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Index

Upcoming Dividends/Distributions

Code	Ex-Div	Pay	Amount	Frank
WHF	27-May	14-Jun	$0.1025	100%
GCI	30-May	8-Jun	$0.0082	0%
KKC	30-May	14-Jun	$0.0100	0%
PCI	30-May	7-Jun	$0.0046	0%
QRI	30-May	15-Jun	$0.0082	0%
TCF	30-May	7-Jun	$0.0300	0%
MOT	31-May	8-Jun	$0.0106	0%
MXT	31-May	8-Jun	$0.0086	0%
PGG	31-May	17-Jun	$0.0072	0%
PIA	31-May	15-Jun	$0.0135	100%
NBI	1-Jun	9-Jun	$0.0080	0%
MEC	6-Jun	24-Jun	$0.0150	100%
WAM	6-Jun	17-Jun	$0.0775	100%
FPC	7-Jun	21-Jun	$0.0300	100%
CAM	5-Jul	28-Jul	$0.0128	100%

A high conviction for conservative income appetites

The combination of hawkish central banks and the developing conflict between Russia and Ukraine has elevated commodity prices, recalibrated interest rate expectations and rattled bond markets over numerous months. China also has reaffirmed their zero Covid-19 policy and concerns over weaker global economic growth is now priced into the yield curve. So where should investors look when 'stable' investments are no longer stable?

The Gryphon Capital Income Trust (ASX:GCI) aims to provide investors with predictable monthly income (with a Target Return equal to the RBA Cash plus a 350bp margin net of fees and costs) and a low risk of capital loss through the economic cycle by investing in securitised assets. Unlike generalist fixed income managers, Gryphon Capital specialises solely in structured finance securities, including Australian residential mortgage-backed securities (RMBS) and asset-backed securities (ABS), an important part of the Australian economy.

Most investors will be well acquainted with the concept of residential mortgages. The primary mortgage market sees banks issue collateralised loans to customers who in turn agree to repay principal and interest, while in the secondary market, institutions pool together these residential mortgages into tranches to sell. As banking regulations have tightened, institutions will commonly securitise assets to remove them from the balance sheet in managing risk, to diversify their funding sources and free up regulatory capital. Prime RMBS then have important structural protections that mitigate the risk of bondholders taking a principal loss.

But what is driving relative attraction and the slight premium?

Inflation Protection

Australian RMBS and ABS are structured as Floating Rate Notes (FRNs) that are reset monthly at the prevailing interest rate. Provided that interest rates continue to increase (note that the 30 Day Interbank Cash Rate Futures are implying 3.29% by September 2023), GCI's income will also increase. This means that distributions paid to unitholders will be insulated, keeping up with higher rates of income offered elsewhere in the market without destroying principal (i.e. such as investment grade and high yield in recent months). The trailing 12 month distributions delivered to unitholders has been at a 4.65% margin over Cash. Assuming that this endures and the Cash Rate increases, the Trust would be yielding 7.9% on asset backing.

Borrower's Equity, Savings and Lender's Mortgage Insurance

GCI had a weighted average Loan-to-Value-Ratio (LVR) of 66% and a weighted average Underlying Loan Balance of $369,089 as at 30 April, meaning that the typical borrower has ~$190k in equity with appreciating house prices. Add to this the pandemic build-up in savings and repayment buffers. A fall in house prices in excess of 40% would be required before negative equity is experienced. In the event of default where the sale of the secured asset is insufficient to cover the principal amount outstanding on the loan, then Lenders Mortgage Insurance (LMI) is placed to a absorb the loss on mortgages with an LVR >80%.

No Anticipated Payment Shocks

As at 30 April GCI had 0.32% 90+ Days in Arrears as percentage of total loans and a weighted average Interest Rate of 3.19%. Mortgage rates were approximately 2% higher at 5.18% in the portfolio during October 2018, not long after the float, where just 0.20% of borrowers were 90+ Days in Arrears. In comparison Westpac recorded 0.14% impaired loans and 0.56% borrowers in 90+ days delinquency as a percentage of total committed exposures for March.

Sensible AUM Growth

GCI successfully raised $175m and listed on the exchange in May 2018, later raising additional capital in August 2019 ($122m), December 2019 ($103m) and September/October 2021 ($74m). Proceeds have continually been deployed with minimal cash drag, preserving distributions to unitholders while targeting deals with sufficient risk-adjusted returns.

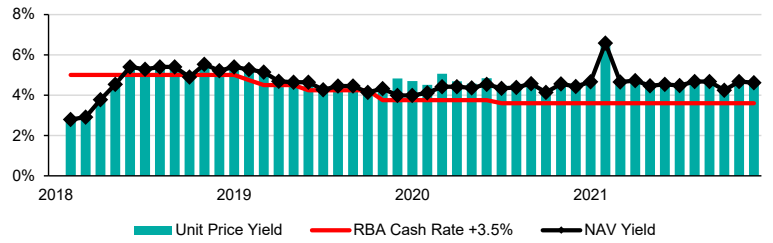
Diversification

The portfolio is heavily diversified by rating, geography and origination, removing idiosyncratic risk that may result from such sources. The Trust is also moderated on loan seasonality, cashflow frequency and maturity profile. GCI had 108 Bond Holdings, 98,612 Underlying Mortgage Loans and a weighted average Seasoning of 27 months (2.3 years) as at 30 April. These are likely to contain greater equity than those loans issued during and post the pandemic, improving with vintage.

Asset Backing Stability

Amortised Bond Holdings and ultimately Underlying Mortgage Loans account for the Trust's major assets that underpin the Net Tangible Asset (NTA) Value. RMBS and ABS is a large and active Over-The-Counter market, where the GCI portfolio is independently priced on a daily basis through a third-party provider. Despite equity market volatility and an overhang of RMBS supply during the early stages of the pandemic, market conditions remained open and improved with flows of lending, while GCI also experience a more stable and uncorrelated movement in the NTA during this time.

Figure 1 - Annualised distributions



SOURCE: IRESS, GRYPHON CAPITAL INVESTMENTS, BELL POTTER. FROM MAY 2018 TO APR 2022.