Lonsec

3 Investment Grade

Product Review
Gryphon Capital Income Trust

ISSUE DATE 25-11-2020

About this Review

ASSET CLASS REVIEWED	FIXED INTEREST
SECTOR REVIEWED	ALTERNATIVE INCOME HIGH
SUB SECTOR REVIEWED	LIT
TOTAL COMPANIES RATED	3

About this Trust

ASIC RG240 CLASSIFIED	NO
LIT REVIEWED	GRYPHON CAPITAL INCOME TRUST
ASX CODE	GCI
PDS OBJECTIVE	MONTHLY INCOME & CAPITAL PRESERVATION AT A PORTFOLIO LEVEL BY INVESTING IN A PORTFOLIO OF FIXED INCOME SECURITIES INC. RMBS & ABS
INTERNAL OBJECTIVE	PRODUCE A YIELD OF RBA CASH RATE +3.5% P.A. (NET OF FEES) THROUGH THE ECONOMIC CYCLE.
DISTRIBUTION POLICY	MONTHLY
MANAGEMENT COSTS	0.9% P.A. (12 MONTHS TO SEPTEMBER 2020)
RESPONSIBLE ENTITY	ONE MANAGED INVESTMENT FUNDS LTD

Market data

MARKET CAPITALISATION	$405M
UNITS ON ISSUE	206M
UNIT PRICE (24-11-2020)	$1.96
52 WEEK HIGH/LOW UNIT PRICE	$2.06 / $1.30
NAV (19-11-2020)	$2.02
52 WEEK HIGH/LOW NAV	$2.02 / $1.99
UNIT PRICE PREM/(DISC) TO NAV	-2.49%

About the Fund Manager

FUND MANAGER	GRYPHON CAPITAL INVESTMENTS PTY LTD
OWNERSHIP	100% GRYPHON CAPITAL PARTNERS PTY LTD
ASSETS MANAGED IN THIS SECTOR	$2.2BN (SEPTEMBER 2020)
YEARS MANAGING THIS ASSET CLASS	26

Investment Team

PORTFOLIO MANAGER	STEVEN FLEMING, ASHLEY BURTENSHAW
INVESTMENT TEAM SIZE	5
INVESTMENT TEAM TURNOVER	NIL
STRUCTURE / LOCATION	BRISBANE

Investment process

STYLE/ASSETS	INCOME/RMBS & ABS
BENCHMARK	RBA CASH RATE
TYPICAL NUMBER OF POSITIONS	95
SINGLE BORROWER LIMIT	10%
LEVERAGE	MAX 25% NAV (FOR USE IN FUTURE CAPITAL RAISES)
DERIVATIVES	YES
CURRENCY	100% HEDGED

Trust rating history

NOVEMBER 2020	INVESTMENT GRADE
AUGUST 2019	INVESTMENT GRADE
AUGUST 2018	INVESTMENT GRADE

What this Rating means

The **'Investment Grade'** rating indicates that Lonsec has conviction the financial product can generate risk adjusted returns in line with relevant objectives. However, if applicable, Lonsec believes the financial product has fewer competitive advantages than its peers.

Scope of this rating

- Lonsec has used its Managed Funds research process in forming an opinion on this Listed Investment Trust's (LIT or Trust) ability to meet its stated investment objectives. The extent of any 'point-in-time' divergence between GCI's unit price and its underlying Net Asset Value (NAV) per unit is not part of the ratings consideration.
- Lonsec does consider whether structural or management issues could potentially lead to a LIT trading at a significant discount to its NAV over an extended period of time without any recourse for unitholders. This aspect forms part of the wider qualitative and quantitative assessment that Lonsec undertakes when assessing the relative investment merits of a LIT.

Strengths

- The two Portfolio Managers hold deep and extensive experience in securitised markets.
- The strategy utilises a thorough and repeatable investment process tailored to the specific needs of the asset class.
- Risk management is embedded in the portfolio construction process.

Weaknesses

- The investment team size is small and is investing in an asset class which requires large volumes of data to be sourced, cleaned and analysed on an ongoing basis. Consequently, there is heightened key person risk relating to the core members of the investment team as they bring a targeted skillset.
- The proprietary in-house models used in the analysis process have not been audited by an external party.
- The Trust's assets are vulnerable to the negative impact of a strained economic environment, including increases in the unemployment rate which could see borrower's ability to make loan repayments diminished.

ANALYST: JOSHUA NAPPA | APPROVED BY: AMY HO

Gryphon Capital Income Trust

Trust Risk Characteristics

	LOW		MODERATE		HIGH
BUSINESS SUSTAINABILITY RISK				●	
CAPITAL VOLATILITY				●	
CREDIT RISK				●	
FOREIGN CURRENCY EXPOSURE		●			
INTEREST RATE RISK			●		
SECURITY CONCENTRATION RISK			●		
SECURITY LIQUIDITY RISK				●	
LEVERAGE RISK		●			

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIOmetrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

	LOW		MODERATE		HIGH
RISK TO INCOME			●		

Features and benefits

	LOW		MODERATE		HIGH
COMPLEXITY				●	
ESG	●				

Fee profile

	LOW		MODERATE		HIGH
FEES VS. UNIVERSE				●	
FEES VS. ASSET CLASS		●			

Fee BIOmetrics are a function of expected total fee as a percentage of expected total return.

What is this Trust?

- The Gryphon Capital Income Trust (ASX:GCI) ('the Trust') is an actively managed LIT which primarily invests in securitised assets, with the aim of providing predictable monthly income with a low risk of capital loss and returns in excess of the RBA Cash Rate by 3.5% net of all costs through the economic cycle. The portfolio is primarily comprised of Australian residential mortgage-backed securities ('RMBS') and asset-backed securities ('ABS'). The Trust is managed by Gryphon Capital Investments ('the Manager' or 'Gryphon') who are a specialist manager of structured finance securities issued in Australia, UK and Europe. As at September 2020, Gryphon had in excess of $2.0bn funds under management.
- The look-through underlying securities in the Trust will be comprised of RMBS, ABS (securitisations backed by pools of consumer loans, loans to SMEs and auto loans among others) as well as cash. Investments will be predominantly denominated in Australian dollars; however, the Manager reserves the right to invest in securities domiciled in other currencies. Any foreign currency investments will be hedged back to Australian dollars. Excess returns are expected to be generated predominantly from security selection and sector rotation.
- Gryphon believes the RMBS and ABS (Asset-backed securities) markets are an important and substantial part of the Australian market, offering an alternative investment option for retail investors seeking exposure to income streams.
- Lonsec notes that the Trust is governed by an investment strategy which imposes broad mandate limits in terms of sub-investment grade credit (maximum of 50% of the portfolio), individual holdings (maximum of 10% in any one security) and exposure to an originator (must not exceed 30% of NAV).
- The Manager does not intend to use debt to enhance returns. The Trust's gearing policy limits debt to up to 25% of the Trust's NAV for short term liquidity timing purposes only. For example, the Manager does not intend to use debt unless it has also planned to raise new capital from the issue of new Units and identifies a buying opportunity for the portfolio which will settle prior to the new capital raise flowing into the Trust's bank account.
- Derivatives are only permitted for efficient portfolio management (e.g. hedging) and not for market speculative purposes to increase returns.
- The Responsible Entity has provided a working capital loan to the Manager for 10 years. As outlined in the review and acknowledged by Gryphon, the proceeds of the manager loan have been used to pay upfront costs of capital raisings. The loan balance as of 30 September 2020 was 2.36% of total funds raised or approximately $9.7m. The proceeds are also permitted to be used for working capital, including but not limited to investor relations, capital management and to facilitate future capital raisings from the Trust. However, Gryphon has stated there is no intention to call upon proceeds of the manager loan to facilitate anything other than capital raising costs. Interest will be paid on the loan at a 5% rate. The loan will be repaid over the ten-year initial term of the Investment Management Agreement ('IMA') and will be an asset of the Trust with its inherent credit risk.
- The appointment of the Manager is governed by an IMA with an initial term of 10 years subject to automatic extension.
- For the 12 months to September 2020, the management cost charged to retail investors was 0.90% p.a. The management cost is used to pay the operating costs of the Trust, including responsible entity fees, custody fees, administration, registry, annual ASX fees, and audit costs of the Trust. It excludes abnormal expenses which are payable from the assets of the Trust.
- **The rating is not a credit assessment of Gryphon Capital Investments Limited or the Gryphon Group, who are party to the manager loan which forms part of the assets of the Trust.**

Using this Trust

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

Gryphon Capital Income Trust

- Funds in the **Alternative Income (High)** sector are typically managed with the aim of generating returns that exceed a cash proxy such as the Bloomberg AusBond Bank Bill Index by a margin or are absolute return in nature. Lonsec notes that whilst the Trust may exhibit relatively low volatility of NAV, this may be a function of the relatively low liquidity in terms of secondary market activity and lack of observable price points for the underlying securities.
- Lonsec suggests that the Trust should only be considered for those clients that are seeking yields greater than cash or cash-like instruments **and are prepared to accept greater** credit risk.
- Investments in asset-backed securities may provide diversification and income generation benefits to a traditional fixed income portfolio. A key risk of the type of securities this Trust will invest in is illiquidity risk. The Trust's underlying securities are not liquid and the ability of the Manager to dispose of an investment will depend on the prevailing market liquidity at the time. There may be a significant difference between a security's market price supporting the NAV and a transaction price resulting in sharp gains or losses. The Trust is also permitted to invest in up to 50% of the portfolio in sub-investment grade or lower credit quality securitised assets.
- Lower quality RMBS and ABS securities hold particular risks to investors with the potential for increased capital erosion due to the higher probability of default. Changing interest rates and market conditions can also have a larger impact on the values of sub-investment grade RMBS and ABS. The Trust is highly exposed to the Australian residential housing market through its RMBS holdings, and therefore susceptible to prevailing and future movement of mortgage borrowing rates.
- Historically, interest rates in Australia have generally mirrored the U.S. in terms of trajectory, although in more recent times, this relationship has broken down given the divergence in the two economies. Longer-term investors are advised to remain mindful of the impact rising interest rates may have on homeowner's ability to meet mortgage repayment obligations. However, a higher interest rate environment in comparison to the current historical lows is yet to be genuinely tested. Interest rates and loan serviceability only form a part of the factors which affect the asset classes within this Trust. Domestic unemployment rates, property prices and regulatory risk also play a large part in shaping the sentiment and performance of the asset class.
- ABS that are not secured by mortgages over property also present additional risks for investors. In a default scenario, the collateral backing the loan may not be sufficient to support the required repayments. Some ABS may also not access the same degree of security or recourse over related collateral. For example, credit card receivables securitised into an ABS are generally unsecured.
- RMBS and ABS differ from traditional bonds mainly due to the frequency of interest and principal repayments and thus the uncertainty of a final maturity date. The majority of securities pay interest (and may also pay down principal) on a monthly basis, though some securities may pay coupons quarterly. Prepayment speed (the speed with which principal is returned to investors) fluctuates with the ability of borrowers to service their debt or refinance. Maturity dates may be shorter than expected if prepayment occurs more quickly than anticipated or maturity dates may extend if borrowers take longer to repay, or use redraw facilities.
- Further, in a portfolio construction context, Lonsec recommends that allocations into the Trust be made from growth rather than defensive assets.
- The Trust expects to make distributions on a monthly basis, although this is not guaranteed. To date, since June 2018 the Trust has successfully paid a monthly distribution to investors.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
			●	●	

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- Gryphon announced in early November 2019 a 1-for-3 non-renounceable offer to existing holders to raise up to $103.6m. The offer was oversubscribed and raised the full amount. The increase in NTA has also reduced the Trust's management costs to 0.90% p.a.
- Warren Mellor joined in the investment team in February 2020 as a Senior Quantitative Analyst and subsequently departed in July 2020, prior to the completion of his probation period. The Manager intends to add a junior resource in 1H 2021.
- Sergey Podzorov, Portfolio Analyst announced in November 2019 his intention to retire in June 2021. Podzorov is to be replaced by Piers De Putron who joined in September 2020. Podzorov's duties will transition to De Putron over a 10-month period.
- The Manager began receiving loan-level data which flagged whether the loan was 'COVID Impacted' (a general indicator of the borrower utilising a payment holiday or payment plan).

Lonsec Opinion of this Trust

People and resources

- Gryphon was founded by Steven Fleming, Ashley Burtenshaw and Henry Cooke. Fleming and Burtenshaw previously worked together at Babcock and Brown from 2005, before moving across to Columbia Threadneedle ('Threadneedle') in 2009 to run ABS portfolios. Cooke joined the team in 2010. In 2014, the team spun out from Threadneedle to establish Gryphon as a standalone entity. Burtenshaw and Fleming are responsible for the Australian fixed income mandates, and are the Portfolio Managers of the Trust. Lonsec views the team's longstanding working relationships to be a positive attribute for the Trust.
- Fleming and Burtenshaw are considered to be particularly skilled in the analysis and investment of asset-backed securities. Both have been closely involved with this asset class for several years with domestic and global experience on both the buy and sell-side. Lonsec considers both to be strong portfolio

managers with the necessary in-depth knowledge to manage the Trust.

- The respective skill sets of each individual are considered to be complementary, spanning across trading, funds management and deal structuring. As such, Lonsec assigns high key person risk to both portfolio managers. However, this is mitigated somewhat by the ownership structure. Entities controlled by Fleming and Burtenshaw own 40% each of the business, with the remaining balance of 20% belonging to Cooke. Lonsec believes this structure also serves to strengthen the alignment of interests with investors.
- Henry Cooke, with 31 years industry experience is the most senior member of the team and part-owner of Gryphon Capital. Cooke is based in London and will not be involved with the management of the Trust, although he remains available if additional support is needed by the investment team.
- Fleming and Burtenshaw are supported day-to-day by three analysts who form the Quantitative Team: Shane Stanton (Portfolio Management and Analytics), Vijay Singh (Investment Analytics) and new-hire Piers De Putron (Portfolio Analyst). The retirement of Sergey Podzorov has seen the addition of De Putron, albeit with a handover period until Podzorov's departure in mid-2021. Lonsec notes that Podzorov performed a niche role within Gryphon where he was responsible for the construction and maintenance of the Manager's proprietary systems. These systems are responsible for loan tape data aggregation, market pricing and portfolio management that are crucial to the Trust's management.
- The handover is expected to occur over a number of months which appears logical given the specialist nature of the systems used. De Putron holds prior experience primarily in business systems and risk functions in banks. His most recent role was as a Senior Manager in Non-Traded Market Risk at Bank of Queensland. Lonsec will seek to focus on De Putron's integration into the team and operational cohesiveness.
- Stanton has previously worked alongside Fleming and Burtenshaw during their time at Threadneedle since 2005. Stanton has 14 years of credit market experience across securitisation, derivatives, funds management and structured finance. Stanton is responsible for developing the front-end user interface for Gryphon's analytical tools which are considered critical for this complex and data-intensive asset class. Stanton is also responsible for sourcing the necessary data for accurate and timely assessment of issues, ensuring data quality, and the development and maintenance of cash flow models used in the regular assessment of issues. Stanton is also involved in the stress testing of individual assets and the overall portfolio. Stanton is assisted by Singh who joined in mid-2019. His responsibilities include maintaining and developing portfolio applications including models, attribution systems, analytics and risk models. Lonsec considers Stanton to have a notable workload, although this has moderated since Singh and De Putron's appointments.
- Although members of the Quantitative Team (and the outgoing Podzorov) are not key decision-makers for the Trust, their support is vital when managing an asset class that Lonsec considers to be relatively labour intensive (i.e. data gathering, analysis and daily portfolio management). Further, Fleming and Burtenshaw may at times be distracted by non-investment related functions, common in a boutique structure. Overall, investment team resourcing is adequate given recent funds under management growth, although resourcing could be stretched in times of high issuance.
- The team also has a dedicated compliance resource in Michael Groom, Head of Operations and Compliance. Groom is also ex-Threadneedle, and is responsible for the firm's financial affairs, as well as managing Gryphon's operational compliance and company practices. Emmanuel Tumini fulfils the role of Fund Administrator for the Trust, with Rachelle Reed responsible for Investor Relations. Lonsec considers the addition of Tumini and Reed to be beneficial for the investment team.
- Pleasingly, a number of operational business requirements have been outsource to third party providers. These include legal, IT support, accounting/tax, audit service (internal controls only). Lonsec views this as an appropriate structure to minimise non-investment related duties for the team.
- Accountability is viewed as adequate. The collegiate culture is believed to contribute positively to transparency and accountability within the investment team. Fleming and Burtenshaw drive decision making with the support of the Quantitative Team, and the proprietary database and systems.

Board of directors and governance

- One Managed Investment Funds Limited is the Responsible Entity of the Trust. The Responsible Entity monitors the performance of the Manager in much the same way as a board monitors the performance of management of the entity they are appointed to. The Responsible Entity is a member of One Investment Group (OIG) which is a funds management business specialising in providing responsible entity, trustee, custody and administration services.
- As the Responsible Entity is a member of OIG, a Board of Directors is appointed by OIG. The OIG Board consists of three Executive Directors. The OIG Board does not have visibility into the firm's investments but is responsible for ensuring that corporate strategy is executed optimally and that the Trust is strictly compliant.
- The Board does not have a separate audit committee with the full board considering all financial reporting for the Trust. The Responsible Entity has appointed the Administrator, Mainstream Fund Services, and has delegated to the Administrator the responsibility for preparing all financial reporting for the Trust. The Board obtains appropriate representations from OIG management and where necessary the Manager and Administrator as to record-keeping, risk management and the compliance with accounting standards of the financial statements.
- Being ASX-listed, the Trust will also need to comply with the stringent listing rules of the ASX, including valuation of assets. Lonsec views securitised investments as more of a niche, and at times an opaque asset class with few actual trades to use as

price points in comparison to traditional fixed income assets. This can give rise to elevated mark to market risk for investors.

Research and portfolio construction

- The investment process is a combination of top-down and bottom-up analysis, with the latter the dominant driver of portfolio construction.
- Key to the research and portfolio construction process is understanding the individual risk characteristics of each RMBS or ABS assessed. This cannot be ascertained in isolation, with top-down macro research focusing on the key drivers of the Australian economy and trends in the housing market. The macro process helps shape the construction of the portfolio, specifically influencing idea generation, asset allocation decisions, sector weightings and providing direction on the research agenda. Lonsec believes Gryphon's key strength lies in the thoroughness of its bottom-up securities analysis, although notes the macro research undertaken is both sound and appropriate.
- Over time, Fleming and Burtenshaw have developed long-standing relationships within the industry and will use this to their advantage. Often originators will contact Gryphon directly prior to an issue launching, allowing the portfolio managers to begin assessing the appropriateness of the upcoming offer. Lonsec believes that these relationships are additive to the investment process, as they provide the team with enhanced market transparency and deal flow.
- The first step in assessing an issue, is to determine if it displays relative value either at the portfolio level and/or individual transaction level. This decision is made by the IC. If the decision is made to move forward, Gryphon then proceeds with a formal underwrite report followed by a deep dive analysis of the securitisation/transaction, sourcing loan-level data for all loans included in the pool. This data is used to create a 'Collateral Stratification' report which determines the overall risk in the pool. Factors assessed include the loan to value ratio (LVR) of each loan, employment statistics of borrowers, postcode analysis, type of dwelling, loan classification, repayment type. All this information and more (up to 50 data points per loan) are analysed and aggregated to illustrate how investing in a transaction would affect the portfolio from an overall risk sense. Lonsec notes that this process, while intensive, is detailed and necessary for the type of debt the team are investing in.
- Once the team is satisfied with the assessment of loan-level data, cashflow (waterfall) analysis of the asset-backed structure is undertaken using proprietary models which track the frequency of loan repayments. These models allow the team to stress test various scenarios that may affect repayment rates of the loan pool and impair the value of various tranches. Once the team is satisfied with the relative value on offer, the balance of collateral in the underlying pool and results of stress tests they will present the issue for consideration at the IC meeting. Each issue that is considered must have an Underwrite report, Collateral Stratifications report and Large Loan Review report. Throughout the process, Fleming and Burtenshaw with the assistance of Stanton, overlay a qualitative view which considers macro influences on the domestic economy and their long-term knowledge of the asset class. The use of both bottom-up and top-down analysis in the consideration of issues is viewed as pragmatic.
- Gryphon does not intend to actively trade in the secondary market on a regular basis. A security will be traded if there is a change in the relative value view, or an opportunity to lock in solid gains for the portfolio arises or concerns around the issue eventuate. Lonsec views this as standard practice, which is enhanced through the constant monitoring and data collection of underlying collateral pools.
- The IC meets formally once a week. A structured IC pack is provided which looks at various macroeconomic factors (global and domestic) including but not limited to RMBS delinquency rates and house price analysis. The IC will also discuss and deliberate over new investment opportunities that have been evaluated via the research process. Lonsec believes that the use of an IC aids the investment process, particularly by facilitating debate regarding portfolio positioning and security selection.
- The Manager's investment philosophy and process are solely focused on securitised assets, distinguishing the Trust from the majority of fixed income funds covered by Lonsec. Other funds may invest in securitised assets as a sleeve of a more broadly diversified portfolio. Lonsec notes that investing in such assets requires a specialised skill set and the operational ability to filter and analyse large volumes of data regularly. Another key challenge for institutional investors is the lack of standard off-the-shelf systems available for analysing such data. Gryphon has developed various methods of analysing securitised assets, and the proprietary models are considered to be good quality and reasonably robust. However, Lonsec maintains the view that the ongoing maintenance and review of internal systems is necessary, which is an additional drain on the investment team's time. Notably, there has been no external auditing or review of these systems to date. Lonsec does however take some comfort that the analytical monitoring spreadsheets used include cashflow reconciliation.
- The largest shareholder in the Trust (approximately 6.5%) is Loannet Pty Ltd. Loannet Pty Ltd is a related party to Liberty Financial Pty Ltd, a significant issuer in non-prime mortgages (a sector in which this Trust invests into), and an entity Gryphon has had a longstanding relationship with. Gryphon has reaffirmed all potential investment opportunities are assessed at "arms-length" following the processes and procedures outlined above. Gryphon employees must comply at all times with its Code of Business Conduct and Ethics Policy, which includes a policy on dealings with related parties. At this point in time, Lonsec is satisfied with this approach but will continue to closely monitor portfolio allocations going forward and the underlying shareholder base.

ESG Integration

- The Manager has indicated a commitment to ESG. However, there is little evidence in its public positioning, and the policy framework to support its ESG approach is limited. Overall, Lonsec views the strength of this commitment to be in-line with peers. Notably, there is relatively little scope to consider ESG factors within the strategy given the nature of the underlying assets (pools of loans and mortgages). Accordingly, evidence of ESG integration within the investment process for the Trust was viewed as low relative to peers in the broader sector.

Risk management

- Lonsec believes that robust analysis of securitised assets requires both vast amounts of data, and sophisticated modelling approaches to fully assess risk and relative value. Pleasingly, Gryphon displays a keen awareness of risks within the portfolio, and demonstrates a deep level of knowledge of the asset class. Gryphon does not subscribe to the notion of timing the market, but instead focuses on utilising the team's collective experience and knowledge to drive investment decisions. Lonsec notes that the Manager's risk management efforts are reliant on systems which are built and maintained in-house. Maintenance of these systems is therefore dependent on the specialised skillset of the team, which carries an element of continuity risk should those responsible for the systems depart.
- Once an investment is made, Gryphon undertakes regular monitoring by accessing ongoing loan-level data on a monthly basis. Stanton and Singh, are key to this process as they are responsible for sourcing data, cleaning the data to improve quality and undertaking regular risk assessments via the cashflow models.

Funds under management

- Gryphon currently has approximately $2.2bn funds under management (September 2020). Considering the current team size of five, Lonsec continues to be supportive of any additional resourcing being added, particularly in regards to the data collection and analysis of loan pools.
- Lonsec acknowledges that the securitised market in Australia is substantial and continues to grow. The growth of the domestic market has increased rapidly over the last few years with large volumes of issuance. The current market size is in excess of $100bn, with $23.4bn of RMBS issued in 2020 YTD and approximately $46.1bn in 2019. Lonsec notes that whilst the growth of the market is substantial, the investment team has shown a conscious effort in ensuring the growth of the Fund is within a manageable size.
- Lonsec observes that the securitised market, although large, is subject to increasing demand from investors given the prevalent need for income and yield. The challenge for this type of product is the Manager's ability to source investments which match their required criteria. Pleasingly, the Manager has managed to deploy the majority of funds raised in the latest offering to investors.

Performance

- The Trust seeks to yield a target return of 3.5% p.a. (net of fees) above the RBA Cash Rate through the economic cycle. Over the two years to September 2020, the Trust delivered 4.7% p.a. of income distributions (based on NTA) which equated to an excess return of 3.8% p.a. over the RBA Cash Rate. From a total return perspective, the Trust returned 2.5% p.a. (based on unit price) over this period. Pleasingly, the Trust has continued to pay regular monthly distributions since its inception.
- Similar to other fixed-income LITs rated by Lonsec, the Trust began trading at a discount in late-February as the economic impact of the pandemic unfolded. Due to the nature of the Trust's underlying assets as well as the structure in which the Trust is formed (closed-end), the market price reached a discount of ~35% to its NAV during the peak period of market panic in late-March. The market price has gradually recovered since then although it continues to trade at an average 5-8% discount to NAV.

Overall

- Lonsec has maintained the Trust's **'Investment Grade'** rating at its latest review. The rating is supported by the deep bench of experience present in the investment team, particularly Steven Fleming and Ashley Burtenshaw. Lonsec considers their experience within the asset class to be paramount in the management of the Trust. Their sound asset class knowledge that is applied via the rigorous investment and research process, is viewed by Lonsec as a key strength of the offering.
- However, Lonsec considers the team to be quite lean for such a data-intensive (and at times necessarily manual) process, exposing some vulnerability to key person risk. In addition, Lonsec highlights the Trust is susceptible to adverse macroeconomic conditions in the domestic market.

People and Resources

Corporate overview

Gryphon Capital Investments ('Gryphon') is an asset management firm focused on investments in the structured finance and 'less liquid credit markets' in both Europe and Australia. The three founding partners maintain full ownership of the firm. Gryphon is the investment manager of the Trust.

One Managed Investment Funds Limited is the Responsible Entity of the Trust. The Responsible Entity is a member of One Investment Group (OIG) which is a funds management business.

A Board of Directors is appointed by OIG. The OIG Board consists of three Executive Directors. The OIG Board does not have visibility into the firm's investments but is responsible for ensuring that corporate strategy is executed optimally and that the Trust is strictly compliant.

Gryphon Capital Income Trust

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
STEVEN FLEMING*	MANAGING PARTNER/ CEO	25 / 6
ASHLEY BURTENSHAW*	MANAGING PARTNER/CIO	24 / 6
SHANE STANTON*	PORTFOLIO ANALYST	14 / 6
VIJAY SINGH	PORTFOLIO ANALYST	6 / 1
PIERS DE PUTRON	PORTFOLIO ANALYST	23 / <1

* The team has longer co-tenure together including time at Threadneedle

The investment committee is comprised of Fleming and Burtenshaw.

Steven Fleming has 25 years of industry experience. He has worked in a variety of roles across in investment banking and funds management, including principal finance, structured finance, property and project finance transactions in London, New York and Australia. Fleming has held senior positions in several large highly regarded companies including Threadneedle International Limited, Babcock & Brown and Nomura. Fleming's previous roles were focused on the management of securitized assets.

Ashley Burtenshaw has 24 years of industry experience with a background in trading credit across domestic and international markets. Burtenshaw also held senior positions at Threadneedle International Limited in the mortgage business, and at Credit Suisse First Boston where he was hired to establish their Structured Credit and ABS business in 2004. He commenced his career at Nomura London and also spent time at Babcock & Brown managing ABS.

Shane Stanton has 14 years industry experience across securitization, derivatives, funds management and structured finance. Stanton previously worked with Fleming and Burtenshaw at Threadneedle Investments.

Vijay Singh has six years of industry experience in securitisation and covered bonds. Prior to joining Gryphon, Singh was employed at the Bank of Queensland.

Piers De Putron has more than 23 years of industry experience, primarily within the risk function of financial institutions and business systems. De Putron was previously a Senior Manager in Non-Traded Market Risk at the Bank of Queensland.

Investment team remuneration

Both Fleming and Burtenshaw as managing partners each own a 40% equity stake in the business, the remaining 20% is held by Henry Cooke. They do not draw any fixed compensation.

The remaining employees are paid a fixed salary which is determined based on market analysis and contribution to overall business outcomes. There is also a variable short-term incentive which is discretionary and may be in the range of 0%-100% of the fixed compensation amount. Gryphon believes this remuneration structure incentivises employees to achieve agreed objectives which align with long term business goals. Gryphon does not offer a compensation deferral policy at present.

Research Approach

Overview

Gryphon applies a blend of top-down and bottom-up research to construct a portfolio that is diversified across various risk buckets. Gryphon only invests in securitised assets, predominantly residential mortgage-backed securities and to a lesser degree asset-backed securities. The investible universe for the Trust is mainly comprised of Australian domiciled securities, however, mandate guidelines allow exposure to foreign-denominated issues. Any such exposures would be fully hedged.

Gryphon undertakes macroeconomic analysis on a regular basis to assess how changes in the global and domestic economy could impact the portfolio of assets. The IC receives a weekly information pack outlining key economic indicators which are combined into a macro summary dashboard. Factors assessed include data on: market volatility, treasury yield curves, employment rates, wage earnings, and shipping and trade data. Of particular importance is data pertaining to the domestic housing market such as: housing affordability statistics, house price analysis and mortgage delinquency rates. Spread comparison reports across various global markets versus Australian securitised sectors are also analysed.

The team then uses the broad-based macro view to guide the fundamental analysis of securities. Primarily, portfolio managers assess if a security offers good relative value and is appropriate for inclusion in the portfolio. Once the initial decision is made to consider the security for analysis, a formal underwrite report is developed. The reports assess the following factors:

1. Deal Structure – amortization/step down conditions, liquidity support, hedging;
2. The form of credit enhancement – LMI, excess spread, subordination;
3. Risk Analysis – default risk, performance risk, downgrade risk, loan arrears deterioration, non-call risk;
4. Provision of reporting and underlying loan data; and
5. Cashflow modelling – analysing credit protection, stress testing and scenario analysis

A collateral stratification report is generated by breaking down the loan pool data into sub-sectors allowing the team to assess the level of risk held within the transaction and whether they are comfortable with the underlying constituents. The loan pool is broken down into bands including LVR, security type (e.g. residential luxury), loan classification residential or investment, loan purpose, employment type of borrowers, locality, loan type (fixed or variable), current loan balances, LMI provider or none and repayment type, seasoning of loans, arrears data and percentage of properties situated in a flood postcode.

Next, a report is generated to analyse large loans in the underlying pool. This report provides individual loan line assessment looking at the loan balance, loan type, loan purpose, loan classification, employment type of borrower, arrears (if any), the location of a property, indexed LVR, loan type. Gryphon prefers to avoid loan pools that are barbelled with respect to large loans, particularly those with high LVRs.

Once the documentation is completed the team provides a formal IC paper with a recommendation for investment across the various tranches of the issue. A formal recommendation must also be drafted for IC consideration if a security is sold on the secondary market.

Portfolio Construction

Overview

The Trust is constructed using a bottom-up approach with a focus on capital preservation. This includes estimating the potential losses of the Trust by comparing each security's individual characteristics to the available credit protection built into the transaction. All investment actions must be approved by the IC. Investment decisions do not need to be made in consensus; however, it does suggest that further analysis may be required. The Manager seeks to diversify the Trust across rating bands, geographical allocations, and originators, and will also balance the portfolio in terms of seasoning of underlying loans, LVRs, cashflow frequency and maturity profile. Ultimately, the Manager's ability to access the deal sizes and favoured tranches depends on market demand.

Risk Management

Risk limits

RMBS EXPOSURE	70-100%
ABS EXPOSURE	0-30%
MAXIMUM GROSS EXPOSURE TO SINGLE ORIGINATOR	30%
MAXIMUM INDIVIDUAL SECURITY WEIGHT	10%
MAXIMUM PORTFOLIO WEIGHT AVERAGE LIFE	LESS THAN 5.5 YEARS
CURRENCY EXPOSURE	100% FULLY HEDGED
DERIVATIVES	YES
MAXIMUM SUB-INVESTMENT GRADE ALLOCATION	50%
MAXIMUM SUB-INVESTMENT GRADE ABS	15%
MINIMUM CREDIT RATING	UNRATED
LEVERAGE	MAX 25% NAV (FOR USE IN FUTURE CAPITAL RAISES, SHORT TERM PURPOSES ONLY)
SEPARATE RISK MONITORING	NO

The Trust is constrained by a set of hard and soft risk limits to promote appropriate diversification. Note that the Trust has the ability to be 100% exposed to RMBS.

Risk monitoring

Portfolio risk is actively monitored to optimise the balance between risk exposure and risk mitigation. In-house risk systems are used to stress test potential investments, as well as the Trust on an ongoing basis. The team's qualitative opinion on the Trust's risk exposures provides an additional layer of oversight within this risk management framework.

Currency management

All currency risks are hedged.

Risks

An investment in the Trust carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the PDS and should be read in full and understood by investors. Lonsec considers major risks to be:

Investment risk

Being a LIT, its securities may trade on the ASX at a discount to its NTA for extended periods of time.

Asset backed securities risk

The value of an RMBS and ABS can be affected by a number of factors, including:

(i) changes in the market's perception of the underlying assets backing the security (for example, RMBS are particularly at risk from a decline in the housing market);

(ii) economic and political factors such as interest rates and levels of unemployment and taxation which can have an impact on the arrears, foreclosures and losses incurred with respect to the pool of assets backing the security;

(iii) changes in the market's perception of the adequacy of credit support built into the security's structure to protect against losses caused by arrears and foreclosures;

(iv) changes in the perceived creditworthiness of the originator, of the underlying security or any other third parties to the transaction, and

(v) the speed at which mortgages or loans within the pool are repaid by the underlying borrowers (whether voluntary or due to arrears or foreclosures).

At times of rapid changes in market conditions, it may be difficult to value certain RMBS and ABS, and values may fluctuate considerably. Market prices can quickly become out of date, and not reflect the value which would be realised on a sale of the relevant investments. The value of the Trust will be determined regularly based on prices at which its investments trade in the wholesale market and, accordingly, falls in the market price will result in a corresponding fall in the Trust's NAV and the Units.

The investment characteristics of RMBS and ABS differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, very often monthly or quarterly, and that principal may be prepaid at any time.

Credit risk

The Trust may invest in sub-investment grade RMBS and ABS. These securities have an increased risk of capital erosion due to a higher probability of default by the issuer. Changing market conditions and interest rate levels can also have a larger impact on the values of high yielding RMBS and ABS.

The Trust is also exposed to the credit risk associated with the Gryphon Group as an entity through the provision of the manager loan. As an unsecured loan, the Trust's right to recover the loan will rank behind the secured creditors of Gryphon Capital Management (GCM). If GCM is unable to meet its contractual obligations under the loan, then the Trust may incur a loss, and this would have an adverse effect on its value.

Interest rate risk
The Manager will primarily invest the Trust in floating-rate loans. As the underlying base rate rises and falls, the relative attractiveness to other instruments may change.

Liquidity risk
The Trust's investments are not liquid securities, and the ability of the Manager to dispose of an investment will depend on the market liquidity prevailing at that time. The value of Trust may be adversely affected if a security cannot be bought or sold quickly enough to minimise potential losses.

Leverage risk
The Manager does not intend to use long-term debt to enhance returns, but may use it in limited circumstances. For example, the Manager does not intend to use debt unless it has also planned to raise new capital from the issue of new units, which will be used to repay any borrowings. If a proposed capital raise is not successful, then any leverage may magnify the Trust's losses and gains.

Valuation risk
ABS will be valued in accordance with the Trust's valuation policy which includes wherever possible using security pricing sourced from third parties. However, estimates of the fair value of such securities are inherently difficult to establish, and are the subject of substantial uncertainty.

Market disruption risk
As a lender, Gryphon is exposed to market disruption risk. A market disruption event occurs in relation to a loan if borrowers are unable to refinance.

Service provider risk
The operation of the Trust relies on the successful performance of the Responsible Entity's contracts with service providers. There is also a risk that Gryphon is replaced due to unforeseen circumstances.

Lonsec

Gryphon Capital Income Trust

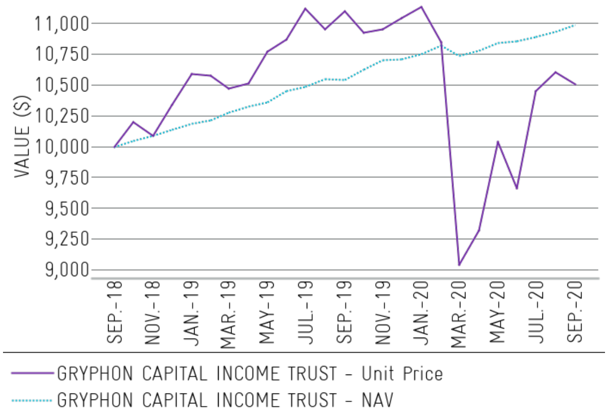
Quantitative Performance Analysis - annualised after-fee % returns (at 30-9-2020)

Performance metrics

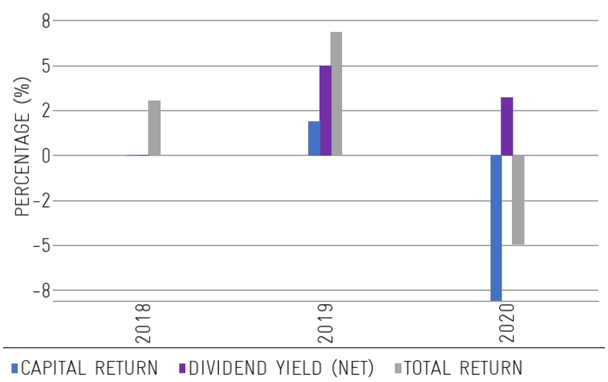
	1 YR	2 YR	3 YR	5 YR
TOTAL RETURN (% PA)	-5.37	2.48	-	-
STANDARD DEVIATION (% PA)	21.96	15.75	-	-
EXCESS RETURN (% PA)	-9.35	-1.93	-	-
WORST DRAWDOWN (%)	-18.86	-18.86	-	-
TIME TO RECOVERY (MTHS)	NR	NR	-	-
TRACKING ERROR (% PA)	21.97	15.74	-	-

PRODUCT: GRYPHON CAPITAL INCOME TRUST
PRODUCT BENCHMARK: RBA CASH RATE + 3.50%
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

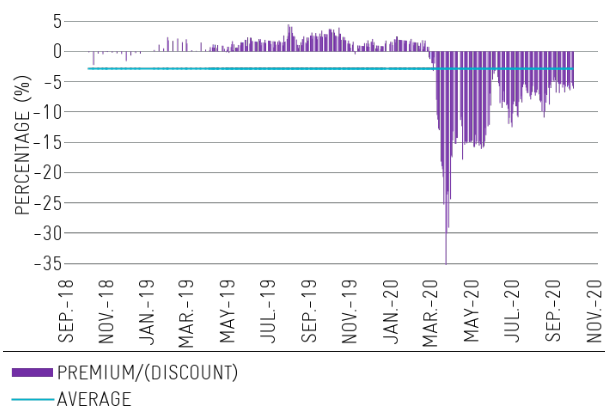
Growth of $10,000 over two years



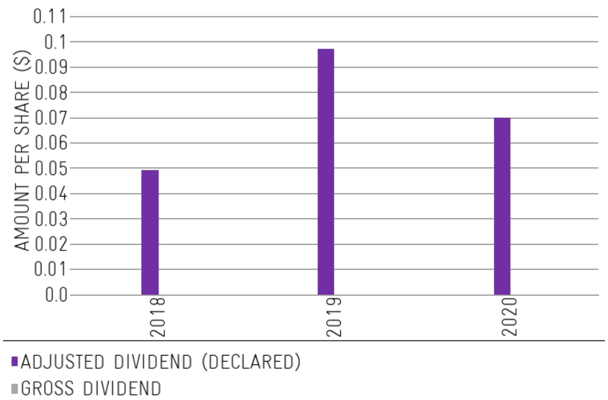
Calendar Year Returns over three years



Unit Price Premium/Discount to NAV over two years



Dividend Record over three years



ANALYST: JOSHUA NAPPA | APPROVED BY: AMY HO

Lonsec

Gryphon Capital Income Trust

Glossary

Click here for the glossary of terms.

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned entity with a multi-brand strategy of providing leading financial services research and investment execution. Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.