DAINTREE HIGH INCOME TRUST (NZD)

QUARTERLY FACTSHEET: 31 March 2021

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 NZD Unit Class (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 RBNZ Cash Rate by 3%-4% p.a. over a rolling three to five-year period.

Quarterly Highlights

- In a challenging period for markets, the fund delivered positive performance in each month of the quarter
- Overlay performance was positive for the quarter, offsetting weaker performance from higher interest rates. Tighter credit spreads in the Australian residential mortgage-backed securities sector also added value

Key Statistics

Modified Duration (Yrs)	0.81
Spread Duration (Yrs)	3.04
Portfolio Yield (%)	3.82
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 (NZD Unit Class)
Responsible Entity	Perennial Investment Management Ltd
Portfolio managers	Mark Mitchell & Justin Tyler
Inception date	1 November 2018
APIR code	WPC0529AU
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	New Zealand Dollar

Platforms

The Daintree High Income Trust (NZD Unit Class) is available on the following platforms:

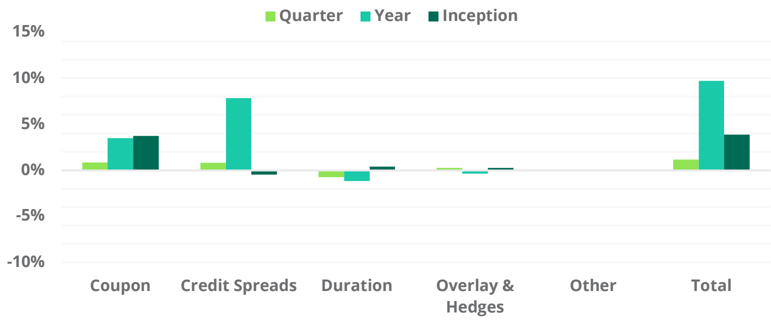
- FNZ
- Aegis

Performance & Analytics

	Month (%)	Quarter (%)	1 Year (%)	Inception (% pa)
Fund (gross)	0.17	1.15	9.70	3.87
Fund (net)	0.11	0.96	8.96	3.13
Distribution (net)	0.20	0.60	2.58	2.50
Growth (net)	-0.09	0.37	6.38	0.63
RBNZ Cash Rate	0.02	0.06	0.25	0.89
Excess Return	0.09	0.90	8.71	2.23

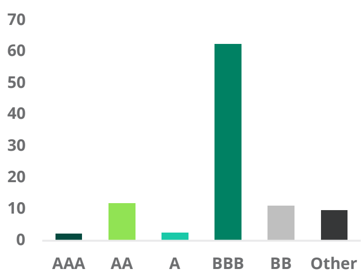
Note: Performance inception is 1 November 2018. Excess return is measured with reference to net performance. Returns for periods longer than one year are annualised. Distribution return is the difference between total return and ex-distribution unit price return. Past performance is not a reliable indicator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

Performance Contribution (Pre Fees)

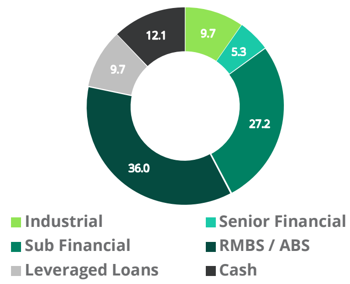


Note: Overlay strategies use derivatives to ensure that the fund exposure to interest rates, credit and other relevant factors is controlled separately to the physical assets in the portfolio

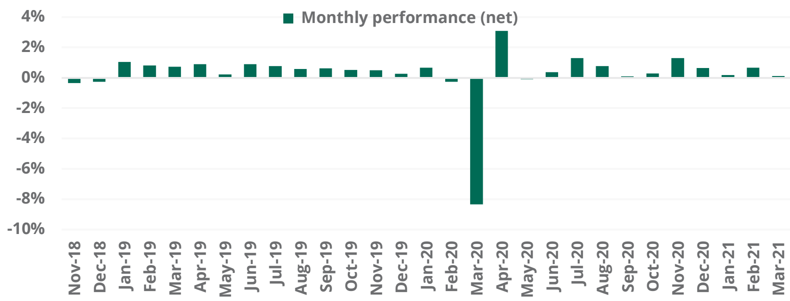
Rating Exposure (%)



Sector Exposure (%)

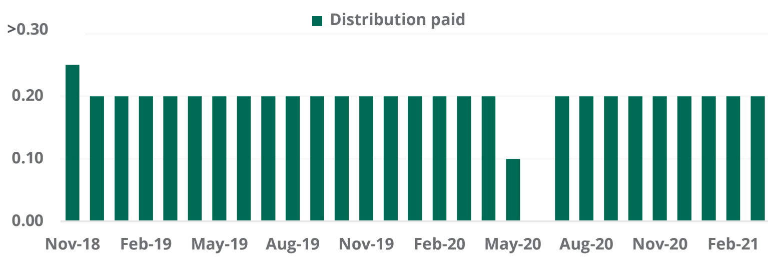


Monthly Performance



Cash Income

The Fund distributed 0.20 cents per unit in March.



Fund Review

The first quarter of 2021 will be remembered as one of the most challenging for duration-exposed investors, as growth optimism and growing inflation concerns triggered a meaningful move higher in interest rates. The Federal Reserve lent implicit support to market pricing when it announced in mid-March that it would not extend a pandemic relief program for the banks, and that it would not stand in the way of (modestly) higher rates.

Our core duration position was a small detractor in this environment of higher bond yields, however credit spreads offset this with positive performance from the residential mortgage-backed securities sector in particular. Strong performance from overlay positions also added to performance, allowing the funds to post positive net performance in each month of the quarter.

Outlook

The coming few quarters will require some perspective from investors. Global lockdowns, starting as early as February 2020 in some places, have caused huge disruptions for more than 12 months. Economic data should therefore be interpreted with caution because of the impact of base effects. Huge year-on-year growth numbers are being reported in some data, solely because the starting point for measurement one year ago is historically depressed. This is particularly the case for prices across economies, where markets are sensitive to any evidence of inflationary pressures building. Looking past the change in prices to their current level highlights the ground that needs to be made up, not just relative to the immediate pre-Covid period, but (more importantly) relative to years of disinflation.

Market sensitivity stems from the evidence that is beginning to pile up. A range of commodities are enjoying strong demand conditions, such as iron ore (China stimulus/recovery investment), copper (construction and renewable energy) and lumber (largely residential construction). Supply chain disruptions are also becoming evident due to a shortage of shipping containers, not to mention the temporary blockage of the Suez Canal! Ultimately, inflation data in the second quarter will matter little, because markets have discounted a wide range of expectations (hence higher bond market volatility) and central banks will in any case see the results as transitory.

For lasting inflation to take hold, further reductions in unemployment are required globally to catalyse stubbornly stagnant wage growth. Even if a strong recovery is sustained through 2021, employment markets, by their nature, will take longer to recover. For example, in the United States there are 10 million fewer people in work at the end of March 2021 than there was a year ago.

Some countries are deploying vaccines more effectively than others, but it is hard to argue that we have passed the peak rate of infections. Regardless of the progress on the vaccine front, we still see little appetite from governments to withdraw the many support measures in place. Indeed, there are discussions now commencing in the United States on a circa $2tr infrastructure package, hot on the heels of a $1.9tn stimulus package promised during the election.

The economic recovery is running ahead of schedule in Australia. Output is only about one percent below the peak reached in the fourth quarter of 2019, with the possibility of trend growth being re-established in early-to-mid 2022. Employment has also been a positive surprise, with the total number of people employed back to the pre-pandemic peak. Structural challenges will remain while international borders remain closed, with the agricultural and hospitality sectors struggling to attract workers to jobs normally filled by backpackers and seasonal workers from overseas. The end of JobKeeper has long been feared as a potential "cliff", but abundant job vacancies will help to cushion the immediate blow, in our view.

As 2021 progresses, we believe that interest rates will trickle higher on growth optimism, but bond market volatility will moderate. A risk to this view is a US infrastructure bill that is not largely or fully funded by accompanying revenue measures. While it is now attractive for European and Japanese investors to buy US Treasuries hedged back to their home currencies, the funding requirements for an infrastructure bill as well as the current fiscal deficit would be immense, and the future path for both US interest rates and the US dollar is therefore even more clouded than normal.

We expect a mild tightening of credit spreads on balance, within the context of a range-bound market. On the one hand, credit spreads have largely priced in a vaccine-led recovery and corporates have taken full advantage of this by refinancing at more attractive levels and at longer tenors. On the other hand, strong and consistent flows into credit ETFs and other passive products have in some cases forced real yields on corporate bonds below zero. This reinforces our view that spreads could trade in a narrow range because while we find it difficult to see negative catalysts on the horizon, persistent negative real yields may lead to sectoral rotation.

This backdrop remains challenging 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 past quarter has highlighted the challenges of this status quo. Is duration exposure worthwhile while nominal yields remain at historic lows and real yields are stubbornly negative? We expect investors in government bonds to continue reassessing their exposures in the months ahead.

Another option is explicit protection strategies, for example those that utilise equity put options. We see such strategies as being very attractive, with equity volatility approaching the lows seen pre-Covid. These strategies are also quite path dependent though – that is, the efficacy of the protection received depends in large part on whether it was purchased at levels close to market turning points. Professional management is therefore a requirement.

Low duration credit portfolios, like those we manage at Daintree, also remain 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.

As 2021 progresses, we thank our investors for their continued support. We remain committed not only to our products achieving their return objectives, but to their doing so while minimizing the various risks inherent in fixed income portfolios to the greatest extent possible.