Lonsec

Recommended

Product Review
Gryphon Capital Income Trust

ISSUE DATE 07-09-2023

About this Review

ASSET CLASS REVIEWED	FIXED INTEREST
SECTOR REVIEWED	SPECIALISED HIGH INCOME
SUB SECTOR REVIEWED	LIT
TOTAL COMPANIES RATED	2

About this Trust

ASIC RG240 CLASSIFIED	NO
LIT REVIEWED	GRYPHON CAPITAL INCOME TRUST
TICKER	GCI
PDS OBJECTIVE	MONTHLY INCOME & CAPITAL PRESERVATION BY INVESTING IN A PORTFOLIO OF RMBS & ABS
INTERNAL OBJECTIVE	RBA CASH RATE +3.5% P.A. (NET OF FEES) THROUGH THE ECONOMIC CYCLE
DISTRIBUTION POLICY	MONTHLY
RESPONSIBLE ENTITY	ONE MANAGED INVESTMENT FUNDS LTD

Market data

MARKET CAPITALISATION	$489M
UNITS ON ISSUE	243M
UNIT PRICE (6-9-2023)	$2.01
52 WEEK HIGH/LOW UNIT PRICE	$2.01 / $1.85
NAV (5-9-2023)	$2.00
52 WEEK HIGH/LOW NAV	$2.02 / $2.00
UNIT PRICE PREM/(DISC) TO NAV	0.28%

About the Fund Manager

FUND MANAGER	GRYPHON CAPITAL INVESTMENTS PTY LTD
OWNERSHIP	100% GRYPHON CAPITAL PARTNERS PTY LTD
ASSETS MANAGED IN THIS SECTOR	$2.8BN (AUGUST 2023)
YEARS MANAGING THIS ASSET CLASS	29

Investment Team

PORTFOLIO MANAGER	STEVEN FLEMING, ASHLEY BURTENSHAW
INVESTMENT TEAM SIZE	9
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	PM, ANALYSTS / BRISBANE

Investment process

STYLE / ASSETS	INCOME / RMBS & ABS
BENCHMARK	RBA CASH RATE
TYPICAL NUMBER OF POSITIONS	105
SINGLE BORROWER LIMIT	10%
LEVERAGE	MAXIMUM 25% OF NAV (FOR FUTURE CAPITAL RAISES)
DERIVATIVES	YES
CURRENCY	100% HEDGED

Trust rating history

SEPTEMBER 2023	RECOMMENDED
OCTOBER 2022	RECOMMENDED
SEPTEMBER 2021	RECOMMENDED

What this Rating means

The **'Recommended'** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Scope of this rating

- Lonsec has used a holistic approach in forming an opinion on this Listed Investment Vehicle's (LIV) ability to meet its stated investment objectives. The rating model includes an assessment of the underlying investment capability in addition to the vehicle's effectiveness. When assessing the underlying investment capability Lonsec has relied upon its Managed Funds research process. Vehicle effectiveness considers a range of characteristics in combination with empirical observations.
- The rating should not be considered, or in any way interpreted, as Lonsec's forward-looking opinion or otherwise on the 'intrinsic value' of the LIV and whether Lonsec believes this to be 'overvalued' or 'undervalued' relative to the prevailing traded price.

Strengths

- The co-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.
- Strong risk management is embedded at the security level.

Weaknesses

- There is key person risk around the two Managing Partners Steven Fleming and Ashley Burtenshaw.
- The retention of key investment professionals, team cohesiveness and business integration remain watchpoints following the acquisition by Barings.
- Co-tenure of the Quantitative Team is low given recent team expansion and departures.

Trust Risk Characteristics

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

ANALYST: ISRIN KHOR | APPROVED BY: HONG HON

Gryphon Capital Income Trust

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. The portfolio is primarily comprised of Australian residential mortgage-backed securities ('RMBS') and asset-backed securities ('ABS'). The Trust aims to provide 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 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.
- 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 markets are an important and substantial part of the Australian market, offering an alternative investment option for retail investors seeking exposure to income streams.
- 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 40% 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 capital from the issue of Units and identifies a buying opportunity for the portfolio which will settle prior to the capital raise flowing into the Trust's bank account. As at the time of this review, the Manager has yet to use debt for the Trust.
- Derivatives are only permitted for efficient portfolio management (e.g. hedging) and not for market speculative purposes to increase returns.
- The Responsible Entity, One Managed Investment Funds Limited ('the RE'), 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 31 August 2023 was approximately $7.8m. 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.
- The Fund's PDS dated 4 November 2019 disclosed the Annual Fees and Cost ('AFC') charged to retail investors was 0.89% p.a. The AFC included (a) the management fees of 0.72% and (b) costs used to pay the operating costs of the Trust, including Trustee fees (0.04%), audit fees (0.01%), admin fees (0.05%), custody fees (0.01%), ASX fees (0.01%), annual listing cost (0.01%), registry fee (0.02%) and small bank charges (0.00%). 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.

- Lonsec notes that the Manager has produced a Target Market Determination ('TMD'), which forms part of the Responsible Entity's Design and Distribution Obligations for the Trust. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.
- Funds in the **Specialised High Income** 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.

ANALYST: ISRIN KHOR | APPROVED BY: HONG HON

- 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 liquidity 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 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 that 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

- Barings, a global investment manager, completed the 100% acquisition of Gryphon Capital Partners Pty Ltd, the parent company of wholly-owned Gryphon Capital Investments Ltd ('Gryphon') on 31 March 2023.
- The Gryphon team has joined the Global Structured Finance team at Barings, which consists of over 30 investment professionals, with combined assets under management of US$10.4bn as at 31 March 2023.
- There are no material changes to the investment process, philosophy, investment team or investment committee following the acquisition.
- Quantitative Analyst Shane Staton left the firm in July 2023. Jerry Jiang was recently hired as an Associate / Quantitative Analyst.

Lonsec Opinion of this Trust

People and resources

- Established in 2014, Brisbane-based asset manager, Gryphon Capital Investments ('Gryphon') is a specialist fixed income focusing on structured finance. In June 2023, Gryphon was acquired by Barings, a US$351bn global investment manager, with assets across public and private fixed income, real estate and specialist equity markets. Lonsec considers Gryphon's business to be more sustainable following the acquisition. The consolidated assets under management of Barings' Global Structured Finance and Gryphon was US$10.4bn as at 28 February 2023. Lonsec views that Gryphon is expected to benefit from Baring's scale, product development, capital raising and operational and business support. That said, Lonsec highlights the transaction is in its early stages of integration and business integration will be the focus in future reviews.
- The Gryphon team has joined the Global Structured Finance ('GSF') team at Barings, which consists of over thirty investment professionals based in Charlotte, North Carolina, London and Brisbane. Lonsec is comforted Gryphon's co-founders and managing directors Steven Fleming and Ashley Burtenshaw continue to be the portfolio managers for the Trust, which provides continuity. Lonsec believes their deep experience in securitised markets and longstanding working relationship to be a positive attribute for the Trust. Fleming and Burtenshaw have previously worked together since 2005 at Babcock and Brown and then at Columbia Threadneedle ('Threadneedle') in 2009. 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.

- Lonsec believes the Trust's investment team resourcing is adequate and views positively the team's ability to leverage the broader GSF team. The Portfolio Managers are supported by dedicated seven analysts from the Quantitative Team. Although members of the Quantitative Team 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).
- Accountability is viewed as sufficient for the Trust. 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.
- Lonsec is mindful of departures in recent years including Quantitative Analyst Shane Stanton in July 2023, Vijay Singh in 2022 and Sergey Podzorov in June 2021. Lonsec considers Stanton and Podzorov's departure and retirement, respectively to be disappointing given their roles in developing the front-end user interface for Gryphon's analytical tools which are considered critical for this complex and data-intensive asset class. However, Lonsec is comforted that the systems are more mature and require less extensive developments. Lonsec considers the co-tenure outside Fleming, Burtenshaw and Michael Groom to be very low following the expansion of the team and departures in recent years. Lonsec will continue to monitor team cohesiveness and integration into the broader Barings GSF teams.
- Lonsec is pleased to note that the team also has a dedicated compliance resource in Michael Groom, Head of Operations and Compliance. Groom has over 23 years of relevant experience, and is responsible for the firm's financial affairs, as well as managing Gryphon's operational compliance and company practices. A number of operational business requirements have been outsourced to third party providers, including legal, IT support, accounting/tax, audit service (internal controls only). Lonsec expects the internalisation of the non-investment related functions following the acquisition over time.
- Lonsec considers the alignment of interests to investors to be moderate following the sale of the co-founders' equity interests in the firm. Fleming and Burtenshaw's remuneration are linked to the performance of Gryphon business units within Barings. Lonsec will also be monitoring for retention of key professionals in future reviews.

Research and portfolio construction

- Lonsec believes Gryphon's key strength lies in the rigour of its bottom-up securities analysis, with its macro research to be sound and appropriate. 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 highlights the Manager has the required specialised skill set and the operational ability to filter and analyse large volumes of data regularly to invest in securitised assets. The Manager's investment philosophy and process are solely focused on securitised assets. This distinguishes the Trust from the majority of fixed income funds covered by Lonsec, which may only invest in securitised assets as a sleeve of a more broadly diversified portfolio.
- The Portfolio Managers have developed long-standing relationships within the industry. Originators will often 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, which the Trust uses to its advantage.
- Lonsec views positively the detailed and intensive nature of the Trust's investment process. The Trust's first step in assessing any asset-backed security is to determine the attractiveness of its relative value either at the portfolio level and/or individual transaction level. This decision is made by the Investment Committee ('IC'). Once approved, 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 and repayment type. All this information and 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 highlights that the use of both bottom-up and top-down analysis in the consideration of issues is viewed as structured and repeatable. 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 the Quantitative Team, overlay a qualitative view which considers macro influences on the domestic economy and their long-term knowledge of the asset class.

- Gryphon has developed various methods of analysing securitised assets, and the proprietary models are considered to be good quality and reasonably robust. Lonsec notes that there is a lack of standard off-the-shelf systems available for analysing such data on the market. Lonsec maintains the view that the ongoing maintenance and review of internal systems is necessary and is pleased with the build out of the Quantitative Team to support system maintenance notwithstanding the recent departures. Further, Lonsec is pleased that the systems are audited on a regular basis by PwC to ensure they remain compliant.
- Lonsec believes that the use of an IC aids the investment process, particularly by facilitating debate regarding portfolio positioning and security selection. 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 also discusses and deliberates over investment opportunities that have been evaluated via the research process.
- 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.

ESG integration

- Lonsec's ESG integration assessment considers how rigorous, robust and structured the ESG process for the Trust is as well as how well it integrates into the overall investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Trust's portfolio or the Manager's adherence to any form of impact, green/sustainable or ethical standards.
- At the corporate level Lonsec views the Manager's overall ESG policy framework and transparency as broadly aligned with peers. The Manager has indicated a commitment to the integration of ESG within their investment process with evidence of public positioning and policy framework. The recently updated Responsible Investing (RI) policy is freely available on the firm's website and tends to focus on governance issues, which is appropriate for this asset class. The updated policy covers the Manager's engagement process, and pleasingly provides clearer guidelines on engagement objectives and prioritisation. While the policy is considered in line with peers, Lonsec would welcome reporting on engagement outcomes to be publicly available.
- The Manager has indicated that their Responsible Investment style is 'ESG Integration' and as such they take Environmental, Social and Governance factors into consideration when assessing investment opportunities. With a primary ESG style of 'Risk or Value' the Manager will determine inclusion based on the balance of overall risk (including ESG risk) and potential return. As a result this approach may mean that lower quality ESG companies may be included if the return potential is sufficient and this may conflict with some clients' perception of what a strong ESG process would deliver.
- Within the management of this specific Fund Lonsec notes:
  - The Manager has no observable approach to the collection or use of ESG data within their investment process.
  - There is no internal ESG research carried out by the Manager for this Fund.
  - There is no relationship between ESG factors and the stock selection process.
  - Portfolio level measurement or assessment of ESG risks is not evident.
  - There are no signs that company engagement on ESG issues is a component of the Manager's current investment approach for this Fund.
  - ESG does not form a component of the Manager's broader compliance framework and overall transparency provided to investors is lagging.

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. This involves metrics such as monitoring top sponsors, portfolio rating and weighted average life distributions, top five negative equity holdings, top five worst performing postcodes, top five lowest probable maximum loss implied market value of debt holdings and the top five slowest conditional prepayment rates amongst others. 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 and not be replaced by people equally able to maintain the system.
- Lonsec highlights that there is no separate risk monitoring processes via a risk committee in place, notwithstanding that PwC conducts scheduled audits of the systems, which provides some comfort to Lonsec.

Gryphon Capital Income Trust

- Once an investment is made, Gryphon undertakes regular monitoring by accessing ongoing loan-level data on a monthly basis. The Quantitative Team is 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. Lonsec sees this process as prudent and reasonable.
- Lonsec notes that the Trust will also need to comply with the stringent listing rules of the ASX, including valuation of assets. Securitised investments is considered 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.

Management fees and costs

- The Trust's fee comprises of management fee of 0.89% p.a., an estimated performance fee of 0.00% p.a., and net transaction costs of 0.00% p.a. Lonsec considers the total fee load for the Trust (AFC of 0.89% p.a.) as moderate compared to the broader fixed income peers.

Product considerations

- GCI is a fixed income strategy focused on securitised assets. Hence, Lonsec does not consider it to be operationally challenging to implement. Additionally, the Manager employs high quality 'tier 1' service providers.
- TheTrust is a registered managed investment scheme ('MIS') for which One Managed Investment Funds Limited is the Responsible Entity ('RE'). The RE is responsible for operating and managing the MIS, holds an AFSL and as such is required to comply with its AFSL and RE obligations as outlined under the Corporations Act. Lonsec notes the RE has built experience in operating and managing a number of schemes over an extended period of time.
- A key risk for investors in any LIT is the possibility for the structure to trade at a substantial discount to Net Tangible Asset ('NTA') for an extended period. At its lowest, GCI was trading at a 35% discount to NTA in early 2020 but Lonsec views positively that the trading performance of the share price to NTA continues to improve, with the discount narrowing to -1.2% as at 28 August 2023. The average discount was around 2.5% over the last five years.
- The LIC predominately invests in securitised assets which may pose some liquidity challenges at times over an investment cycle.

Capacity management

- As of 30 June 2023 the Manager oversees assets of \$2.8bn in AUM. The market capitalisation of GCI of \$477.8m as at 31 July 2023. The Manager is targeting \$1bn over the next five years. Therefore, Lonsec does not have any immediate capacity concerns.
- The build out in resourcing to the team to improve the data and collection analysis of loan pools is viewed favourably. Lonsec will monitor the team's ability to manage this function following the departures from the investment team over the past years.
- 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 estimated to be in excess of \$100bn. 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 Trust 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.

Performance

- The Trust seeks to deliver a target return of 3.5% p.a. (net of fees) above the RBA Cash Rate through the economic cycle.
- The performance outcomes are complicated by the ASX-listed nature of the product and the potential for the traded unit price to differ from the underlying per unit net tangible asset value.
- The Trust delivered 5.8% p.a. and 5.4% p.a. of income distributions (based on NTA) over three and five years to 31 July 2023, respectively. The Trust has outperformed its cash plus 3.5% objective by 1% and 0.7% p.a., respectively. From a total return perspective, the Trust returned 7.5% p.a. and 5.2% p.a. (based on unit price and income distributions) over three and five years to 31 July 2023. Pleasingly, the Trust has continued to pay regular monthly distributions since its inception.
- Lonsec notes that the Trust has historically traded close to NAV, notwithstanding the Trust's unit price experiencing a significant deviation from NAV during the COVID pandemic period. This was experienced by other fixed-income LITs rated by Lonsec.
- For investors, it should be noted the Trust's performance outcome is determined ultimately by the income distributions received and the price of the unit trust which is susceptible to deviations from its NAV.

Overall

- Lonsec has maintained the Trust's rating of **'Recommended'** at its latest review. The rating is supported by the extensive experience and expertise of the investment team, particularly the Portfolio Managers and co-founders 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 highlights that there is significant key person risk surrounding Fleming and Burtenshaw. Lonsec notes that the co-tenure of the Quantitative Team. Lonsec views the acquisition of Barings positively, but will monitor for retention of key professionals, business and team integration over next few reviews.

Gryphon Capital Income Trust

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. In June 2023, Gryphon was acquired by Barings, a US$351bn global investment manager, with assets across public and private fixed income, real estate and specialist equity markets.

The consolidated assets under management of Barings' Global Structured Finance and Gryphon was US$10.4bn as at 28 February 2023.

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.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
STEVEN FLEMING*	MANAGING DIRECTOR / PORTFOLIO MANAGER	29 / 9
ASHLEY BURTENSHAW*	MANAGING DIRECTOR / PORTFOLIO MANAGER	29 / 9
PIERS DE PUTRON	DIRECTOR / DATABASE MANAGER & SYSTEMS ANALYST	25 / 2
CHRISTIAN LARNEY	ASSOCIATE DIRECTOR / QUANTITATIVE ANALYST	22 / 1
LUKE VECCHI	ASSOCIATE DIRECTOR / QUANTITATIVE ANALYST	4 / 2
JEFF WU	SENIOR ASSOCIATE / QUANTITATIVE ANALYST	4 / 1
ALEX BRADFORD	ASSOCIATE / QUANTITATIVE ANALYST	2 / 2
THOMAS BIGGS	ASSOCIATE / QUANTITATIVE ANALYST	4 / 1
JERRY JIANG	ASSOCIATE / QUANTITATIVE ANALYST	2 / <1

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

The investment committee is comprised of Fleming and Burtenshaw.

Steven Fleming has 29 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 securitised assets.

Ashley Burtenshaw has 29 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.

Piers De Putron has more than 25 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

The 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 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

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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.

Once the loan pool is broken down 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 bar-belled 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

SEPARATE INVESTMENT RISK MONITORING	NO
MINIMUM CREDIT RATING	UNRATED
MAXIMUM PORTFOLIO WEIGHTED AVERAGE LIFE	5.5 YEARS
MAXIMUM INDIVIDUAL SECURITY WEIGHT	10%
MAXIMUM GROSS EXPOSURE TO SINGLE ORIGINATOR	40%
RMBS EXPOSURE	60-100%
ABS EXPOSURE	0-40%
MAXIMUM SUB-INVESTMENT GRADE ALLOCATION	50%
MAXIMUM SUB-INVESTMENT GRADE ABS	15%
MAXIMUM PORTFOLIO EXPOSURE TO NON-AUD DENOMINATED CURRENCIES	20%
CASH EXPOSURE	0-20%
DERIVATIVES	YES
LEVERAGE	MAXIMUM 25% OF NAV (FOR FUTURE CAPITAL RAISES / SHORT TERM PURPOSES ONLY)
CURRENCY EXPOSURE	100% HEDGED

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.

Board of directors and governance

One Managed Investment Funds Limited is the Responsible Entity ('RE') of the Trust. The RE 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 RE 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 RE 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 RE 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.

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Currency management

Any currency risks are fully hedged. The Trust currently has no non-AUD denominated securities exposure but can have a maximum exposure of up to 20% towards non-AUD tranches of Australian RMBS to capture relative value opportunities.

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 capital from the issue of 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.

Derivative risk

Derivatives are only permitted for efficient portfolio management (e.g. hedging) and not for market speculative purposes in an attempt to increase returns.

Currency risk

The Trust predominantly invests in assets that are denominated in Australian dollars. The Trust can, however, have a maximum exposure of up to 20% towards non-AUD tranches of Australian RMBS to capture relative value opportunities. Any derivative or FX product trades are approved by Fleming and Burtenshaw.

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.

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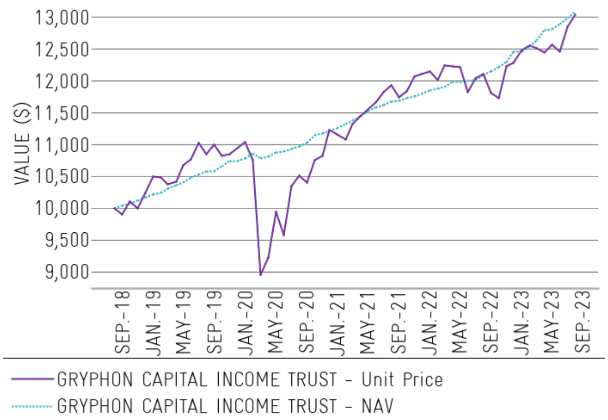
Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2023)

Performance metrics

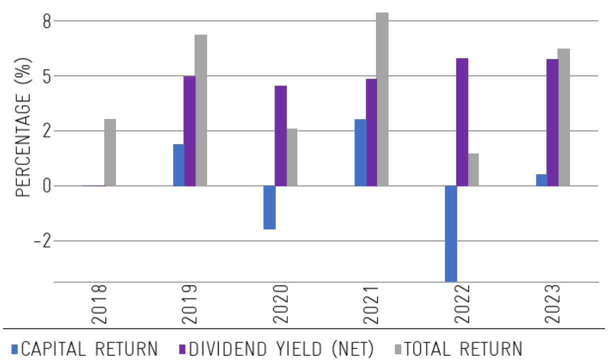
	1 YR	2 YR	3 YR	5 YR
TOTAL RETURN (% PA)	7.78	4.57	7.48	5.47
STANDARD DEVIATION (% PA)	6.38	5.76	5.59	10.74
EXCESS RETURN (% PA)	-	-	-	-
WORST DRAWDOWN (%)	-3.10	-4.18	-4.18	-18.86
TIME TO RECOVERY (MTHS)	1	2	2	9
TRACKING ERROR (% PA)	-	-	-	-

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

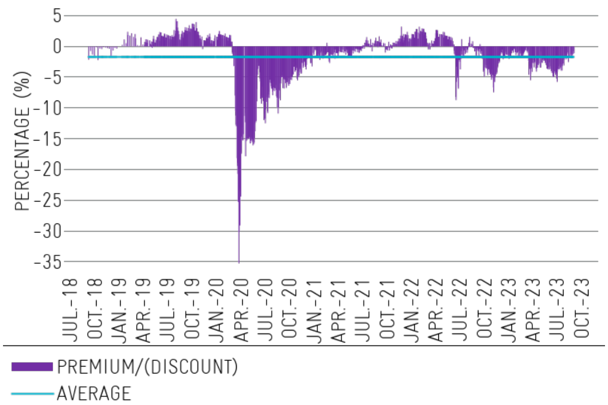
Growth of $10,000 over five years



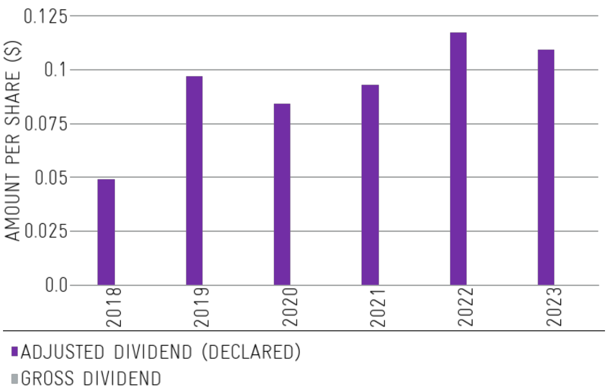
Calendar Year Returns over six years



Unit Price Premium/Discount to NAV over five years



Dividend Record over six years



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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.