

Kapstream Absolute Return Income Fund - A Share Class

Responsible Entity Contact	Fidante Partners Limited www.fidante.com.au	Indirect Cost Ratio Liquidity	0.70% Daily	Report Date APIR Code	31-May-2018 HOW0052AU
-------------------------------	--	----------------------------------	----------------	--------------------------	---------------------------------

Fund Characteristics

Fund Size	AUD 6,438,710,512	Yield	3.30%	Duration	0.64	Spread Duration	3.31	Avg Rating	A	# of Issuers	113
-----------	-------------------	-------	-------	----------	------	-----------------	------	------------	---	--------------	-----

Fund Performance

	Calendar year										Fund Inception (31/05/2007)
	1 month	3 months	to date	1 year	2 years	3 years	4 years	5 years	7 years	10 years	
Fund Return - "A" Class (net of fees)	0.14%	0.22%	0.87%	2.67%	2.91%	2.72%	3.06%	3.30%	4.13%	4.93%	4.94%
RBA Cash Rate	0.13%	0.38%	0.63%	1.50%	1.52%	1.67%	1.85%	1.99%	2.51%	3.09%	3.44%
Active Return	0.02%	-0.15%	0.24%	1.17%	1.39%	1.05%	1.20%	1.30%	1.62%	1.84%	1.50%

Past performance is not a reliable indicator of future performance

¹Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

Fund Performance Attribution

Fund Performance Attribution										
Return Components (basis points)		Calendar year								
		1 month	3 months	to date	1 year	2 years	3 years	4 years	5 years	
Fixed Income Portfolio	Coupon Income	0.28%	0.81%	1.34%	3.16%	3.20%	3.34%	3.46%	3.64%	4.21%
	Rate Duration (hedge)	-0.05%	-0.01%	0.04%	-0.25%	-0.38%	-0.23%	-0.12%	-0.15%	-0.03%
	Spread Duration	-0.16%	-0.40%	-0.36%	0.06%	0.33%	-0.14%	-0.15%	0.01%	0.15%
	Other/Selection	0.14%	-0.05%	-0.06%	-0.07%	-0.02%	0.02%	0.07%	0.00%	-0.01%
	Fund Fees	-0.06%	-0.18%	-0.23%	-0.70%	-0.70%	-0.70%	-0.70%	-0.70%	-0.70%
	Total beta (%)	0.14%	0.18%	0.73%	2.21%	2.43%	2.29%	2.56%	2.80%	3.62%
Alpha Book (overlay positions)	Corporate Relative Value	0.01%	0.01%	0.00%	0.03%	0.04%	0.05%	0.03%	0.03%	0.06%
	Country Relative Value	0.00%	-0.02%	0.02%	0.19%	0.19%	0.14%	0.14%	0.15%	0.11%
	Currency	-0.01%	0.02%	0.05%	0.08%	0.05%	0.06%	0.12%	0.11%	0.16%
	Rates/Curve (active)	0.00%	0.04%	0.06%	0.15%	0.20%	0.17%	0.20%	0.20%	0.17%
	Volatility	0.00%	0.00%	0.00%	0.00%	0.00%	0.02%	0.01%	0.01%	0.01%
	Total alpha (%)	0.00%	0.04%	0.14%	0.46%	0.48%	0.44%	0.50%	0.50%	0.51%

* Return attribution for periods longer than 1 month are not geometrically compounded, hence the small difference between actual fund performance and attribution.

Other Fixed Income Benchmarks

	Calendar year										Fund Inception (31/05/2007)
	1 month	3 months	to date	1 year	2 years	3 years	4 years	5 years	7 years	10 years	
Fund's Benchmark ²	0.22%	0.48%	0.84%	1.74%	1.93%	2.07%	2.35%	2.43%	2.84%	3.35%	3.67%
UBS Bank Bills	0.17%	0.48%	0.77%	1.78%	1.81%	1.96%	2.13%	2.24%	2.76%	3.39%	3.73%
UBS Composite (All Maturities)	0.69%	1.18%	1.21%	1.67%	2.09%	2.93%	4.05%	4.07%	5.27%	6.07%	5.85%
Leh Global Agg (Hedged in \$A)	0.37%	0.82%	-0.10%	1.47%	2.07%	3.39%	4.36%	4.66%	5.83%	6.89%	6.95%
Annualised CPI				1.90%	2.01%	1.78%	1.67%	1.92%	1.96%	2.23%	2.42%

²As at 1 February 2014, the benchmark of the Fund was changed from the RBA Cash Rate to a composite benchmark comprising 50% Bloomberg AusBond Bank Bill Index & 50% Bloomberg AusBond Composite 0-3 Yr Index. The performance above reflects this change in benchmark.

Fund Objectives

The Fund aims to provide a steady stream of income and capital stability over the medium term while aiming to outperform its benchmark through market cycles. Kapstream draws on information from many sources including economic roundtables, investment banks, brokers, ratings agencies and central banks. Kapstream employs a rigorous evaluation process for individual trades, first confirming that a prospective trade meets Kapstream's global macroeconomic view, then incorporates various risk variables such as duration, yield curve, country and currency positions. The Fund is intended for investors who are seeking potentially higher levels of returns compared to cash and cash-like securities with low to moderate volatility in the unit price.

Fund Holdings

Fund Holdings			
Credit Quality	%	Sector	%
AAA/Cash	14	Cash/Deposits	2
AA	11	Govt/Agency	4
A	38	Consumer	3
BBB	37	Energy	2
Below IG	0	Senior Financials	43
Total	100	Sub Financials	4
		Industrials	11
		Utilities	20
		MBS/ABS	9
		Total	100
		Region	
		Australia	68
		US	12
		Asia	12
		Europe	4
		Other	3
		Total	100

Monthly Alpha Trades

Strategy	Type	Instrument	Added Value
Long AU interest rates vs. US	Rates	Futures	0.01
Long China versus Short Korea 5yr	Country Relative Value	CDS	-0.05
Long Aus Itraxx vs. NAB CDS 5yr	Corporate Relative	CDS	0.00
Long JPY 5y5y Payer	Rates	Swaptions	-0.05
Long 1Y1Y Aud receiver vs. 2Y Bonds	Country Relative Value	Swaps	0.02
Long Euro vs. CAD	Currency	FX Forward	-0.93
Long 1Y1Y Aud receiver vs. 5&10 Year US	Country Relative Value	Swaps/Futures	0.01
Short Big 4 banks	Corporate Relative	CDS	0.67
Long Euribor futures	Rates	Futures	0.41
Total			0.09

Performance

The Fund retrned 0.14% (after 'A' shareclass fees) in May and 0.87% calendar year-to-date. The Funds Interest income from its corporate bond holdings was the main contributor to Fund returns. The Fund's 3+ years of credit spread duration exposure detracted from returns as corporate bond spreads moved slightly wider over the month. A small interest-rate duration position of 0.64 years slightly detracted from returns over the month. We maintained the Fund's interest-rate duration near 0.65 years as a hedge against our corporate bond holdings.

Portfolio Strategy

After decreasing portfolio risks in March following increasing market volatility, we maintained the Fund's more conservative risk positions. However, we believe the sell-off in rates and corporate bond spreads is largely finished. Temporary factors such as increasing bond supply caused by both US tax repatriation allowing corporates to sell their short-dated corporate holdings in order to move cash back to the US and the continuation of large corporate borrowing plans for 2018 put short-term stress on corporate bond markets, pushing spreads wider. Over April and May we continued reducing our liquidity bucket of cash and government-related securities, which had reached 11.5% in March. We currently remain at 8.5% but will aim to reduce this exposure to 6% over the coming months. We still believe the RBA is likely to maintain rates at 1.50% for some time, making Australia rates the most attractive, globally. 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

We foresee a continuation of firmer global economic data, consistent with the past few months, which will lead to further removal of global central bank accommodation. Tighter labour markets and firmer commodity prices will increase inflation expectations, albeit marginally. Whilst we remain surprised at the progress made on tax reform, we remain pessimistic on the likelihood for it to meaningfully increase growth or inflation. In our view, tax cuts for the wealthy and corporations will lead to little overall economic benefit. Nonetheless recent tax cuts leave us less pessimistic on short-term US growth and we have become more neutral to the 2+ more hikes priced in 2018. The recent uptick in trade war rhetoric, particularly with regard to China could reduce US growth by up to 0.50% annually.

Like US dollar strength, global bond yields will remain a barometer of markets' faith in Trump/the Republican'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.

Normalization of the Fed's balance sheet will produce only modest tapering. Last June's statement, indicating initial monthly tapering caps of USD6 billion and USD4 billion for Treasuries and MBS, respectively, peaking at USD30 billion and USD20 billion through progressive quarterly caps, indicate a USD1 trillion taper over the next 3½ 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.

Whilst 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, despite new risks of a trade war given new US tariffs. Payroll gains corroborate the last 7+ years of stable and steady jobs growth, but recent data indicate inflation risks. We expect unemployment to remain close to the current 3.75%, an 18-year low. Wage pressures will eventually become a concern, with average hourly earnings increasing to 2.7% 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 Reserve Bank of Australia to remain on hold for all of 2018 and likely 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. GDP remaining near 6.5%, in line with targets, remains our base case. 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 1.9%, employment gains (particularly the recent gains in full-time hiring) and improved terms of trade provide for a solid domestic story. We foresee a continuation of the string of 26 years of recession free growth. However, non-mining investment and a lack of wage growth will cause the RBA to tread carefully. Whilst recent employment gains remain solid, globalization 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 below the RBA's 2% to 3% target. The underemployment rate remains at 8.4%, a still near-record high. 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 2018. While the RBA will tolerate a stronger currency, financial conditions are tightening, limiting the RBA's ability to increase rates. We expect continuing AUD strength leading to further subdued price pressures.

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

* wider yield spreads versus comparable US, Euro and Japanese issuers

Therefore, our portfolios continue to have material exposure to Australia, currently at about 69% 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 and 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 2nd tier banks and 1st tier hybrids, we remain bullish on Australian senior bank debt given conservative business models, strong profitability and implicit government support.

We remain less supportive of European bond opportunities. In the nearer-term, political risks have decreased following the French elections and near-term growth has improved, aided by increased consumer spending and improving employment, but we see little inflationary pressure. We believe the ECB will continue to struggle with the effectiveness of its quantitative easing program, currently at EUR30 billion/month in sovereign and corporate bond purchases. Prospects for a greater QE program later in 2018 are increasing despite market expectations for an eventual end to QE. 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 are particularly concerned over the European banking sector, which had historically done little in raising new capital or writing down bad debts. 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 nationalization of weaker performing banks. This scenario may be many years away. In the interim, we expect more QE, with little growth and inflation prospects in the Southern European region.

Elsewhere, we like systemically important, highly rated Asian issuers such as government-related energy, telecom 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.

Contact us

For more information, please contact Fidante Partners Adviser Services on 1800 195 853 or Fidante Partners Investor Services Team on 13 51 53, or visit www.kapstream.com or www.fidante.com.au/im/KapstreamARIF.htm

Unless otherwise specified, any information contained in this publication is current as at the date of this report and is provided by Fidante Partners Limited (ABN 94 002 835 592, AFSL 234668) the issuer and responsible entity of the Kapstream Absolute Return Income Fund (ARSN 124 152 790) (Fund). Kapstream Capital Pty Limited (ABN 19 122 076 117, AFSL 308870) is the investment manager of the Fund. It should be regarded as general information only rather than advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain the relevant Product Disclosure Statement (PDS) relating to the Fund and consider that PDS before making any decision about the Fund. A copy of the PDS can be obtained from your financial adviser, our Investor Services team on 13 51 53, or on our website www.fidante.com.au. If you acquire or hold the product, we and/or a Fidante Partners related company will receive fees and other benefits which are generally disclosed in the PDS or other disclosure document for the product. Neither Fidante Partners nor a Fidante Partners related company and our respective employees receive any specific remuneration for any advice provided to you. However, financial advisers may receive fees or commissions if they provide advice to you or arrange for you to invest in the Fund. Kapstream Capital, some or all Fidante Partners related companies and directors of those companies may benefit from fees, commissions and other benefit received by another group company. All fund performance figures are not indicative nor represent any future performance of the fund nor are any guarantee of any future performance. All views expressed in the document are that of the author only. See the PDS for detailed explanation of investment terms used in this document. Some numbers in this report may differ due to rounding.