be adhered to. The Trust maintains its strategy of targeting an absolute return over time by investing in a global, diversified portfolio of predominantly investment grade fixed income securities, according to Kapstream's global macroeconomic and market views.

Results

The performance of the Trust, as represented by the results of its operations, was as follows:

	30 June 2018 $'000	30 June 2017 $'000
Net operating profit	**164,654**	150,560
Distributions paid and payable	**196,428**	160,981
Distributions (cents per unit) - Class A	**3.60**	3.84
Distributions (cents per unit) - Class I	**3.52**	3.53

Significant changes in state of affairs

In the opinion of the Directors, there were no significant changes in the state of affairs of the Trust that occurred during the financial year.

Directors' report (continued)

Matters subsequent to the end of the financial year

No matter or circumstance has arisen since 30 June 2018 that has significantly affected, or may significantly affect:

(i) the operations of the Trust in future financial years, or
(ii) the results of those operations in future financial years, or
(iii) the state of affairs of the Trust in future financial years.

Likely developments and expected results of operations

The Trust will continue to be managed in accordance with the investment objectives and guidelines as set out in the governing documents of the Trust and in accordance with the provisions of the Trust's Constitution.

Further information on likely developments in the operations of the Trust and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Trust.

Indemnity and insurance of officers

No insurance premiums are paid for out of the assets of the Trust in regards to insurance cover provided to the officers of Fidante Partners Limited. So long as the officers of Fidante Partners Limited act in accordance with the Trust's Constitution and the *Corporations Act 2001*, the officers remain indemnified out of the assets of the Trust against losses incurred while acting on behalf of the Trust. The auditors of the Trust are in no way indemnified out of the assets of the Trust.

Fees paid to and interests held in the Trust by the responsible entity or its related entities

Fees paid to the Responsible Entity and its related entities out of Trust property during the year are disclosed in note 15 to the financial statements.

No fees were paid out of Trust property to the Directors of the Responsible Entity during the year.

The number of interests in the Trust held by the Responsible Entity or its related entities as at the end of the financial year are disclosed in note 15 to the financial statements.

Interests in the Trust

The movement in units on issue in the Trust during the year is set out below:

	30 June 2018 No. '000	30 June 2017 No. '000
Units on issue - Opening	**4,773,155**	3,843,550
Units issued	**2,321,578**	1,846,995
Units redeemed	**(1,409,885)**	(917,390)
Units on issue - Closing	**5,684,848**	4,773,155

The movement in units on issue in the Trust during the year is further disclosed in note 5 to the financial statements.

Value of assets	**30 June 2018 $'000**	30 June 2017 $'000
Value of Trust assets at 30 June	**6,580,372**	5,559,314

Directors' report (continued)

Interests in the Trust (continued)

The value of the Trust's assets and liabilities is disclosed in the statement of financial position and derived using the basis set out in note 2 to the financial statements.

Environmental regulation

The operations of the Trust are not subject to any particular or significant environmental regulations under a Commonwealth, State or Territory law.

Rounding of amounts to the nearest thousand dollars

The Trust is an entity of a kind referred to in ASIC Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to the 'rounding off' of amounts in the Directors' report. Amounts in the Directors' report have been rounded to the nearest thousand in accordance with that Instrument, unless otherwise indicated.

Auditor's independence declaration

A copy of the Auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 7.

This report is made in accordance with a resolution of Directors.

Audrey Collins

A Collins
Director

Sydney
12 September 2018

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Auditor's Independence Declaration to the Directors of Fidante Partners Limited

As lead auditor for the audit of Kapstream Absolute Return Income Fund for the financial year ended 30 June 2018, I declare to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

b) no contraventions of any applicable code of professional conduct in relation to the audit.

Ernst & Young

Rita Da Silva
Partner
12 September 2018

Statement of comprehensive income

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
Income			
Interest income		**203,323**	158,559
Other income		**6,421**	2,569
Net (losses)/gains on financial instruments held at fair value through profit or loss	3	**(23,188)**	3,564
Net foreign exchange gains		**14,124**	15,472
Total income		**200,680**	180,164
Expenses			
Management fees	15	**34,310**	26,963
Interest expense		**-**	1,400
Transaction costs		**707**	467
Other expenses		**1,009**	774
Total expenses		**36,026**	29,604
Net profit before finance costs		**164,654**	150,560
Finance costs attributable to unitholders			
Distributions to unitholders	6	**(196,428)**	(160,981)
Decrease in net assets attributable to unitholders	5	**31,774**	10,421
Other comprehensive income		**-**	-
Total comprehensive income for the year		**-**	-

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

Statement of financial position

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
Assets			
Cash and cash equivalents	16(b)	**86,387**	314,115
Collateral and margin accounts		**59,470**	12,298
Receivables	7	**72,337**	37,954
Financial assets held at fair value through profit or loss	8	**6,362,178**	5,194,947
Total assets		**6,580,372**	5,559,314
Liabilities			
Distributions payable	6	**59,513**	57,972
Payables	11	**46,704**	96,941
Financial liabilities held at fair value through profit or loss	9	**43,639**	4,539
Total liabilities (excluding net assets attributable to unitholders)		**149,856**	159,452
Net assets attributable to unitholders	5	**6,430,516**	5,399,862

The above statement of financial position should be read in conjunction with the accompanying notes.

Statement of changes in unitholder funds

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
At 1 July - Opening Balance - Liability		**5,399,862**	4,371,569
Change in net assets attributable to unitholders		**(31,774)**	(10,421)
Applications for units		**2,544,278**	2,037,619
Redemptions of units		**(1,571,560)**	(1,053,997)
Units issued upon reinvestment of distributions		**89,710**	55,092
At 30 June - Closing Balance - Liability	5	**6,430,516**	5,399,862

The above statement of changes in unitholder funds should be read in conjunction with the accompanying notes.

Statement of cash flows

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
Cash flows from operating activities			
Proceeds from sale of financial instruments held for trading		**58,772**	75,670
Purchase of financial instruments held for trading		**(55,246)**	(4,697)
Interest received		**194,742**	153,167
Other income received		**26**	2,569
Management fees paid		**(33,469)**	(26,564)
Payment of other expenses		**(2,092)**	(1,290)
Net cash inflow from operating activities	16(a)	**162,733**	198,855
Cash flows from investing activities			
Proceeds from sale of investments designated at fair value through profit or loss		**2,104,860**	3,093,909
Purchase of investments designated at fair value through profit or loss		**(3,357,784)**	(4,081,803)
Net cash outflow from investing activities		**(1,252,924)**	(987,894)
Cash flows from financing activities			
Proceeds from applications by unitholders		**2,518,848**	2,033,963
Payments for redemptions by unitholders		**(1,555,961)**	(1,057,420)
Distributions paid		**(105,177)**	(71,193)
Net cash inflow from financing activities		**857,710**	905,350
Net (decrease)/increase in cash and cash equivalents.		**(232,481)**	116,311
Cash and cash equivalents at the beginning of the year		**314,115**	204,536
Effects of exchange rate changes		**4,753**	(6,732)
Cash and cash equivalents at the end of the year	16(b)	**86,387**	314,115

The above statement of cash flows should be read in conjunction with the accompanying notes.

1 General information

These financial statements cover Kapstream Absolute Return Income Fund ('the Trust') as an individual entity. The Trust is an Australian registered managed investment scheme and was constituted on 31 May 2007. The Trust will terminate on 31 May 2087 unless terminated earlier in accordance with the provisions of the Trust's Constitution.

The financial statements were authorised for issue by the Directors on 12 September 2018.

The nature of the operating and principal activities of the Trust are described in the Directors' report.

On 5 May 2016, the Attribution Managed Investment Trust ("AMIT") regime, applying to Managed Investment Trusts was enacted under the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016. With its introduction, the Responsible Entity has amended the Trust's Constitution to allow the Trust to operate as an AMIT. The Responsible Entity has sent a notice to unitholders on the Trust's intention to elect into the AMIT regime from the financial year ended 30 June 2018. As at 30 June 2018, the Trust met the conditions to operate as an AMIT and reassessed the other criteria in AASB 132 *Financial Instruments: Classification* for classifying unitholders' funds. The Trust has determined that unitholders' funds should continue to be classified as a financial liability on 30 June 2018 as they do not meet the criteria under AASB 132 *Financial Instruments: Presentation* to be classified as equity. Refer to note 2(c) and note 5 for further information.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated in the following note.

(a) Basis of preparation

These general purpose financial statements have been prepared in accordance with the Trust's Constitution, Australian Accounting Standards and the *Corporations Act 2001*.

The financial statements are presented in Australian dollars and are prepared on the basis of fair value measurement of assets and liabilities except where otherwise stated.

The statement of financial position is presented on a liquidity basis. Assets and liabilities are presented in decreasing order of liquidity and are not distinguished between current and non-current. All balances are expected to be recovered or settled within twelve months, except for investments in financial instruments and net assets attributable to unitholders. The amounts expected to be recovered or settled beyond twelve months after the end of each reporting period cannot be reliably determined.

Compliance with International Financial Reporting Standards

The financial statements have been prepared in accordance with the Australian Accounting Standards as issued by the Australian Accounting Standards Board and the International Financial Reporting Standards as issued by the International Accounting Standards Board.

(b) Financial instruments

(i) Classification

The Trust's investments are carried at fair value through profit or loss. They comprise:

- Financial instruments held for trading

These include derivative financial instruments such as credit default swaps, cross currency swaps, forward currency contracts, futures, interest rate swaps and swaptions. The Trust does not designate any derivatives as hedges in a hedging relationship.

2 Summary of significant accounting policies (continued)

(b) Financial instruments (continued)

(i) Classification (continued)

- Financial instruments designated at fair value through profit or loss upon initial recognition

These include financial assets and financial liabilities that are not held for trading purposes but which may be sold. These are investments in agency bonds, asset-backed securities, capital indexed bonds, commercial papers, corporate bonds, discount securities, floating rate notes, mortgage-backed securities, semi-government bonds and supranational bonds.

(ii) Recognition/derecognition

The Trust recognises financial assets and financial liabilities on the date it becomes party to the contractual agreement (trade date) and recognises changes in fair value of the financial assets or financial liabilities from this date.

Investments are derecognised when the right to receive cash flows from the investments has expired or the Trust has transferred substantially all risks and rewards of ownership.

(iii) Measurement

Financial assets and liabilities held at fair value through profit or loss

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities held at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in the fair value recognised in the statement of comprehensive income.

- Fair value in an inactive or unquoted market

The fair values of financial assets and liabilities that are not traded in an active market are determined using valuation techniques. These include the use of recent arm's length market transactions, reference to the current fair value of other substantially similar instruments, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the reporting date applicable for an instrument with similar terms and conditions. For other pricing models, inputs are based on market data at the end of the reporting period.

The fair values of derivatives that are not exchange traded are estimated at the amount that the Trust would receive or pay to terminate the contract at balance date taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date. The fair value of an option contract is determined by applying the Black Scholes option valuation model.

(iv) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(c) Net assets attributable to unitholders - Liability

Units are redeemable at the unitholders' option and are classified as financial liabilities as the Trust is required to distribute its taxable income, and the units can be redeemed by the unitholders at any time for cash based on the redemption price. The fair value of redeemable units is measured at the redemption amount that is payable (based on the redemption unit price) at the reporting date if unitholders exercised their right to redeem units in the Trust.

2 Summary of significant accounting policies (continued)

(c) Net assets attributable to unitholders - Liability (continued)

Units are classified as equity when they satisfy the following criteria under AASB 132 *Financial instruments: Presentation:*

- the puttable financial instrument entitles the holder to a pro-rata share of net assets in the event of the Trust's liquidation;
- the puttable financial instrument is in the class of instruments that is subordinate to all other classes of instruments and class features are identical;
- the puttable financial instrument does not include any contractual obligations to deliver cash or another financial asset, or to exchange financial instruments with another entity under potentially unfavourable conditions to the Trust, and it is not a contract settled in the Trust's own equity instruments; and
- the total expected cash flows attributable to the puttable financial instrument over the life are based substantially on the profit or loss and cannot be guaranteed.

As at 30 June 2017, net assets attributable to unitholders are classified as a financial liability. Effective from 30 June 2018, unitholders' funds have not been reclassified from financial liability to equity as they did not satisfy all the above criteria, following the amendments to the Trust's Constitution on election into the AMIT regime.

(d) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Payments and receipts relating to the purchase and sale of investment securities held for trading are classified as cash flows from operating activities, as movements in the fair value of these securities represent the Trust's main income generating activity.

Payments and receipts relating to the purchase and sale of investment securities designated at fair value are classified as cash flows from investing activities, as movements in the fair value of these securities represent the Trust's investment activity.

(e) Collateral and margin accounts

Collateral and margin accounts represent short term investments which are not held for the purpose of meeting short-term cash commitments. They also include restricted deposits for derivative financial instruments and/or for securities sold short. Margin accounts represent cash deposits held with brokers as collateral against open futures contracts.

(f) Investment income

Net gain from financial instruments at fair value through the profit or loss includes all realised and unrealised fair value changes. Any foreign exchange differences are recorded as a separate line item. Net gain from financial instruments at fair value through the profit or loss excludes any interest, dividend, distribution income and is recorded in accordance with the policies described in note 2(b).

Interest income is recognised in the statement of comprehensive income for all debt instruments, which are not held at fair value through profit or loss, using the effective interest method. Other changes in fair value for such instruments are recorded in accordance with the policies described in note 2(b).

Interest earned on financial instruments classified as at fair value through profit or loss is recognised in interest income according to the terms of the contracts.

(g) Expenses

All expenses, including management fees, are recognised in the statement of comprehensive income on an accruals basis.

2 Summary of significant accounting policies (continued)

(h) Income tax

Under current legislation, the Trust is not subject to income tax as all assessable income, exempt income and non-assessable income will be attributed to unitholders under the AMIT regime.

Financial instruments held at fair value may include unrealised capital gains. Should such a gain be realised, that portion of the gain that is subject to capital gains tax will be distributed/attributed so that the Trust is not subject to capital gains tax.

Realised capital losses are not distributed/attributed to unitholders but are retained in the Trust to be offset against any realised capital gains. If realised capital gains exceed realised capital losses, the excess is distributed/attributed to unitholders.

The benefit of imputation credits and foreign tax paid are passed on to unitholders.

The Trust currently incurs withholding tax on investment income imposed by certain countries. Such income is recorded gross of withholding tax in the statement of comprehensive income.

(i) Distributions

In accordance with the Trust's Constitution, the Trust distributes income adjusted for amounts determined by the Responsible Entity, to unitholders by cash or reinvestment. The distributions are recognised in the statement of comprehensive income as finance costs attributable to unitholders.

(j) Goods and Services Tax (GST)

The GST incurred on the costs of various services provided to the Trust by third parties such as investment management fees have been passed onto the Trust. The Trust qualifies for Reduced Input Tax Credits (RITC) at the rates of 75% and 55%, as applicable, on all investment management fees and other expenses. Accordingly, all relevant expenditure has been recognised in the statement of comprehensive income net of the amount of GST recoverable from the Australian Taxation Office (ATO). Accounts payable are inclusive of GST. The net amount of GST recoverable from the ATO is included in receivables in the statement of financial position. Cash flows relating to GST are included in the statement of cash flows on a gross basis.

(k) Receivables

Receivables may include amounts for interest. Interest is accrued at the reporting date from the time of last payment in accordance with the policy set out in note 2(f) above. Amounts are generally received within 30 days of being recorded as receivables.

Receivables may include amounts for RITC receivable from the ATO and application monies receivable from unitholders.

Trades are recorded on trade date, and normally settled within three business days. Sales of financial instruments and assets that are unsettled at the reporting date are included in receivables.

(l) Payables

Payables may include liabilities and accrued expenses owing by the Trust which are unpaid as at the reporting date.

Payables may include amounts for GST payable to the ATO and redemption monies payable to unitholders.

Trades are recorded on trade date, and normally settled within three business days. Purchases of financial instruments that are unsettled at the reporting date are included in payables.

The distribution amount payable to unitholders as at the reporting date is recognised separately on the statement of financial position when the right for unitholders to receive payment is established.

2 Summary of significant accounting policies (continued)

(m) Applications and redemptions

Applications received for units in the Trust are recorded net of any entry fees payable prior to the issue of units in the Trust. Redemptions from the Trust are recorded gross of any exit fees payable after the cancellation of units redeemed.

Unit redemption prices are determined by reference to the net assets of the Trust divided by the number of units on issue.

(n) Foreign currency

(i) Functional and presentation currency

Items included in the Trust's financial statements are measured using the currency of the primary economic environment in which it operates (the 'functional currency'). This is the Australian dollar, which reflects the currency of the economy in which the Trust competes for funds and is regulated. The Australian dollar is also the Trust's presentation currency.

(ii) Transactions and balances

Transactions in foreign currencies are translated into presentation currency, Australian dollars, at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated into Australian dollars at the foreign exchange rate ruling at the reporting date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction. Non-monetary items measured at fair value in a foreign currency shall be translated to Australian dollars using the exchange rates ruling at the date when the fair value was determined.

(o) Use of estimates

The Trust holds financial instruments for which quoted market prices are readily available. However, the majority of the Trust’s financial instruments, including over-the-counter derivatives or unquoted securities, are fair valued using valuation techniques. Where valuation techniques (for example, pricing models) are used to determine fair values, they are validated and periodically reviewed by experienced personnel of the Responsible Entity, independent of the area that created them.

Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments. Models are calibrated by back testing to actual transactions to ensure that outputs are reliable.

For certain other financial instruments, including amounts due from/to brokers and payables, the carrying amounts approximate fair value due to the short-term nature of these financial instruments.

(p) Unit prices

Unit prices are determined in accordance with the Trust's Constitution and are calculated as the net assets attributable to unitholders of the Trust, less estimated costs, divided by the number of units on issue, on a forward pricing basis, as determined by the Responsible Entity.

(q) Terms and conditions on units

Each unit issued confers upon the unitholder an equal interest in the Trust, and is of equal value per class. A unit does not confer any interest in any particular asset or investment of the Trust. Unitholders have various rights under the Constitution and the *Corporations Act 2001*, including the right to:

- have their units redeemed;
- receive income distributions;
- attend and vote at meetings of unitholders; and
- participate in the termination and winding up of the Trust.

2 Summary of significant accounting policies (continued)

(q) Terms and conditions on units (continued)

The rights, obligations and restrictions attached to each unit are identical in all respects.

(r) New accounting standards and interpretations

In the Directors' opinion, there are no standards, interpretations or amendments to existing standards that are effective for the first time for the financial year beginning 1 July 2017 that have had a material impact on the Trust's financial statements or accounting policies.

Certain new accounting standards and interpretations have been published that are not mandatory for the 30 June 2018 reporting period. The Directors' assessment of the impact of these new standards (to the extent relevant to the Trust) and interpretations is set out below:

(i) AASB 9 *Financial Instruments* (and applicable amendments) (effective from 1 July 2018)

AASB 9 *Financial Instruments* addresses the classification and measurement of financial assets and liabilities. The current four categories of financial assets, stipulated in AASB 139 *Financial Instruments: Recognition and Measurement,* will be replaced with two measurement categories: fair value and amortised cost. AASB 9 only permits the recognition of fair value gains/(losses) in other comprehensive income if they relate to equity investments that: are not held for trading (and this election is taken); or debt investments that meet the cash flow characteristics test and is held in a business model of both collecting contractual cash flows and selling. The Trust does not expect any significant impact on the financial statements arising from an adoption of the standard.

(s) Rounding of amounts

The Trust is an entity of the kind referred to in ASIC Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to the 'rounding off' of amounts in the financial statements. Amounts in the financial statements have been rounded off to the nearest thousand in accordance with that Instrument, unless otherwise indicated.

3 Net (losses)/gains on financial instruments held at fair value through profit or loss

Net (losses)/gains recognised in relation to financial instruments held at fair value through profit or loss:

	30 June 2018 $'000	30 June 2017 $'000
Held for trading at fair value	**14,167**	18,305
Designated at fair value	**(37,355)**	(14,741)
Net (losses)/gains on financial instruments held at fair value through profit or loss	**(23,188)**	3,564

4 Auditor's remuneration

The cost incurred for auditing the financial report of the Trust is paid directly by the Responsible Entity. The audit fees paid/payable by the Responsible Entity for the year were $6,800 (2017: $6,500).

5 Net assets attributable to unitholders - Liability

As stipulated within the Trust's Constitution, each unit represents a right to an individual share in the Trust and does not extend to a right to the underlying assets of the Trust. There are two separate classes of units and each unit has the same rights, preferences and restrictions attaching to it as all other units of the Trust.

5 Net assets attributable to unitholders - Liability (continued)

Movements in the number of units and net assets attributable to unitholders during the year were as follows:

	30 June 2018 No. '000	30 June 2017 No. '000	30 June 2018 $'000	30 June 2017 $'000
Net assets attributable to unitholders - Class A				
At 1 July - Opening Balance - Liability	**2,427,438**	2,085,029	**2,939,674**	2,527,270
Applications for units	**1,103,114**	830,710	**1,344,269**	1,014,893
Redemptions of units	**(508,528)**	(507,435)	**(619,669)**	(620,054)
Units issued upon reinvestment of distributions	**26,683**	19,134	**32,375**	23,271
Change in net assets attributable to unitholders	**-**	-	**(17,951)**	(5,706)
At 30 June - Closing Balance - Liability	**3,048,707**	2,427,438	**3,678,698**	2,939,674

	30 June 2018 No. '000	30 June 2017 No. '000	30 June 2018 $'000	30 June 2017 $'000
Net assets attributable to unitholders - Class I				
At 1 July - Opening Balance - Liability	**2,345,717**	1,758,521	**2,460,188**	1,844,299
Applications for units	**1,137,210**	966,910	**1,200,009**	1,022,726
Redemptions of units	**(901,357)**	(409,955)	**(951,891)**	(433,943)
Units issued upon reinvestment of distributions	**54,571**	30,241	**57,335**	31,821
Change in net assets attributable to unitholders	**-**	-	**(13,823)**	(4,715)
At 30 June - Closing Balance - Liability	**2,636,141**	2,345,717	**2,751,818**	2,460,188

	30 June 2018 $'000	30 June 2017 $'000
Total net assets attributable to unitholders	**6,430,516**	5,399,862

Capital risk management

Daily applications and redemptions are reviewed relative to the liquidity of the Trust's underlying assets on a daily basis by the Responsible Entity. Under the terms of the Trust's Constitution, the Responsible Entity has the discretion to reject an application for units and to defer or adjust a redemption of units if the exercise of such discretion is in the best interests of unitholders.

The Trust monitors the level of daily applications and redemptions relative to the liquid assets in the Trust. Sufficient liquid assets are maintained within the Trust. Liquid assets include cash and cash equivalents and investments in corporate bonds, mortgage backed securities and floating rate notes.

6 Distributions to unitholders

Timing of distributions

The distributions for the year were as follows:

	30 June 2018 $'000	**30 June 2018 CPU**	30 June 2017 $'000	30 June 2017 CPU
Distributions - Class A				
Distributions paid - September	**24,344**	**0.93**	13,649	0.63
Distributions payable - December	**22,291**	**0.81**	21,242	0.93
Distributions paid - March	**23,956**	**0.82**	22,568	0.98
Distributions payable - June	**31,797**	**1.04**	31,595	1.30
	102,388		89,054	

	30 June 2018 $'000	**30 June 2018 CPU**	30 June 2017 $'000	30 June 2017 CPU
Distributions - Class I				
Distributions paid - September	**23,171**	**0.90**	11,590	0.65
Distributions paid - December	**21,461**	**0.79**	16,597	0.91
Distributions paid - March	**21,692**	**0.78**	17,363	0.85
Distributions payable - June	**27,716**	**1.05**	26,377	1.12
	94,040		71,927	

The component of the final distribution for the year which was unpaid at the reporting date is shown in the statement of financial position.

7 Receivables

	30 June 2018 $'000	30 June 2017 $'000
Receivables		
Interest receivable	**41,047**	32,466
Applications receivable	**30,643**	5,213
GST receivable	**646**	275
Other receivables	**1**	-
Total receivables	**72,337**	37,954

8 Financial assets held at fair value through profit or loss

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
Held for trading			
Derivatives	10	**6,604**	24,585
Total held for trading		**6,604**	24,585
Designated at fair value through profit or loss			
Agency bonds		**204,705**	124,229
Asset-backed securities		**123,515**	137,985
Capital indexed bonds		**30,757**	30,560
Commercial papers		**-**	90,741
Corporate bonds		**2,611,042**	2,253,434
Discount securities		**19,956**	-
Floating rate notes		**2,824,660**	2,118,588
Mortgage-backed securities		**466,630**	314,985
Semi-government bonds		**-**	28,981
Supranational bonds		**74,309**	70,859
Total designated at fair value through profit or loss		**6,355,574**	5,170,362
Total financial assets held at fair value through profit or loss		**6,362,178**	5,194,947

An overview of the risk exposures and fair value measurements relating to financial assets at fair value through profit or loss is included in notes 13 and 14 respectively.

9 Financial liabilities held at fair value through profit or loss

	Notes	**30 June 2018 $'000**	30 June 2017 $'000
Held for trading			
Derivatives	10	**43,639**	4,539
Total held for trading		**43,639**	4,539
Total financial liabilities held at fair value through profit or loss		**43,639**	4,539

An overview of the risk exposures and fair value measurements relating to financial liabilities at fair value through profit or loss is included in notes 13 and 14 respectively.

10 Derivative financial instruments

In the normal course of business the Trust enters into transactions in various derivative financial instruments which have certain risks. A derivative is a financial instrument or other contract which is settled at a future date and whose value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variables.

Derivative financial instruments require no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

10 Derivative financial instruments (continued)

Derivative transactions include many different instruments such as forwards, futures and options. Derivatives are considered to be part of the investment process and the use of derivatives is an essential part of the Trust's portfolio management. Derivatives are not managed in isolation. Consequently, the use of derivatives is multifaceted and includes:

- hedging to protect an asset or liability of the Trust against a fluctuation in market values or to reduce volatility;
- a substitution for trading of physical securities; and
- adjusting asset exposures within the parameters set in the investment strategy, and adjusting the duration of fixed interest portfolios or the weighted average maturity of cash portfolios.

While derivatives are used for trading purposes, they are not used to gear (leverage) a portfolio. Gearing a portfolio would occur if the level of exposure to the markets exceeds the underlying value of the Trust.

The Trust holds the following derivative instruments:

(a) Credit default swaps

A credit default swap is a derivative, under which the party buying the protection makes one or more payments to the party selling protection in exchange for an undertaking by the seller to make a payment to the buyer following a credit event (as defined in the contract) with respect to a third party credit entity. Settlement following a credit event may be a net cash amount or cash in return for physical delivery of one or more obligations of the credit entity and is made regardless of whether the protection buyer has actually suffered a loss. After a credit event and settlement, the contract is terminated.

The fair value of swaps is the estimated amount the trust would receive or pay to terminate the swap at the end of the reporting period, taking into account current interest rates and the current creditworthiness of the swap counterparties.

(b) Cross currency swaps

A cross currency swap is an agreement between counterparties to exchange interest and principal payments in different currencies at a particular point in time in the future.

The fair value of swaps is the estimated amount that the Trust would receive or pay to terminate the swap at the end of the reporting period, taking into account the current value of the underlying currencies.

(c) Forward currency contracts

A forward currency contract is primarily used by the Trust to hedge against foreign currency exchange rate risks on its non-Australian dollar denominated trading securities. The Trust agrees to receive or deliver a fixed quantity of foreign currency for an agreed upon price on an agreed future date. Forward currency contracts are valued at the prevailing market price at the end of each reporting period. The Trust recognises a gain or loss equal to the change in fair value at the end of each reporting period.

(d) Futures

A future is a contractual obligation to buy or sell financial instruments on a future date at a specified price established in an organised market. The futures contracts are collateralised by cash or marketable securities. Changes in futures contracts' values are usually settled net daily with the exchange.

Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates at a future date at a specified price, established in an organised financial market.

(e) Interest rate swaps

An interest rate swap is an agreement between two parties to exchange their interest obligations (payments or receipts) at set intervals on a notional principal amount over an agreed time period.

The fair value of interest rate swaps is the estimated amount that the Trust would receive or pay to terminate the swap at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

10 Derivative financial instruments (continued)

(f) Swaptions

A swaption is an option to enter into an interest rate swap. In exchange for an option premium, the buyer gains the right to but not the obligation to enter in a specific swap agreement with the issuer on a specified future date.

The Trust's derivative financial instruments at year-end are detailed below:

30 June 2018		**Fair values**	
	Contract/ notional $'000	**Assets $'000**	**Liabilities $'000**
Long Positions			
Credit default swaps	**1,388**	**1,359**	**-**
Cross currency resettable swaps	**13,875**	**-**	**317**
Forward currency contracts	**1,208,745**	**3,817**	**38,988**
Interest rate futures	**2,300,688**	**-**	**-**
Interest rate swaps	**672,300**	**931**	**-**
Swaptions	**2,044**	**497**	**-**
Short Positions			
Credit default swaps	**(2,817)**	**-**	**2,762**
Interest rate futures	**(1,818,203)**	**-**	**-**
Swaptions	**216**	**-**	**1,572**
	2,378,236	**6,604**	**43,639**

30 June 2017		Fair values	
	Contract/ notional $'000	Assets $'000	Liabilities $'000
Long Positions			
Credit default swaps	1,475	1,475	-
Cross currency resettable swaps	-	-	-
Forward currency contracts	1,460,647	22,211	1,584
Interest rate futures	-	-	-
Interest rate swaps	-	-	-
Swaptions	5,796	899	-
Short Positions			
Credit default swaps	(2,695)	-	2,695
Interest rate futures	-	-	-
Swaptions	1,220	-	260
	1,466,443	24,585	4,539

An overview of the risk exposures and fair value measurements relating to derivative financial instruments are included in note 13 and note 14.

11 Payables

	30 June 2018 $'000	30 June 2017 $'000
Payables		
Amounts owing to the Responsible Entity	**3,268**	2,427
Redemptions payable	**17,007**	1,408
Outstanding trade settlements	**26,429**	93,106
Total payables	**46,704**	96,941

12 Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. As at 30 June 2018 there are no financial assets and financial liabilities that have been offset in the statement of financial position (2017: $Nil). As at 30 June 2018, the Trust has no netting arrangements which if applied would have a material impact on the disclosure of financial assets and liabilities.

(i) Master netting arrangement – not currently enforceable

The Trust presents the fair value of its derivative financial assets and liabilities on a gross basis. Certain derivative financial assets and liabilities are subject to legally enforceable master netting arrangements, such as an International Swaps and Derivatives Association (ISDA) master netting agreement. In certain circumstances, for example, when a credit event such as a default occurs, all outstanding transactions under an ISDA agreement are terminated, the termination value is assessed and only a single net amount is payable in settlement of all transactions.

An ISDA agreement does not meet the criteria for offsetting in the statement of financial position as the Trust does not have any current legally enforceable right to offset recognised amounts. The right to offset is enforceable only on the occurrence of future event such as a default.

As at 30 June 2018, if these netting arrangements were applied to the derivative financial instruments, derivative financial assets of $6,604,000 would be $1,769,000, and derivative financial liabilities of $43,639,000 would be $38,805,000 (2017: derivative financial assets of $24,585,000 would be $22,756,000 and derivative financial liabilities of $4,539,000 would be $2,710,000).

13 Financial risk management

(a) Overview

The Trust's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The Trust's overall risk management program focuses on ensuring compliance with the Trust's Product Disclosure Statement and seeks to maximise the returns derived for the level of risk to which the Trust is exposed. The Trust may use derivative financial instruments to alter certain risk exposures. The Responsible Entity is responsible for identifying and controlling the risks that arise from these financial instruments.

The allocation of assets between the various types of financial instruments is determined by the Trust's Asset Manager who manages the Trust's assets to achieve the Trust's investment objectives.

Divergence from target allocations and the composition of the assets is monitored on a regular basis.

The Responsible Entity of the Trust is aware of the risks associated with the business of investment management. A financial risk management framework has been established to ensure that procedures and controls adequately manage the risks arising from current business activities. Central controls include (but are not limited to):

- clear policies and procedures covering operations;
- post trade investment compliance monitoring;

13 Financial risk management (continued)

(a) Overview (continued)

- segregation of the dealing and investment management function from the administration and settlement function;
- an independent service provider for the valuation of securities; and
- a compliance function with a separate reporting line from the Trusts' Management team.

As part of the risk management framework, the Responsible Entity is subject to regular reporting and committee meetings regarding risk and compliance issues. The purpose is to facilitate a flow of information between the Trust and the Responsible Entity's Board and Committees. Any material matters identified are promptly investigated and reported.

As part of its risk management strategy, the Trust may use derivatives including exchange traded derivatives, to manage exposures resulting from changes in index prices, equity risks and exposures arising from forecast transactions.

There are no changes in the strategies used to manage the financial risks from the previous reporting period.

(b) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Trust's income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Trust is exposed to market risks influencing investment valuations. The Trust may utilise derivatives to manage this risk.

(i) Price risk

Price risk is the risk that the value of an instrument will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market.

As the Trust does not hold any equity securities, and the majority of its investments carried at fair value with fair value changes recognised in the statement of comprehensive income are debt instruments, price risk is not considered to be significant.

(ii) Foreign exchange risk

Trusts that invest in international assets are exposed to foreign exchange risk. Foreign exchange risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Fund managers may enter into derivatives contracts (such as forwards, swaps, options and futures) through approved foreign exchange dealers to minimise risk. However, the use of these contracts must be consistent with the investment strategy and restrictions of the Trust, and agreed acceptable level of foreign exchange risk.

The Trust holds both monetary and non-monetary assets denominated in currencies other than the Australian dollar. The foreign exchange risk relating to non-monetary assets and liabilities is a component of price risk. Foreign exchange risk arises as the value of monetary securities denominated in other currencies will fluctuate due to changes in exchange rates.

The Trust also enters into forward currency contracts principally to hedge the foreign exchange risk implicit in the value of the portfolio securities denominated in foreign currencies and to secure a particular exchange rate for a planned purchase or sale of securities. The term of these contracts rarely exceeds 12 months and may not necessarily indicate the total effect on the Trust's net assets attributable to unitholders of future movements in foreign exchange rates.

The Trust's underlying investments are primarily in US fixed interest securities hedged back to Australian dollars. The Trust is to be as fully hedged as practicable which is defined as 100% hedged back into Australian dollars with a plus or minus 5% tolerance.

13 Financial risk management (continued)

(b) Market risk (continued)

(ii) Foreign exchange risk (continued)

The table below summarises the Trust's exposure to foreign exchange risk.

30 June 2018

	AUD $'000	USD $'000	EUR $'000	JPY $'000	NZD $'000	OTHER $'000	Total $'000
Assets							
Cash and cash equivalents	86,291	-	1	-	14	81	86,387
Margin accounts	39,878	20,388	(796)	-	-	-	59,470
Receivables	61,469	10,125	325	(5)	423	-	72,337
Financial assets held at fair value through profit or loss	5,118,120	1,121,135	48,740	1,491	72,692	-	6,362,178
Total assets	5,305,758	1,151,648	48,270	1,486	73,129	81	6,580,372
Liabilities							
Distribution payable	(59,513)	-	-	-	-	-	(59,513)
Payables	(46,704)	-	-	-	-	-	(46,704)
Financial liabilities held at fair value through profit or loss	-	(43,322)	(3)	(280)	(34)	-	(43,639)
Total liabilities	(106,217)	(43,322)	(3)	(280)	(34)	-	(149,856)
Net assets attributable to unitholders	5,199,541	1,108,326	48,267	1,206	73,095	81	6,430,516

30 June 2017

	AUD $'000	USD $'000	EUR $'000	JPY $'000	NZD $'000	OTHER $'000	Total $'000
Assets							
Cash and cash equivalents	310,778	260	1	2,678	87	311	314,115
Margin accounts	20,811	(8,513)	-	-	-	-	12,298
Receivables	26,842	10,348	267	-	497	-	37,954
Financial assets held at fair value through profit or loss	3,710,699	1,351,989	30,658	268	101,333	-	5,194,947
Total assets	4,069,130	1,354,084	30,926	2,946	101,917	311	5,559,314

13 Financial risk management (continued)

(b) Market risk (continued)

(ii) Foreign exchange risk (continued)

30 June 2017

	AUD $'000	USD $'000	EUR $'000	JPY $'000	NZD $'000	OTHER $'000	Total $'000
Liabilities							
Distribution payable	(57,972)	-	-	-	-	-	(57,972)
Payables	(60,204)	(12,720)	-	-	(24,017)	-	(96,941)
Financial liabilities held at fair value through profit or loss	(260)	(2,709)	(1,454)	-	(116)	-	(4,539)
Total liabilities	(118,436)	(15,429)	(1,454)	-	(24,133)	-	(159,452)
Net assets attributable to unitholders	3,950,694	1,338,655	29,472	2,946	77,784	311	5,399,862

The table in part (c) of this note summarises the sensitivities of the Trust's financial instruments to foreign exchange risk. The analysis is based on the assumption that the Australian Dollar weakened and strengthened by 10% (2017: 10%) against the material foreign currencies to which the Trust is exposed.

(iii) Cash flow and fair value interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Trust has established limits on the total interest rate exposure, which are monitored on a daily basis. The Trust may use derivatives to hedge unexpected increases in interest rates.

Part (c) of this note demonstrates the sensitivity of the Trust's statement of comprehensive income to possible changes in interest rates, with all other variables held constant. The analysis is based on the assumptions that interest rates increased by 100 bps (2017: 100 bps) and decreased by 100 bps (2017: 100 bps).

The sensitivity of the statement of comprehensive income is the effect of the assumed changes in interest rates on:

- the interest income for one year, based on the floating rate financial assets held at 30 June 2018; and
- changes in the fair value of investments for the year based on revaluing fixed rate financial assets at 30 June 2018.

(c) Summarised sensitivity analysis

The following table summarises the sensitivity of the Trust's operating profit and net assets attributable to unitholders to foreign exchange risk and interest rate risk for financial assets and liabilities held at balance date. The possible movements in the risk variables have been determined based on management's best estimate, having regard to a number of factors, including historical levels of changes in interest rates and foreign exchange rates. However, actual movements in the risk variables may be greater or less than anticipated due to a number of factors, including unusually large market shocks resulting from changes in the performance of the economies, markets and securities in which the Trust invests. As a result, historic variations in risk variables are not a definitive indicator of future variations in the risk variables.

13 Financial risk management (continued)

(c) Summarised sensitivity analysis (continued)

	Impact on operating profit/Net assets attributable to unitholders					
	Interest rate risk		Foreign exchange risk			
	-100bps	+100bps	-10% USD	+10% USD	-10% EUR	+10% EUR
	$'000	$'000	$'000	$'000	$'000	$'000
30 June 2018	**42,435**	**(41,666)**	**(1,145)**	**1,145**	**181**	**(181)**
30 June 2017	27,764	(27,649)	1,995	(1,632)	(4,084)	3,342

	Impact on operating profit/Net assets attributable to unitholders			
	Foreign exchange risk			
	-10% JPY	+10% JPY	-10% OTHER	+10% OTHER
	$'000	$'000	$'000	$'000
30 June 2018	**(95)**	**95**	**357**	**(357)**
30 June 2017	4,695	(3,841)	(79)	64

During the financial year the Responsible Entity amended the methodology used to calculate foreign exchange risk sensitivity shocks shown in the above table. The current years' methodology is to shock the portfolio currency (AUD) of foreign denominated assets compared to the prior year where the assets were shocked in their local currency. The Responsible Entity has determined that the difference in the results over the two years is immaterial.

(d) Credit risk

Credit risk represents the risk that the counterparty to the financial instrument will fail to discharge an obligation and cause the Trust to incur a financial loss.

The main concentration of credit risk, to which the Trust is exposed, arises from the Fund's investment in debt securities. The Trust is also exposed to counterparty credit risk on derivative financial instruments, cash and cash equivalents, amounts due from brokers and other receivables. The Trust's exposure to credit risk is equal to the fair value of these instruments as disclosed in the statement of financial position. This does not represent the maximum risk exposure that could arise in the future as a result of changes in values, but best represents the current maximum exposure at the reporting date.

The Trust manages counterparty risk in relation to over-the-counter derivatives by using only counterparties with an acceptable credit rating in accordance with the provisions of the Trust's policies. Exposures to counterparties are monitored by the Asset Manager on a regular basis.

The credit quality of financial assets is managed by the Trust using the Standard & Poor's rating categories, in accordance with the investment mandate of the Trust. The Trust's exposure in each grade is monitored on a regular basis. This review process allows the Responsible Entity to assess the potential loss as a result of risks and take corrective action.

13 Financial risk management (continued)

(d) Credit risk (continued)

The following table details the breakdown by credit rating of the underlying investment assets, including derivatives, held by the Trust:

S&P Bond and Derivative Counterparty Credit Ratings	30 June 2018 $'000	30 June 2017 $'000
Rating		
AAA	**751,960**	572,612
AA+	**34,763**	59,541
AA	**151,763**	145,043
AA-	**487,392**	867,906
A+	**212,520**	289,497
A	**565,158**	564,328
A-	**1,633,228**	1,013,515
A-1	**-**	11,103
BBB+	**1,556,291**	929,211
BBB	**850,215**	691,316
BBB-	**91,486**	50,875
Not rated	**27,402**	-
Total	**6,362,178**	5,194,947

(e) Liquidity risk

Liquidity risk is the risk that the Trust will not be able to meet its financial obligations as they fall due.

The Trust's product disclosure statement provides for daily redemption of units and it is therefore exposed to liquidity risk of meeting unitholders' redemption at any time.

This risk is controlled through the Trust investing the majority of its assets in investments that are traded in an active market and investing only a limited proportion of its assets in investments not actively traded on a stock exchange.

The Trust's investments are considered to be readily realisable.

The investment management process includes the consideration of liquidity, both in terms of market quality and cash flow. In asset construction, securities/investments (including derivatives) are only purchased that meet investment criteria and this includes the assessment of saleability in different market conditions. Before entering into a transaction, consideration is given (among others):

- whether the purpose of the investment is consistent with the investment strategy of the Trust;
- the ease of selling the security should market conditions change unfavourably;
- whether there are sufficient assets to cover the underlying liabilities of that transaction; and
- the overall liquidity level for the Trust.

Under the terms of its Constitution, the Trust has the ability to manage liquidity risk by delaying redemptions to unitholders, if necessary, until the funds are available to pay them.

13 Financial risk management (continued)

(e) Liquidity risk (continued)

Maturity analysis for financial liabilities

Financial liabilities of the Trust comprise trade and other payables, distributions payable and net assets attributable to unitholders. Trade and other payables and distributions payable have no contractual maturities but are typically settled within 30 days.

Net assets attributable to unitholders are entirely payable on demand.

The table below analyses the Trust's derivative financial liabilities based on their contractual maturity. The Trust may, at its discretion, settle derivative financial liabilities prior to their original contractual settlement date, in accordance with its investment strategy, where permitted by the terms and conditions of the derivative instruments.

30 June 2018

	Less than 1 month $'000	**1-6 months $'000**	**6-12 months $'000**	**Beyond 12 months $'000**	**Total $'000**
Credit default swaps	**-**	**-**	**-**	**2,762**	**2,762**
Cross currency swaps	**-**	**-**	**317**	**-**	**317**
Forward currency contracts	**17,566**	**21,422**	**-**	**-**	**38,988**
Swaptions	**-**	**-**	**1,572**	**-**	**1,572**
	17,566	**21,422**	**1,889**	**2,762**	**43,639**

30 June 2017

	Less than 1 month $'000	1-6 months $'000	6-12 months $'000	Beyond 12 months $'000	Total $'000
Credit default swaps	-	-	-	2,695	2,695
Cross currency swaps	-	-	-	-	-
Forward currency contracts	-	-	-	1,584	1,584
Swaptions	-	-	260	-	260
	-	-	260	4,279	4,539

14 Fair value measurement

(a) Fair value estimation

All financial assets and financial liabilities included in the statement of financial position are carried at recurring fair value.

The carrying amounts of the Trust's financial assets and financial liabilities at the end of each reporting period are equivalent to their fair values.

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income.

The Trust values its investments in accordance with the accounting policies set out in note 2. For the majority of its investments, the Trust relies on information provided by independent pricing services for the valuation of its investments.

14 Fair value measurement (continued)

(a) Fair value estimation (continued)

The quoted market price used for financial assets held by the Trust is the current bid price; the appropriate quoted market price for financial liabilities is the current asking price. When the Trust holds derivatives with offsetting market risks, it uses mid-market prices as a basis for establishing fair value for the offsetting risk positions and applies this bid or asking price to the net open position, as appropriate.

For over-the-counter instruments including bonds, floating rate notes and loans, fair value is determined using market quoted prices or an external valuation service provider.

The fair value of over-the-counter derivatives is estimated at the amount, determined by an external valuation service provider, the Trust would receive or pay to terminate the contract at the end of the reporting period taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value or estimated future cash flows, discounted at appropriate market rates at the valuation date.

(b) Fair value hierarchy

The Trust classifies fair value measurements using a fair value hierarchy that reflects the subjectivity of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The level in the fair value hierarchy within which an asset or liability is categorised is determined on the basis of the lowest level of input that is significant to the measurement as a whole. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, it is classified as a level 3 measurement. Assessing the significance of a particular input to the fair value measurement as a whole requires judgement and consideration of factors specific to the asset or liability.

The determination of what constitutes 'observable' requires significant judgement by the Responsible Entity. The Responsible Entity considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

14 Fair value measurement (continued)

(b) Fair value hierarchy (continued)

The tables below set out the Trust's financial assets and liabilities (by class) measured at fair value according to the fair value hierarchy.

30 June 2018

	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial assets				
Financial assets held for trading:				
Credit default swaps	-	1,359	-	1,359
Forward currency contracts	-	3,817	-	3,817
Interest rate swaps	-	931	-	931
Swaptions	-	497	-	497
Financial assets designated at fair value through profit or loss:				
Agency bonds	-	204,705	-	204,705
Asset-backed securities	-	123,515	-	123,515
Capital indexed bonds	-	30,757	-	30,757
Commercial paper	-	-	-	-
Corporate bonds	-	2,611,042	-	2,611,042
Discount securities	-	19,956	-	19,956
Floating rate notes	-	2,824,660	-	2,824,660
Mortgage-backed securities	-	466,630	-	466,630
Semi-government bonds	-	-	-	-
Supranational bonds	-	74,309	-	74,309
Total	-	6,362,178	-	6,362,178
Financial liabilities				
Financial liabilities held for trading:				
Cross currency resettable swaps	-	(317)	-	(317)
Credit default swaps	-	(2,762)	-	(2,762)
Forward currency contracts	-	(38,988)	-	(38,988)
Swaptions	-	(1,572)	-	(1,572)
Total	-	(43,639)	-	(43,639)

14 Fair value measurement (continued)

(b) Fair value hierarchy (continued)

30 June 2017

	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial assets				
Financial assets held for trading:				
Credit default swaps	-	1,475	-	1,475
Forward currency contracts	-	22,211	-	22,211
Interest rate swaps	-	-	-	-
Swaptions	-	899	-	899
Financial assets designated at fair value through profit or loss:				
Agency bonds	-	124,229	-	124,229
Asset-backed securities	-	137,985	-	137,985
Capital indexed bonds	-	30,560	-	30,560
Commercial paper	-	90,741	-	90,741
Corporate bonds	-	2,253,434	-	2,253,434
Discount securities	-	-	-	-
Floating rate notes	-	2,118,588	-	2,118,588
Mortgage-backed securities	-	314,985	-	314,985
Semi-government bonds	-	28,981	-	28,981
Supranational bonds	-	70,859	-	70,859
Total	-	5,194,947	-	5,194,947
Financial liabilities				
Financial liabilities held for trading:				
Cross currency resettable swaps	-	-	-	-
Credit default swaps	-	(2,695)	-	(2,695)
Forward currency contracts	-	(1,584)	-	(1,584)
Swaptions	-	(260)	-	(260)
Total	-	(4,539)	-	(4,539)

Financial instruments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs are classified within level 2. These include investments in fixed income securities and over-the-counter derivatives. As level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and/or non transferability, which are generally based on available market information.

15 Related party transactions

(a) Responsible entity

The Responsible Entity of Kapstream Absolute Return Income Fund is Fidante Partners Limited whose immediate parent company is Challenger Funds Management Holdings Pty Limited and ultimate parent company is Challenger Limited.

(b) Key management personnel

(i) Directors

Key management personnel includes persons who were Directors of Fidante Partners Limited at any time during the financial year and up to the date of the report as follows:

T Bofinger (appointed 1 July 2018)
A Collins
A Murphy
I Saines
A Tobin
R Willis (resigned 30 June 2018)

(ii) Other key management personnel

The Responsible Entity is considered to be the key management personnel with authority for the strategic direction and management of the Trust.

The Asset Manager, Kapstream Capital Pty Limited, is a related party to the Trust as it is a member of the same group as the Responsible Entity.

(c) Key management personnel unitholdings

At 30 June 2018 no key management personnel held units in the Trust (2017: Nil).

(d) Key management personnel compensation

No amount is paid by the Trust directly to the Directors of the Responsible Entity.

Compensation is paid to the Responsible Entity in the form of fees and is disclosed below.

(e) Responsible Entity's fees and other transactions

Under the terms of the Trust's Constitution, the Responsible Entity is entitled to receive management fees, calculated by reference to the average daily net assets (excluding net assets attributable to unitholders) of the Trust as follows:

(i) 0.70% (2017: 0.70%) of the Class A; and
(ii) 0.41% (2017: 0.41%) of the Class I.

These fees are inclusive of GST, net of RITC available to the Trust per annum.

In addition to the management fee, the Responsible Entity is also entitled to receive performance fees for Class A. The performance fees are calculated at 20% of the difference between the Trust’s daily return (after fees and expenses) and the performance benchmark, being the 50% Bloomberg AusBond Composite Bond 0-3 year Index and 50% Bloomberg AusBond Bank Bill Index.

For the year ended 30 June 2018, in accordance with the Trust's Constitution, the Responsible Entity received performance fees of 0.00% (2017: 0.00%) for Class A (inclusive of GST, net of RITC, available to the Trust) per annum. Class I is not subject to performance fees.

15 Related party transactions (continued)

All related party transactions are conducted on normal commercial terms and conditions. The transactions during the year and amounts payable at year end between the Trust and the Responsible Entity were as follows:

	30 June 2018 $	30 June 2017 $
Management fees for the year paid by the Trust to the Responsible Entity	**34,310,499**	26,962,719
Aggregate amounts payable to the Responsible Entity at the end of the reporting period	**3,268,141**	2,426,733

(f) Related party unitholdings

Parties related to the Trust (including Fidante Partners Limited, its related parties and other schemes managed by Fidante Partners Limited), held units in the Trust as follows:

30 June 2018

Unitholder	**No. of units held opening (Units)**	**No. of units acquired (Units)**	**No. of units disposed (Units)**	**No. of units held closing (Units)**	**Interest held (%)**	**Distributions paid/payable by the Trust ($)**
Kapstream Capital Pty Limited	**5,276,413**	**183,059**	**-**	**5,459,472**	**0.10**	**190,391**
Total	**5,276,413**	**183,059**	**-**	**5,459,472**	**0.10**	**190,391**

30 June 2017

Unitholder	No. of units held opening (Units)	No. of units acquired (Units)	No. of units disposed (Units)	No. of units held closing (Units)	Interest held (%)	Distributions paid/payable by the Trust ($)
Kapstream Capital Pty Limited	5,127,887	148,526	-	5,276,413	0.11	184,359
Total	5,127,887	148,526	-	5,276,413	0.11	184,359

16 Reconciliation of profit to net cash inflow from operating activities

(a) Reconciliation of profit to net cash inflow from operating activities

	30 June 2018 $'000	30 June 2017 $'000
Net profit attributable to unitholders	**164,654**	150,560
Net losses/(gains) on financial instruments held at fair value through profit or loss	**23,188**	(3,564)
Net foreign exchange gains	**(14,124)**	(15,472)
Proceeds from sale of financial instruments held for trading	**58,772**	75,670
Purchase of financial instruments held for trading	**(55,246)**	(4,697)
Net change in receivables and other assets	**(8,954)**	(4,026)
Net change in payables and other liabilities	**841**	384
Non-cash CDS amortisation	**(6,398)**	-
Net cash inflow from operating activities	**162,733**	198,855

16 Reconciliation of profit to net cash inflow from operating activities (continued)

(b) Components of cash and cash equivalents

	30 June 2018 $'000	30 June 2017 $'000
Cash as at the end of the financial year as shown in the statement of cash flows is reconciled to the statement of financial position as follows:		
Cash at bank	**86,387**	314,115
Cash and cash equivalents	**86,387**	314,115

(c) Non-cash investing and financing activities

Reinvestment of unitholder distributions	**89,710**	55,092

17 Events occurring after the reporting period

No significant events have occurred since the reporting date which would impact on the financial position of the Trust as at 30 June 2018 or on the results and cash flows of the Trust for the year ended on that date.

18 Contingent assets and liabilities and commitments

There are no outstanding contingent assets, liabilities or commitments as at 30 June 2018 (2017: $Nil).

Directors' declaration

In the opinion of the Directors of the Responsible Entity:

(a) the financial statements and notes set out on pages 8 to 35 are in accordance with the *Corporations Act 2001*, including:

(i) complying with Australian Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

(ii) giving a true and fair view of the Trust's financial position as at 30 June 2018 and of its performance for the financial year ended on that date;

(b) the financial statements and notes comply with International Financial Reporting Standards as disclosed in note 2(a); and

(c) there are reasonable grounds to believe that the Trust will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of Directors.

On behalf of the Board of Fidante Partners Limited.

Andrey Collins

A Collins
Director

Sydney
12 September 2018

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Independent Auditor's Report to the unitholders of Kapstream Absolute Return Income Fund

Opinion

We have audited the financial report of Kapstream Absolute Return Income Fund (the "Trust"), which comprises the statement of financial position as at 30 June 2018, the statement of comprehensive income, statement of changes in unitholder funds and statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of Kapstream Absolute Return Income Fund is in accordance with the Corporations Act 2001, including:

a) giving a true and fair view of the Kapstream Absolute Return Income Fund's financial position as at 30 June 2018 and of its financial performance for the year ended on that date; and

b) complying with Australian Accounting Standards and the Corporations Regulations 2001.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Report section of our report. We are independent of the Trust in accordance with the auditor independence requirements of the Corporations Act 2001 and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (the "Code") that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information Other than the Financial Report and Auditor's Report Thereon

The directors of Fidante Partners Limited as the Responsible Entity of the Trust (the "Responsible Entity") are responsible for the other information. The other information is the directors' report accompanying the financial report.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the Financial Report

The directors of the Responsible Entity are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors of the Responsible Entity are responsible for assessing the Trust’s ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Trust or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Responsible Entity’s internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors’ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Trust’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Trust to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Ernst & Young

Ernst & Young

R Da Silva

Rita Da Silva
Partner
Sydney
12 September 2018

Directory

Responsible Entity
Fidante Partners Limited
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AFSL 234668

Registered office and principal place of business
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Custodian
Citigroup Pty Limited
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Sydney NSW 2000

Auditor
For the Responsible Entity and the Trust
Ernst & Young
200 George Street
Sydney NSW 2000