Challenger IM Credit Income Fund – Class A

ARSN 620 882 055 APIR HOW8013AU

Monthly Report July 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	0.69	1.93	4.15	0.69	8.67	5.86	-	6.05
Challenger IM Credit Income Fund - Class I[3]	0.69	1.93	4.15	0.69	8.67	5.86	4.78	-
Bloomberg Bank Bill Index	0.37	1.10	2.18	0.37	4.37	2.56	1.69	2.01
Active return	0.31	0.82	1.97	0.31	4.30	3.30	3.23	4.04

Data Source: Fidante Partners Limited, 31 July 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	$692.6 mil
Buy/Sell Spread	+0.18/-0.18%
Distribution Frequency	Quarterly
Redemption Terms	Monthly with 10% Fund level gate

Key Statistics

Number of Issuers	122
Running yield (%) p.a	6.4
Modified duration (yrs)	0.13
Average Rating	BBB-
Portfolio Credit Spread Duration (yrs)	3.0
Non-AUD Denominated	23%
Private Credit Allocation	24%

Monthly Commentary

Performance Update:

The Fund was up 0.69% in July, a return of 0.31% over the Bloomberg AusBond Bank Bill Index Benchmark, and 0.17% over the Bloomberg AusBond Credit FRN index.

The main driver of returns was coupon income with no contribution from spread tightening this month.

Over the last 12 months, the Fund has returned 8.67% outpacing the 5.85% return on the Bloomberg AusBond Credit FRN index, exceeding our goal of outperforming daily liquid credit by 1-2% per annum.

Fund Positioning:

Recent volatility in markets has reinforced our view that spreads are at or close to the tight levels. Despite this we remain aware that spreads can remain at seemingly tight levels for extended periods. As such our positioning reflects the current level of spreads rather than a strong directional bias.

Even as spreads in public markets have tightened over the past 12 months, illiquidity premiums have held steady and even expanded to north of 2% per annum. Consequently, our reweighting towards private markets continues. Currently at 24%, we expect the private allocation to increase towards the low 30s as a strong pipeline of private investments is deployed.

As the portfolio is reweighted towards private markets the credit risk profile will also increase moderately. This is not deliberate (we are not necessarily seeking to add risk at this point in the cycle) but a byproduct of our investment approach and target investment universes. Private investments in the fund average around a BB+/BB rating while public investments are average around a BBB+/BBB rating. The spread duration will also shorten as our private investments average around a 2 year spread duration while public investments average close to 3.5 years.

Across sectors the process of remixing our commercial real estate exposures is ongoing. We currently have 15% exposure to real estate debt of which 3% is private, both of which are slight increases over the year. We don't expect to materially increase the real estate exposure from current levels but will continue to allocate more of the allocation to private markets where there is a growing opportunity.

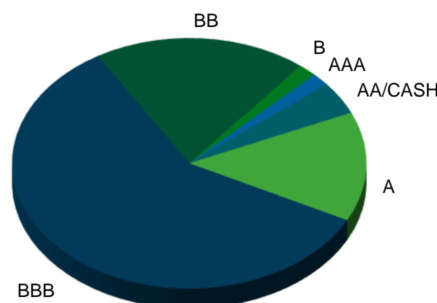
Asset quality in the fund continues to the steady with one position in the healthcare sector underperforming. The position, which totals 0.7% of the Fund has been downgraded to a B- rating and the valuation is currently sitting in the mid-90s reflective of moderate but not severe stress.

Over the month the fund added 2 private non-financial corporate positions plus 1 private real estate transaction. There were a small number of redemptions during the month and post month end we were notified of the early repayment of another more substantial private corporate loan position. On the public markets side, our activity was more moderate and split between primary and secondary market activity. As reporting season concludes we expect more primary activity in August and September.

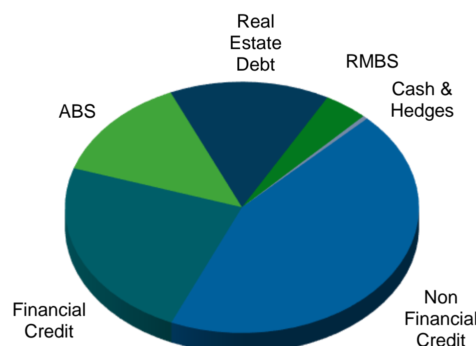
Performance Statistics

Standard Deviation (ann.)	2.2%
% of Down months	7.2%

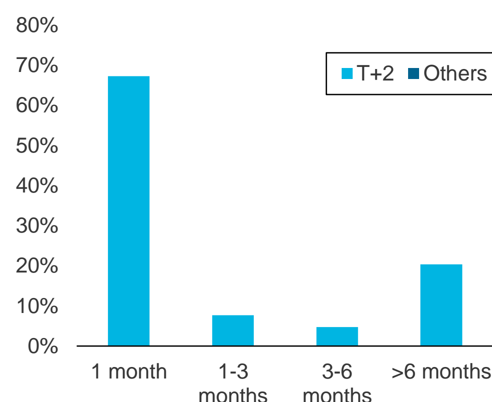
Fund Credit Quality



Fund Asset Allocation



Fund Liquidity Exposure



Market conditions:

Yields fell meaningfully in July as markets started to price in the potential for rate cuts in the United States during the back end of 2024. The decline in long term rates was a positive catalyst for equity markets which performed strongly over the month before retracing somewhat early in August. Credit spreads were flat to wider as lower outright yields spurred on strong levels of issuance.

US investment grade issuance was US$118 billion in July, exceeding the Bloomberg projection of US$85 billion and taking year to date issuance to US$986 billion, a 27% year on year increase. Domestic corporate issuance was close to A$8 billion in July, a substantial figure given it came in front of FY24 earnings announcements.

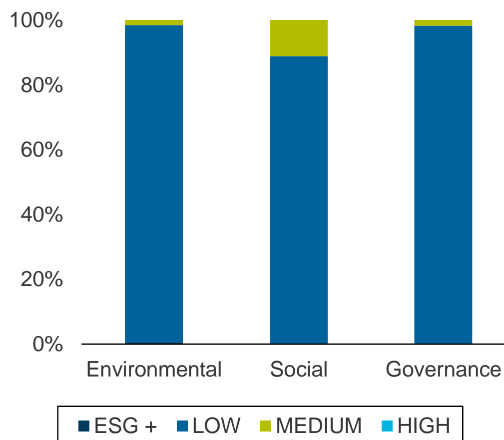
Speaking of earnings, the US Q2 earnings season is almost complete with 463 out of 500 S&P500 companies reporting. Sales growth was 4.8% with earnings growth of 8.5%, broadly in line with Q1 growth rates. Smaller companies are not faring as well on the earnings side with the Russell 2000 constituents showing around 7% revenue growth and less than 5% earnings growth. Guidance was generally okay with earnings growth forecast to be c. 10% in the coming 12 months on the back of sales growth of around 5%. This leaves the S&P pricing at around 22 times forward earnings versus 18 times in Australia (for the ASX200) and c. 19 times for the MSCI world index.

As noted earlier the biggest shock to markets occurred in early August as a weaker payrolls number in the United States caused a sharp rally in rates and sell off in equities. On the Friday that payrolls were announced the S&P500 sold off by 1.8% before declining another 3% on the Monday, the biggest decline in two years. The moves were more extreme in Asia and in particular in Japan where the Nikkei was down almost 13% on Monday having already declined by almost 6% on the preceding Friday. Many speculated that the proximate cause of the severe selloff in Japan was an unwinding of the Yen carry trade which had been impacted by the appreciation of the Yen against the dollar.

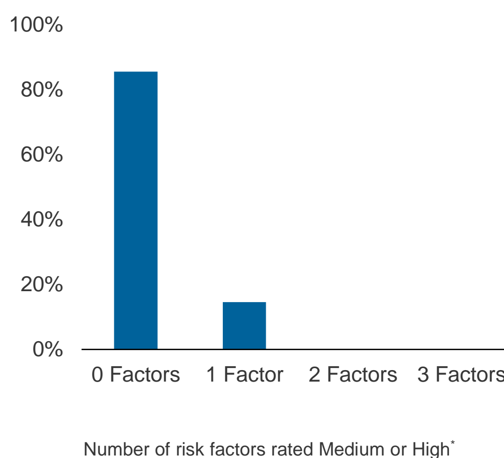
A little over a week later, calm seems to have returned to markets. The Nikkei recovered its losses and is now only 10% below the peak level from July having been as much as 25% lower. Equities in Australia and the United States are only a couple of percent below July peak levels and credit is moderately wider, with primary issuances trading heavy in the secondary market.

The recent volatility is not expected to sway central bankers, especially the RBA who has reminded markets that is does not expect to be cutting rates in 2024. Despite this guidance, Australian interest rate markets appear to be more swayed by moves offshore and now have 0.9 cuts priced for the December meeting a complete reversal from the end of June where there were 0.7 hikes priced.

ESG Profile



ESG Risk Layering



Number of risk factors rated Medium or High*

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

With the volatility so short-lived, private market activity showed no sign of slowing. Despite increasingly cautious headlines regarding governance and asset quality issues, especially in development lending, there appears to be strong appetite for private credit. The successful IPO of the Pengana Global Private Credit Trust and the strong performance of other ASX-listed private credit vehicles suggest that many investors are still willing to look through these issues. This came even as ASIC called out the lack of transparency within private credit funds with Chairman Joe Longo suggesting that further regulation was required to address questions about conflicts of interest and valuations.

CIM welcomes further regulation particularly as it pertains to conflicts of interest (i..e managers investing in multiple parts of the same deal without adequate controls) which we think are an underappreciated risk. With the number of private credit managers in Australia numbering well over 150 there is significant diversity in the range of offerings. This diversity means investors have plenty of opportunity to compare and contrast the different approaches managers are taking to such issues as valuations, upfront fees, disclosure of underperforming assets and investing in equity and debt of the same transactions.

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