



### 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 2,646m
Distribution frequency	Quarterly
Management fee	0.55%
Buy/sell spread	0.00%/-0.07%

### Fund Statistics

Interest rate duration	0.51yrs
Credit spread duration	2.05yrs
Average credit rating	BBB+
No of issuers	89
Yield to maturity	5.97%

### Fund Guidelines

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

### October 2022

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) <sup>1</sup>	-0.05	0.00	-1.35	-1.41	0.10	1.19	2.44	3.81
RBA Cash Rate <sup>2</sup>	0.21	0.55	0.77	0.79	0.44	0.82	1.50	2.68
Active Return <sup>1</sup>	-0.27	-0.55	-2.12	-2.20	-0.34	0.36	0.94	1.12

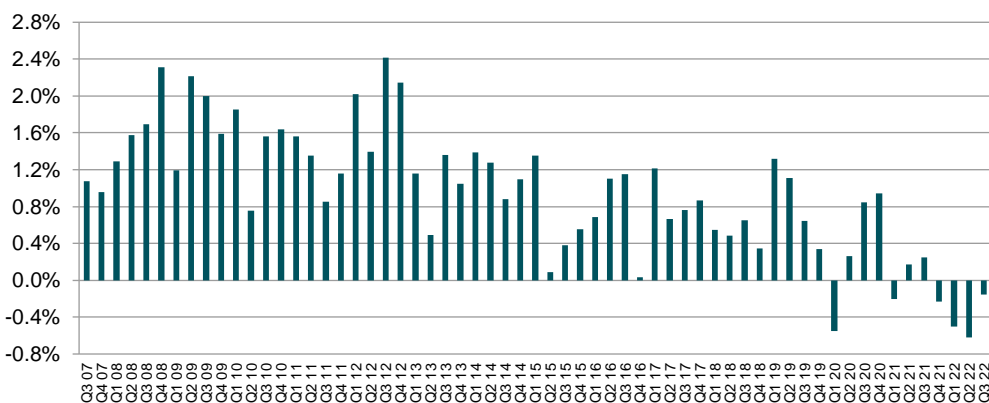
#### Past performance is not a reliable indicator of future performance

<sup>1</sup> 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%.

<sup>2</sup> 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 October 2022

### Quarterly Performance History<sup>3</sup>



<sup>3</sup> Source: Kapstream Capital, 31 October 2022

### Performance Commentary

The key themes of 2022 continued into October, with rising interest rates and challenging risk market conditions yet again impeding progress. The benefits of being defensively positioned were again evident in the month, protecting the portfolio from any meaningful drawdown and registering only a negligible decline of -0.05% (after class A unit fees). The rise in yields detracted from performance, despite our light positioning, as did some of the synthetic credit protection in the fund which compressed at a time when the physical credit holdings widened marginally (something that tends to reverse fairly quickly). However, the coupon income carry in the portfolio helped to largely offset the impact from these adverse market movements, with the yield to maturity rising further and ending the month at 5.97%. This compares with 1.30% just eighteen months ago and shows how the return of yield into fixed income will act as a significant positive return foundation looking forward.

### Portfolio Managers

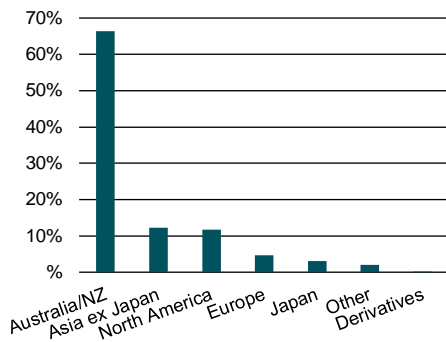


**Daniel Siluk**  
Co-Lead Portfolio Manager

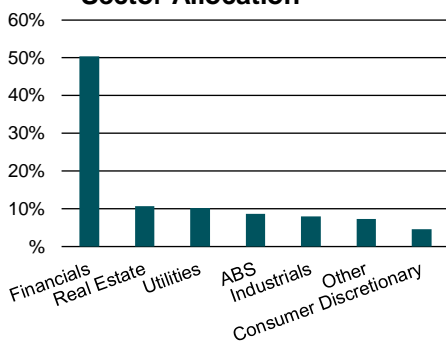


**Dylan Bourke**  
Co-Lead Portfolio Manager

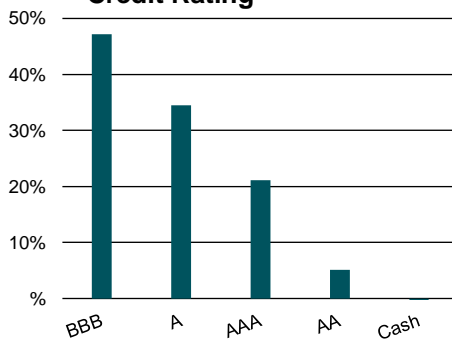
## Geographic Allocation



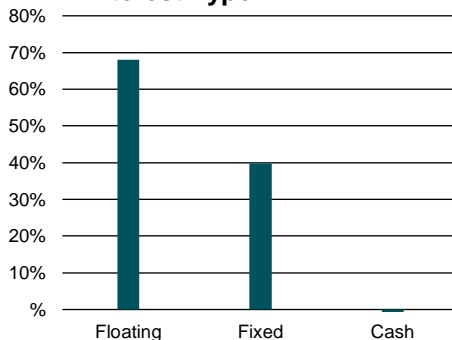
## Sector Allocation



## Credit Rating



## Interest Type



## Market Commentary

The key theme across financial markets in October was the potential slowing in the pace of hikes from central banks. The Reserve Bank of Australia was one of the central banks at the forefront of this move, acting on an earlier communication that a slowing was needed following the amount of tightening already undertaken, and the usual lags with which monetary policy impacts the economy. The 25bps hike in early October was a notable change from the 50bps hikes at each of the preceding four meetings. The Bank of Canada also lowered the pace of rate hikes, to a still notable 50bps in late October, resisting market and analyst expectations of a 75bps move. There was also a notable tone to recent Federal Open Market Committee (FOMC) Minutes and officials towards the risk of over-tightening given the hikes already undertaken.

It should be remembered though that the slowing in the rate of increase, whilst a pivot of sorts, is not a true pivot towards stopping the tightening cycle altogether. It's an acknowledgement that official interest rates have moved quickly to be closer to their neutral level, after which the pace of increase should slow naturally whilst we await additional economic information. As long as inflation comes in above expectations however, as it did across many regions across the world again in October, the commitment toward further rate hikes will remain in the fight against inflation. This is a battle that no central banker will want to be remembered for being complacent about or losing.

Risk markets rebounded on the prospect of less aggressive central banks, following a particularly poor period from mid-August through to mid-October. The S&P 500 fell by almost 20% over that period but has since rebounded by more than 10% into month's end. US investment grade synthetic credit compressed by around 20bps in that more positive risk environment of the past two weeks, going back to its mid-September levels but keeping the longer-term uptrend channel this year firmly in place. Physical credit was more rangebound in the US (& Australia), reflecting supply in the US and talk of English pension funds selling credit to fund margin calls given the sharp sell-off in UK bonds being used for collateral. Credit on a spread to bond basis was also far worse off in Australia, with a sharp widening in swap spreads (around +20bps in 3yr and 10yr swap spreads) causing that component of the spread to blow out.

## Portfolio Strategy

There was little change in our broad positioning in the month – we continue to be defensively positioned. Interest rate duration remains below our typical level of around one year, and credit spread duration is targeted to be well inside the historical average of around three years.

As outlined above, most US (and therefore global) yield cycles tend to peak around the end of the tightening cycle and we're still some way away from that point. This is why we have not rushed to significantly add to our duration positioning despite the increase in carry on offer. Our cautiousness on this front has paid dividends, as the negative impact from yield increases has more than offset the benefits this carry offers. That being said, when we see that the increase in yields has run its course, we do intend to increase our exposure to the carry on offer. We just don't see that as being likely this side of the year end. As such, our duration positioning remained broadly unchanged at around half a year over the month of October.

On the credit front we continue to position defensively, holding physical credit spread duration under 2yrs (ex. SSGA), gently reducing over the passage of time. We maintained Credit Default Swap Index (CDX) credit protection at ~7%, reducing spread duration by ~-0.3yrs. We are balancing concerns about the Fed's ability to guide the global economy through an inflation and rate hiking induced slowdown vs the difficulty of ascertaining the bottom in any bear market. Physical spread duration suffered some minor spread widening and CDX tightened in sympathy with a rally in the SP500, which also detracted. Despite those detractors, credit was still a net positive contributor, accounting for the carry from the credit spread.

We continue to buy selectively but mainly on a switch basis. In particular we are buying short dated fixed rate financial bonds in primary given attractive new issue concessions and wide spreads. Fixed rate financial bonds have continued to perform well driven by strong buying technicals from middle markets and high net worth buyers in Australia and Asia. Our ability to buy is possible as a result of the more acute barbell-shaped strategy we've pursued in the portfolio for some time to limit losses and provide liquidity at opportune times. This approach (1) underweights longer dated A-rated credits and overweights shorter dated lower rated credits (mainly BBB-rated), assets with similar carry but less spread compression providing greater resilience in sell-offs, and (2) invests in a small bucket of higher spread assets to subsidise an overweight position in highly liquid assets, which provides the ammunition to add cheap new credits.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~40%), corporates and Real Estate Investment Trusts (REIT) (~32%), and asset and mortgage-backed securities (<15%) with the residual in cash and liquids. Approximately 85% of the portfolio is held in Australian & New Zealand names, and by currency around ~90% of the portfolio is held in AUD-denominated securities.

The move in Australian swap spreads over not just October but since mid-2020 warrants further discussion this month. Swap spreads locally have moved from being in negative territory to being in the range of 70-80bps more recently, with around 20bps of that in the past month alone. Holdings of fixed rate bonds do not fare well in such environments, reflecting that a component of this spread directly relates to swap spreads. Our decision to hedge the majority of this swap-spread related risk is an example of 'a penny saved is a penny earned', in line with our core objective of capital preservation.

## Outlook

Given that bond yields tend to keep rising until closer to the end of the tightening cycle, the possible slowing in the pace does not therefore mean that we've seen the peak in yields for this cycle. Many markets saw new yield highs in October, with US 2-year yields reaching 15-year highs of 4.61% in the month as terminal rates continued to get revised higher. With at least a few more months of rate hikes from the Fed ahead, we continue to see further upside potential to yields until some time closer to the last rate hike. UK yields bucked the trend and came back from their late September tantrum, with the eventual change of leader and policy seeing yields generally fall back to their pre-mini budget levels. Australian yields peaked at around their June highs, as the less aggressive tightening path from the RBA offset the global impulse toward higher yields.

We expect to remain defensively positioned on both the rates and credit front. The uncertainty of exactly where the terminal rate is likely to be in this cycle for all central banks has prevented us from moving back towards more normal exposure levels, and we believe it will remain prudent to maintain cautious posture. This year has highlighted the dramatic effect a wholesale withdrawal of central bank intervention can have (and continues to have) on markets with stimulus being removed, and a clearly-stated intention of moving into restrictive territory quickly to prevent higher inflation and inflation expectations from becoming entrenched. There remains still a great deal of uncertainty in the coming months.

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