Challenger IM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report January 2023

Performance[1]

	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	1.24	2.86	3.70	4.33	3.73	-	-	4.54
Challenger IM Credit Income Fund - Class I[3]	1.24	2.86	3.70	4.33	3.73	3.34	3.90	-
Bloomberg Bank Bill Index	0.27	0.77	1.31	1.44	1.52	0.61	1.03	0.67
Active return	0.97	2.09	2.38	2.89	2.21	2.73	2.87	3.87

Data Source: Fidante Partners Limited, 31 January 2023.

[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	$522.3 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.	5.2
Modified duration (yrs)	0.11
Average Rating	BBB-
Credit Spread Duration (yrs)	2.7
Non-AUD Denominated	28%
Private Credit Allocation	19%

Monthly Commentary

Performance Update: The Fund started 2023 with a 1.17% return fuelled by a strong return in risk markets. Spread compression contributed around 0.90% to the return for the month. Given the roughly 3 years of credit duration in the Fund, the return was equivalent to a 30 basis point aggregate spread tightening, a significant move in a single month.

The strong start to the year takes the trailing 1 year return to 3.62%, an excess return of 2.20% over bank bills.

Fund Positioning: The extraordinarily strong start to the year has led us to reassess views around positioning. Continued scarcity in public market non-financial corporate paper has made the sector the most challenging in the whole portfolio. We are underweight and would like to add but see little relative value in the sector at current spread levels.

We are similarly unimpressed with the returns on offer in financial paper. Call risk is not priced, despite repeated warnings from APRA (although to be fair we have seen little action on this front). Fortunately spreads in securitised markets are far more attractive and supply is likely to be significant in the early part of this year. We are currently running a 20% allocation to securitised credit with a strong BBB average rating and a much lower spread duration than the overall fund.

Our outlook for credit is that defaults will have to rise from here, reflecting the significant tightening in financial conditions. Patience is key here as valuations are not reflective of financial conditions. This view drives our allocation to sub-investment credit where we are being particularly cautious. Our current allocation is 13%.

We also hold mixed views on private credit. On one hand, the higher interest rate environment will limit the supply of BB- and higher rated credits, creating some scarcity value to the deals into our pipeline. However current illiquidity premiums are reflective more of the expensiveness of public markets than the cheapness of private markets. Despite the tighter financial conditions, we do expect deal flow to pick up as bank treasury teams start to pass through higher funding costs to the lending parts of the balance sheet. As such, we expect to be origination led and allocating to private transactions for deal specific reasons.

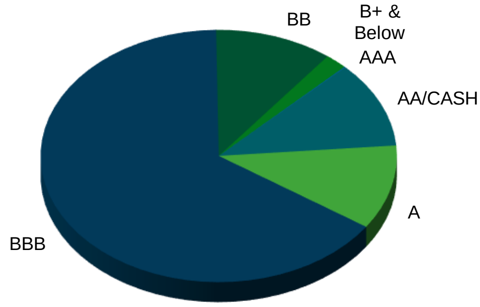
Market conditions: 2023 was the strongest January for US investment grade credit markets since 2009. US markets were up 1.7% versus swaps in January following a strong risk-on tone across broader markets. The S&P500 was up 6.2%, the second strongest start to the year since 1990.

The positive performance in risk markets were driven by a robust rally in rates markets. The ICE/BofA Australian Broad Market index had its best January performance on record and the ICE/BofA US Broad Market Index delivered the strongest performance since the late 1980s.

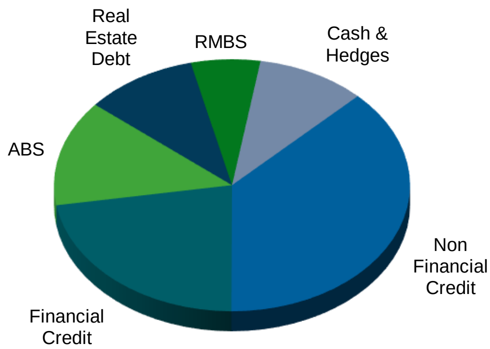
Performance Statistics

Standard Deviation (ann.)	2.4%
% of Down months	9.5%

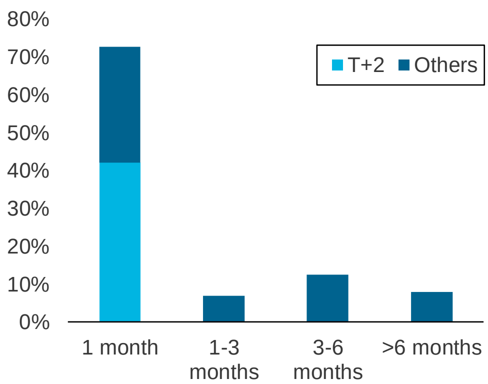
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Exposure



While this performance from equities and rates is a pleasing start to the year for most investors it is a reminder that the environment from 2022 is not behind us. Rates and equities remain positively correlated with ongoing questions around the traditional 60/40 portfolio remaining unanswered.

The rally in rates has left curves deeply inverted. The US 2s10s curve is the most inverted that it has been since the early 1980s with futures markets implying interest rates hikes will end in mid-2023 before cuts start in Q3. Despite our general level of caution, we feel that this is premature. The consumer is proving to be surprisingly resilient to tighter financial conditions with unemployment remaining close to cycle lows.

Fundamental credit risks also appear low, but we think it is inevitable that defaults rise from here. The January Senior Loan Officer Opinion Survey produced by the US Federal Reserve is showing the most rapid tightening in lending conditions since a brief period in 2020 and before that since the Global Financial Crisis. Credit Suisse noted that the current level of tightening is consistent with a 5% loan issuer default an increase from around 1% today. Bank lending spreads are also increasing at a pace near recessionary levels.

The story in Australia is similar, albeit lagged. Securitisation arrears remain anchored along with interest rates. Household deposits sitting on bank balance sheets are defying the higher interest rate environment and still increasing (even as non-financial deposits started to decline) and aggregate credit growth remains positive at a system level.

The resilience of the consumer is underpinning our thesis around staying patient. We still believe that tougher times are ahead as higher interest rates begin to bite but this will take time. Our base case is that upward pressure on interest rates will continue until there are clear signs that the consumer is under pressure evidenced by declines in credit outstanding, reduced deposit balances or increased unemployment.

In contrast to US banks which have been aggressively tightening lending standards, financial conditions in Australia do not reflect recessionary conditions. The NAB Monthly Business Survey showed broadly similar levels of credit availability to 2022 and strong demand for credit ongoing.

Despite things appearing rosy, there are cracks appearing if you are willing to look hard enough. In early February, OpenPay, a Buy-Now-Pay-Later lender focussed on SMEs appointed receivers, unable to pivot to sustainable profitability before running out of liquidity. The OpenPay situation has parallels with Nano exiting residential mortgage lending last year and we suspect more non-banks will follow, unable to achieve consistent through the cycle profitability in the current interest rate environment.

With this backdrop in place, it has been surprising to see the volume of securitisation deals hitting the market, both in Australia and offshore. While no deals priced in Australian markets in January, there is a pipeline of over a dozen deals looking to price in the coming months, hoping to take advantage of the more benign tone in markets. Pricing has moved tighter but does remain attractive relative to financials.

Corporate markets remain moribund with even an inverted yield curve and tighter credit spreads unable to entice issuers to market. Financial supply was better with over $9 billion issued in January. CBA priced a 5yr senior unsecured deal at a margin of 115 basis points in mid-January with Westpac coming at 98 basis points only one month later.

In contrast to the corporate bond markets, private debt markets have started on a more active tone with several M&A situations in play.

For further information, please contact:

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