Kapstream
— JANUS HENDERSON —

Kapstream Absolute Return Income Fund

KANGANEWS AWARDS 2017 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2018 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2019 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2021 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2022 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
KANGANEWS AWARDS 2023 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR

Monthly Report - Class A Units

Fund Objective

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.

Fund Details

APIR code	HOW0052AU
Inception date	31 May 2007
Fund size	AUD 1,977m
Distribution frequency	Quarterly
Management fee	0.55%
Buy/sell spread	0.00%/-0.07%

Fund Statistics

Interest rate duration	1.20yrs
Credit spread duration	1.86yrs
Average credit rating	BBB+
No of issuers	72
Yield to maturity	6.19%

Fund Guidelines

Target return	cash plus 2-3%
Target volatility	<1.5% annualised
Duration limits	-2 to +2 years
Credit quality	>85% investment grade

May 2024

Performance	1 month %	3 months %	CYTD	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund Return (Net)[1]	0.67	1.42	1.95	5.70	2.34	1.94	2.52	3.95
RBA Cash Rate[2]	0.36	1.08	1.81	4.25	2.32	1.57	1.68	2.79
Active Return[1]	0.30	0.34	0.14	1.45	0.02	0.37	0.84	1.16

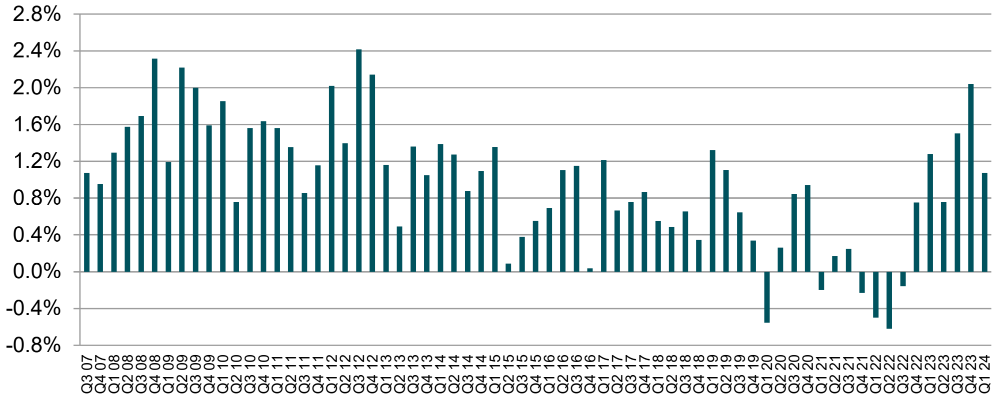
Past performance is not a reliable indicator of future performance

[1] Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowances are made for tax when calculating these figures. After fee returns inclusive of annualised total expenses for Class A Units. Prior to 1 October 2019, annualised total expenses were 0.70%. From 1 October 2019, annualised total expenses are 0.55%.

[2] From 1 February 2014 to 30 September 2019, the Fund's benchmark was 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.

Source: Fidante Partners Limited, 31 May 2024

Quarterly Performance History[1]



[3] **Source: Kapstream Capital, 31 May 2024**

Performance Commentary

The Fund returned 0.67% in May.
Performance was supported by the high running yield of the portfolio, which remained near decade highs at 6.19% at the end of the month. There was also a tailwind from improved risk sentiment, with the equities generally up solidly and credit spreads compressing in the month. While bond yields varied across regions, the extension in duration ahead of the coming easing cycle globally positively contributed in May. Over the past 12 months, net performance has risen to 5.70%, to be 145bps above the RBA cash benchmark [(after accounting for class A/I unit fees)]. Before fees performance has risen back to be within the 2-3% return objective and is strong relative to peers.* At the same time, volatility remains low at below the 1.50% limit and compared with other fixed income funds.** Correlations with other fixed income indices and asset classes are generally below 0.2 over most time frames.***

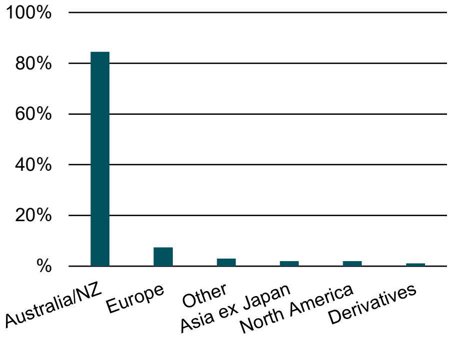
* Kapstream's flagship and plus funds have placed in the top quartile of Lonsec's combined investment universe (for diversified and unconstrained fixed income funds) over the past 1, 3 and 5 years as at January, 2024.
** Kapstream has ranked in the bottom quartile for volatility over 1, 3 and 5 years in the Morningstar as at April 2024.
*** Kapstream has calculated the monthly return correlation with the Australian based indices used in APRA's annual performance test for the Australian superannuation industry.

Portfolio Managers

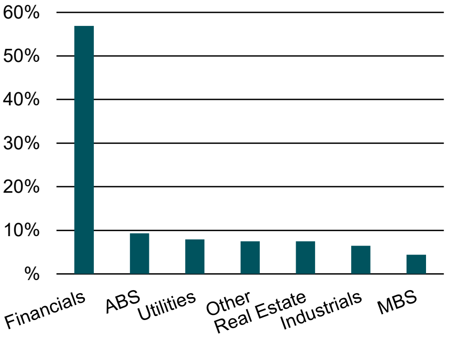
Dan Siluk
Co-Lead Portfolio Manager

Dylan Bourke
Co-Lead Portfolio Manager

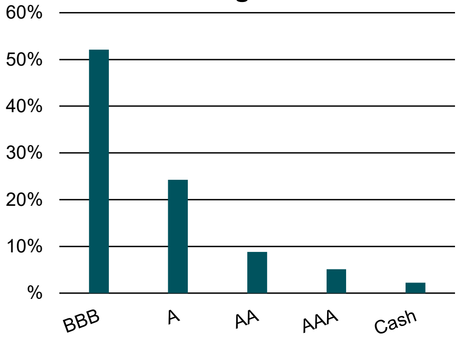
Geographic Allocation



Sector Allocation

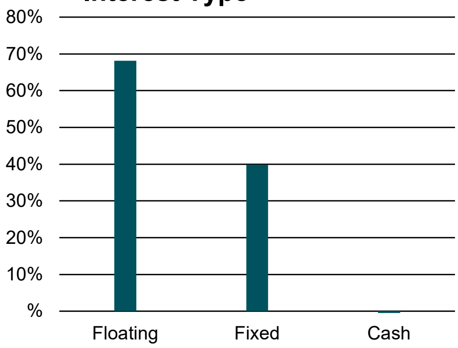


Credit Rating



*of which 4.61% of Investment Grade and 2.13% of High Yield were internally rated

Interest Type



Market Commentary

The improvement in risk sentiment was the dominant market theme in May. After a dip in April, the uptrend in asset prices since late 2022 resumed. The ongoing strength in earnings, supported by a US economy that is not just avoiding recession but showing solid growth, continued to provide a tailwind to risk assets. The S&P 500 was up 4.8% in May and is now up almost 30% from the lows in late 2022 and set fresh record highs. Credit spreads have narrowed in tandem. US physical credit, as measured the Bloomberg US Credit Aggregate, fell by 2bps to 85bps in May, down from 165bps in late 2022. This index now sits towards the bottom of it's 76bps to 618bps range since 2000. Australian physical credit spreads (in the form of the Bloomberg Ausbond credit 0+ index OAS) narrowed an even larger 8bps to 130bps in May, with the greater compression partly reflecting that Australian spreads are closer to the historical average of 131bps. The larger move therefore partly reflects some catch up to the moves seen offshore.

The uptrend in asset prices also seems to be resisting the 'higher for longer' theme that appears appropriately priced into fixed income markets for now. Bond yields were little changed over the month of May and were mixed depending on the region. Yields fell in the US - down 16bps at the 2yr part of the curve where our exposures tend to be concentrated, as core inflation figures over the month showed a modest decline. In contrast, German 2yr yields were 6bps higher in the month as the market re-assesses the path of easing from the European Central Bank (ECB) with the preliminary core CPI inflation figure for May unexpectedly rising by 0.2pps to 2.9%. Other markets, such as Australia, saw a very limited change in yields over the month. Given the rise on the higher for longer theme earlier in 2024, bond yields therefore still sit towards the upper end of the largely sideways range of the past two years.

Portfolio Strategy

Exposures in the portfolio were largely unchanged over May, with developments not affecting the key macro themes underpinning our positioning.

Duration positioning was little changed, at around 1.2 years, slightly beyond the historical average amount of duration in the portfolio. The mix remains more weighted towards Europe and to a lesser extent Canada, where the central banks are expected to begin their easing cycles on the back of inflation falling towards target. We still maintain an exposure to the US for the same reasons, albeit that the conviction around when the Fed will begin easing has reduced as the progress on inflation has stalled. We continue to see little chance of a move in official rates in Australia so are largely neutral that region.

The portfolio's physical spread duration increased slightly to ~1.86yrs, while retaining lower sensitivity to spread change than we have historically targeted. We took advantage of primary issuance that offered good carry, attractive new issue concession and had a strong potential for spread compression, such as the NAB 2039 transaction. Despite the flow of new deals, we saw further credit spread compression. Spread performance in the portfolio continued to add to returns over the month and calendar-year-to-date period and slightly outpaced the compression in broader Australian credit indices, evidencing positive security selection.

The high coupon continues to provide a return robustness which hasn't been seen for around a decade. The quality of this coupon is strong given it is comprised of a higher than average credit spread, despite being focused on shorter dated assets. Given this high coupon we remain cautiously optimistic. Additionally as the odds of a soft landing (rather than hard landing) in the US continues to increase given strong GDP and unemployment data, we expect to hold spread duration around 1.8-2yrs over the coming months in Australian credit, as home market credit spreads remain around long term averages in comparison to the US where credit spreads are significantly tighter against averages. In the absence of a hard landing globally, we expect Australian spreads will continue to follow the US lead and move towards the lower end of historical ranges.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~60%), corporates and REITs (~25%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~85% of the portfolio is held in Australian & New Zealand names, and by currency <5% is held in non-AUD denominated securities.

Portfolio liquidity remains high, with 'Level 1' liquidity is at ~10% (cash, commercial paper, SSGA) and slightly above the high end of the range for 'Level 2' liquidity at ~21% (<1yr investment grade), as a few bonds matured and we selectively redeployed proceeds into attractive new issuance. We believe the high level of liquidity provides the flexibility to buy attractive credits or take advantage of a better entry point should there be a sell-off.

Outlook

The improvement in risk sentiment has one significant threat to dodge: a global recession under the weight of the significant monetary policy tightening in recent years. While economic activity has slowed below trend in most developed markets, US economic activity (historically more correlated with risk markets) has remained stubbornly strong. What is behind this US exceptionalism? Much looser fiscal policy is the most commonly cited influence, as well as the benefit to consumer spending from excess savings being drawn down. This has seen the chances of a near-term recession in the US fall from around a two-in-three chance a year ago to around a one-in-three chance presently.

The outlook for rates markets has significant and two-sided risks. If inflation fails to continue it's downtrend and stabilises above central bank targets, we may not only see high for longer for monetary policy but even higher for even longer! In this scenario the central banks may see monetary policy as not restrictive enough (in contrast to the currently held opposite view). This is not our base case, but still a risk of driving higher bond yields. Even if inflation were to decline at a pace slower than the central banks are currently forecasting, then a delay in rate cuts could see bond yields rise and duration positions suffer. However, with the repricing of this higher for longer theme into markets in 2024 the hurdle to beat is now lower. Inflation only need show a resumption of the downtrend for it to be in touching distance of target. Central banks would likely look to ease policy off its currently restrictive stance in that setting. This highlights just how important near term inflation outcomes are to fixed income fund performance looking ahead.