Kapstream Absolute Return Income Fund

Responsible Entity	Fidante Partners Limited	Indirect Cost Ratio	0.70%	Report Date	**30-September-2017**
Contact	www.fidante.com.au	Liquidity	Daily	APIR Code	HOW0052AU

Fund Characteristics

Fund Size	Yield	Duration	Spread Duration	Avg Rating	# of Securities
AUD 5,939,143,621	3.11%	0.57	2.99	A+	270

Fund Performance

	1 month	3 months	Calendar year to date	1 year	2 years	3 years	4 years	5 years	7 years	Fund Inception (31/05/2007)
Kapstream Fund Total Return[1]	0.20%	0.76%	2.65%	2.69%	3.12%	3.06%	3.46%	3.81%	4.48%	5.09%
RBA Cash Rate	0.13%	0.38%	1.13%	1.50%	1.68%	1.86%	2.02%	2.20%	2.82%	3.57%
Active Return	0.07%	0.38%	1.52%	1.19%	1.44%	1.20%	1.44%	1.61%	1.66%	1.52%

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.

Fixed Income Benchmarks

	1 month	3 months	Calendar year to date	1 year	2 years	3 years	4 years	5 years	7 years	Fund Inception (31/05/2007)
Fund's Benchmark[2]	0.11%	0.42%	1.52%	1.75%	2.07%	2.37%	2.48%	2.56%	3.08%	3.71%
UBS Bank Bills	0.14%	0.43%	1.32%	1.76%	1.97%	2.14%	2.27%	2.43%	3.07%	3.86%
UBS Composite (All Maturities)	-0.31%	-0.07%	2.18%	-0.75%	2.42%	3.90%	4.42%	3.90%	5.41%	5.97%
Leh Global Agg (Hedged in $A)	-0.43%	0.89%	2.76%	0.53%	4.30%	4.77%	5.60%	5.10%	6.18%	7.33%
Annualised CPI				1.93%	1.48%	1.49%	1.87%	1.97%	2.09%	2.42%

[2]As 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 table above reflects this change in benchmark.

Fund Performance Attribution

Return Components (basis points)	1 month	3 months	Calendar year	1 year	2 years	3 years	4 years	5 years	7 years
Coupon Income	26	76	236	318	328	340	360	377	446
Rate Duration	2	6	10	-32	2	23	24	12	22
Spread Duration	4	13	54	62	38	-4	17	35	30
Currency	0	1	7	5	6	13	14	20	17
Other/Selection	-8	-4	10	-14	7	4	2	7	12
Fund Fees	-6	-18	-53	-70	-70	-70	-70	-70	-70
Total (%)	**0.19%**	**0.75%**	**2.64%**	**2.70%**	**3.11%**	**3.06%**	**3.46%**	**3.82%**	**4.58%**

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

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

Credit Quality	%
AAA/Cash	16
AA	13
A	40
BBB	31
Below IG	0
Total	**100**

Sector	%
Cash/Deposits	5
Govt/Agency	5
Consumer	4
Energy	3
Senior Financials	39
Sub Financials	5
Industrials	12
Utilities	17
MBS/ABS	10
Total	**100**

Region	%
Australia	65
US	15
Asia	13
Europe	3
Other	5
Total	**100**

Performance

The Fund returned 0.20% in September and 2.65% year-to-date, after fees.

Outlook & Strategy

US political drama will continue to drive global bond markets. Controversy surrounding the healthcare/immigration/tax reform debate and the latest addition/purge in the revolving show circus that has become the White House inner-circle (otherwise known as adult day care) are the smaller of our political concerns.

2 of the 3 branches of government are currently broken. We expect little from the Republican led Congress on tax reform following failures on healthcare overhaul and immigration. Congress' past 7 years' worth of work has led to a seven page tax reform outline with little detail, albeit arguably an improvement over an original 1 page outline. We remain pessimistic on the likelihood for comprehensive tax reform although tax cuts for the wealthy are a likely outcome, leading to little overall economic benefit.

The recent hurricane/floods, while detracting from employment and growth in the very short-run, will provide an estimated $75 billion boost and could deliver an additional 0.2% to 0.4% growth over the next few quarters.

Like US dollar strength, global bond yields will remain a barometer of the markets' faith in Trump/Republican's economic plans. Over the remainder of 2017, we expect those plans will continue to be delayed as internal missteps, controversies, resignations and investigations cause continuing short-run volatility as markets price in rumour and innuendo. Whilst jobs growth remains mostly robust, wage increases and inflation remain well contained, despite September's employment data. The US may be close to full employment as strong payrolls data, less job openings and quit rates point to a strong labour market. Nonetheless, inflation remains well contained, as wage inflation remains low, driven by weak labour bargaining power.

Considering US political disorder and a succession of soft Consumer Price Index prints, the Federal Reserve (FED) is unlikely to hike again in 2017, particularly with the Quantitative Easing (QE) tapering programme beginning in the 4th quarter. Normalisation of the Fed's balance sheet is expected begin later this year, but we expect only modest reinvestment tapering which would also reduce prospects for a larger set of rate hikes in 2018. The June statement, indicating initial monthly tapering caps of $6 billion and $4 billion for Treasuries and Mortgage-Backed Securities, respectively, peaking at $30 billion and $20 billion through progressive quarterly caps, indicate a $1 trillion taper over the next 3-1/2 years leaving the Fed with a $3.3 trillion balance sheet. Nonetheless, we expect the Fed to tread carefully, given Brexit concerns, European banking volatility, slower Asian growth, geopolitical risks and little progress in Trump's economic plans.

While we foresee eventual rises in service sector inflation, goods inflation will remain well contained. We believe goods inflation is less linked to decreasing US unemployment as spare global capacity continues to make cheap imports a viable alternative to domestic products. We had been surprised by the market's more hawkish recent tone. Year to Date (YTD) payroll gains corroborate the last 7+ years of stable and steady jobs growth, but the story is so far non-inflationary. We expect unemployment to remain close to the current 4.2%, a 16-year low. Wage pressures will eventually become a concern, with average hourly earnings at 2.5% and the ratio of job seekers to number of available jobs moving from 9:1 toward 1:1, but not in 2017. We believe core inflation will remain contained until wage gains move beyond 3%, a level not seen since 2009.

September's employment data including the loss of 33k jobs are likely an anomaly and to a certain extent related to hurricane season in the South, particularly with the temporary loss of 105k food service jobs on the month.

We remain sympathetic to the Fed's Kashkari's belief that recent rate hikes have been "doing real harm" to the US economy, leading to "slower job growth, leaving more people on the sidelines, leading to lower wage growth, lower inflation and lower inflation expectations." Overestimating labour market tightness and its impact on inflation will become a more central theme as the Fed leaves rates on hold longer than markets currently anticipate.

In global bond markets we continue to favour Australian rates versus the rest of the world, particularly as Australian bonds underperformed the US in the 3rd quarter. Like the US Fed, we expect the Reserve Bank of Australia (RBA) to remain on hold for the remainder of 2017. 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.

Chinese growth will remain key for Australia and we remain optimistic despite a deceleration in credit provisions. Gross Domestic Product remaining near 6.5%, in line with targets, remains our base case and should continue through to the 19th Party Congress later in the year. We expect to see an agenda which supports adding 10 million people per year into the urban labour force, remaining as a central economic policy theme whilst financial sector reforms will remain an important yet secondary policy goal.

Strong Chinese and Asian growth, core inflation reaching 1.8%, 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, globalisation and technology advancements mean wage growth is likely to remain well contained. Averaging 33k/month and 268k YTD, jobs gains remain strong and an unemployment rate at 5.6% reconfirms a solid, firm jobs story. Higher participation rates have kept the unemployment rate +/- 5.5% range since 2009 and we expect a decrease only gradually in the coming years.

The latest wage data re-confirm weak wage growth at an annualised 1.8%, the lowest level in more than 25 years, suggesting core inflation will likely remain below the RBA's 2% to 3% target. The underemployment rate remains at 8.6%, a near-record high. A 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 eventually 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 64% of our holdings. Favoured holdings remain 1) the banking sector due to attractive yields and greater liquidity, and 2) infrastructure-type assets such as airports and toll roads which offer attractive yields, solid cash flows, systemic importance, monopolistic businesses, high regulation and quality underlying collateral. 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 pressures. We believe the European Central Bank (ECB) will continue to struggle with the effectiveness of its quantitative easing program, currently at €60 billion/month in sovereign and corporate bond purchases. Prospects for a greater QE program later in 2017 or 2018 are increasing despite market expectations for a further QE decrease. We expect 2017 European growth and inflation to continue 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 nationalisation 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.

More globally, 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
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