Kapstream
—JANUS HENDERSON—

Monthly Report

Kapstream Absolute Return Income Fund

August 2018

Fund Characteristics					
Fund Size: $ 6,169m	**Yield:** 3.30%	**Duration:** 0.67yr	**Spread Duration**: 3.10yrs	**Average Rating:** A	**Number of Issuers:** 109

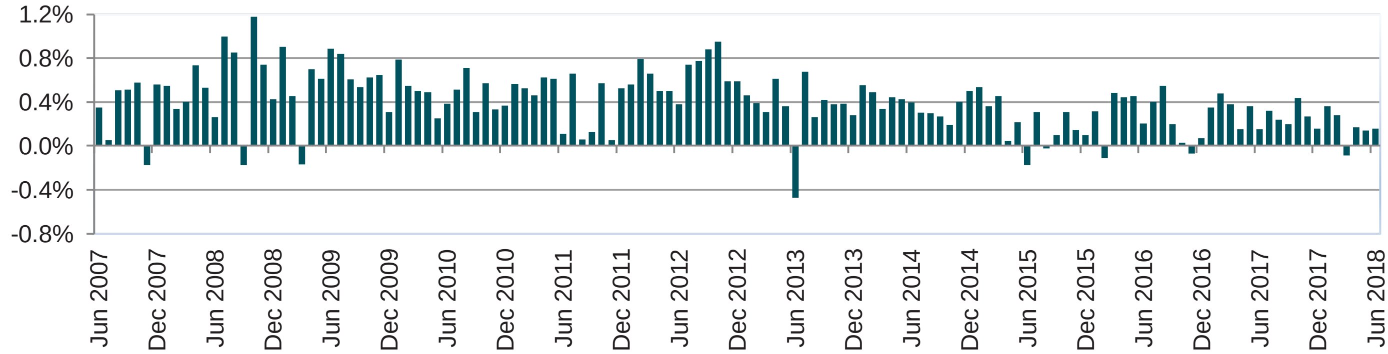
Performance as at 31 July 2018	Month (%)	3 Months (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	Inception (%) p.a.
Fund Return (Net)[1]	0.34	0.70	2.66	2.93	3.34	4.89
Benchmark[2]	0.24	0.58	2.03	2.06	2.41	3.58
Active return (Net)[1]	0.10	0.12	0.63	0.87	0.94	1.31
RBA Cash Rate	0.13	0.38	1.50	1.63	1.93	3.40

Past performance is not a reliable indicator of future performance

[1] Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. After fee returns inclusive of current 0.70% annualised total expenses for A shareclass.

[2] The Fund's Benchmark is a composite benchmark comprising 50% Bloomberg AusBond 0-3 Yr Index & 50% Bloomberg AusBond Bank Bill Index. Prior to 1 February 2014, the Fund's benchmark was the RBA Cash Rate

Kapstream Absolute Return Income Fund Monthly Performance (Net)[1]



Fund Holdings

Credit Quality	%
AAA/Cash	12
AA	10
A	37
BBB	41
Below IG	0
Total	**100**

Region	%
Australia	67
US	11
Asia	17
Europe	4
Other	2
Total	**100**

Sector	%
Cash/Deposits	1
Govt/Agency	3
Consumer	3
Energy	3
Senior Financials	42
Sub Financials	7
Industrials	11
Utilities	20
MBS/ABS	11
Total	**100**

Performance

The Fund returned 0.34% in August and 1.58% calendar year-to-date (after "A" shareclass fees). The Fund's coupon income remains the main contributor to returns. Corporate bonds continued to rally over the month aiding fund returns. The Fund's small interest rate position of 0.7 years also aided returns as rates rallied, as did the Fund's long position in Australian versus US rates. By month-end, Australian 10-year rates fell to 2.51%, some 0.35% less than comparable 10-year US Treasuries, a spread differential not seen since the early 1980's. The Fund's focus on short maturity instruments in Australia and New Zealand were the main positive drivers of alpha relative value positions (positive outperformance gained from exploiting mispricing between similar securities). We continue to favour Australian and New Zealand rates given our expectations for the central banks to remain on hold through 2018 and 2019.

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Portfolio Strategy

After decreasing portfolio risks in the first quarter following greater market volatility, we increased portfolio risks over the second quarter, believing the sell-off in rates and corporate bond spreads was largely complete. Temporary factors such as increasing corporate bond supply put short-term stress on corporate bond markets, pushing spreads wider. We have maintained our low cash position at 5.5%, given attractive corporate issuance. We still believe the Reserve Bank of Australia (RBA) is likely to maintain rates at 1.50% for some time, making Australian rates the most attractive globally. We expect to maintain Australian duration in the 0.5 to 0.7 range. However, US rates are beginning to look more attractive due to rising LIBOR rates, a tailwind of positive currency hedging yields (basis swap) and greater liquidity. We expect to increase our US issuer exposures in the coming months (whilst hedging back to the AUD).

Outlook

August US jobs gains of 201k reconfirm solid US economic data, consistent with the past few months. While average hourly earnings moving toward 3% renew our concerns over US inflation, we believe the trade war will remain a negative theme and keep a cap on where rates can go. The recent uptick in trade war rhetoric could reduce US growth by up to 0.50% annually, completely unwinding the benefits of recent tax cuts. As a result of this political uncertainty, we foresee only one more US Federal Reserve (Fed) rate hike in 2018, below market consensus. We expect terminal the Fed Funds rate in the 2.50% range, also below market consensus.

Like US dollar strength, global bond yields will remain a barometer of markets' faith in Trump's economic plans. Whilst we remain negative on the US political situation, jobs growth remains robust and wage gains may eventually reach 3%, which will lead to greater overall inflation expectations. The US is close to full employment as strong payrolls data, less job openings and quit rates point to a strong labour market. Nonetheless, weak labour bargaining power will put a cap on long-term wage gains and core inflation.

Further normalisation of the Fed's balance sheet will produce only modest tapering. Sales of Treasuries and Mortgage Backed Securities, peaking at USD30 billion and USD20 billion, respectively through progressive quarterly caps, indicate a USD1 trillion taper over the next three and a half years, leaving the Fed with a USD3.3 trillion balance sheet. We expect the Fed to tread carefully, given Brexit concerns, European banking volatility, slower Asian growth and geopolitical risks.

While we foresee eventual rises in service sector inflation, goods inflation will remain well contained, being less linked to decreasing US unemployment. Global spare capacity will continue to make cheap imports a viable alternative to domestic products, although a trade war's tax on consumers may limit imports' effects. Payroll gains corroborate the last eight years of stable and steady jobs growth, but recent data indicate small inflation risks. We expect unemployment to remain close to the current 3.9%, near an almost 50-year low. Wage pressures will eventually become a concern, with average hourly earnings increasing to 2.9% and the ratio of job seekers to number of available jobs moving from 9:1 toward 1:1. We believe core inflation may increase once wage gains move beyond 3%, and we are moving closer to that level.

In global bond markets we continue to favour Australian rates versus the rest of the world. We expect the RBA to remain on hold for all of 2018 and 2019. Housing and labour markets will remain key factors in future growth and inflation expectations and we expect the RBA will await further data before acting. The latest employment data reconfirm the continuation of last year's strong employment data when 400,000 jobs were added, with 75% of them being full-time. However, employment slack remains with businesses more recently focused on part-time hiring and remaining reluctant to increase wages.

Chinese growth will remain key for Australia and we remain optimistic despite a deceleration in credit provisions and a looming trade war. Gross Domestic Product remaining near 6.5%, in line with targets, remains our base case, despite the trade war rhetoric. We expect continuation of an agenda supporting the addition of 10 million people/year into the urban labour force as a central economic policy theme whilst, financial sector reforms will remain an important yet secondary policy goal.

Strong Chinese and Asian growth, inflation reaching 2.2%, employment gains (particularly the recent gains in full-time hiring) and improved terms of trade provide for a solid Australian domestic story. We foresee a continuation of the string of 26 years of recession free growth. However, non-mining investment, an over-levered consumer and a lack of wage growth will cause the RBA to tread carefully. Whilst recent employment gains remain solid, globalisation and technology advancements mean wage growth is likely to remain well contained.

Averaging 33k/month through 2017, jobs gains remain strong and an unemployment rate at 5.5% reconfirm a solid jobs story. Higher participation rates have kept the unemployment rate in the +/-5.5% range since 2009 and we expect a decrease only gradually in the coming years. Nonetheless, weaker household consumption and still heavily indebted consumers will offset much of solid jobs story.

The latest wage data re-confirm weak wage growth at an annualised 2.1%, near the lowest levels in more than 25 years, suggesting core inflation will likely remain at the lower end of the RBA's 2% to 3% target. The underemployment rate remains at 8.5%, a still near-record high. RBA Governor Lowe noted that "wage growth of 2.0% and reasonable labour productivity are unlikely to make for 2.5% inflation" (the middle of the RBA's 2 -3% target). Lowe further stated that 3.5% wage growth would likely be required to move inflation toward the middle of the RBA target.

The need for Australia to become more competitive in a global world, technological change and weaker labour bargaining power will likely continue to keep downward pressure on wages. The impact of macro-prudential policy changes have yet to filter through the economy, but we believe inflation risks will remain to the downside, keeping the RBA on hold well into 2019. We continue to hold a positive view on investment grade credit in Australia, largely due to:

- attractive real yields;
- healthiness of issuers compared to other developed markets; and
- wider yield spreads versus comparable US, Euro and Japanese issuers.

Therefore, our portfolios continue to have material exposure to Australia, currently at about 67% of our holdings. Favoured sectors remain the banking sector due to attractive yields and greater liquidity, and infrastructure such as airports and toll roads which offer attractive yields, solid cashflows, and are typically monopolistic businesses with high regulation and quality underlying collateral of systemic importance. Whilst Australian banks came under further pressure with the revelation of a new bank tax and rating agency downgrades of second tier banks and first tier hybrids, we remain bullish on Australian senior bank debt given conservative business models, strong profitability and implicit government support.

Elsewhere, we like systemically important, highly rated Asian issuers such as government-related energy, telecommunication and banking entities and the US 'too-big-to-fail' banks, whose bonds should be supported by an increasingly robust regulatory environment focused on less risk taking and greater capital requirements.

We remain less supportive of European bond opportunities. In the nearer-term, growth has improved, aided by increased consumer spending and improving employment, but we see little inflationary pressure. Stresses in the Euro region have increased, particularly with the emergence of an Italian coalition government focused on decreasing taxes and increasing spending with little concern over growing deficits. With Italian risks increasing, we believe it will be difficult for the European Central Bank (ECB) to end quantitative easing (QE) in the fourth quarter. We expect 2018 European growth and inflation to continue to underperform expectations amidst structural rigidities in labour and product markets, particularly in peripheral regions. Low/negative bond yields already reflect this scenario.

Despite low growth, low inflation and easy monetary policy, we have found bond opportunities limited given low/negative yields and too great risks associated with higher-yielding investments. We expect to continue to avoid Europe, given uncertainty surrounding the Brexit campaign, low yields and limited corporate profitability. We remain concerned over the European banking sector, which had historically done little in raising new capital or writing down bad debts. Although this has improved somewhat so far this year with bank bad debt sales and continuing capital increases, stresses remain in the Peripherals. While the ECB has the capacity to continue to paper over the problem in the shorter-run, balance sheet expansion will be the likely end result, at least before nationalisation of weaker performing banks. This scenario may be many years away. In the interim, we expect QE to continue longer than markets anticipate, with little growth and inflation prospects in the Southern European region.

Contact Details

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