ActiveX Kapstream Absolute Return Income Fund (Managed Fund) (CXA:XKAP)

ARSN 632 896 176

Fund Facts – 30 April 2022

CXA Ticker	XKAP		
Fund Inception Date	10 October 2019	**Fund Size**	$12.0 million
Underlying Fund Inception Date	31 August 2007	**Underlying Fund Size**	$3.1 billion
Distribution Frequency	Quarterly	**Unit Registry**	Link Market Services
Management Fee	0.55% p.a.	**Fund Issuer**	Fidante Partners Limited

Fund Overview

The ActiveX Kapstream Absolute Return Income Fund (Managed Fund) aims to deliver an alternative approach to fixed income. It provides access to global fixed income markets, in order to facilitate a steady income stream with capital stability across economic cycles.

Kapstream adheres to an active and less traditional approach to fixed interest management, one that blends top down macroeconomic outputs with bottom-up security selection. Unlike more mainstream competitors, it is not subject to the same benchmark relative constraints, providing the investment team with greater scope to incorporate best trade ideas and position the portfolio in response to varying market conditions.

Suits Investors Seeking

- Stable income across market cycles.
- Potentially higher levels of returns compared to cash.
- Low to moderate volatility.
- A diversified portfolio that can complement other asset classes.

Monthly Performance Report – 30 April 2022

Fund Performance[1, 2]	1 month	3 months	CYTD	1 year	3 years	5 years	Since inception[3]
Fund	-0.19%	-0.74%	-0.72%	-0.64%	-	-	1.83%
RBA Cash Rate	0.01%	0.02%	0.03%	0.10%	-	-	0.25%
Excess Return	-0.20%	-0.76%	-0.75%	-0.74%	-	-	1.59%

1 Performance figures are based on the Fund's net asset value, are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of likely future performance. All periods longer than 1 year are annualised.

2 The performance of the Fund will not exactly replicate that of the Underlying Fund, for example, where cash is held by the Fund.

3 The Fund's inception date is 10 October 2019.

Source: Fidante Partners Limited, 30 April 2022.

Underlying Fund

The Fund invests in Kapstream Absolute Return Income Fund (Underlying Fund). In this report, where we refer to the Fund's investments we generally do so on a 'look-through' basis; that is, we are referring to the underlying assets that the Fund is exposed to through its investment in the Underlying Fund.

Underlying Fund Performance[4]	1 month	3 months	CYTD	1 year	3 years	5 years	Since inception[5]
Underlying Fund	-0.19%	-0.74%	-0.71%	-0.63%	0.81%	1.66%	3.98%
RBA Cash Rate[6]	0.01%	0.02%	0.03%	0.10%	0.38%	0.83%	2.72%
Excess Return	-0.20%	-0.76%	-0.74%	-0.73%	0.43%	0.83%	1.26%

4 Performance figures are calculated after fees have been deducted, assume distributions have been reinvested, and include the impact of sell spreads. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of likely future performance. All periods longer than 1 year are annualised.

5 The Underlying Fund's inception date is 31 December2007.
6 From 1 February 2014 to 30 October 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, 30 April 2022.

Fund Benefits

Unconstrained approach
Investing wherever the best risk adjusted opportunities can be found by Kapstream irrespective of the benchmark index.

Conservative risk focus
Priority is given to actively managing the Fund's investment risks within limits.

Flexibility
Able to meaningfully shift exposure to different geographies, sectors and fixed income categories to meet its return and risk objectives.

Capital stability
Conservatively managed, the Fund is well suited to investors looking for potentially higher levels of returns compared to cash with low to moderate volatility.

Income stream
Investing predominantly in high quality bonds provides the potential for a stable quarterly income stream.

Diversification
A flexible, unconstrained approach results in a diversified portfolio that can be complementary to other asset classes.

Fund Risks

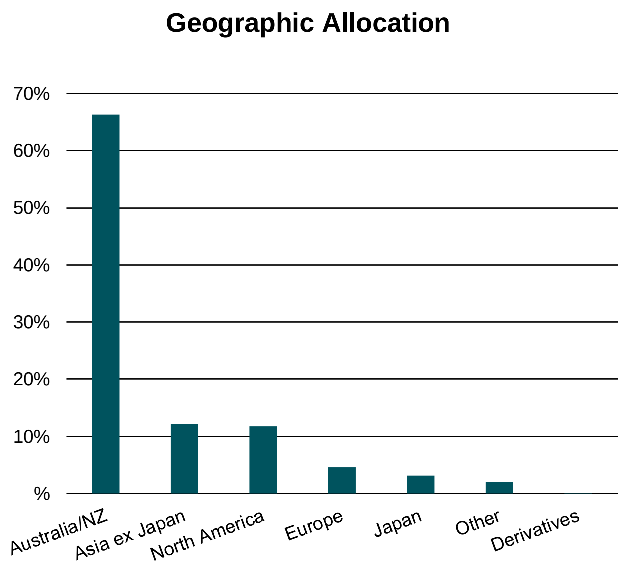
The Fund is exposed to a number of risks including interest rate risk, market risk, and collateral risk. Please refer to the Product Disclosure Statement for more information.

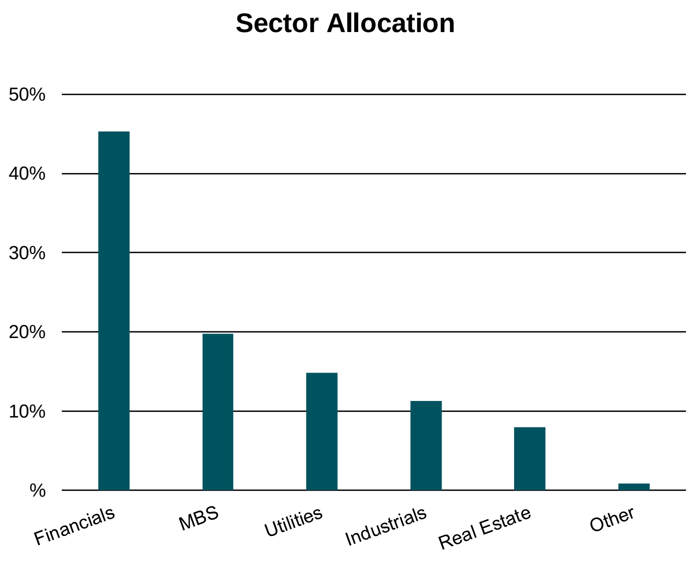
Underlying Fund Guidelines

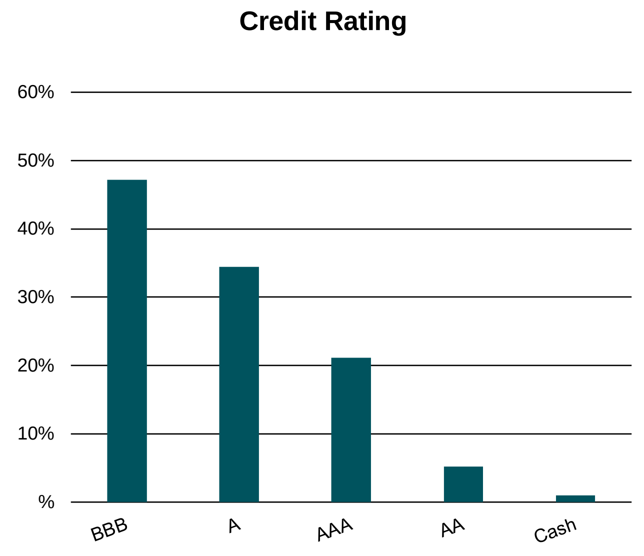
Target Return	Target Volatility	Duration Limits	Credit Quality
Cash plus 2-3%	<1.5% annualised	-2 to +2 years	>85% investment grade

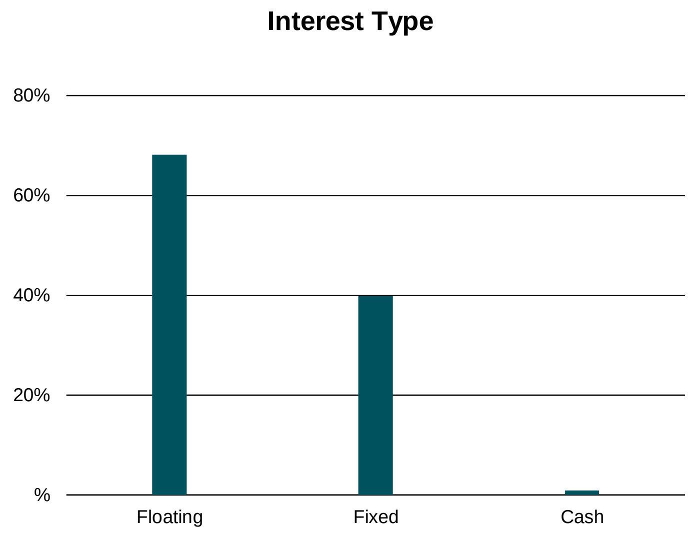
Underlying Fund Statistics

Interest Rate Duration	Credit Spread Duration	Average Credit Rating	Number of Issuers	Yield to Maturity
0.47yrs	2.65yrs	A-	101	4.17%









Monthly Commentary

Performance & Market Commentary

The Underlying Fund returned a modest negative return in April of -0.19% (after class A unit fees), a relatively resilient outcome given continued stresses across most markets and further sharp falls in risk assets, not to mention highly unusual and temporary positive correlation between rates and credit spreads. Coupon income remained consistently positive, though this was offset by credit spread widening, and rising sovereign yields also detracted from performance.

The Bloomberg AusBond Composite Index lost a further -1.49% in April and is now down -7.28% calendar-year-to-date, highlighting the enormous challenge for fixed income market participants investing traditionally.

After a challenging first quarter for equities, credit and rates markets, there was no respite in April. In the US, the S&P 500 lost -8.8%, the Volatility Index (VIX) was up 62% to 33.4 and the Investment Grade CDS Index widened +16 basis points to 83 basis points. Australian equities have held in better than their US counterparts this year given the exposure to the mining / energy sector and this was true of April as well with the S&P/ASX 200 down only -0.9%. However the Australian iTraxx CDS Index followed the US in widening +15 basis points to 96 basis points.

While broader risks have not changed - war in Ukraine and increased economic uncertainty in Europe; China's deficient plan of dealing with COVID-19 and subsequent slowing data; central banks grappling to deal with an environment of persistent inflation and slowing growth - investors have begun to price in greater chance of monetary policy mistakes leading to increased probability of a hard landing and/or recession. Add to the mix first quarter earnings news in the US, which despite being quite strong on a backward looking basis, came with forward looking forecasts revised lower by many companies (particularity volatile mega-cap and big-tech names), adding to the softer risk sentiment this month.

In the US, economic data was mixed over the month of April. Unemployment and underemployment fell to cyclical lows of 3.6% and 6.9% respectively and while the Institute for Supply Managements various gauges of manufacturing and services data fell and were lower than expectations, they remain at high levels. The biggest data surprise came in the form of the first quarters' GDP print at -1.4%, driven largely by lower net exports (imports exceeding exports). However, an import surge tied to solid consumer demand suggests growth may return to positive territory over subsequent quarters and this does not signal an impending recession. Meanwhile, quarterly wage data, in the Employment Cost Index, was released late in the month and this showed a record +1.4% increase quarter-on-quarter which will fuel the inflation narrative going forward, adding to pressure on US Federal Reserve's (FED) inflation-fighting credibility. The Consumer Price Index (CPI) continued to accelerate with headline inflation at 8.5% year-on-year. Needless to say there is a growing chorus of Federal Open Market Committee (FOMC) members who believe rates will need to be raised beyond neutral to combat inflation. While there was no April FOMC meeting, they did convene early May and hiked rates 50 basis points, with further 50 basis point hikes priced into upcoming June and July meetings. Given that elevated realised inflation and inflation expectations over the longer term remain anchored at around 3%, we believe the FED will continue on it's aggressive hiking path throughout the year. As investors ponder this regime shift from the FED, rate markets will remain volatile. The front end of the Treasury curve sold off further over the month with the 2-year Treasury up +38 basis points to 2.71%, while the 10-year rose +60 basis points to 2.94%.

While's Russia's ongoing invasion of Ukraine continues to weigh on investor sentiment across Europe, as well as impacting food and energy prices globally, one piece of positive news from the region was Emmanuel Macron's victory in the French national elections. Macron's election ensures a degree of certainty across the economic and political landscape in Western Europe, particularly important in the face of the threats Russia and Putin have brought to the fore, and this was viewed positively by markets. Today Macron is Europe's defacto-leader, after Germany's Angela Merkel stepped down in 2021. Financial markets however were not as impressed with the European Central Bank (ECB) who failed to present the market with a firm plan as to when their asset purchase program will unwind, sending the Euro currency lower. While member commentary points to readiness in raising rates, ECB President Lagarde remains circumspect saying *"if I raise interest rates today, it is not going to bring the price of energy down".* German 2-yr government bond yields rose 34 basis points 0.26%, while the 10-yr rose +39 basis points to 0.94%.

Australia saw economic data broadly underperform expectations. Home loans, both owner-occupier and investor, fell as higher mortgage rates charged by the banks has slowed the pace of house price growth, even seeing declines in some capital cities. Fewer jobs than anticipated were created and the unemployment rate remained at an albeit low level of 4.0%, narrowly missing expectations of 3.9%. CPI data at a headline level was 5.1% with strong price increases in non-tradeables (services) inflation signalling that there is momentum driven by higher wages and demand, not just the supply-induced disruptions relating to China and Ukraine which garner most of the attention. While the RBA did not alter policy rates in April, it was this inflation data and expectations of wage inflation remaining elevated which led to a 25 basis point increase in the policy rate to 0.35% early May. Governor Lowe, no longer *"patient",* has communicated the Board's flexibility to raise rates based on data *"over coming months"*. The yield on the 3-year Australian Government Bond rose +37 basis points to 2.71%, while the 10-year rose +29 basis points to 3.13%.

In Asia, China saw a slowing of both manufacturing and non-manufacturing Purchasing Manager Indices (PMI), in particular the latter which has been impacted mostly by China's lack of a plan when it comes to dealing with COVID-19, where growing infections are leading to city-wide lockdowns across the country. Stimulus measures thus far have been insufficient to deal with the slowing. In Japan, the focus was on currency markets as the Japanese Yen (JPY) declined sharply, one of the weakest performers in the G10, -6.6% against the US Dollar (USD), having fallen -5.8% in March also. A source of the currency performance was the Bank of Japan (BOJ) who reaffirmed their highly accommodative monetary policy settings, saying they will buy unlimited quantities of Japanese government bonds in order to defend their yield curve control target. BOJ's Governor Kuroda's commitment to overshooting inflation remains unchanged.

Outlook & Portfolio Strategy

The portfolio yield-to-maturity rose during April, breaching 4%, driven by a combination of higher yields in risk-free rates as well as credit spreads which continue to drift wider. Overall portfolio liquidity remains high at ~11% for *'Level 1'* investments (cash, commercial paper, term deposits, government, semi-government, and supranationals) and ~17% in *'Level 2'* investments (less than 1 year investment grade bonds). We anticipate reducing *'Level 1'* liquidity to 10% (normal range being 5-10%) as we use a backdrop of volatility from FED rate hikes, tapering, possible balance sheet run-off and geopolitical risks to gradually add discounted credits.

Spread duration ex SSGA was roughly unchanged at ~2.43 years. Macro volatility provides good opportunity to add credit with idiosyncratic mispricing, and we have been adding credits where there has been significant widening as well as a material new issue concession, or where we believe the secondary market is materially mispriced, more recently on a switch basis.

This 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 points. This approach (1) underweights longer dated A-rated credits and overweights shorter dated lower rated credits (mainly BBB assets), assets with equal 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 liquid assets which provide the ammunition to add cheap new credits.

In the short term, given the inflation shock, a hawkish Fed, decelerating PMI's and GDP we expect further volatility as market chatter around an increased likelihood of recession in 18-24 months is expected to further cheapen up credit. Whilst recession is not our base case, we have added over 10% notional of US Investment Grade CDS as a hedge at ~76 basis points, reducing spread duration by around half a year, taking the net number close to 1.9 years. Over the medium term, once we gain more certainty that economic deceleration stabilises ruling a recession less likely, or a recession is more fully priced in, we aim to peel off CDS hedges, increasing our spread duration as credits cheapen, shifting from an underweight to a more neutral credit positioning. This places us in a strong position to provide a stable and appealing income stream, well insulated from the various headwinds faced, and maintaining a yield in the 3-4% range, higher in a spread sense than for several years.

While yields on risk free assets are substantially more attractive today then one year, or even three months ago, we recognise that we are in an unusual and temporary period where risk free rates and credit spreads are positively correlated and hence simply adding duration is insufficient to protect against credit spread widening. We will continue to explore even more CDS and other alternative strategies to mitigate volatility in the credit assets.

In terms of asset allocation, the portfolio can be split across three major ‘buckets’; financials (~35%), corporates (~40%), and asset and mortgage-backed securities (<15%) with the residual in cash and liquids. By currency, we currently have a 90%/10% split between Australian & New Zealand and international issuers, adding around 5% to foreign currency denominated bonds during the month, mostly USD-denominated, given attractive spreads and above average new issue concessions.

Having run an average interest rate duration of 0.25 years over quarter one this year, we began to increase duration during April, closing the month at 0.45 years with an average over the month of 0.32 years. It is pertinent to point out that the addition of duration is only in the front end of curves as we don’t believe investors are being paid adequately for the additional term premium. To highlight this, upon examining the breakeven level of rate rises an investor could withstand for a three month holding period for a US 2-year and 10-year Treasury, we calculate the 2-year at 41 basis points and the 10-year at only 9 basis points. We’ll look to add front end duration carefully and gradually, diversifying exposure across different regions and sectors, seeking the best carry and roll down dynamics and superior risk adjusted returns.

CONTACT US

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