

Challenger IM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report November 2022

Performance¹

	1 Month (%)	Quarter (%)	6 Months (%)	FYTD (%)	1 Year (%)	3 Years (%) p.a.	5 Years (%) p.a.	Since Inception (%) p.a. ²
Challenger IM Credit Income Fund – Class A	0.79	1.27	1.67	2.24	2.35	-	-	3.93
Challenger IM Credit Income Fund - Class I ³	0.79	1.27	1.67	2.24	2.35	2.89	3.66	-
Bloomberg Bank Bill Index	0.25	0.64	0.97	0.92	1.01	0.49	0.99	0.48
Active return	0.55	0.63	0.70	1.32	1.34	2.40	2.67	3.44

Data Source: Fidante Partners Limited, 30 November 2022.

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

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

³As 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.

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	\$503.7 mil
Buy/Sell Spread	+0.18/-0.18%
Distribution Frequency	Quarterly
Redemption Terms	Monthly with 10% Fund level gate

Key Statistics

Number of Issuers	117
Running yield (%) p.a.	5.1
Modified duration (yrs)	0.21
Average Rating	BBB-
Credit Spread Duration (yrs)	3.3
Non-AUD Denominated	29%
Private Credit Allocation	20%

Monthly Commentary

Performance Update: The Fund ticked over its 5 year anniversary in November. Since launching in October 2017, the Fund has delivered an excess net annualised return of 2.71% (simulated net of Class A fees) over the Benchmark.

Our goals at launch with the Fund were to achieve consistent levels of income generation whilst not forgoing capital stability. Annualised volatility since inception has been 2.4% with a maximum drawdown of 4.4% (March 2020) which was recovered in 7 months. Interest income represents virtually all of the total returns of the fund with only small negative contributions from credit spread widening and yield curve movements.

Focussing on the last month alone, we experienced strong performance driven broadly equally by a tightening in credit spreads and interest income. Performance was broad based with the most strength in corporate and financial names. Our securitised allocation was flat over the months as the repricing of risk post the Liability-Driven Investment sell continues to leak into secondary spreads.

Fund Positioning: With volumes starting to thin as we approach year end, we spent November deploying excess cash. As highlighted last month, we are more constructive on securitised credit than we have been for some time and thus have started selectively adding risk.

The Fund participated in several new issues, targeting non-mortgage collateral which we expect to deleverage quickly. All purchases were investment grade rated reflecting our up in quality bias. We had some activity in corporate names as well, adding some exposure to Origin Energy upon the announcement of a potential acquisition by Brookfield.

This leaves us with a cash position that has declined to below 5%. Our securitised allocation has ticked back up above 20% on a nominal basis and is now 10% on a spread duration weighted basis.

The running yield of the fund continues to increase reflecting the rising cash rate. It is now over 5% on a backward looking basis with the yield to maturity over 7%. This is incidentally only 50bps lower than the yield on CCC rated US high yield credit at the start of 2022, showing how much things have changed in less than 12 months.

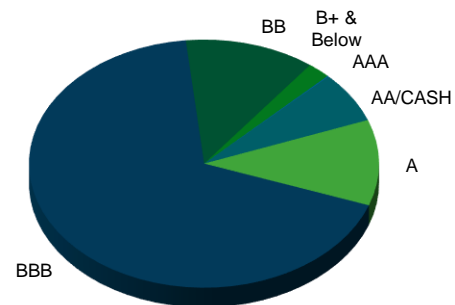
We did not extend spread duration as much as we would have liked during the volatility in recent months and with the repricing in securitised credit we do not expect to materially increase from here. Our foreign currency allocation has also likely peaked in the low 30% area as strong rebounds in these markets have reduced the relative value.

The private market allocation is currently constrained by the pipeline of opportunities we are seeing. Most corporate deal flow is rated below BB- placing it outside of the mandate of the Fund. We see this as largely a reflection of higher interest rates and resultant lower interest coverage on deals.

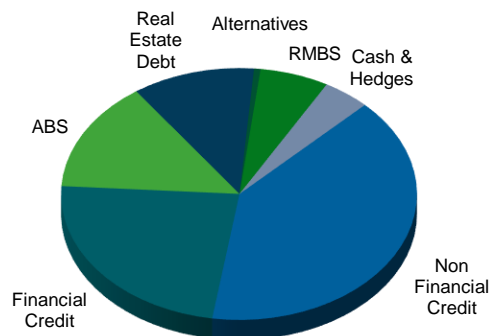
Performance Statistics

Standard Deviation (ann.)	2.4%
% of Down months	9.7%

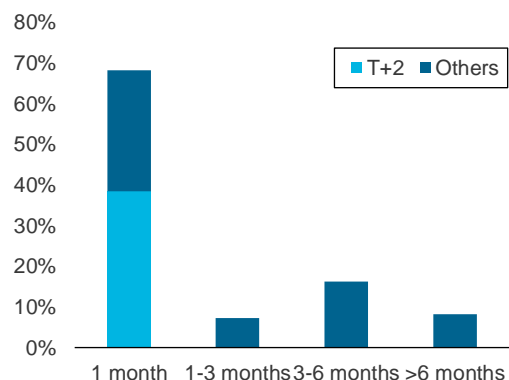
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Exposure



Market conditions: As has been the case for much of 2022, the inflation story was centre-stage in November. Long term interest rates declined circa 0.75% from the peak in mid-October as economic data started to indicate that the peak in inflation may be behind us. To date the moderation appears concentrated in goods with services still in the expansionary phase.

Markets responded positively to the more dovish tone. Equities followed a strong October with another >5% return, the first consecutive months of positive returns this year.

US investment grade credit outperformed equities on a relative basis with the November returns the strongest this calendar year. Leveraged loans were also up in November, albeit the weaker cohort in the index (B3 and Caa rated names) continue to lag, reflective of the challenging outlook for earnings.

The main focus for the Australian credit market was APRA's announcement around their "expectations on capital calls." APRA's focus was on so-called uneconomic calls, essentially redeeming a capital instrument with a low coupon to replace it with an equivalent instrument with a higher coupon. This announcement set the cat amongst the pigeons as there were two capital instruments (issued by AMP and Challenger, respectively) due to be called in November which could have been argued were "uneconomic". The immediate response was that USD Additional Tier 1 instruments declined by 2-4 points (in price terms) and AUD 10 non call 5 Tier 2 instruments widened by 20-30 basis points. Listed AUD retail hybrids didn't move in price at all, a point we suspect did not go unnoticed by APRA.

In the end both instruments were called as scheduled and as we sit here in early December, it appears that the market has discounted the APRA statement. The on-the-run CBA Tier 2 which widened from a margin of 270 basis points to close to 300 basis points is now bid at 240 basis points, 30 tighter than where it was trading pre-APRA announcement!

Our view is that there is a lot more water to go under this particular bridge. There were valid reasons why the AMP and Challenger notes were called (Challenger had already issued the replacement security and AMP was in an excess capital position and had APRA approval to buy back shares). There are outstanding deals in the market where issuers do not have excess capital positions, have not already issued replacement securities and where the cost of the existing capital instrument are significantly less than where they would issue today. The reality is that the call decision is complex for issuer and regulator alike and so we will be looking for more observation points to better price the call risk in these deals.

Securitised markets in Australia continue to defy the odds. Major bank warehouses at the end of September increased to A\$84 billion despite elevated prepayment rates for mortgages and A\$10 billion in securitised issuance. Pricing in BBB-rated mezzanine tranches hit 510 basis points which is more than 200 basis points wider than 2021 levels and reflective of the technical pressure the securitised market is under.

In private markets, the banks continue to be our biggest foes. APRA data through the end of October showed that bank non-financial corporate loans are approaching \$950 billion, up 14% YoY and 7% CAGR over the last 3 years, both of which are basically in line with system growth. Anecdotally we are seeing aggressive pricing by several banks on leveraged buyout debt as they chase lending growth. This is a theme we will be watching closely in the new year.



For further information, please contact:

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

This material has been prepared by Challenger Investment Partners Limited (Challenger Investment Management or Challenger) (ABN 29 092 382 842, AFSL 234678), the investment manager of the Challenger IM Credit Income Fund ARSN 620 882 055 (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. Challenger Investment Management 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, Challenger IM 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.

The rating issued for Challenger IM Credit Income Fund – Class A, 09/2022 is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Ratings are general advice only, and have been prepared without taking account of your objectives, financial situation or needs. Consider your personal circumstances, read the product disclosure statement and seek independent financial advice before investing. The rating is not a recommendation to purchase, sell or hold any product. Past performance information is not indicative of future performance. Ratings are subject to change without notice and Lonsec assumes no obligation to update. Lonsec uses objective criteria and receives a fee from the Fund Manager. Visit lonsec.com.au for ratings information and to access the full report. © 2022 Lonsec. All rights reserved.

The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) ("Zenith") rating (assigned Challenger IM Credit Income Fund – Class A, 10 Jun 2021) referred to in this piece is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual, including target markets of financial products, where applicable, and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product. Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of, and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at [Fund Research Regulatory Guidelines](#).