CIPAM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report November 2021

Performance[1]

	1 Month (%)	Quarter (%)	6 Months (%)	FYTD (%)	1 Year (%)	3 Years (%) p.a.	5 Years (%) p.a.	Since Inception (%) p.a.[2]
CIPAM Credit Income Fund – Class A	0.15	0.51	1.47	1.08	3.99	-	-	5.30
CIPAM Credit Income Fund - Class I[3]	0.15	0.51	1.47	1.08	3.99	3.77	-	-
Bloomberg Bank Bill Index	0.01	0.01	0.01	0.01	0.02	0.68	-	0.04
Active return	0.14	0.50	1.46	1.07	3.96	3.09	-	5.26

Data Source: Fidante Partners Limited, 30 November 2021.

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

[2] The Inception date for Class A is October 1 2020.

[3] As at the date of this report two classes of units are offered: Class I which has been offered since the inception of the Fund on 3 October 2017 and Class A which has been offered since 1 October 2020. For information purposes, and to give a longer term view of the Fund's performance, the returns for the Class I are also provided in the Performance table and shows Class I's performance. The returns quoted for Class I have been adjusted to reflect the fees applicable to the Class A units.

Past Performance is not a reliable indicator of future performance.

Fund Features

Experienced team - Boasting one of the longest track records In institutional private lending strategies, the team is uniquely positioned to exploit opportunities across both public and private lending markets. The team's breadth of experience allows the Fixed Income team to exploit market inefficiencies across all sectors in the global credit market.

Risk management - The Fund aims to reduce market risk by considering low cross-sectoral correlations and maintaining a relatively short spread duration. The team identifies complexity risks to provide income and what they consider to be attractively priced but hard to access liquidity, allowing the Fund to minimise more volatile currency and interest rate risks.

Diversification - The Fund invests across both public and private credit markets providing the opportunity to allocate to the most attractive sectors over time. The Fund targets a weighted average investment grade rating and the diversified set of asset classes in which the Fund can invest includes secured loans, securitised credit, corporate bonds and real estate debt.

Strong governance - The Fixed Income team's clients benefit from a robust governance framework including an independent credit risk management team within the Challenger Group.

Fund Objective:

The Fund aims to achieve superior absolute returns over the medium to long term whilst offering capital stability and a steady income stream.

Fund Details

Management Fee	0.60% p.a.
Strategy FUM	$358.4 mil
Buy/Sell Spread	+0.25/-0.50%
Distribution Frequency	Quarterly
Redemption Terms	Monthly with 10% Fund level gate

Key Statistics

Number of Issuers	99
Running yield (%) p.a.	3.4
Modified duration (yrs)	0.05
Average Rating	BBB-
Credit Spread Duration (yrs)	2.9
Non-AUD Denominated	19%
Private Credit Allocation	27%

Monthly Commentary

Performance Update: The Fund returned 0.15% for the month of November. As was the case in October, the Fund outperformed both bank bills (0.01% return) and the Bloomberg AusBond Credit FRN index (-0.02% return).

The main detractor from performance was related to widening in the basis between interest rate futures and swap pricing. Like many investment managers, we hedge our interest rate risk using a mix of interest rate futures and interest rate (or cross currency) swaps while our portfolio is valued on a spread to swap basis. Hedging with futures induces a small amount of basis risk into portfolios; while we are fully hedged in terms of interest rate duration, we are long 1 year interest rate swaps and short 1 year futures. During November, the basis between 3yr swaps and 3yr futures widened by around 24 basis points, the largest monthly move since 2011. This led to a negative impact of 29 basis points on the Fund return.

Away from the basis risk, income generation and spread tightening drove the overall positive return for the month. Indeed many funds like our own employ similar hedging strategies to our own but their lack of income generation resulted in a drawdown for the month of November.

Fund Positioning: With liquidity starting to dry up as the calendar year end approaches, we are maintaining the overweight private/overweight liquids barbell we adopted last month.

This moderately increases the available liquidity in the event of any volatility during year end and early January. While we are not predicting any short term volatility we are mindful that the potential for volatility increases around year ends. This year is no exception with event risk around both the Omicron variant and the Federal Reserve's inflation narrative.
While our private allocation currently sits at 27%, once our pipeline is invested this will increase into the low 30s. Spread duration, a key metric which measures our sensitivity to moves in market spreads will remain low at 3 years, post this deployment.

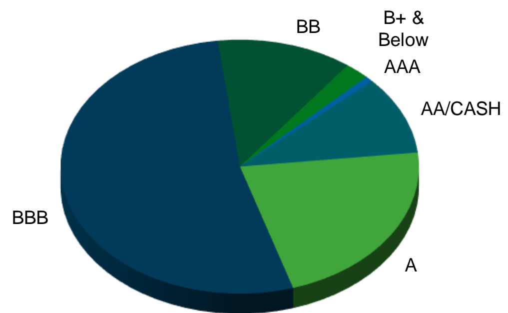
Over the month the fund was relatively quiet with the bulk of the activity focused in primary and secondary corporate bond markets. We also participated in a UK consumer ABS transaction, our first offshore ABS deal for some time. This was driven by the better relative value there versus what we are seeing domestically.

On the private side, our activity is elevated on both sides of the equation with five transactions in our pipeline and three existing deals likely to repay early in the new year.

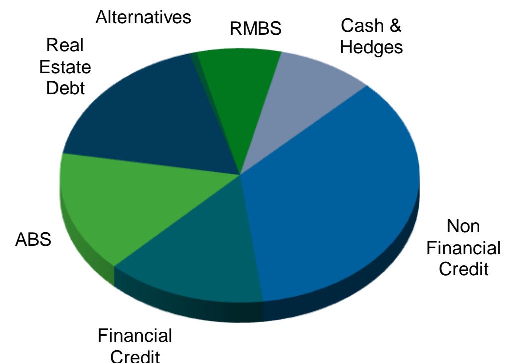
Performance Statistics

Standard Deviation (ann.)	2.5%
% of Down months	2.0%

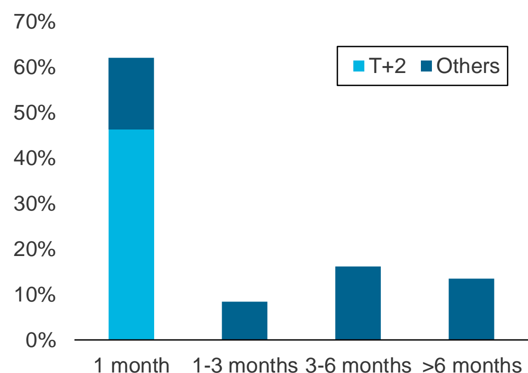
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Profile



Market Conditions: Having widened very slightly in October, credit spreads tightened in November, ending the month at the same levels as they ended September. However, under the surface, we are observing some interesting trends.

Firstly, the financial credit curve is flattening. Major bank senior spreads continue to leak wider and are now trading in the low 60s in spread terms, up from the high 30s in early September. Meanwhile, tier 2 debt is trading only around 10-15 points wider. Typically when spreads are widening credit curves steepen (i.e. the riskier sells off more); this time the opposite has occurred.

A potential reason for this is the fact these moves are technically (as opposed to fundamentally) driven. With the Term Funding Facility expiring, the Committed Liquidity Facility ending, issuance from the major banks will have to normalise towards pre-COVID levels, if not higher. At the same time, Australian Prudential Regulation Authority (APRA) has also finalised the loss absorbing capacity requirements for the major banks and Macquarie. They ultimately elected to increase the total loss absorbing capacity (TLAC) requirements by 1.5% equivalent to an additional $20 billion of issuance by 2026. When added to the 3% increase already announced, this was in the middle of the 4-5% increase previously proposed by the regulator and may have been viewed positively given APRA didn't require a 5% total increase.

A similar trend can be observed in domestic securitised markets which have already surpassed the 2019 peak year of issuance (post GFC) and look like they may exceed $50 billion. According to Westpac around 77% of issuance has come from the non-bank sector, a quite extraordinary number given pre-COVID share of less than 50% and 6 years ago a share of 25%. Like major bank senior, AAA spreads have started to widen, moving from mid to high 60s in early September to mid to high 80s today. At the same time, mezzanine tranches rated from AA to BB are all broadly unchanged, outperforming even Tier 2 paper. We consider this to be unsustainable and expect AAA spreads to widen further from here and eventually for this widening to start to weigh on mezzanine spreads as investors belatedly acknowledge that there is some call risk in these transactions.

Lastly, the basis between corporates and financials has started to widen a little. Pre-COVID spreads between corporates and financials were flat. During COVID the basis increased to around 20 basis points before declining to around 10 basis. More recently this has increased towards the mid teens.

We'd also note that despite the lack of headlines (maybe headline fatigue), the issues in the Asian high yield market keep bubbling away. Spreads were wider during November with yield to maturity at around 23%, up from 22% in October and 13% at the end of August. While there hasn't appeared to be a liquidity event or forced unwind leading to contagion in other markets, we're still in the early innings here and suspect that the focus will transition from technical risks to real tangible credit risks as issuers start to default and restructure their debts.

Away from credit markets, interest rate markets were relatively subdued after the significant sell off in October. The front end of the curve remains steep setting up a fascinating confrontation between domestic markets and the central bank. Interestingly for us and worryingly for Dr Lowe, the market implied policy rate in Australia in one year is actually higher than the market implied policy rate in the United States. Our view continues to be that inflation will beget more inflation and that central banks will need to catch up, risking a medium term tightening in financial conditions.

In contrast, private markets keep ticking along. As we sit here in mid December, we have around a dozen deals in advanced stages of due diligence. In normal years, this figure would decline significantly in December as deals transition into the coming year. Interestingly activity is evenly distributed across commercial real estate, corporate and securitised transactions.

Unlike earlier in the year, none of the names in our pipeline are large syndicated transactions and instead are concentrated in the middle market bilateral/lightly syndicated space where we prefer to traffic.

For further information, please contact:

Fidante Partners Investor Services | **p:** 13 51 53 | **e:** info@fidante.com.au | **w:** www.fidante.com

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This material has been prepared by Challenger Investment Partners Limited (ABN 29 092 382 842, AFSL 234 678) CIPAM, the investment manager of the CIPAM Credit Income Fund. Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (**Challenger Group**) and is the responsible entity of the Fund. Other than information which is identified as sourced from Fidante in relation to the Fund, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Fund's Target Market Determination and Product Disclosure Statement (PDS) available at www.fidante.com should be considered before making a decision about whether to buy or hold units in the Fund. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. CIPAM and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, CIPAM and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the *Banking Act 1959* (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (**Challenger ADI**) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.

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