Kapstream — JANUS HENDERSON —

# Kapstream Absolute Return Income Fund - A Share Class

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|---|---|---|---|---|---|
| Responsible Entity | Fidante Partners Limited | Indirect Cost Ratio | 0.70% | Report Date | **30-April-2018** |
| Contact | www.fidante.com.au | Liquidity | Daily | APIR Code | HOW0052AU |

## Fund Characteristics

| Fund Size | AUD 6,593,143,679 | Yield | 3.23% | Rate Duration | 0.73 | Spread Duration | 3.12 | Avg Rating | A+ | # of Issuers | 115 |
|---|---|---|---|---|---|---|---|---|---|---|---|

## Fund Performance

| | 1 month | 3 months | Calendar year to date | 1 year | 2 years | 3 years | 4 years | 5 years | 7 years | 10 years | Fund Inception (31/05/2007) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Fund Return - "A" Class (net of fees)** | **0.17%** | **0.36%** | **0.73%** | **2.90%** | **3.07%** | **2.75%** | **3.13%** | **3.34%** | **4.20%** | **4.97%** | **4.96%** |
| RBA Cash Rate | 0.13% | 0.38% | 0.50% | 1.50% | 1.53% | 1.69% | 1.88% | 2.01% | 2.55% | 3.14% | 3.46% |
| Active Return | 0.04% | -0.02% | 0.23% | 1.40% | 1.54% | 1.06% | 1.25% | 1.33% | 1.65% | 1.83% | 1.50% |

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.

## Fund Performance Attribution

| | **Return Components** (basis points) | 1 month | 3 months | Calendar year to date | 1 year | 2 years | 3 years | 4 years | 5 years | 7 years |
|---|---|---|---|---|---|---|---|---|---|---|
| Fixed Income Portfolio | Coupon Income | 0.27% | 0.80% | 1.06% | 3.14% | 3.20% | 3.34% | 3.48% | 3.66% | 4.25% |
| | Rate Duration (hedge) | 0.03% | 0.07% | 0.09% | -0.16% | -0.33% | -0.22% | -0.06% | -0.20% | 0.00% |
| | Spread Duration | 0.02% | -0.33% | -0.19% | 0.35% | 0.42% | -0.10% | -0.10% | 0.07% | 0.16% |
| | Other/Selection | -0.10% | -0.07% | -0.14% | -0.24% | -0.02% | -0.03% | 0.03% | -0.04% | -0.02% |
| | Fund Fees | -0.06% | -0.18% | -0.23% | -0.70% | -0.70% | -0.70% | -0.70% | -0.70% | -0.70% |
| | Total beta (%) | 0.16% | 0.30% | 0.59% | 2.40% | 2.57% | 2.29% | 2.65% | 2.79% | 3.69% |
| Alpha Book (overlay positions) | Corporate Relative Value | 0.00% | 0.00% | 0.00% | 0.03% | 0.04% | 0.04% | 0.03% | 0.02% | 0.05% |
| | Country Relative Value | 0.00% | -0.02% | 0.02% | 0.19% | 0.20% | 0.14% | 0.14% | 0.15% | 0.11% |
| | Currency | 0.01% | 0.02% | 0.06% | 0.11% | 0.05% | 0.08% | 0.12% | 0.15% | 0.17% |
| | Rates/Curve (active) | 0.00% | 0.06% | 0.06% | 0.18% | 0.20% | 0.18% | 0.19% | 0.22% | 0.18% |
| | Volatility | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.02% | 0.00% | 0.01% | 0.01% |
| | Total alpha (%) | 0.01% | 0.06% | 0.14% | 0.51% | 0.50% | 0.46% | 0.48% | 0.55% | 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

| | 1 month | 3 months | Calendar year to date | 1 year | 2 years | 3 years | 4 years | 5 years | 7 years | 10 years | Fund Inception (31/05/2007) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Fund's Benchmark[2] | 0.14% | 0.43% | 0.62% | 1.78% | 1.98% | 2.08% | 2.38% | 2.43% | 2.87% | 3.38% | 3.68% |
| UBS Bank Bills | 0.16% | 0.44% | 0.59% | 1.75% | 1.82% | 1.96% | 2.14% | 2.26% | 2.80% | 3.44% | 3.74% |
| UBS Composite (All Maturities) | -0.35% | 0.79% | 0.52% | 2.16% | 2.38% | 2.71% | 4.22% | 3.91% | 5.36% | 6.01% | 5.83% |
| Leh Global Agg (Hedged in $A) | -0.38% | 0.22% | -0.47% | 1.74% | 2.17% | 3.17% | 4.57% | 4.30% | 5.98% | 6.80% | 6.97% |
| Annualised CPI | | | | 1.90% | 2.01% | 1.78% | 1.67% | 1.92% | 1.96% | 2.23% | 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 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 | 18 |
| AA | 10 |
| A | 37 |
| BBB | 34 |
| Below IG | 0 |
| **Total** | **100** |

| Sector | % |
|---|---|
| Cash/Deposits | 7 |
| Govt/Agency | 4 |
| Consumer | 3 |
| Energy | 2 |
| Senior Financials | 40 |
| Sub Financials | 4 |
| Industrials | 11 |
| Utilities | 21 |
| MBS/ABS | 9 |
| **Total** | **100** |

| Region | % |
|---|---|
| Australia | 69 |
| US | 13 |
| Asia | 12 |
| Europe | 3 |
| Other | 3 |
| **Total** | **100** |

## Monthly Alpha Trades

| Strategy | Type | Instrument | Added Value |
|---|---|---|---|
| Long AU interest rates vs. US | Rates | Futures | 0.00 |
| Long China versus Short Korea 5yr | Country Relative Value | CDS | 0.00 |
| Long Aus Itraxx vs. NAB CDS 5yr | Corporate Relative | CDS | 0.00 |
| Long JPY 5y5y Payer | Rates | Swaptions | 0.00 |
| Long 1Y1Y Aud receiver vs. 2Y Bonds | Rates | Swaps | -0.10 |
| Short NZD/USD | Currency | FX Forward | 1.00 |
| Long 1Y1Y AUD Rreceiver vs. 5 & 10 Year US | Country Relative Value | Swaps/Futures | -0.25 |
| Short Euro Main & Aussie Itraxx CDS | Corporate Relative | CDS | -0.45 |
| **Total** | | | **0.20** |

**Performance**

The Fund returned 0.17% (after 'A' shareclass fees) in April and 0.73% calendar year-to-date. The Fund's interest income from its corporate bond holdings was the main contributor to Fund returns. The Fund's 3+ years of credit spread duration exposure slightly aided returns as corporate bond spreads firmed following March's sell-off. A small interest-rate duration position of 0.73 years slightly aided returns as bond yields fell over the month. We maintained the Fund's interest-rate duration near 0.7 years as a hedge against our corporate bond holdings. We removed the Funds long position in a basket of Asian currencies (THB, SGD and INR) vs. the USD, taking profits and aiming to reduce risk over this volatile period.

**Portfolio Strategy**

After decreasing portfolio risks in March following increasing market volatility, we maintained the Fund's more conservative risk positions over April. 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 we began reducing our liquidity bucket of cash and government-related securities, which had reached 11.5% in March. We currently remain at 10.5% but will aim to reduce this exposure to 6% over the coming months. We still believe the Reserve Bank of Australia (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 London interbank offered 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 cuts, 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.

Normalisation of the US Federal Reserve's (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 Mortgage Backed Securities, 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.

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, 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 3.9%, a 16-year low. Wage pressures will eventually become a concern, with average hourly earnings increasing to 2.6% 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 likely 2019. Housing and labour markets will remain key factors in future growth and inflation expectations, we expect the RBA will await further data before acting. The latest employment data reconfirms 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. Gross Domestic Product 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, 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 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, keeping 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, 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 European Central Bank (ECB) will continue to struggle with the effectiveness of its quantitative easing (QE) 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 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.

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