Challenger IM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report February 2024

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	0.72	2.51	4.44	6.00	8.36	5.27	-	5.78
Challenger IM Credit Income Fund - Class I[3]	0.72	2.51	4.44	6.00	8.36	5.27	4.70	-
Bloomberg Bank Bill Index	0.34	1.09	2.12	2.88	4.10	1.95	1.47	1.72
Active return	0.38	1.42	2.32	3.12	4.26	3.32	3.23	4.06

Data Source: Fidante Partners Limited, 29 February 2024.

[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	$650.3 mil
Buy/Sell Spread	+0.18/-0.18%
Distribution Frequency	Quarterly
Redemption Terms	Monthly with 10% Fund level gate

Key Statistics

Number of Issuers	127
Running yield (%) p.a	6.1
Modified duration (yrs)	0.10
Average Rating	BBB-
Portfolio Credit Spread Duration (yrs)	2.7
Non-AUD Denominated	25%
Private Credit Allocation	19%

Monthly Commentary

Performance Update:
The rally continues. The Fund was up 0.72% in February, a return of 0.38% over bank bills taking the 1 year trailing return to 4.3% over the bank bills, exceeding the target return of 3% per annum over the Benchmark.

As was the case the main drivers of the returns continue to be income and spread tightening. There was no meaningful contribution from yield curves and currency movements, which is consistent with the strategy for the Fund to not take these risks.

Since inception the Fund has returned 5.8% per annum outpacing the 2.4% per annum return on the Bloomberg AusBond Credit FRN index, exceeding our goal of outperforming daily liquid credit by 1-2% per annum.

Fund Positioning:
The sharp rally in credit spreads has continued unabated into 2024. The current yield to maturity on the Fund is 6.8% and is projected to increase towards 7% as we increase our allocation to private debt investments. For context, for every percentage point increase in our private debt allocation increases the yield on the Fund by 2-3 basis points.

Our immediate private debt pipeline will see the allocation to private debt increase to around 23% which is roughly around neutral. With public market spreads continuing to test tighter, we are moving the portfolio towards an overweight to private debt.

The private allocation will focus on corporate and real estate markets with our public allocation focussed on financial and non-financial bonds. Asset backed markets have performed exceptionally well over the last few months with spreads approaching late 2019/early 2020 levels, albeit with investment grade rated mezz remaining 50-75 basis points wide of 2021 tight levels. The difference is that the backdrop today is weaker with less credit support provided and slightly elevated arrears levels.

Despite increased interest from investors the securitised credit markets remain highly inefficient and we do see parts of the market where there are opportunities. BB-rated tranches look cheap to BBB and higher up ratings and some consumer lending products are not as well liked by the markets.

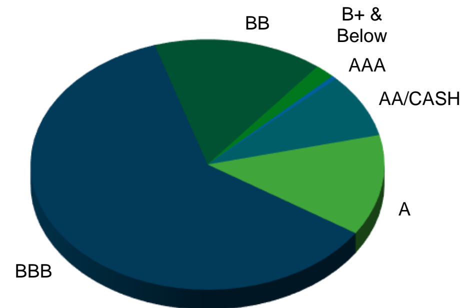
The underlying credit quality of the Fund is in line with expectations with a default weighted average rating of around BBB to BBB- (Moody's WARF of just under 500). Less than 2% of the Fund is rated below BB- and 17% is rated below BBB-. With a cautious outlook our bias remains towards stronger BB rated names in private debt markets. This may see the average rating of the Fund move closer to BBB- albeit still with a reasonable buffer.

Our allocation to foreign currency denominated credit remains at around 25%. Cross currency basis levels remain unfavourable but spreads on an outright basis do look attractive, especially in corporate and financial markets.

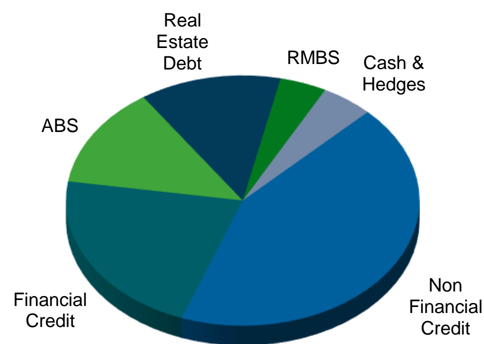
Performance Statistics

Standard Deviation (ann.)	2.2%
% of Down months	7.7%

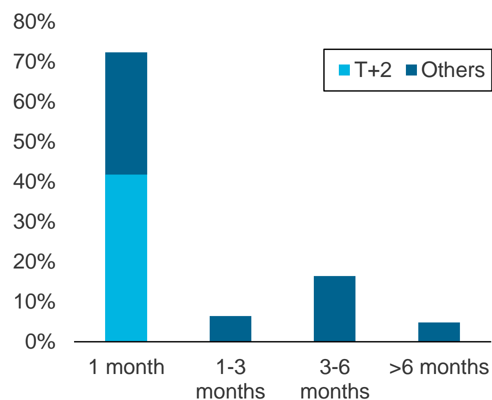
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Exposure



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We have previously discussed our approach to real estate exposure where we have long held an underweight position, biased towards senior unsecured bonds issued by REITs and away from bilateral private senior secured loans to single assets. Our current allocation is 13% of which 3% is in private markets. This is expected to increase slightly over the coming month as we have several attractive defensive private transactions in the pipeline.

Over the month the Fund invested in one private transaction in primary markets and was drawn down on two existing exposures. With more activity in primary public bond markets the Fund was active mainly in corporate and financial issuance.

Market conditions:
Credit spreads ended February at 24 month tights. US high yield is trading inside 3% as an asset swapped spread, only 25 basis points from the tight level from December 2021. BB-rated credit is even more fully priced, only 10 basis points from the tights. Interestingly investment grade is more like 35 basis points from the tights.

To put in context in December 2021, the Fed Funds rate was 0.25%, today it is 5.5%. In December 2021, the US 10 year treasury was trading at 1.50%, today it is 4.25%.

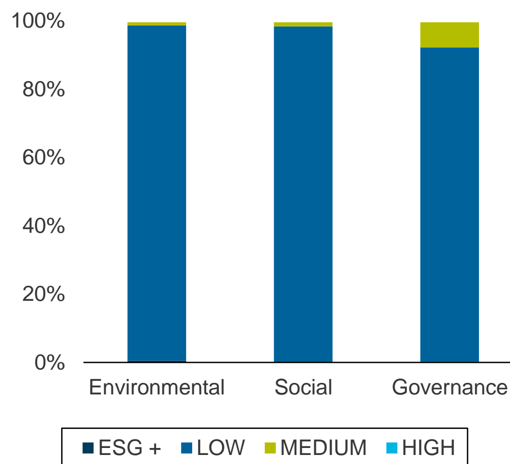
In fact, in December 2021, Moody's projected a 12 month forward default rate of just under 1%, today it is just under 4%. In December 2021 recoveries for senior unsecured bonds were 55%, today they are 33%. 1 yr forward expected losses today are around 2.5% versus 0.5% in December 2021 so on a loss adjusted basis, spreads are well inside the tights of the last few years.

The current rally in credit was predicated by a sharp rally in long term interest rates in the last quarter of 2023 when the US 10 year rallied by over 100 basis points. Since then, rates have sold off by around one third, yet risk assets have continued to perform. It has been many years since spreads and fundamentals were so in conflict. The US 2s10s, often cited as a recession indicator has been inverted since June 2022, the longest period in the last 50 years and the deepest inversion since 1980. Over 10% of loans backed by offices in US CMBS are in special servicing with 6.6% of loans more than 30 days delinquent (up from 2.4% 12 months ago). The last time we felt this was back in 2007 when the equity markets bought into the idea that the issues in the housing market were contained. While we don't think that markets are as complacent now as they were then (in 2007 high yield spreads were 100 basis points tighter than today's levels), there are similar arguments being made about risks being "contained". We're not so sure.

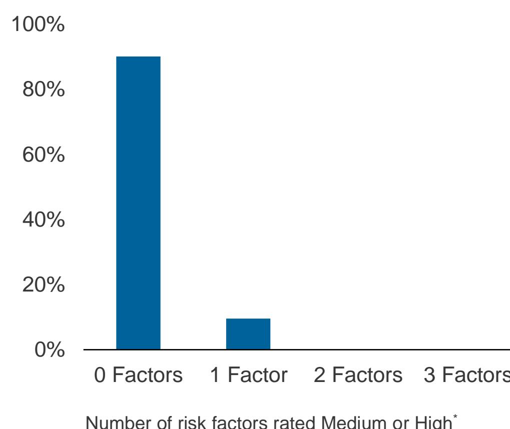
Similar themes exist in the asset backed finance market. Arrears are rising, albeit slowly, and spreads are crunching in even as structures become more leveraged. BBB rated non-conforming RMBS spreads hit 300 basis points, the tightest level since late 2021 when spreads hit 270 basis points. Current BBBs are coming with 1.8% credit enhancement versus 2.4% in late 2021.

Within private markets levels are more attractive, albeit on a relative basis. Illiquidity premiums on recent originations are in the 2-3% range, around historical averages. Deal flow is elevated, albeit deal quality is not. In the fourth quarter of 2023 the team only proceeded with around 10% of corporate and real estate backed transactions, around half the historical level. There continue to be signs of idiosyncratic stress with ASIC insolvencies back to levels last seen in late 2015 when iron ore was trading at approximately 50% of the current level.

ESG Profile



ESG Risk Layering



* Percentage of deals which have multiple risk factors rated Medium or High. For example, 2 might be Environmental and Governance risk rated Medium.

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