DAINTREE
HIGH INCOME TRUST

QUARTERLY FACTSHEET: 31 December 2020

Daintree CAPITAL

Awards & Credentials

The Daintree High Income Trust has been awarded an Approved rating by Zenith. Daintree Capital is also a signatory to the United Nations Principles for Responsible Investment.

Zenith Investment Partners — Approved

Signatory of: PRI 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

- Performance has been strong, with tighter credit spreads the main driver. This was particularly the case in October and November, with spread compression slowing in December
- Overlay performance was positive for the month, but down slightly for the quarter

Key Statistics

Modified Duration (Yrs)	1.69
Spread Duration (Yrs)	3.14
Portfolio Yield (%)	4.13
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

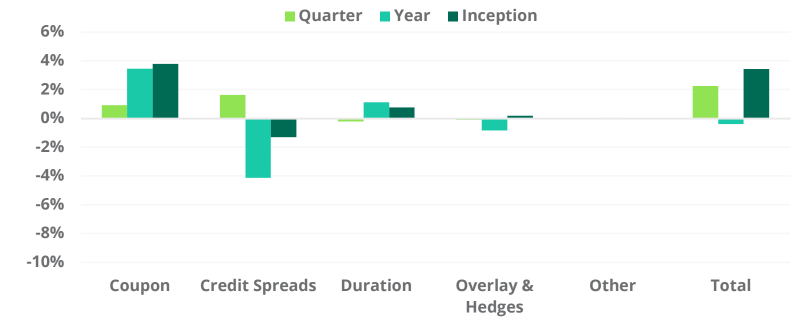
Trust name	Daintree High Income Trust
Responsible Entity	Perennial Investment Management Ltd
Portfolio managers	Mark Mitchell & Justin Tyler
Inception date	1 November 2018
APIR code	WPC1583AU
Management costs	0.75% pa
Buy/sell spread	+0.15% / -0.15%
Entry and exit fees	None
Pricing frequency	Daily
Initial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

Performance & Analytics

	Month (%)	Quarter (%)	1 Year (%)	Inception (% pa)
Fund (gross)	0.68	2.30	-0.33	3.46
Fund (net)	0.61	2.12	-1.08	2.71
Distribution (net)	0.20	0.62	2.63	2.69
Growth (net)	0.41	1.50	-3.72	0.02
RBA Cash Rate	0.01	0.06	0.38	0.84
Excess Return	+0.60	+2.06	-1.46	+1.88

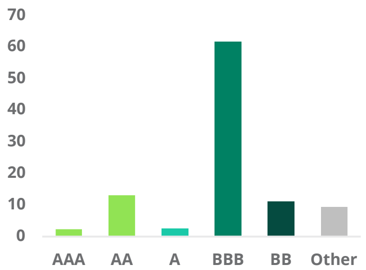
Note: Performance inception is 1 November 2018. Excess return is measured with reference to net performance. Returns for periods longer than one year are annualised. Distribution return is the difference between total return and ex-distribution unit price return. Past performance is not a reliable indicator of future performance.

Performance Contribution (Pre-Fees)

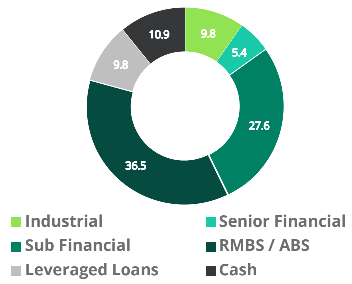


Note: Overlay strategies use derivatives to ensure that the fund exposure to interest rates, credit and other relevant factors is controlled separately to the physical assets in the portfolio

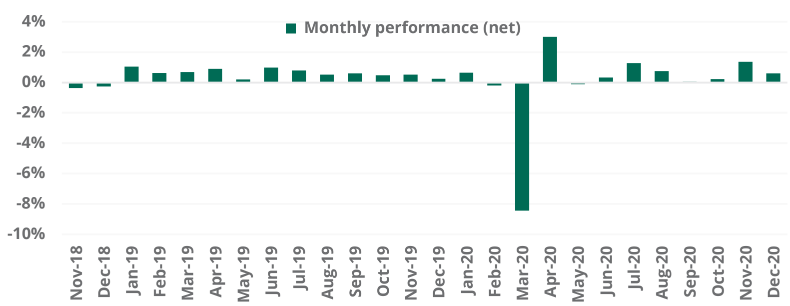
Rating Exposure (%)



Sector Exposure (%)

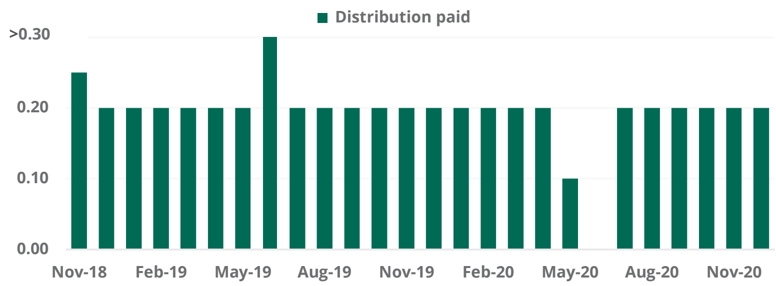


Monthly Performance



Cash Income

The Fund distributed 0.20 cents per unit in December.



Fund Review

The final quarter of the year was defined by the notable performance of risk assets. This translated to credit markets, particularly in the month of November which saw a notable move narrower in credit spreads across sectors. Credit spread compression was therefore the main driver of fund performance for the quarter, with financial names moving first and non-financial names following in the latter part of the quarter. Higher beta names outperformed.

A little value was detracted by our core duration position (0.4 years) as yields rose. We believe yields may rise a little further from current levels during 2021, but such increases are likely to be limited by central bank purchase programs.

Outlook

Many people cannot wait to see the back of 2020. Locally, the sequence of bushfires and then COVID-19 caused hardship for many in our community. For investors, however, 2020 was for the most part a good year (despite the volatility of March). Looking forward to 2021, continued low policy rates and a lack of appetite for austerity from major governments (a welcome contrast to the GFC) continue to be large positives for the global economy. Although GDP in most economies will not regain pre-Covid levels until 2022 at the earliest, the significant rebound in GDP growth from a historically low base has been a positive for markets – a sign that policy support is working and that the worst is over for the global economy. Some businesses will, unfortunately, still close due to the stresses of the past several months summing to an insurmountable burden. At the same time, however, applications to form new businesses in the US are rising. This is no doubt the case elsewhere too. As capital is put to new and more productive uses and as surviving companies cut office space, reduce travel, tap a vast online labour pool and re-orient towards a more significant online sales presence, lasting productivity gains can be locked in. The forced adaptation of businesses to Covid has seen a meaningful acceleration of these trends. In the long run this is good news for living standards. Meanwhile, there is also the potential for consumers to reduce significant precautionary savings balances as the recovery continues to take hold. A willingness to spend that has been missing from the post-GFC recovery may materialise, boosting the backdrop still further. While some in markets worry about inflation as a result, at Daintree we instead see the ingredients of a recovery that should prove more durable than the experience of the last decade, and sufficient to gradually reduce the significant slack that still exists in labour markets both here and overseas.

Of course, during a pandemic there is no amount of policy stimulus that can support significant and long-lived economic gains without positive news on the health front. The second half of 2020 provided that positive news. The scientific progress that has given rise to several promising vaccine candidates is the catalyst that allowed massive policy stimulus from both governments and central banks to be fully discounted into asset prices. The vaccine rollout that has commenced in many countries has already been largely reflected in market pricing, and this is an important reason for the lack of impact that European and US lockdowns have had on markets over the last several weeks. Health policy has evolved as well, and major lockdowns like that seen in Victoria earlier in the year may be mitigated by much higher rates of testing and localised isolation, while the potential for further policy stimulus remains in the wings as a last resort.

Looking into 2021 then, there are many reasons to be positive. At Daintree, however, we are credit investors. It is our role to examine potential downsides closely. This is particularly the case given markets have already priced in significant good news: the sum of FOMO + TINA always gives rise to risks to the status quo. For markets then, we see some potential that the latest vaccines ultimately prove to be a double-edged sword. Pre-release testing has been curtailed in the interest of an expedited global rollout, and as a result there is the potential for side-effects to be more widespread than indicated in the limited testing to date. There is also the potential for efficacy to be questioned when vaccines are rolled out on a large scale. In addition, the WHO's Chief Scientist Dr. Soumya Swaminathan noted in late December: "At the moment, I don't believe we have the evidence on any of the vaccines, to be confident that it's going to prevent people from getting the infection and passing it on." Such sentiments present the clear risk that international borders remain closed, and quarantine arrangements remain in place locally, for longer than originally expected. Viral mutation, logistical problems, and unexpectedly low rates of vaccination in the community are other potential risks to the positive sentiment in markets at present. All represent a threat to current market pricing.

This backdrop is a particularly challenging one for those tasked with the stewardship of multi-asset portfolios – what is the best way to participate in upside price moves while limiting exposure to the downside?

One option is the historical status quo of government bonds. The outlook for duration remains challenging, as the 'risk-free return' sought by multi-asset investors from this part of their portfolios has morphed into a 'return-free risk'. Is duration exposure worthwhile when nominal yields are at lows not seen for a millennium and real yields are deeply negative? We continue to expect many fixed income investors to reassess their fixed income exposures in the months ahead.

Another option is explicit protection strategies, for example those that utilise equity put options. Such strategies remain expensive relative to the sorts of levels seen pre-Covid. They are also quite path dependent – that is, the efficacy of the protection received depends in large part on whether it was purchased at levels close to market turning points.

Credit portfolios, like those we manage at Daintree, are worthy of consideration. Credit represents a middle ground – a way for investors to generate a positive yield without taking excessive risk. There is no free lunch though, and investment returns will exhibit market-related volatility that increases with the yield the investor expects to earn.

There is no easy choice here, and if there is one constant between the disruption of 2020 and the hope for a better 2021, it is that investors remain in this relatively new paradigm. It used to be possible to earn a modest positive yield with little market volatility, but this is no longer the case. Portfolio construction is still adapting to this new reality.

As 2020 draws to a close we thank our existing investors for their support, and hope that in 2021 we can assist a wider group of investors to invest their defensive assets more effectively.