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

ARSN 632 896 176

Fund Facts – 31 August 2021

CXA Ticker	XKAP		
Fund Inception Date	10 October 2019	**Fund Size**	$9.7 million
Underlying Fund Inception Date	31 August2007	**Underlying Fund Size**	$4.1 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 – 31 August 2021

Fund Performance[1, 2]	1 month	3 months	CYTD	1 year	3 years	5 years	Since inception[3]
Fund	0.05%	0.35%	0.57%	1.92%	-	-	3.57%
RBA Cash Rate	0.01%	0.03%	0.07%	0.13%	-	-	0.30%
Excess Return	0.04%	0.33%	0.50%	1.79%	-	-	3.27%

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, 31 August 2021.

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	0.01%	0.23%	0.25%	1.42%	1.84%	2.18%	4.24%
RBA Cash Rate[6]	0.01%	0.03%	0.07%	0.13%	0.69%	1.01%	2.85%
Excess Return	0.00%	0.20%	0.18%	1.29%	1.15%	1.17%	1.39%

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 August2007.
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, 31 August 2021.

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.

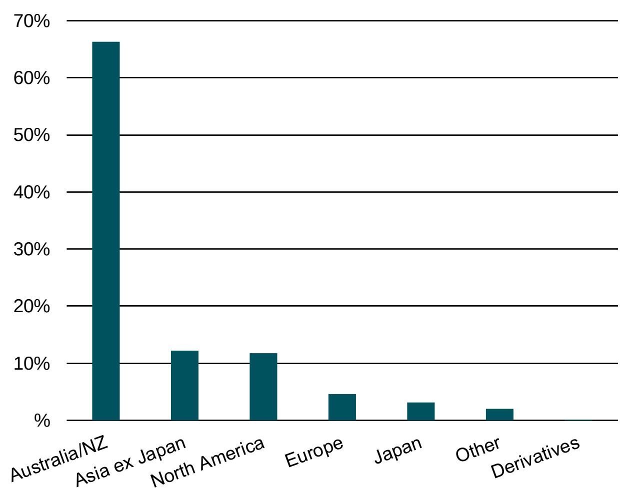
Underlying Fund Guidelines

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

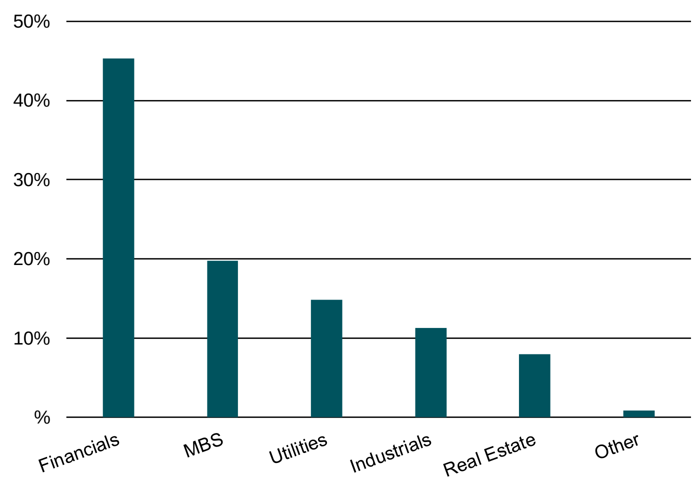
Underlying Fund Statistics

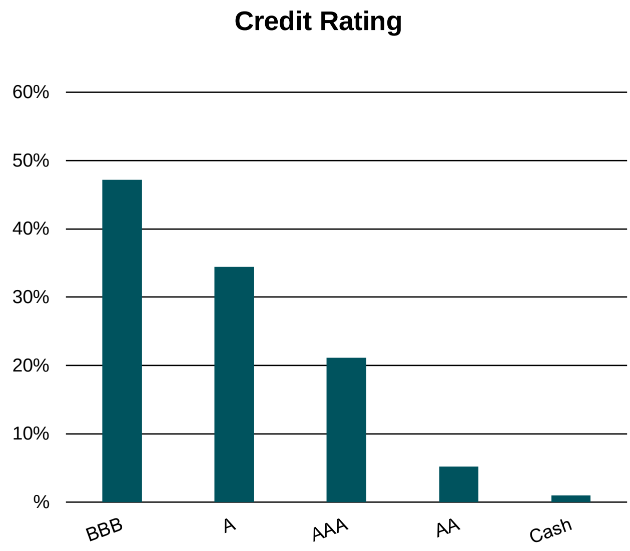
Interest Rate Duration	Credit Spread Duration	Average Credit Rating	Number of Issuers	Yield to Maturity
0.42yrs	2.65yrs	A	95	1.30%

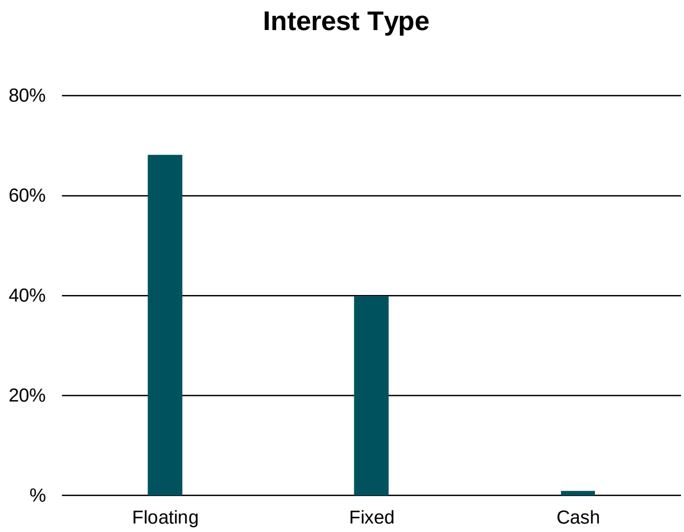
Geographic Allocation



Sector Allocation







Monthly Commentary

Performance & Market Commentary

The Fund returned 0.01% in August (after Class A Units fees). Coupon income was the primary driver of returns, with mild spread compression also contributing positively over the month. The main detractor of returns was swap-spread widening in Australia, where a 5-7 basis point widening across the curve cost the portfolio about 10 basis points. The interest rate component of the portfolio's corporate assets are typically hedged by selling government bond futures, which naturally makes us long swap spreads. Our currency positions, of being long USD vs. CAD, GBP, JPY and EUR added 1 basis point to returns as the USD strengthened.

Key data prints in the US, namely payrolls and inflation, continue to be robust. Non-farm payrolls came out at +943k relative to expectations of +870k, this saw unemployment drop to a post-pandemic low of 5.4%, down from 5.9% the prior month. Meanwhile, headline inflation for the month was a strong 0.5%, as expected, with an annual rate tracking at 5.4%, modestly above expectations of 5.3%. The details showed a slowing in the transitory elements of the inflation basket, namely used cars, hotels and recreation. However, global shipping, transportation and storage costs (excluding fuel) continue to be high which speaks to the supply-chain constraints caused by COVID-19 and this in our view will lead to persistently higher inflation over the short term. The much anticipated Jackson Hole speech by US Federal Reserve (Fed) Chair Jerome Powell confirmed conditions have been met for a tapering of the balance sheet to begin in the coming months, so the key focus will now shift to interest rate hikes where a clear distinction has been communicated to the market that tapering does not represent a tightening of financial conditions. We expect the Fed to maintain rates at or near zero for the next couple years with uncertainty as to the direction of inflation leading to volatility further out the curve. Rates were higher and steeper over the month with 2-year +2.5 basis points to 0.21% and 10-year +8.7 basis points to 1.31%.

In Australia, tightening of restrictions and ongoing lockdowns due to the spread of COVID-19's Delta-variant, particularly in New South Wales and Victoria, are weighing on investor sentiment. Business Conditions saw its largest monthly fall since the depths of 2020’s COVID-19 crisis, down 13.5pts to 11, while Business Confidence is now in negative territory, down 18.5pts to -8, in the red for the first time since September 2020. Earlier in the month the RBA met and retained the current composition of monetary policy; rates at 0.1% and quantitative easing purchases at a rate of A$5bn per month. Doves were left disappointed as the RBA did not indicate they were prepared to delay a tapering of asset purchases to $4bn per month in mid November. This suggests that the RBA believes the current mix of monetary policy settings is sufficiently loose and that any loss of economic activity through lockdowns will rebound quite quickly in subsequent months. Rates were little changed with 3-year down half a basis point to 0.237% and 10-year down 2.6 basis points to 1.16%.

The Bank of England also maintained unchanged policy settings, however, Governor Bailey delivered a hawkish statement in acknowledging a “modest tightening” of settings will be required “to be consistent with meeting the inflation target sustainably”. This tables a concern other MPC members also hold, which is that inflation may not be as transitory as the other central banks are implying (or hoping!). Bailey raised expectations for near-term inflation to 4% and forecasting a return to 2% in three years time. The European Central Bank did not meet in August however we have noted an uptick in hawkish commentary from Governing Council members who believe it is time to begin discussions on how to transition away from emergency stimulus as inflation and growth both rise across the region. The German 10-year was up 8 basis points to -0.38%.

In Asia, the Bank of Korea hiked rates by 25 basis points to 0.75%. Governor Lee was fairly dismissive of COVID-19 downside risks and instead chose to focus on potential financial imbalances and prolonged negative real rates as being harmful for markets and economy activity, as his rationale for hiking. In China, the partial shutdown of its major shipping port in Ningbo-Zhoushan (the third largest cargo port in the world) due to a COVID-19 Delta outbreak highlights the precarious nature the virus continues to hold over global supply chains. Such a shutdown only serves to further delay the transitory inflation narrative in ensuring transportation and storage costs remain elevated. Chinese data continues to print on the softer side; retail sales, industrial production and manufacturing purchasing managers indices (PMIs) all printing below expectations. We note that China appears to be entering a period of economic adjustment as it adapts to a new political and economic paradigm and while they have used policy tools, both monetary and fiscal, effectively in the past, such cultural and political shifts make policy changes more difficult going forward.

Outlook & Portfolio Strategy

The portfolio maintained a yield-to-maturity of 1.3%, which at 120 basis points above the RBA's cash rate we believe provides us with a strong tailwind for returns going forward. This is towards the high end of our historical range during a non-stressed period, driven by an attractive off-index idiosyncratic pipeline. We rotated into attractive securitised and T2 investments, taking profits on tight senior financials and corporates. We continue to run a barbell strategy preferring shorter dated BBB credits over longer dated A credits given their similar spread and lower losses in a sell-off. Credit spread duration and average maturity were little changed over the month at 2.65 years and 2.77 years respectively. August is traditionally a quiet month for new issuance in the US as their summer holidays draw to a close, this theme permeates into the Australian corporate bond market where primary markets also completely dried up. Credit spread volatility was low, supported by accommodative policy and a quiet month for turnover. We anticipate the pipeline for new issuance to expand quite dramatically through September, and expect to see additional activity next month.

One area where we have been conducting additional research is in the US Loan space, as a relative value trade against High Yield. At a broad market level, the major USD Loan funds can yield north of 5%, and with High Yield Credit Default Swap Indices cost of carry well below 3% throughout this calendar year and volatility stable, we believe we can find an attractive risk adjusted return structure, to enhance portfolio returns without adding undue risk.

In terms of asset allocation, the portfolio can be split across three major ‘buckets’; financials (~33%), corporates (~44%), and asset and mortgage-backed (~15%) with the residual in cash and liquids. Geographically, we have maintained a roughly 70/30 split between Australian and international issuers.

In rates, we reduced duration from 0.6 years at the end of July to 0.4 years at the end of August. At a country level, the breakdown is 0.3 years Australasian duration and 0.1 years US duration. The reduction in duration of approximately 0.2 years primarily came from the 10 year part of the US curve. Whilst we believe central banks will keep rates on hold, ensuring the front end of yield curves is little changed, this promise to maintain rates near the effective lower bound could result in a return to markets pricing in modest levels of inflation, albeit at a slower pace than witnessed in the first quarter of this year. Hence 10yr US Treasury yields in the 1.2-1.3% range are too low by our reckoning and we expect rates to be higher by year end, in the 1.5-1.6% range.

CONTACT US

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