Product Assessment

Report as at 10 Sep 2024

RECOMMENDED

Gryphon Capital Income Trust

Rating issued on 13 Jun 2024 | Exchange Code: GCI

Investment objective

To achieve a target income level of the Reserve Bank of Australia (RBA) Cash Rate plus 3.50% p.a., net of fees, over the medium to long term.

Manager	Gryphon Capital Investments Pty Ltd
Distributor	Gryphon Capital Investments Pty Ltd
Sector	Australian Fixed Interest \ Specialist
Investment Style	Active
RI Classification	Aware
Absolute Risk	Moderate
Relative Risk	Active - Benchmark Unaware
Investment Timeframe	5-6 Years
Benchmark	Bloomberg AusBond Bank Bill Index
Min Investment Amount	N/A
Redemption Frequency	Daily
Income Distribution	Monthly
Fund Size (31 Jul 2024)	$681.19M
Management Cost	0.89% p.a. Incl. GST
Performance Fee	Nil
Buy / Sell Spread	N/A
Inception Date	30 Jun 2018

Fund facts

- LIT exposure to Australian RMBS and ABS
- Returns targeting a margin above cash with monthly income distributions
- Potential to invest in sub-investment grade and non-AUD securities hedged back to AUD

Viewpoint

The Trust, managed by Brisbane-based Gryphon Capital Investments (Gryphon), is a specialist fixed interest strategy, accessed in a Listed Investment Trust (LIT) structure. The LIT seeks to generate attractive returns above cash by investing in a diversified portfolio of residential mortgage-backed securities (RMBS) and asset-backed securities (ABS). In Zenith's opinion, Gryphon's deep expertise in the structured credit sector coupled with its use and development of systematic processes to identify attractively priced securities, places the Trust as an attractive option in the LIT sector.

In March 2023, Gryphon was acquired by Barings, a large global fund manager and wholly-owned subsidiary of MassMutual, one of the largest life insurers in the US. As part of the agreement, Barings acquired 100% of the business and the key investment principals have made a medium-term commitment to remain with the firm.

Zenith highlights that Gryphon has integrated seamlessly into the broader Barings business, benefiting from a range of non-investment support functions (including distribution, product and legal). Further, the access to capital from MassMutual and the ability to interact with a broader pool of structured credit experts is expected to be beneficial over the long-term.

Gryphon’s investment team comprises eight members and is led by Portfolio Managers and Managing Directors, Steven Fleming and Ashley Burtenshaw. The key principals manage the portfolio collaboratively with Burtenshaw leading the firm's coverage of public market transactions while Fleming is primarily responsible for private market transactions.

In Zenith's opinion, Burtenshaw's expertise in understanding RMBS and ABS is a key competitive advantage, which extends to in-depth modelling of collateral pools and also analysing the structural features of these securities.

The investment process is applied to a universe of structured credit securities issued in the Australian market, primarily comprising private warehouse facilities and to a lesser extent, publicly traded RMBS and ABS. In terms of excess returns, security selection and sector relative value are expected to be the principal drivers of performance outcomes.

In our opinion, Gryphon's specialisation in structured credit markets is a point of differentiation, noting that the spreads from these securities represent compensation for complexity, subordination, weighted average life (WAL) extension risk and prepayment speeds, most of which are less than perfectly correlated with the broader credit cycle.

As part of the security-level assessment, each loan pool is segmented into bands across loan to value ratio (LVR), security type, classification (owner occupier or investment for RMBS), loan purpose (ABS), borrower employment category, asset location, outstanding loan balance, loan seasoning, arrears data and property risk factors. The team constructs a high conviction portfolio representing their best ideas, with exposure to private and public RMBS (prime and non-conforming) and ABS.

The Trust has had a higher allocation to private transactions over recent years, reflecting the shortage of capital in these markets and also the risk-adjusted opportunity set. Zenith highlights that the spreads available in private market transactions are typically higher relative to public markets, representing an illiquidity and complexity premia. In our opinion, the permanent capital feature of the LIT structure is consistent with funding private transactions and extracting an illiquidity premium for investors.

Fund analysis

Fund characteristics

Constraint	Value
Investment Grade Securities	50% to 100%
Sub-Investment Grade Securities	Max: 50%, RMBS: 50%, ABS: 15%
Non-Australian Dollar Securities - Hedged	Max: 20%
Tranche Limit	Max: 10%
Originator Limit	Max: 40%

Investment objective and philosophy

The Trust is managed to achieve a target income level of the Reserve Bank of Australia (RBA) Cash Rate plus 3.50% p.a. (net of fees), over the medium to long-term. In achieving this, Gryphon seeks to deliver a stable and predictable monthly income stream, with a focus on attractive risk-adjusted returns.

Zenith notes that the return objective is made on a 'through the cycle' basis, and portfolio outcomes will be largely influenced by pricing in the prevailing market environment. To achieve this objective, the portfolio comprises a minimum 50% of securities rated at least investment grade.

The investment process is applied to a universe of structured credit securities issued in the Australian market, primarily comprising private warehouse facilities and to a lesser extent, publicly traded RMBS and ABS. While the firm has the flexibility to invest in offshore securities, the underlying collateral is domiciled in Australia, and all currency exposure hedged back to Australian dollars. In terms of excess returns, security selection and sector relative value are expected to be the principal drivers of performance outcomes.

Zenith highlights that Gryphon's specialisation in structured credit markets is a point of differentiation, noting that the spreads from these securities represent compensation for complexity, subordination, weighted average life (WAL) extension risk, prepayment speeds and default risk, most of which are less than perfectly correlated with the broader credit cycle.

Underpinning the investment process is the view that capital markets are inefficient, with informational asymmetries providing opportunities for those investors with specialist research abilities. As such, Gryphon draws on the best available data in the market, subsequently applying its research-intensive process to each of the underlying sub-sectors. The team adopts a 'buy and hold' strategy, as opposed to seeking to time their entry and exit points into different sub-sectors or individual securities.

The investment process commences with idea generation, and through the weekly IC process, where the team identifies those segments of the market offering attractive relative value. Included in this process is a detailed review of the existing portfolio and its credit profile, which is assessed relative to market risks, performance of underlying collateral pools and pricing across sub-sectors.

Included in idea generation is an overlay process that considers a range of factors including the macroeconomic environment, historical pricing, relative pricing, portfolio concentration by geography, changes in the regulatory landscape, supply and demand balances, and portfolio composition.

Zenith believes the investment process is well-structured, with close linkage between the top-down views of the IC and bottom-up research conducted during the security selection phase. Furthermore, we believe the data-intensive approach employed by Gryphon provides Burtenshaw with a detailed understanding of each security, allowing the portfolio to be constructed with a high level of precision.

Portfolio applications

Structured credit securities, such as residential mortgage-backed securities (RMBS) and asset-backed securities (ABS), are types of fixed interest securities where a security or note is issued over a pool of loan or debt obligations, such as residential mortgages, leveraged loans or credit card securities.

Gryphon aims to provide investors with regular income (i.e. monthly), by constructing a high conviction portfolio that invests primarily in domestic investment grade and sub-investment grade RMBS and ABS. The portfolio's structured credit allocation predominantly comprises private warehouse facilities and to a lesser extent, publicly traded securities.

Zenith believes the Trust is suitable for investors seeking exposure to a higher yielding strategy, which may improve a portfolio's potential risk-return profile. However, as the Trust can invest up to 50% of the portfolio's net asset value (NAV) in sub-investment grade securities, it may not be suitable for the more risk averse investor.

Investors should be aware that the Trust may not provide the defensive characteristics of traditional bonds and returns may be correlated with those of broader equity markets in periods of stress. Further, as a LIT, units will have their own trading patterns and may trade away from their NAV, which at times may impact the effectiveness of Gryphon's investment process and/or the expected risk-return profile.

Due to the potential for moderate to high levels of volatility, with the possibility of capital loss, Zenith recommends taking a medium to long-term investment time frame. We caution against the Trust being used by investors with short-term (e.g. daily) liquidity needs.

Fund responsible investment attributes

Key Information	Description
Zenith RI classification*	Aware
Has Responsible Investment Policy	Yes
PRI Status	
PRI Signatory	Yes

*Zenith RI Classification scale:

- Traditional
- Aware
- Integrated
- Thematic
- Impact

Absolute performance

Performance as at 31 Jul 2024

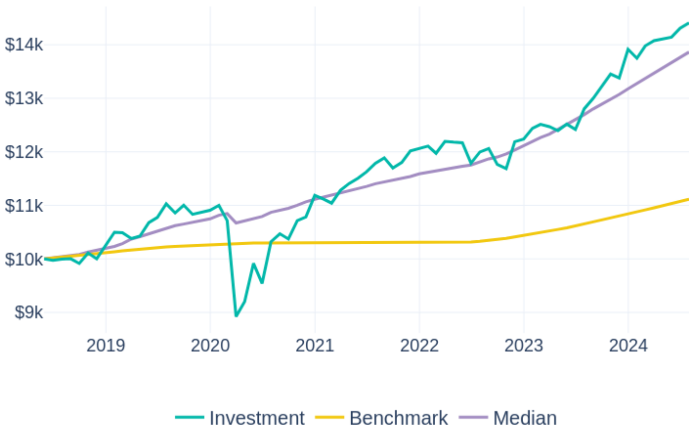
Monthly performance history (%, net of fees)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	BM YTD*	BM2 YTD**
2024	-1.21%	1.68%	0.70%	0.23%	0.24%	1.18%	0.70%						3.55%	2.56%	5.50%
2023	1.66%	0.59%	-0.34%	-0.60%	0.98%	-0.79%	3.11%	1.52%	1.73%	1.73%	-0.54%	4.01%	13.73%	3.85%	8.97%
2022	0.37%	-1.12%	1.86%	-0.12%	-0.09%	-3.14%	1.77%	0.53%	-2.46%	-0.66%	4.30%	0.39%	1.44%	1.25%	4.91%
2021	-0.63%	-0.67%	2.17%	1.12%	0.88%	1.03%	1.36%	0.87%	-1.58%	0.87%	1.84%	0.37%	7.84%	0.03%	5.29%
2020	0.85%	-2.60%	-16.73 %	3.12%	7.76%	-3.75%	8.15%	1.45%	-0.94%	3.33%	0.63%	3.73%	2.55%	0.37%	4.45%

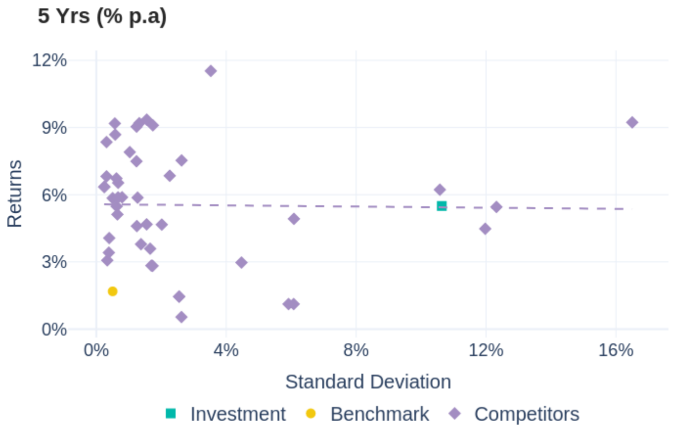
**Bloomberg AusBond Bank Bill Index*

***GCI Net Portfolio Returns*

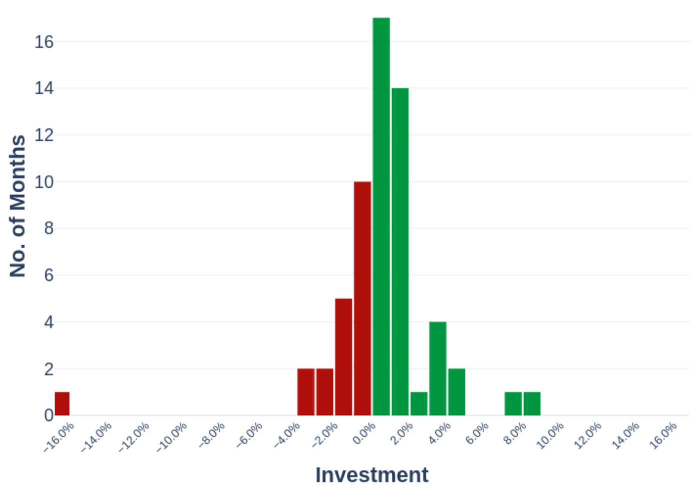
Growth of $10,000



Risk / return



Monthly histogram



Minimum and maximum returns (% p.a.)

Absolute performance analysis

Instrument	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Investment	12.54%	9.60%	6.93%	5.50%	6.10%
Benchmark	4.34%	3.74%	2.55%	1.68%	1.73%
Median	9.20%	8.36%	6.72%	5.56%	5.44%
Cash	4.34%	3.74%	2.55%	1.68%	1.73%

Ranking within sector (p.a.)

Ranking within Sector	1 Yr	3 Yrs	5 Yrs	Inception
Fund Ranking	3 / 25	13 / 25	9 / 19	9 / 15
Quartile	1st	2nd	2nd	3rd

Absolute risk

Instrument	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Standard Deviation (% p.a.)					
Investment	4.42%	5.35%	5.33%	10.64%	9.79%
Benchmark	0.05%	0.22%	0.51%	0.50%	0.46%
Median	0.16%	0.42%	0.73%	1.15%	1.07%
Downside Deviation (% p.a.)					
Investment	1.33%	2.16%	2.77%	8.13%	7.35%
Benchmark	0.00%	0.00%	0.01%	0.01%	0.01%
Median	0.00%	0.00%	0.00%	0.73%	0.65%

Absolute risk/return ratios

Instrument	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Sharpe Ratio (p.a.)					
Investment	1.86	1.09	0.82	0.36	0.45
Benchmark	0.00	0.00	0.00	0.00	0.00
Median	31.02	10.91	5.71	3.38	3.48
Sortino Ratio (p.a.)					
Investment	6.18	2.71	1.58	0.47	0.60
Benchmark	NaN	NaN	0.00	0.00	0.00
Median	infinity	infinity	infinity	5.34	5.68

Zenith benchmarks funds in the 'Australian Fixed Interest - Specialist' peer group against the Bloomberg AusBond Bank Bill Index. While this benchmark may not be consistent with the one adhered to by all rated participants, it has been adopted to provide investors with a common reference point against which similarly structured strategies may be assessed.

All performance, consistency and risk/return data is referenced to the Zenith assigned benchmark. Fund performance represents the LIT returns attributable to shareholders (e.g. movements in the ASX share price and dividends reinvested).

The following commentary is effective as at 30 April 2024.

The Trust is managed to achieve a target income level of the Reserve Bank of Australia (RBA) Cash Rate plus 3.50% p.a., net of fees, over the medium to long-term.

Gryphon has consistently achieved its investment objective over all periods of assessment. In addition, peer relative performance has been strong, with the Trust ranking in the upper quartiles of the category over the short to medium-term. Notwithstanding this, meaningful comparisons can be challenging given the heterogeneous nature of the strategies employed across the peer group.

Zenith ratings applied to LITs do not explicitly take into account share prices vs. NAV and do not represent a buy/sell recommendation based on a LIT's valuation. Potential investors should make their own determination of the appropriateness of prevailing premiums or discounts to NAV when acquiring or disposing of a LIT.

Relative performance

Excess returns

Statistic	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Excess Return	8.20%	5.86%	4.38%	3.81%	4.37%
Monthly Excess (All Mkts)	66.67%	62.50%	61.11%	63.33%	62.16%
Monthly Excess (Up Mkts)	66.67%	62.50%	61.76%	64.91%	63.38%
Monthly Excess (Down Mkts)	0.00%	0.00%	50.00%	33.33%	33.33%

Capture ratios (% p.a.)

Statistic	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Downside Capture	0.00%	0.00%	-4386.21%	-440.33%	-440.33%
Upside Capture	279.17%	250.08%	255.92%	319.42%	344.90%

Tracking error (% p.a.)

Instrument	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Investment	4.45%	5.30%	5.23%	10.64%	9.79%
Median	0.16%	0.27%	0.30%	0.99%	0.93%

Information ratio

Instrument	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Investment	1.84	1.11	0.84	0.36	0.45
Median	30.81	17.41	13.78	3.93	3.99

Beta statistics

Statistic	1 Yr	2 Yrs	3 Yrs	5 Yrs	Inception
Beta	-55.62	6.12	2.66	0.57	0.55
R-Squared	0.41	0.07	0.07	0.00	0.00
Correlation	-0.64	0.26	0.26	0.03	0.03

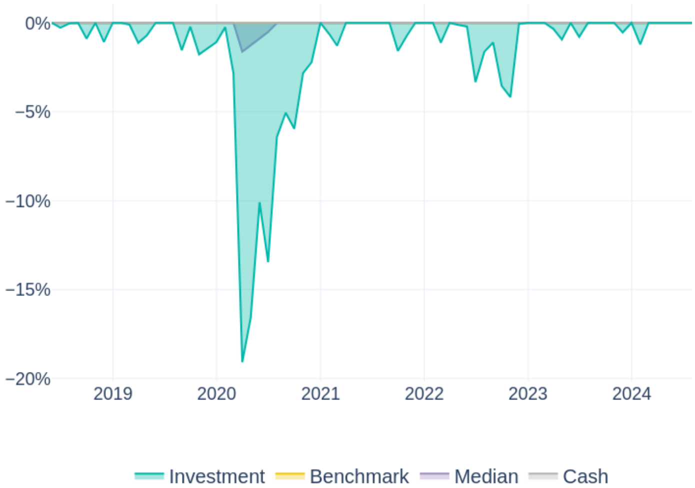
The following commentary is effective as at 30 April 2024.

It is important to note that the relative performance analysis shown above combines the Trust's listed price returns with distributions to give the reader detail on the investor experience and as such, do not directly reflect the performance of the underlying portfolio.

Zenith typically seeks to identify funds which can outperform the assigned index in greater than 50% of months, as we believe this represents a persistence of manager skill. The Trust has achieved this ratio over all time periods.

Drawdown analysis (since inception)

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.



The following commentary is effective as at 30 April 2024.

Consistent with the Trust's capital preservation focus, drawdowns in the underlying portfolio have been constrained; however, drawdowns experienced by the Trust's unit price have been high due to secondary market trading.

Despite the relative attractiveness of the strategy, Zenith highlights that the performance of the Trust reflects the performance of the underlying portfolio, as well as the performance of the ASX vehicle. The latter is subject to the impact of market sentiment, which can result in the Trust trading at a significant discount or premium to NAV.

Product Exposures

Holdings not provided by the manager

Fund commentary

Fund risks

Zenith has identified the following key risks of the Trust. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

Key person risk: Zenith considers Ashley Burtenshaw to be critical to the successful management of the strategy and his departure would be considered material and require a reassessment of our rating. The sale represents a potential exit event and introduces uncertainty with respect to the founders long-term employment beyond the multi-year earn out period.

Sub-investment grade risk: By its nature and as reflected by its rating, sub-investment grade debt has a higher potential of default. Given the Trust can invest up to 50% of the portfolio in sub-investment grade debt, investors should be aware of the increased risk involved in this allocation.

Illiquidity risk: Sub-investment grade securities tend to be less liquid than higher-rated securities, which is particularly evident in times of market stress. Gryphon has the flexibility to invest up to 50% of the portfolio in sub-investment grade and unrated assets. Therefore, there is a risk that the portfolio becomes illiquid, which can result in high unit price volatility and large mark-to-market price variations.

RMBS exposure risk: The Trust is permitted to have sizeable allocations to RMBS, including lower rated tranches and private warehouse facilities. These securities can become highly illiquid and difficult to manage in risk off environments or in an environment of declining residential housing prices. This may be to the detriment of performance, particularly during an environment of rising mortgage stress.

Utilisation risk: The Trust can invest in private warehouses where the level of utilisation or draw down may vary over time, particularly if economic conditions are more challenging. Returns will vary according to the level of utilisation by providers of such warehouse facilities.

Valuation risk: Given the idiosyncratic nature of private warehouse investing, coupled with the limited secondary market, valuation risk is considered moderate for the Trust. While valuations are conducted daily by a third party pricing provider, there is a risk that the realisable value of securities may not align with the mark-to-market value carried by the firm.

Security/asset selection

The next step in the investment process is security selection, with the IC directing the research team to conduct in-depth issuer and issue analysis consistent with the themes and opportunities identified. Gryphon uses its databases and quantitative tools to develop a granular understanding of the characteristics of each security.

While detailed analysis is conducted on underlying collateral pools, investment protections and the amount of excess spread generated in a normal environment, the team also performs similar analysis in a stressed environment, where it models changes in collateral values, unemployment rates, borrower servicing costs, etc. At the completion of the security selection process, analysis on each security is presented to the IC via several standardised reports, with the IC responsible for approving securities prior to inclusion in the portfolio.

Given the nature of securitised assets, the process tends to be more data-intensive and inclusive of a wider set of factors. This process starts with a screen of the RMBS and ABS universe, which is captured in a proprietary database. To align with the investment themes identified at the idea generation stage, the research team filters out securities displaying certain characteristics (e.g. delinquency versus hard credit enhancement ratios, principal payment triggers, LMI recovery history, etc).

For those issues that pass the initial screen, the team conducts a detailed assessment which includes generating a credit underwriting report, deal modelling and stress testing. The credit underwriting report includes key details on deal structure, credit enhancement, risk analysis, underlying loan data, cashflow modelling, and an evaluation of the originator and servicer.

In terms of cashflow modelling, the team has recently developed a Master Cashflow Model, which aims to achieve greater accuracy in projecting the cashflows in each RMBS transaction. Zenith is supportive of the implementation of a centralised cashflow model, given it allows for a consistent modelling approach across transactions, can assist with early detection of arrears, replaces individual cashflow models for each RMBS, and reduces the amount of manual intervention required by the team.

The assessment of originators/servicers include periodic on-site due diligence reviews and a deep dive into the quality of underwriting processes, technology infrastructure, management experience, origination channels, and several other business-related points of focus (e.g. staffing numbers, financial conditions).

The team also maintains continuous surveillance on multiple originators/servicers, regardless of portfolio exposure, with the view to build higher conviction in their underwriting practices through time. Typically, the team screens out new originators until they build scale and demonstrate the robustness of their lending and underwriting practices over time.

The next step in the process is a granular analysis of an issue’s collateral pool, which is dissected based on a number of portfolio metrics. An internally-developed system allows the team to monitor quantitative aspects at an individual loan level, which is then aggregated into a series of dashboards that facilitate the analysis of loan pools.

Each loan pool is segmented into bands across loan to value ratio (LVR), security type, classification (owner occupier or investment for RMBS), loan purpose (ABS), borrower employment category, asset location, loan interest (fixed or variable), outstanding loan balance, LMI provider, repayment profile, loan seasoning, arrears data and property risk factors (flood zones, etc). Reports are also produced to focus on any large loans in an underlying pool, preferring those pools with a more even distribution of borrower risk.

During the research process, the team also assesses fair value, both between sectors and across issuers within a sub-sector. In terms of deal modelling, the team focuses on a security's design features and its potential for credit rating migration (i.e. upgrades/downgrades), and ratings issued by external rating agencies.

Once the investment team has completed its detailed assessment, all information is consolidated into standardised research reports, and presented to the IC for review and ultimate approval. Zenith has reviewed samples of these reports, highlighting the quality and granularity of underlying information.

Zenith highlights that based on the granularity of Gryphon's approach, it is able to invest fluidly across different tranches, including mezzanine or sub-investment grade tranches. This is supported by its modelling work and understanding how excess spread flows through a structure and what level of arrears and principal write-offs can be absorbed before capital values are impacted.

Responsible investment approach

Gryphon became a signatory of the United Nations Principles for Responsible Investment (PRI) in October 2020; however, the firm is currently a PRI signatory as a subsidiary of Barings. The business operates under a Responsible Investment Policy (RIP), which was last updated in September 2022.

All prospective investments are assessed for material Environmental, Social and Governance (ESG) considerations in the course of the underwriting process, which also extends to the determination of the efficacy of green tranche exposures where relevant. While positive ESG impacts are viewed favourably by the investment team, these considerations are secondary to the respective mandate criteria for each strategy managed by Gryphon. The IC is responsible for the oversight of the firm's RIP framework, with Burtenshaw retaining ultimate responsibility for its implementation.

While a series of negative screens is formally applied to exclude any issuers involved in a range of sectors, Zenith is of the opinion that few, if any, of these sectors apply to the Trust's investment universe. As such, we believe they are largely irrelevant.

In Zenith's opinion, while acknowledging that the incorporation of ESG issues into RMBS and ABS is an area that is less developed than other asset classes, we believe Gryphon's approach within the Trust, while evolving, is less advanced than peers.

Zenith has assigned the Trust a Responsible Investment Classification of Aware.

Portfolio construction

Responsibility for the Trust rests with Burtenshaw in his capacity as CIO, however, the IC is ultimately accountable for the performance of the portfolio. Zenith highlights that the composition of the IC is limited to Burtenshaw and Fleming, and therefore is a procedural body, as opposed to producing any differentiated insights.

The portfolio construction process combines the 'best ideas' identified by the IC, with the final output comprising a concentrated portfolio of securities expected to deliver attractive risk-adjusted returns in line with objectives. The IC aims to ensure diversification across rating bands, geographical exposures, LVRs and the amount of loan seasoning.

In terms of building the portfolio, the IC performs a qualitative assessment based on the existing portfolio, approved securities and its top-down views on the prospective performance of each sub-asset class. Different cohorts of securities can cluster in terms of performance, presenting relative value opportunities within structures and across deals.

Factors assessed include portfolio diversification, relative value between existing and prospective holdings, counterparty credit quality (e.g. LMI providers) and drivers of structured credit (e.g. borrower repayment speed, WAL changes).

Furthermore, the team can invest in both private warehouse facilities and publicly traded RMBS and ABS, with the allocation driven by factors including the spread differential between private and public transactions, across credit rating bands and RMBS classifications (prime/non-conforming), and the private warehouse facility terms negotiated. The Trust has had a higher allocation to private transactions over recent years, reflecting the shortage of capital in these markets and also the risk-adjusted opportunity set.

Zenith highlights that the spreads available in private market transactions are typically higher relative to public markets, representing an illiquidity and complexity premia. In our opinion, the permanent capital feature of the LIT structure is consistent with funding private transactions and extracting an illiquidity premium for investors.

In terms of position sizing, the IC considers the attractiveness of an issue relative to the Trust's mandate, with more attractive issues receiving higher allocations, subject to portfolio constraints. Zenith highlights that the Trust can assume concentrated positions, with exposure limits of 10% to a single tranche and 40% to an originator.

Zenith highlights that Gryphon tends to invest with a small number of originators, where it has a high level of confidence in its origination programs and broader underwriting standards. Notwithstanding this, while the level of originator concentration is high, each underlying loan pool is diversified, comprising thousands of underlying borrowers. Furthermore, the commonality of borrowers across loan pools is typically low, and as such, concentration risk only applies to the originator's underwriting standards.

The investment mandate is relatively wide, permitting material exposure to sub-investment grade and non-rated securities, up to a maximum allocation of 50%. Furthermore, a 20% exposure to non-AUD denominated securities is permitted, however, these securities must comprise Australian assets, and foreign currency exposure hedged back to Australian dollars.

The portfolio's credit duration is an outworking of the security selection process and expected to approximate 2.5 years on a 'through the cycle' basis. Typically, Gryphon hold securities to maturity, however, the team can trade securities where there are relative value opportunities, albeit trading is more opportunistic and relatively infrequent.

Zenith notes that while gearing is not intended to be used to enhance returns, the Trust may borrow up to 25% of its NAV for short-term liquidity purposes. Gryphon has indicated that leverage will only be used as a source of bridging finance, to fund the purchase of an attractive buying opportunity on an interim basis, while additional capital is raised.

In Zenith's view, the portfolio construction approach links closely with the security selection process. As the Trust has increased in scale, the underlying portfolio has matured, providing exposure to a range of originators, vintages and different underlying collateral types.

Risk management

The portfolio is managed with a range of non-invasive constraints, allowing sizeable allocations to sub-investment grade debt securities. Zenith highlights that the relatively unconstrained approach to RMBS and ABS has the potential to contribute to a wide range of performance outcomes.

In practice, risk management is incorporated into the investment and portfolio construction process through stress testing, pre and post-trade compliance, portfolio risk analysis, performance monitoring and performance attribution.

Stress testing assesses the performance of RMBS and ABS securities against significant declines in housing prices and increases in default rates are tested on both existing positions and prospective transactions being considered for the portfolio.

Given the idiosyncratic nature of structured credit securities, Gryphon has developed proprietary systems to conduct trade compliance and portfolio analytics. This allows the team to assess more unique features of the portfolio's assets, such as early prepayment risks, soft and hard credit enhancements, and priority cashflow provisions. Zenith considers this to be an important feature of the firm's risk management process, as most mainstream risk systems do not adequately risk manage the structural features of the asset class.

Zenith views the formal constraints around the originator and tranche exposures to be wide, with permissible exposures of 40% and 10%, respectively. While this provides the team with the flexibility to benefit from the most attractive issues, we would prefer to see the Trust managed to tighter constraints. Specifically, we believe tighter limits could be imposed on sub-investment grade and unrated securities, noting these segments of the securitised market have historically shown characteristics of extreme illiquidity during periods of market stress.

In summary, Zenith believes Gryphon's approach to risk management is adequate and addresses the risks associated with investing in securitised structures. As Gryphon further integrates within the wider Barings business, we expect that risk management systems and procedures will become more standardised, with the parent organisation providing an additional layer of support to the risk oversight process.

Investment fees

	Fund	Sector Average
Total Fees and Costs (RG 97)	Not disclosed	0.88% p.a.
Management Fees and Costs	Not disclosed	0.80% p.a.
Transaction Costs	Not disclosed	0.07% p.a.
Performance fees	Not disclosed	0.06%
Performance fees description	Nil	
Management Cost	0.89% p.a.	0.84% p.a.
Buy / Sell spread	N/A	0.07% / 0.06%

All fees and costs are inclusive of GST unless indicated otherwise. The Performance Fee shown is the performance fee disclosed in the PDS. It is calculated by taking the average performance fees charged over the last five financial years (or less if the investment or performance fee mechanism has not been in place for five financial years).

This investment is not required to disclose fees under RG 97.

The sector average cost is based on the average management cost of all flagship 'Australian Fixed Interest - Specialist' funds surveyed by Zenith.

The Trust's cost structure is 0.89% p.a. incl GST (net of RITC), with no performance fee payable.

Overall, Zenith considers the Trust's cost structure to be competitive, particularly when assessed relative to its outperformance target.

(The fees above are reflective of the Trust only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform).

About the fund manager

Organisation

Established in 2014 by Steven Fleming, Ashley Burtenshaw and Henry Cooke, Gryphon Capital Investments Pty Ltd (Gryphon) is a Brisbane-based boutique fixed interest manager comprising a total of 11 full-time employees.

Fleming and Burtenshaw originally commenced working together in 2005 at Babcock and Brown, before moving to Columbia Threadneedle (Threadneedle) in 2009, where they assumed responsibility for the firm's ABS portfolios. Cooke joined Threadneedle in 2010, before the trio spun out of Threadneedle to form Gryphon.

Gryphon has grown its funds under management (FUM) to $A 3.1 billion (as at 31 May 2024), which is spread across a Listed Investment Trust (LIT), an open-ended vehicle and a small number of large institutional investors.

In March 2023, Gryphon was acquired by Barings, a large global fund manager and wholly-owned subsidiary of MassMutual, one of the largest life insurers in the US. As part of the agreement, Barings acquired 100% of the business and the key investment principals have made a medium-term commitment to remain with the firm.

Zenith highlights that Barings is a large and established fund manager, with an existing Global Structured Finance Group that manages in excess of $US 406 billion (as at 31 December 2023). Therefore, a number of synergies should flow from the integration over time, including access to specialist investment personnel, systems and tools.

Zenith highlights that Gryphon has integrated seamlessly into the broader Barings business, benefiting from a range of non-investment support functions (including distribution, product and legal). Further, the access to capital from MassMutual and the ability to interact with a broader pool of structured credit experts is expected to be beneficial over the long-term.

In terms of distribution for the Trust, Gryphon is represented by Seed Partnerships, which is a specialist third party distributor that supports a range of listed offerings. As at 30 April 2024, the Trust had a market capitalisation of approximately $A 631 million.

Zenith highlights that since its listing in May 2018, the Trust has been successful in attracting investor demand via subsequent capital raisings. As FUM has incrementally grown, the increased scale and liquidity has contributed to the Trust consistently trading in line with its net tangible assets (NTA).

Investment personnel

Name	Title	Industry Experience (yrs)	Tenure (yrs)	Location
Steven Fleming	Portfolio Manager & Managing Director	33	10	Brisbane, Australia
Ashley Burtenshaw	Portfolio Manager & Managing Director	29	10	Brisbane, Australia

The investment team comprises eight members and is led by Portfolio Managers and Managing Directors, Ashley Burtenshaw and Steven Fleming. The key principals manage the portfolio collaboratively with Burtenshaw leading the firm's coverage of public market transactions while Fleming is primarily responsible for private market transactions.

Burtenshaw is the Lead Portfolio Manager for all domestic mandates managed by Gryphon, which encompasses several large institutional strategies. With over 29 years of industry experience, he has held a number of senior investment roles at Credit Suisse First Boston, Babcock and Brown, and Threadneedle Investments.

In Zenith's opinion, Burtenshaw's expertise in understanding RMBS and ABS is a key competitive advantage, which extends to in-depth modelling of collateral pools and also analysing the structural features of these securities.

Fleming has over 33 years of industry experience, having worked in several senior roles across Australia, the UK and the US, specialising in structured finance and securitisation. This includes Co-Head of Babcock and Brown's Capital Markets Group, Director of Commercial Property Financing at Nomura and five years at Threadneedle Investments, where he worked alongside Burtenshaw. In addition to his investment-related duties, Fleming is responsible for the strategic direction of the business, risk management and operational oversight.

Both Burtenshaw and Fleming drive idea generation, security selection and portfolio construction. Supporting them is a six-person Quantitative Analytics team, including Quantitative Analysts, Alex Bradford, Luke Vecchi, Christian Larney and Jeff Wu, who provide a range of analytical, programming and data management capabilities.

Gryphon’s investment process is centred around the IC, where idea generation, the research agenda and ultimately, portfolio positioning is determined. The IC, comprising Burtenshaw and Fleming, meets at least on a weekly basis to undertake a detailed assessment of the portfolio. The IC considers key inputs such as market risks, the portfolio’s current credit profile, performance and trends of collateral associated with portfolio positions and market opportunities.

Investment personnel are remunerated through a fixed base salary and discretionary bonus. Zenith notes that each form of remuneration is closely linked to an individual’s performance and business outcomes. In Zenith’s opinion, the remuneration structure is appropriate given the scale and nature of the business.

In our opinion, despite the compact size of the investment team, the quality and specialised knowledge of the key investment principals is high and a point of differentiation. Further, the ability to build and develop systems that analyse large volumes of loan collateral data, to identify mispriced securities or attachment points, obviates the need for a larger analyst pool. Going forward, it is imperative that Gryphon commits more resources to succession planning and developing the next layer of portfolio management capabilities.

About the sector

Sector characteristics

The Zenith 'Australian Fixed Interest – Specialist' sector consists of funds that invest primarily in domestic fixed interest securities, complemented by positions in global markets, including government bonds, investment grade and sub-investment grade bonds, and asset-backed securities. While the domestic and global split varies across the category, Australian Fixed Interest is expected to be the principal driver of returns.

Across the category, managers seek to generate outperformance from a range of active return sources, including duration, sector rotation (i.e. dynamically allocating across sectors), relative value and bottom-up issuer selection. The relative importance from each return source will vary across the peer group, subject to each manager's investment style.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index, which may or may not be reflective of the underlying benchmark used by many of the managers in this category. The index has an average term to maturity of approximately 45 days, comprising 13 bank bills of equal face value, each with a maturity of approximately seven days apart.

The funds in the Specialist sector may display far greater downside volatility than the Bloomberg AusBond Bank Bill Index (i.e. while the index is used as a performance benchmark, it is not representative of the risks embedded in the strategies employed by the typically less constrained Fixed Interest mandates in the sector).

Sector risks

Funds within the 'Australian Fixed Interest – Specialist' sector are exposed to the following broad risks:

Market risk: Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

Interest rate risk: Fixed interest securities are generally sensitive to changes in interest rates. An increase in interest rates may result in a fall in the value of these securities, while a decrease in interest rates can result in an increase in value.

Credit spread risk: In addition to being sensitive to general interest rate changes, non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a government bond and a corporate bond). A widening of spreads results in a fall in the value of these securities.

Default risk: Given fixed interest securities represent loans to borrowers (including governments, banks and companies), there is a risk that these borrowers may default on interest or principal repayments. Default risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

Liquidity risk: Fixed interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

Derivative risk: Derivatives are commonly employed by fixed interest managers to hedge currency and other risks, and/or as an alternative to direct purchases or sales of underlying assets. There are multiple risks associated with the use of derivatives. For example, the value of the derivative may not move in line with the underlying asset, counterparties to the derivative may not be able to meet payment obligations or a particular derivative may be difficult or costly to trade.

Zenith rating

Report certification

Date of issue: 13 Jun 2024

Role	Analyst	Title
Analyst	Darryl Ding	Investment Analyst
Sector Lead	Andrew Yap	Head of Multi Asset & Austn. Fixed Income

Association & relationship

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Rating history

As At	Rating
13 Jun 2024	Recommended
06 Jun 2023	Recommended
31 May 2022	Recommended
10 Jun 2021	Recommended
02 Jun 2020	Recommended
23 May 2019	Approved
14 Mar 2019	Not Rated - Screened Out

Last 5 years only displayed. Longer histories available on request.

In March 2021, Zenith implemented a new ratings methodology for products classified as Traditional Index. Any rating issued from this date forward for Traditional Index products only reflect this change in methodology, with the relevant Traditional Index ratings being Index Approved, Index Recommended and Index Highly Recommended. Ratings issued for Traditional Index products prior to March 2021 are retained for historical purposes in line with our regulatory requirements and were issued in line with Zenith's Fund Research Methodology. Further information in relation to Zenith's Traditional Index Research Methodology and Traditional Index Ratings can be found on the Zenith website.

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This report refers to the Australian unit trust for the fund, and the fund and benchmark returns are all in AUD.

Zenith has charged Gryphon Capital Investments Pty Ltd a fee to produce this report.