Daintree CAPITAL

DAINTREE CORE INCOME TRUST

MONTHLY FACTSHEET: 30 September 2021

Awards & Credentials

The Daintree Core Income Trust has been awarded a Recommended rating by both Lonsec and Zenith. Daintree Capital is also a signatory to the United Nations Principles for Responsible Investment.

Signatory of:

Fund Description

The Daintree Core Income Trust (the Fund) is an absolute return, cash plus bond strategy. The Fund is not constrained by any traditional fixed income index, which provides us the flexibility to seek out the best risk adjusted returns available across regions, sectors and securities.

Fund Objective

The aim of the Fund is to provide a steady stream of income and capital stability over the medium term, by investing in a diversified portfolio of fixed income securities and cash. The Fund seeks to produce a return (net of fees) that exceeds the RBA Cash Rate by 1.50-2.00% p.a. over a rolling three-year period.

Monthly Highlights

- Wider credit spreads detracted from performance in September, with weakness in financials and RMBS/ABS the main drivers.
- Higher bond yields also detracted, although this was mitigated by the low duration stance of the Fund.

Key Statistics

Modified Duration (Yrs)	0.45
Spread Duration (Yrs)	3.86
Portfolio Yield (%)	1.53
Average Credit Quality	A
Portfolio ESG score (MSCI)	A

Note: Portfolio yield is the expected return over the next year, assuming no changes to either portfolio composition or market yields. Average credit quality excludes overlay positions. Portfolio yield and spread duration reflect the net credit default swap exposures in the portfolio. The Portfolio ESG score is the weighted average portfolio ESG rating based on Daintree Capital's application of MSCI data.

Fund facts

Trust name	Daintree Core Income Trust
Funds under management	AUD599m
Responsible Entity	Perennial Investment Management Ltd
Portfolio managers	Mark Mitchell & Justin Tyler
Inception date	5 June 2017
APIR code	WPC1963AU
Management costs	0.50% pa
Buy/sell spread	+0.05% / -0.05%
Entry and exit fees	None
Pricing frequency	Daily
Minimum initial investment	$25,000
Distribution frequency	Monthly
Currency	Australian Dollar

Platforms

The Daintree Core Income Trust is available on the following platforms:

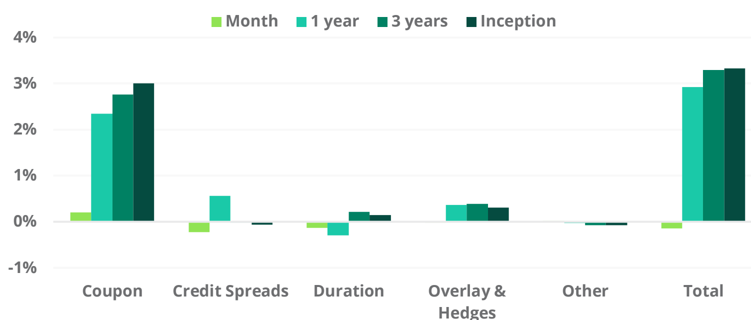
- AMP North
- Asgard
- BT Panorama
- HUB24
- Macquarie Wrap
- Mason Stevens
- MLC Navigator
- MLC Wrap
- Netwealth
- Praemium
- uXchange
- Xplore Wealth

Performance & Analytics

	Month (%)	Quarter (%)	1 Year (%)	3 Years (% pa)	Inception (% pa)
Fund (gross)	-0.14	0.12	2.93	3.29	3.33
Fund (net)	-0.18	-0.01	2.43	2.77	2.78
Distribution (net)	0.10	0.88	1.78	1.82	2.03
Growth (net)	-0.28	-0.89	0.65	0.95	0.76
RBA Cash Rate	0.01	0.03	0.11	0.65	0.90
Excess Return	-0.19	-0.03	2.32	2.12	1.88

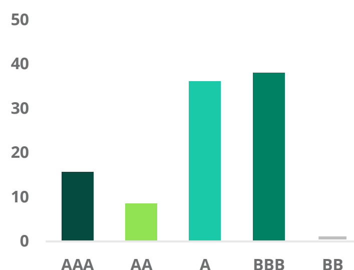
Note: Performance inception is 1 July 2017. Excess return is measured with reference to net performance. Returns for periods longer than one year are annualised. Distribution return is the difference between total return and ex-distribution unit price return. Past performance is not a reliable indicator of future performance.

Performance Contribution (Pre Fees)

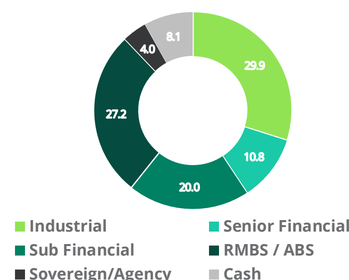


Note: Overlay strategies use derivatives to ensure that the Fund exposure to interest rates, credit and other relevant factors is controlled separately to the physical assets in the portfolio

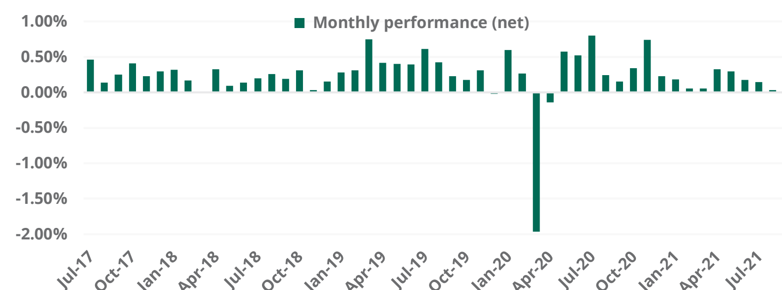
Rating Exposure (%)



Sector Exposure (%)

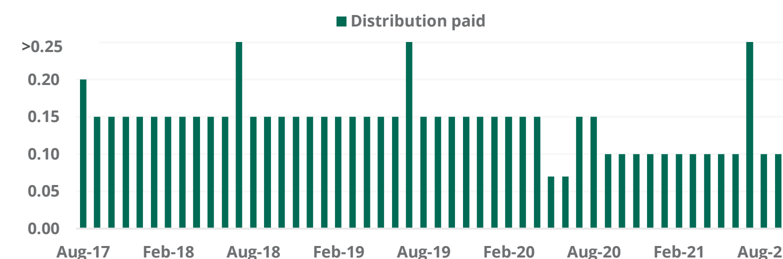


Monthly Performance



Cash Income

The Fund distributed 0.10 cents per unit in September.



Fund Review

The Core Income Fund returned -0.18% for the month bringing the rolling twelve-month performance to 2.43% net of fees. During the month, both duration and credit spreads were negative contributors which more than offset coupon income. Most sectors in the portfolio were negative but RMBS/ABS and subordinated financials were the largest negative contributors. Broader Australian credit spreads were very mixed across sectors and tenors. Energy names performed better than most on the back of higher energy prices. The Fund continues to have a modest interest rate duration positioning at 0.45 years.

RMBS/ABS issuance was healthy with seven new deals pricing during the month totaling $4.3 billion, including the first RMBS deal from a major bank since 2020, as Westpac priced a new deal. Total issuance by corporates and financials was $3.7 billion during the month. Issuance continues to remain below maturity levels with net issuance at -$22.8b year to date. This strong technical has helped overall spreads remain relatively stable despite weakness seen in some offshore markets. We participated in several new deals during the month including Woolworths SLB 2027, Zip 2021-2, Allied 2021-1, Shopping Centre Australia 2029, Dexus Property 2028 and Electranet 2028.

Outlook

Much airtime is devoted to the September seasonal weakness that is often seen across financial markets. September 2021 once again provided confirmation to those who take views on such things. At its lowest on September 29, the benchmark ASX200 index had reverted to levels last seen in June. This weakness in equities was driven by moves in government bond markets that were the most dramatic seen since February this year - government bond prices fell, and their yields re-traced almost two months of moves lower. The Australian benchmark 10-year government bond maturing in November 2031, saw its yield move more than 40 basis points higher from its low of 1.0785 on August 20, ending September at 1.49. Holders of this bond will now need to earn more than 2 and a half years of the 1% coupon return on offer to offset this latest loss of value. Another illustration of the perils of excessive interest rate risk exposure in bond portfolios.

Weakness was not confined to government bonds though, as credit spreads also moved wider. Volatility in credit markets, however, remains much lower than volatility in either government bonds or equities. For example, credit spreads in Australia were between zero and 5 basis points wider on average, a much lesser move than the sorts of moves seen in government bond markets. Offshore credit spreads moved a little more but importantly, we see credit as being supported by low net issuance and a continued hunt for relatively safe income on the part of investors.

As always, the key question for financial markets is how the macroeconomic backdrop will evolve. Will risk markets resume their march higher? Concerns abound: Covid in the northern hemisphere winter; the recurring US debt ceiling saga; falling Chinese growth amid tighter fiscal policy in both China and the US; and policy normalisation on the part of several global central banks as they come to the realisation that global inflation may not be as transitory as they first thought. We expect markets to continue pricing a ‘living with Covid’ status quo which will see the pricing of downside tail risks from this source diminishing over time. We also expect that, once again the debt ceiling will be lifted in the US and a crisis averted. What really matters though is the distribution of risks around these views. With respect to politics, for example, human nature can and has led to unexpected outcomes throughout history. Covid presents a range of issues to consider too - risks include the potential for break-through infections to accelerate amid falling vaccine efficacy, as well as the potential for long Covid to be revealed as a significant public health issue. We feel that given the elevated pricing of some markets (US equities in particular), the potential impact of the major risk factors is significant now.

When we add central bank policy normalisation to the mix, the clouds darken further. Even though recent central bank speeches have fallen on the dovish side and managed to appease markets, each speech that is successful in this regard heightens the bar for future communications. Eventually, market expectations of central banks will be sufficiently dovish that a disappointment will register, or alternatively, the credibility of a consistently dovish stance will be bought into question by the data flow. Inflation is already very elevated, and the yield curve steepening seen in September may mark a new phase for bond markets on this issue. We feel that policy makers are ushering in a period of increased uncertainty in markets, whether they want to or not. Our view on inflation has evolved too and this informs our view on central banks. Is it sensible, for example, to expect shipping costs to fall? Shipping capacity constraints are already prompting companies to increase precautionary inventories, which will in turn increase these shipping-related cost pressures further. Feedback loops like this turn transitory outcomes into long-lived ones in the absence of a policy response. On the supply side, new capacity in both shipping and ports takes years to develop and environmental regulations will increase the costs of such upgrades. Moving from shipping to the consumer, we wonder what happens if Covid does remain under control and travel picks up just as commodity prices (notably oil) are accelerating? Increased services prices beckon at a time when supply chain pressures remain high.

The balance of risks with respect to inflation seems clear and the required policy response is clear as well. What is unclear is the willingness of central banks to cause the sort of market disruption that an accelerated pace of tightening will cause. The problem is that a market correction will be forthcoming anyway if central banks do not react appropriately to incoming data.

We are positioning our portfolios defensively given the particularly uncertain backdrop. Central bank tapering is well-priced by markets, but we watch real yields in the longer-end of the US curve which have risen sharply from record lows over the last two months. Further increases could hamper risk asset valuations. We see US wage growth as perhaps the single most important variable to focus on in the near-term, because the transient inflation narrative will come under further pressure if wages growth does not slow in the coming months in line with increased US labour supply (given the end to unemployment benefits earlier this month) and a decelerating US fiscal pulse. If wage growth cannot decelerate against this backdrop, we feel that treasury yields will see more upward pressure. The likelihood that both treasuries and equities fall in value together will increase. Investors who have not closely assessed the amount of duration risk they are holding in their defensive asset allocation should now address this as a priority.

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