

# CIPAM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

## Monthly Report August 2022

### Performance<sup>1</sup>

	1 Month (%)	Quarter (%)	6 Months (%)	FYTD (%)	1 Year (%)	3 Years (%) p.a.	5 Years (%) p.a.	Since Inception (%) p.a. <sup>2</sup>
CIPAM Credit Income Fund – Class A	0.35	0.40	0.49	0.96	1.58	-	-	3.76
CIPAM Credit Income Fund - Class I <sup>3</sup>	0.35	0.40	0.49	0.96	1.58	2.86	-	-
Bloomberg Bank Bill Index	0.15	0.33	0.35	0.28	0.37	0.36	-	0.21
Active return	0.19	0.07	0.14	0.68	1.21	2.51	-	3.55

Data Source: Fidante Partners Limited, 31 August 2022.

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

<sup>2</sup>The Inception date for Class A is October 1 2020.

<sup>3</sup>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	\$500.7 mil
Buy/Sell Spread	+0.18/-0.18%
Distribution Frequency	Quarterly
Redemption Terms	Monthly with 10% Fund level gate

### Key Statistics

Number of Issuers	111
Running yield (%) p.a.	4.5
Modified duration (yrs)	0.03
Average Rating	BBB-
Credit Spread Duration (yrs)	3.2
Non-AUD Denominated	27%
Private Credit Allocation	20%

## Monthly Commentary

**Performance Update:** The Fund delivered a net return of 0.35% in August, contributing to a trailing 1 year return of 1.58%, an excess return of 1.21% over the benchmark. The Fund continues to track ahead of the Bloomberg AusBond Credit FRN index which is up 0.09% for the year and significantly ahead of composite bond indices, which are down double digits for the year.

Income generation was responsible for almost the entire return over the month, with credit spread and yield curve movements making immaterial contributions for the first time in some months. At a sectoral level, the biggest underperformer was the securitised allocation, a sector we have been negative on for some time. The biggest outperformance came from the financial credit allocation where spreads tightened fractionally.

As interest rates increase and yield curves flatten the income generation of the fund is increasing, albeit without the capital drawdown risk that comes with longer duration strategies.

**Fund Positioning:** With minimal spread changes at an aggregate level, our positioning over the month was largely unchanged. We do continue to carry an elevated amount of liquidity in part a consequence of the larger foreign currency allocation.

Having peaked in June, our turnover declined in July, a trend which continued into August, albeit still at elevated levels of close to 100% on an annualised basis. Much of this activity was focussed on adding foreign currency denominated public market corporate paper (on a fully hedged basis) and switching out of Australian dollar denominated corporate and financial paper.

Given the rally in spreads in July and the flatness in August, we were slightly less biased towards extending our spread duration and overweighting public credit. Our weighting to private credit remains historically low, slipping below 20% in August. As such as we are now actively sourcing new private opportunities which have reset to wider levels. If markets stabilise at current levels, we expect to moderately increase our weighting to private opportunities.

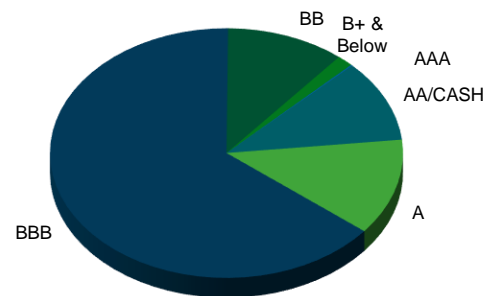
In terms of credit risk appetite, we are comfortable with current positioning which remains highly defensive. Only 12% of the portfolio is rated sub investment grade against a limit of 25%, with less than 2% rated below BB- (there are no CCC rated investments in the Fund). As a reminder based on historical default rates the credit risk of a B-rated issuer is approximately double the risk of a BB-rated issuer and 7.5 times the risk of a BBB-rated issuer.

At this point in the cycle, we are acutely aware of the implications of higher interest rates on our portfolio. Our conservative base case is that interest rates will rise further from here and inflation will prove stickier, placing liquidity stress on borrowers. We are particularly cautious on more highly geared parts of the economy, sectors which are dependent on discretionary spending and in the non-bank sector, lenders who are thinly capitalised, unprofitable and unable to cope with higher levels of loss provisioning across their portfolio.

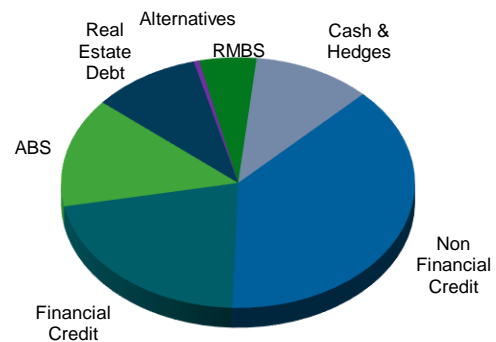
## Performance Statistics

Standard Deviation (ann.)	2.4%
% of Down months	8.3%

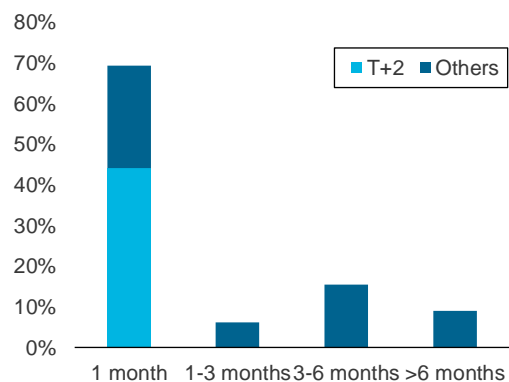
## Fund Credit Quality



## Fund Asset Allocation



## Fund Liquidity Exposure



**Market conditions:** It was a tale of two halves as markets rallied in the first half of August before selling off in the second half. There was some stabilisation through the month as the VIX index declined to below 20 for the first time since early April. Interest rate volatility declined, albeit not by as much as equity markets, remaining above 100, a level that was not touched from 2014 through 2019.

Even as rates volatility declined, interest rates steadily increased. The US 10 year yield increased by close to 55 basis points, more than retracing the rally in July and ending up at 3.2%. The move in nominal rates tracked real interest rates which also increased in August. As we type this in early September, the US 10 year inflation linked bond is trading with an inflation adjusted yield of close to 1%.

In a continuation of the concerning trend observed throughout 2022, equities sold off in August at the same time as government bonds declined in value. This relationship creates challenges for traditional asset allocation models and is makes a compelling case for credit investment which is effectively a blend of growth and defensive.

At least some of the move in rates and equities can be attributed to the ongoing conflict in the Ukraine and more specifically Russia's decision to cut off gas supplies to Western Europe. Natural gas futures had increased sharply in July and legged higher again in August.

With these moves in rates markets in mind, it was somewhat surprising to see credit markets perform as they did. CDX, the US investment grade CDS index was only 10 basis points wider in August. This compares to 20 basis points of widening in June despite similar moves in rates markets over June and August. Cash markets were even better with investment grade markets tightening over the month and high yield markets ending the month flat. The stable conditions in credit markets were conducive to new issuance. Over US\$50 billion was issued in the United States, despite August typically being a very quiet month. In Australia we saw over \$15 billion in issuance in August, making it the busiest month of issuance since January 2022. However over 90% of the domestic issuance was financial issuers. Non-financial issuance was an anaemic \$200 million, the lowest level since April 2020. In fact, through mid-September, total corporate issuance is just \$5.5 billion, making it on track to be the lowest level of issuance since 2009.

In contrast, domestic securitised markets are alive and well, alive. While there was less than \$2 billion in issuance in August, there has already been over \$6 billion in issuance in September. Mezzanine pricing has widened with BBB rated tranches pricing over 100 basis points wider since May, now clearing at margins of north of 4% implying yields to maturity of around 8%.

Private markets were relatively quiet with the most notable piece of news flow, KKR's withdrawal of its bid for Ramsay Healthcare. Activity seems to be concentrated in the middle markets with market volatility significantly increasing execution risk on large cap transactions.



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