

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

ARSN 632 896 176

## Fund Facts – 31 October 2021

<b>CXA Ticker</b>	XKAP		
<b>Fund Inception Date</b>	10 October 2019	<b>Fund Size</b>	\$11.2 million
<b>Underlying Fund Inception Date</b>	31 August 2007	<b>Underlying Fund Size</b>	\$4.0 billion
<b>Distribution Frequency</b>	Quarterly	<b>Unit Registry</b>	Link Market Services
<b>Management Fee</b>	0.55% p.a.	<b>Fund Issuer</b>	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 October 2021

Fund Performance <sup>1, 2</sup>	1 month	3 months	CYTD	1 year	3 years	5 years	Since inception <sup>3</sup>
Fund	-0.17%	-0.14%	0.06%	0.70%	-	-	2.68%
RBA Cash Rate	0.01%	0.02%	0.08%	0.10%	-	-	0.28%
Excess Return	-0.17%	-0.17%	-0.02%	0.60%	-	-	2.39%

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 October 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 <sup>4</sup>	1 month	3 months	CYTD	1 year	3 years	5 years	Since inception <sup>5</sup>
Underlying Fund	-0.16%	-0.14%	0.09%	0.76%	1.66%	2.10%	4.18%
RBA Cash Rate <sup>6</sup>	0.01%	0.02%	0.08%	0.10%	0.61%	0.97%	2.82%
Excess Return	-0.17%	-0.17%	0.01%	0.66%	1.05%	1.13%	1.37%

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 October 2007.

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 October 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.

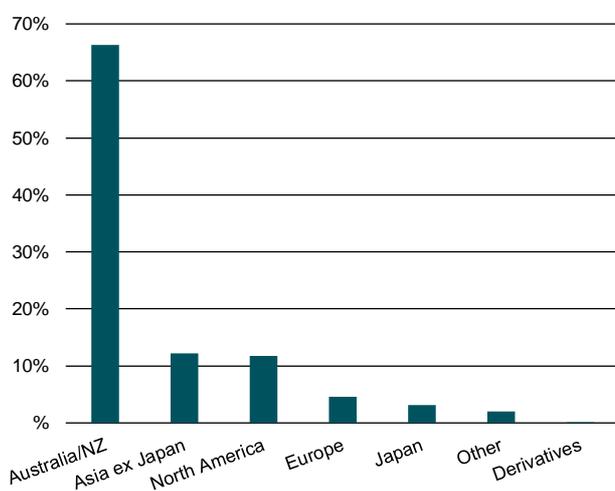
### Underlying Fund Guidelines

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

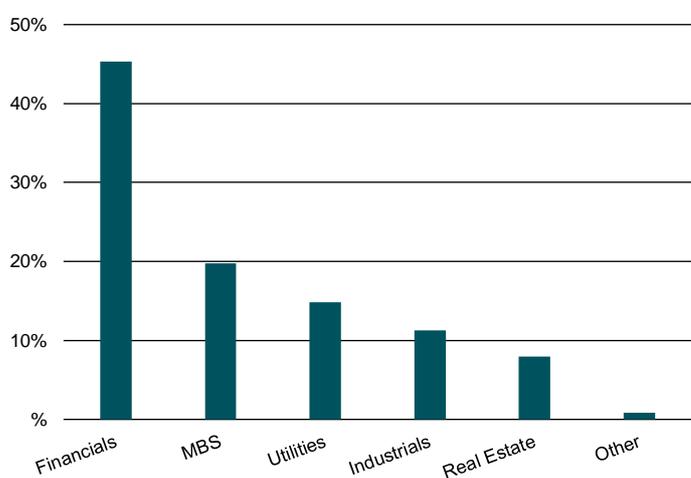
### Underlying Fund Statistics

Interest Rate Duration	Credit Spread Duration	Average Credit Rating	Number of Issuers	Yield to Maturity
0.44yrs	2.71yrs	A-	100	2.22%

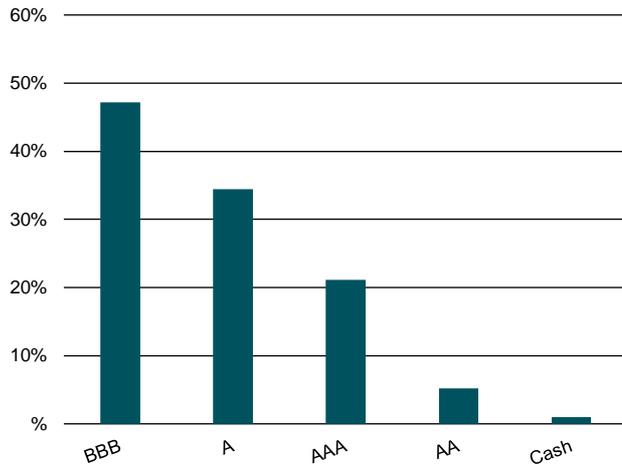
#### Geographic Allocation



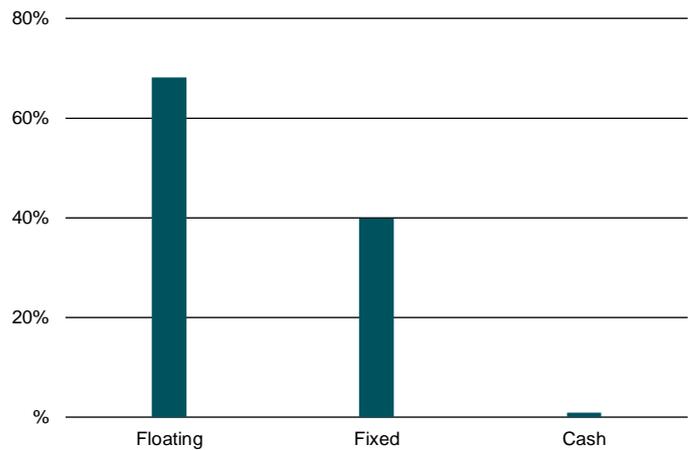
#### Sector Allocation



**Credit Rating**



**Interest Type**



**Monthly Commentary**

**Performance & Market Commentary**

While we never like to report a negative month, the surprise sell off in rates toward the end of the period was a sobering reminder to investors of the potential risks of negative returns within bond portfolios, given a persistent low yielding environment, and uncertain central bank responses to volatile economic data. That said, returns for the month in our fund were only modestly negative at -0.16% (after A class unit fees). The same cannot be said for more conventional bond portfolios. The Bloomberg Ausbond Composite dropped -3.55% in the month, while the Government component was down further at -3.75%. This pushed returns over the CYTD period for the respective indices to -4.94% and -5.36%. This is where funds with a defensive absolute return focus prove their value. Our fund is still showing a positive absolute return over a one year and CYTD timeframe; our focus on capital preservation and 'insulation' techniques minimised the sensitivity of the portfolio to these surprise and rapid changes in rates and bond spreads, providing valuable protection for investors.

From a contribution perspective, despite the volatility in rates and the ferocious sell off in the front end of G10 curves, our duration positioning actually added to returns given a flattening bias in Australian rates, adding two basis points. Consistent with the past, coupon income added 17 basis points, while spread widening, largely in the non-financial corporate sector, detracted 25 basis points.

October's price action was defined by a sharp sell-off (higher yields, lower prices) across developed market curves, particularly in the front end. This was caused by markets re-pricing rate hike expectations, bringing them forward as a result of inflation, which is proving to be more persistent than anticipated. As we enter November, investors continue to grapple with the implications of shifting monetary policy stance across the globe and how countries are choosing to combat and balance rising inflation with softer growth.

All eyes were on Australia where the fiercest moves occurred. The Reserve Bank of Australia's (RBA) policy of Yield Curve Control (YCC), whereby they had targeted 0.10% yields in the 3yr and below part of the curve, was challenged by market participants. On October 21st the April '24 bond traded as high as 0.18% and the following day the RBA purchased \$A 1bn of bonds, bringing the yield closer to target at 0.115%. However, the following week, on October 27th, Australia's Core CPI printed at 2.1% annualised, within the RBA's target range for the first time since 2015, and yields on the April '24 bond climbed to 0.2%. The following day there was anticipation the RBA would be back in the market, purchasing bonds, to draw the yield closer to target once again. The RBA was absent from the market and there were no communications. Over the next few trading sessions, yields on the April '24 bond climbed as high as 0.8%, suggesting YCC would be abandoned at the upcoming RBA meeting early November (which is exactly what transpired). Over the course of the month, the 3yr bond soared 91 basis points to 1.22%, while the 10yr rose 60 basis points to 2.09%.

The Reserve Bank of New Zealand (RBNZ) hiked rates by 25 basis points, as expected, to 0.50%. Having passed on the opportunity to do so in August when a COVID-19 Delta variant case popped up in Auckland a mere 24 hours prior to the RBNZ meeting, this hike went ahead as anticipated with Governor Orr providing a strong commitment to hike again in the future and acknowledging that cost pressures are becoming more persistent. When inflation data was released 12 days later at a lofty annualised level of 4.9% and beating analysts expectations of 4.2%, the RBNZ's actions were justified and markets have since gone on to price in approximately seven additional hikes over the next year. We believe seven hikes over a one year period is excessive and are currently looking at received positions in NZ. The 2yr NZ Government Bond rose 85 basis points to close at 2.055%, while the 10yr was up 54.5 basis points to 2.635%.

In the US, non-farm payrolls once again disappointed relative to market expectations. The monthly gain of 194,000 jobs was significantly less than the 500,000 expected. However, despite the softness in this number, previous months' figures were revised higher and we saw a fall in unemployment from 5.2% to 4.8%, as well as continuing positive development in underemployment which fell from 8.8% to 8.5%. Participation remains weak at 61.6% as ongoing supply constraints continue to weigh on the labour force. The Federal Open Market Committee did not meet in October, however minutes released from their September meeting suggest a taper of asset purchases is likely to begin in November, but will depend on how the data evolves. One example of such data was inflation with headline running at 5.4% annualised and core (which excludes volatile food and energy components) at 4.0%. The details were inflationary as structural factors – not 'transitory' sectors – drove the strong numbers. In particular the shelter component exhibited vigour with owners-equivalent-rent up 0.43% on the month, the strongest monthly gain since 2006. US 2yr Treasury's were 22 basis points higher to close at 0.497%, while the 10yr rose 6.5 basis points to 1.55%.

In neighbouring Canada, inflation too was top of investors' minds with an annualised inflation read of 4.4%, the highest level since 2003 and the third consecutive above-expectation print. The Bank of Canada kept rates on hold at its policy meeting, but their rhetoric was hawkish, somewhat endorsing the recent acceleration in market expectations by moving the forward guidance timing for slack to be absorbed to "sometime in the middle quarters of 2022", from late 2022 previously. On asset purchases they have moved to a "reinvestment phase", which means there will be no additional purchases, they will merely reinvest coupons and maturities, maintaining their balance sheet at a steady level.

In Europe, the European Central Bank (ECB) met late in the month and maintained unchanged policy settings. The ECB remains one of the more dovish developed market central banks and also continues to fervently believe inflation is transitory. Their Chief Economist, Philip Lane, suggests inflation is far from the "red zone", while Board Member Isabel Schnabel fears premature rate hikes are "harmful, and risk jeopardising the ongoing economic recovery". We expect European markets to continue to lag the rest of the world as it pertains to the pricing in of rate hikes. However, across the English Channel, the story is much different. The Bank of England (BOE) Governor, Andrew Bailey, has acknowledged that inflationary pressures are building which has made rate hikes more likely. BOE inflation forecasts have regularly been revised higher and when interviewed by the Financial Times, BOE Chief Economist Huw Pill said that their upcoming November meeting was "live" and "finely balanced". Markets responded by sending front end rates higher – the 2-year UK Treasury rose 30 basis points to 0.71% meanwhile the 10-year was little changed, up 1.3 basis points to 1.03%.

## **Outlook & Portfolio Strategy**

The portfolio yield-to-maturity climbed significantly over the month, rising from 1.60% to 2.22%. This was driven by credit positioning, including the steady addition of idiosyncratic off-index opportunities, which collectively added ~0.27%. Spread widening, as well as higher risk-free rates, added a further ~0.26%. 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 decreased slightly over the month, which given higher overall yields in the portfolio suggests that the spread we're providing investors per unit of spread duration risk has climbed, akin to a rising Sharpe Ratio. All factors combined, on a forward looking basis our confidence in meeting our return objective is higher than at any point over the last 18 months or so.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~30.3%), corporates (~46.1%), and asset and mortgage-backed (~15.0%) with the residual in cash and liquids. Geographically, we've maintained a roughly two-thirds/one-third split between Australian & New Zealand and international issuers.

In rates, overall duration was little changed over the month where we continue to run ~0.4 years exposure. At a country level however we made some adjustments, bringing Australian duration down from 0.3 years to 0.17 years and increasing US duration from 0.05 years to 0.24 years. Also, the curve positioning is critical, where in Australia we have expressed a flattening bias; short the front end of the curve (-0.17 years in the 3yr key rate) with longs in the belly (+0.25 years in the 5yr key rate) and longer end of the curve (+0.09 years in the 10yr key rate). This Australian curve positioning served us well during October's wild market moves.

## CONTACT US

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