CIPAM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report October 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	0.05	0.46	1.56	0.93	5.22	-	-	5.60
CIPAM Credit Income Fund - Class I[3]	0.05	0.46	1.56	0.93	5.22	3.84	-	-
Bloomberg Bank Bill Index	0.00	0.00	0.01	0.00	0.03	0.73	-	0.03
Active return	0.05	0.46	1.55	0.93	5.20	3.11	-	5.56

Data Source: Fidante Partners Limited, 31 October 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	$355.5mil
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.	3.3
Modified duration (yrs)	0.11
Average Rating	BBB-
Credit Spread Duration (yrs)	2.8
Non-AUD Denominated	18%
Private Credit Allocation	29%

Market Commentary

Performance Update: The Fund returned 0.04% for the month of October. Whilst below our targeted return level, pleasingly the Fund outperformed both bank bills (0% return), the Bloomberg AusBond Credit FRN index (-0.1% return) and the Bloomberg AusBond Credit 0+ Index (down 1.2%).

The main detractor from performance was credit spread widening which reflected the broader move in markets. Our strong relative performance compared to most daily liquid credit income strategies was largely driven by our flat duration position. Many daily liquid strategies typically run overweight positions on interest rate duration as a lever to drive additional return and as a hedge against a credit/equity selloff. With front end rates moving sharply higher, even a 0.5 year overweight on interest rate duration would cause a loss of around 0.20%.

The other factor driving our outperformance of the Credit FRN index (which has interest rate duration of around 0.1 years, the same as the Fund) is the high income generation of the strategy. The Fund generates around 25 basis points of income a month which more than offset the spread widening in the month.

Fund Positioning: Having monotonously highlighted our overweight to private markets for several months, we are adopting a more nuanced positioning this month. With volatility in rates markets and spread widening in the most liquid parts of credit markets (semi's and major bank senior unsecured), we are growing cautious on public credit.

Hence the nuance is that while we still want to maintain our overweight to private credit we also want to be prepared for any normalisation in credit spreads from historically tight levels. The way we will look to achieve this is by running a slightly high cash balance, keeping our spread duration short, preferably inside of 3 years and making sure to have some liquidity in the portfolio to facilitate spread accretive switches in the event of volatility.

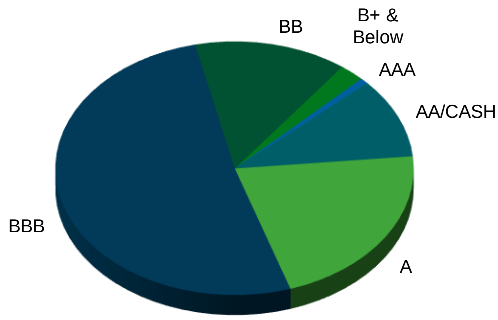
As it stands the current private allocation has dropped to slightly below 30%, though we expect this to increase slightly in the coming months, settling in the low 30% area. Our cash balance is around 10% though net of funding commitments this reduces to around 7%. After excluding private pipeline, cash sits at around 5% which is in line with our current target. Spread duration is 2.8 years though we expect this too to increase slightly as pipeline is deployed.

Over the month the Fund added a private corporate loan exposure and topped up to ABS warehouse exposures. Public activity was elevated in the month as we added some industrials exposure and insurance sub debt.

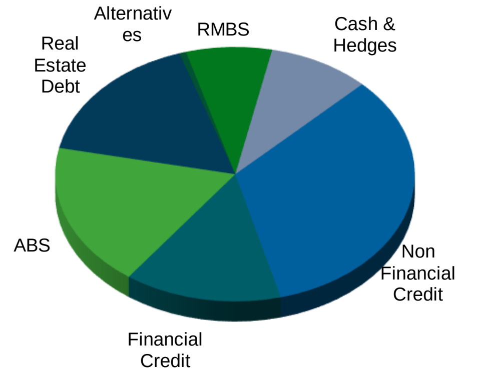
Performance Statistics

Standard Deviation (ann.)	2.6%
% of Down months	2.0%

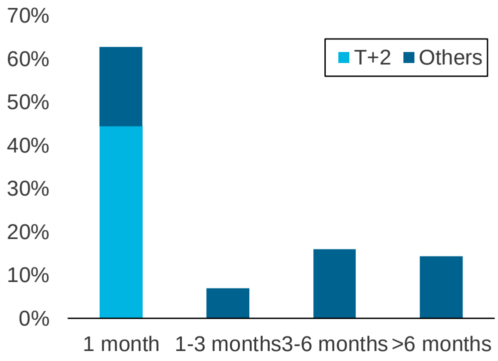
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Profile



Market Conditions:

October was one of the stranger months we have seen in some time. Volatility and illiquidity in the front end of the rates markets was elevated with Australia centre stage but credit and equities sailed through.

The pace of increase in short dated interest rates was noteworthy. Unlike early 2021 where the entire yield curve moved higher, increases in yields were focussed in the front end of the yield curve. To put in context, the ICE/BAML 1-5yr Australian Government index lost 2.37% in October, the largest loss since a 2.6% loss in 1992! The broader significance of this move was that it ultimately led to the RBA capitulating on the 0.1% target yield on the April 2024 bonds. In our view this is another sign of the fallibility of central banks, particularly those of smaller economies and particularly when their policies are diverging from other larger central banks (i.e. the US Federal Reserve).

We've long argued that the danger of unconventional monetary policy, specifically bond buying programs, is the impact on market liquidity. When one homogenous buyer owns a significantly share of a particular bond, small changes in buying and selling patterns can have an outsized impact. In a year the RBA's bond purchase program has accumulated $189 billion in Australian government debt securities, 22% of all debt on issue, up from 0% a year ago. Currently the RBA is increasing its share of the government bond market at a pace of around 1% per month. Now compared to Europe which holds over 30% of sovereign debt in the Eurozone or the United States which holds around quarter of the Treasury market, this may seem reasonable but remember that the other central banks have been conducting quantitative easing (QE) for many years and have much larger sovereign debt markets.

With this backdrop what was especially surprising was how little of this volatility flowed through to equity or credit markets, reminding us of the old saying, "we're all rates traders". The first implication of this was that much of what drove risk premiums across markets, was rates driven and anytime you expressed a view in your market of choice, whether equities, credit, commodities or nowadays even crypto, you were implicitly expressing a view on rates. The second implication was that the rates market was the one we should all be following. When the rates markets starts misbehaving, other markets were viewed as likely to follow.

It was not the case in October. Credit spreads were moderately wider in financials led by the major banks and arguably tighter in corporate bond markets. Tier 2 spreads have followed senior wider but by less than what would have been implied by the ratio in spreads. According to CBA, the Tier 2 to senior unsecured ratio moved from 2.8 times to 2.4 times over the month implying the search for yield in spread markets is still alive and well.

Private market activity is showing signs of returning to pre-COVID trends with the typical pre-holiday season spike in activity in full swing. In addition to settling a number of transactions, we also do expect to see a spike in refinancing activity across all sectors.

Offshore, high yield markets were flat in spread terms with the ICE BAML US High Yield index asset swap spreads settling at 294 basis points. Year to date the index has delivered just under a 6% return after the impact of interest rates. Similar to how domestic credit has been insulated from rates volatility, it seems the global high yield markets have been insulated from volatility in Asian high yield bond markets. Over the month Asian high yield corporate spreads widened 100 basis points, following a 100 basis point rise in September and anther 100 basis points of widening during November month to date. Recall the size of this market Is just under US$200 billion in face value terms, a not insignificant amount.

With respect to the rates market and the Asian high yield bond market, we're sceptical that this volatility can be contained. There is overlap across investor bases and inevitably capital flows will adjust to reflect the new risk premiums available.

And after all, didn't Ben Bernanke tell us back in 2007 that the sub-prime mortgage crisis was contained???

For further information, please contact:

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