DAINTREE HIGH INCOME TRUST

QUARTERLY FACTSHEET: 30 September 2019

Awards & Credentials

Daintree Capital is proud to have been nominated as a Finalist for the Money Management Fund Manager of the Year Award in the Emerging Manager category for 2019. We are also a signatory to the United Nations Principles for Responsible Investment.

Fund Description

The Daintree High Income Trust (the Fund) is an absolute return 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 over the medium term by investing in a diversified portfolio of fixed income securities. The Fund seeks to produce a return (net of fees) that exceeds the RBA Cash Rate by 3%-4% p.a. over a rolling three to five-year period.

Quarterly Highlights

- The Fund performed well, with all return drivers contributing to the quarterly performance outcome
- The quarter was defined by a substantial lift in interest rate volatility. The largest government bond rally in some months took place in August, before being substantially reversed in September
- Credit spreads were mixed, with higher beta names being the main outperformers
- A range of overlay strategies contributed positively to performance

Key Statistics

Modified Duration (Yrs)	1.95
Spread Duration (Yrs)	3.56
Portfolio Yield (%)	4.67
Average Credit Quality	BBB+

Note: Portfolio yield is the expected return over the next year, assuming no changes to either portfolio composition or market yields.

Fund facts

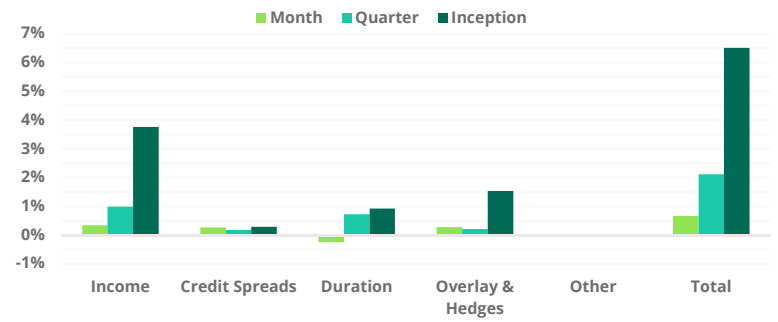
Trust name	Daintree High Income Trust
Responsible Entity	Perennial Investment Management Ltd
Portfolio managers	Mark Mitchell & Justin Tyler
Inception date	1 November 2018
APIR code	WPC1583AU
Management costs	0.75% pa
Buy/sell spread	+0.15% / -0.15%
Entry and exit fees	None
Pricing frequency	Daily
Initial investment	$10,000
Distribution frequency	Monthly
Currency	Australian Dollar

Performance & Analytics

	Month (%)	Quarter (%)	Inception (%)
Fund (gross)	0.67	2.11	6.50
Fund (net)	0.60	1.92	5.82
Distribution (net)	0.20	0.59	2.60
Growth (net)	0.40	1.33	3.22
RBA Cash Rate	0.08	0.25	1.24
Excess Return	+0.52	+1.66	+4.58

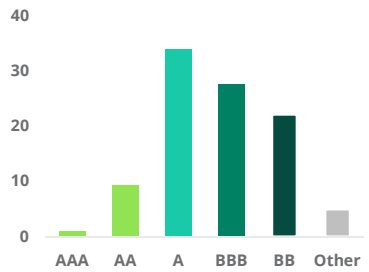
Note: Performance inception is 1 November 2018. Excess return is measured with reference to net performance. Returns for periods longer than one year are annualised. Distribution return is the monthly cents per unit distribution divided by the net asset value unit price at the start of the month. Past performance is not a reliable indicator of future performance.

Performance Contribution (Pre Fees)

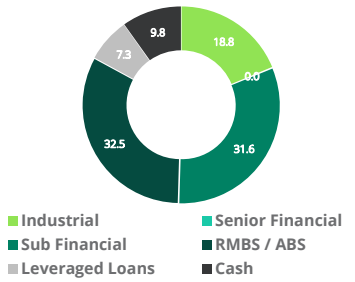


Note: Overlay strategies use derivatives to ensure that the fund exposure to interest rates, credit and other relevant factors is controlled separately to the physical assets in the portfolio

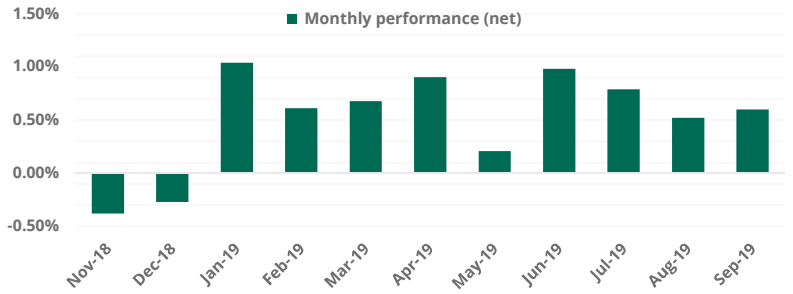
Rating Exposure (%)



Sector Exposure (%)

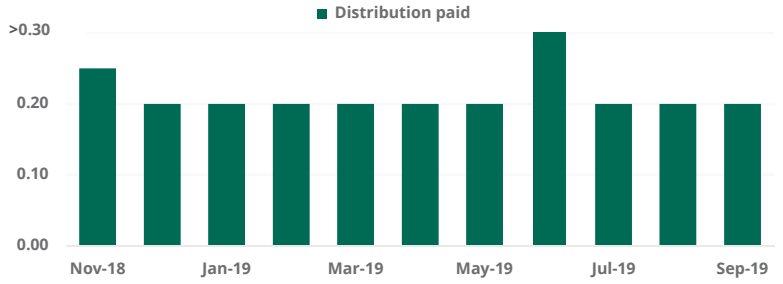


Monthly Performance



Cash Income

The Fund distributed 0.20 cents per unit in September.



Fund Review

The September quarter saw good performance, with value added across most components of the Fund. Credit spreads were mixed, with higher-beta names outperforming. Our core exposure to interest rates was additive to performance as bond yields continued to fall to record lows globally. Overlay strategies performed well too: our proprietary hedging strategies boosted performance amid the underperformance of credit assets in August, while September in particular saw a range of other strategies across both rates markets and currency markets adding value to the Fund.

Outlook

The September quarter saw bond markets awakening from the QE-induced low-volatility environment they had been existing in. August saw the US 10-year treasury yield fall 52 bp, the largest calendar month drop since January 2015. In September the subsequent sell-off almost erased all of these gains, before reversing midway through the month. When the dust settled, the month of September saw only a partial reversal of the August rally, and bond yields around the world remain close to record lows.

Credit markets were rather dull by comparison. In our recent quarterly outlook meeting we discussed the ability of credit, equities and other such 'risky' assets to shrug off the significant uncertainty that has enveloped much of the world. This uncertainty has caused weakness in purchasing manager indices globally, but it has also caused interest rate markets to have high conviction in further central bank easing. This is why current levels of uncertainty that would normally mark a poor environment for credit spreads have actually been quite benign in their impact. It seems that the faith markets have in central banks knows no bounds, even in the face of significant deterioration in the economic data pulse.

This faith of markets in central banks is somewhat ironic because the relationship between governments and their central bankers has become increasingly strained, in both the United States and Australia. Central bankers have become more strident in their calls for fiscal policy to bear some of the easing burden, but these entreaties have fallen upon deaf ears and have led to increasing attacks by government figures on central bank performance. Thus, monetary policy continues to push on a string because the fiscal policy levers seem to be applicable in crises only. In Europe, successive waves of austerity over many years have seen the ECB increasingly forced to explore the boundaries of the monetary policy toolkit. The fall in German yields to negative levels at all points on the term structure has pulled global bond markets to ever lower yields, supporting riskier assets in the process. In the US, for example, current equity prices were last associated with bond yields some 125bp higher than current levels.

That bond yields have been required to fall to the extent they have to support equity prices begs the question as to what might have happened if bond yields had instead remained unchanged during the quarter. This is an important question because the future for central bank policies will look very different to the past. Both the ECB and the BoJ are 'tapped out', and this puts further pressure on the US Federal Reserve to become the driver of ever looser broad financial conditions. We are already seeing the outcome of the Fed's reluctance to match the sort of easing that the other two major banks have undertaken – the US dollar is at its strongest level versus the Euro since 2009. In trade-weighted terms, the US dollar is at levels not seen since 2002. In the past, such strength would have been expected to put pressure on emerging markets, but in the current environment the extra returns on offer are just too tempting for investors to pass up.

Such a backdrop cannot continue indefinitely. At some point, the real economy will bring markets back to earth if data does not improve. In the US, data has been outperforming expectations for the entire quarter but this is less the case in the manufacturing sector, which cannot reliably escape global weakness. There are early signs of improvement in European manufacturing sectors, but the jury is still out. This lack of conviction on the data front sees central banks remaining as the only game in town. That means the US Federal Reserve will likely cut rates further – markets are pricing this eventuality as virtually certain. In Australia, the RBA has cut rates in October following labour market weakness, with the statement pointing to global factors as also being important in the decision. In New Zealand, the surprise 50bp cut in August has helped to provide the economy some breathing space (in particular via a substantial weakening in the NZD). The RBA may take note, in the knowledge that a weaker currency would also help in achieving Australia's objectives. The risks seem skewed towards more aggressive easing in Australia going forward, as opposed to the more measured approach of the past.

What will happen if the Fed remains reluctant to ease policy, disregarding market signals that easing is required? In the absence of better data this would be a recipe for increased market volatility which would eventually tighten financial conditions. Such an outcome would increase pressure on the Fed to relent. We believe the Fed will give in to that pressure, pushing interest rates lower and further supporting risk assets over the next year or so.

The risk to our view is that we see a sudden improvement in US data. If this were to happen, we believe both interest rates and risk assets may initially sell off in tandem, reversing recent moves. This points to a common multi-sector portfolio positioning that we find problematic – an overexposure to equity risk combined with an overexposure to interest rate risk. Just as falling interest rates have been a tailwind to stock market performance recently, we see the potential for a damaging, correlated fall in both bond and equity markets at some point in the future.

Daintree Capital's funds are well-positioned for a continuation of the status quo, but also for just an environment where both traditional fixed income and equities struggle. We continue to offer investors a stable income stream combined with a strong capital preservation imperative. We offer solutions for investors looking to rotate away from traditional bonds, equities, low-yielding term-deposits or indeed all three of these.