Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Gryphon Capital Income Trust

Report data as at 30 Apr 2020
Rating issued on 02 Jun 2020

APIR Code

ASX:GCI

Asset / Sub-Asset Class

Australian Fixed Interest
Listed Investment Entities – LICs/LITs

Investment Style

Active

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.

Zenith Assigned Benchmark

Bloomberg AusBond Bank Bill Index
GCI Net Portfolio Returns

Net Returns (% p.a.)

	1 yr	6 mth	3 mth
LIC	-11.74	-15.06	-16.36
Benchmark	1.12	0.46	0.22

Income (% p.a.)

	Income	Total
FY to 30 Jun 2019	5.03	8.03

Fees (% p.a., Incl. GST)

Management Cost: 0.93%
Performance Fee: N/A

VIEWPOINT

The Trust, managed by Brisbane-based Gryphon Capital Investments (Gryphon), provides investors with access to an actively managed portfolio of securitised fixed interest exposures in a Listed Investment Trust (LIT) structure. Through adherence to a research-intensive investment process, Gryphon seeks to provide investors with returns at a margin above cash with income paid on a regular basis. Zenith views Gryphon's specialist skill-set in identifying and understanding opportunities within the Australian securitised market as a compelling capability. A developing track record as a LIT and improved scale in assets has led to an increase in out conviction in the Trust.

Gryphon was established by Steven Fleming (Chief Executive Officer (CEO)), Ashley Burtenshaw (Chief Investment Officer (CIO)) and Henry Cooke (Partner) in 2014, after the three separated from Columbia Threadneedle where they had managed several asset backed securities (ABS) and residential mortgage backed securities (RMBS) mandates.

Burtenshaw retains ultimate investment responsibility across all mandates managed by Gryphon including this Trust. That said, Gryphon employs a team-based approach to portfolio management, with the Gryphon Investment Committee (IC) tasked with all decision-making responsibility. The IC comprises all senior investment personnel and is well-supported by a team of portfolio analysts.

Driving Gryphon’s 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 seeks to draw on the best available data in the market, subsequently applying their research-intensive process that has been developed over more than ten years of investment management in the RMBS and ABS sectors.

The investment process begins with idea generation, which is top-down in nature and conducted by the IC through periodic meetings conducted on a weekly basis. Included in idea generation is an overlay process that considers a range of top-down and portfolio-specific factors, with the overarching aim of identifying a set of investment themes and opportunities which will support the Trust’s investment objectives.

The next step in the process is security selection. This begins with the IC directing the research team to conduct in-depth issuer and issue analysis, consistent with the themes and opportunities identified in the idea generation stage. With the view to gain an informational advantage, security selection requires further inputs on issues, which coupled with Gryphon’s comprehensive data base is used to gain a sound understanding of the detailed characteristics of each security.

To meet the Trust’s investment objective, the team will construct a high conviction portfolio representing their best ideas, with exposure to ABS, RMBS (conforming and non-conforming), and cash. Zenith notes that the Trust’s portfolio is relatively unconstrained, with the team permitted to invest up to 50% of the portfolio’s value in sub-investment grade and unrated securities, and up to 20% in Australian originated securities issued offshore.

Overall, Zenith believes Gryphon has achieved a competitive advantage over many peers when investing in RMBS and ABS opportunities. For example, Gryphon are comprehensive in understanding risks inherent in securitised deals, which extends to loan-level modelling, Originator and Servicer due diligence and long-term surveillance, stress and scenario testing. In turn, this provides Gryphon with the requisite level of conviction to seek opportunities throughout deal structures, including non-investment grade and unrated tranches.

FUND FACTS

- LIT exposure to Australian Asset Backed Securities and Residential Mortgage Backed Securities
- Potential to invest in sub-investment grade, unrated, and Non-AUD Denominated Securities hedged back to AUD
- Returns targeting a margin above cash with regular income distributions

ABSOLUTE RISK (SECTOR)

VERY HIGH
HIGH
MODERATE
LOW
VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

High Yield
Investment Grade
Multi-Sector
Opportunistic Credit
Private Credit

INCOME DISTRIBUTIONS PER

MONTH QUARTER 6 MONTH ANNUM

INVESTMENT TIMEFRAME

1-2 YRS 3-4 YRS 5-6 YRS 7+ YRS

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Trusts (LITs)

In assessing the performance of LITs, it is vital to understand how their structure affects the final performance figures as it is materially different to unlisted funds. As listed vehicles, the portfolio returns generated are exposed to additional volatility from unit price movements and can trade at significant premiums or discounts to Net Asset Value (NAV).

As an indication however, a series of return data can be viewed on the basis of the returns generated by:

- Unit price and distributions
- Change in NAV and distributions
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill in generating returns. However, these returns may not be able to be fully crystallised for holders given the potential for unit price movements on the ASX.

At various times when assessed on a purely quantitative basis, a LIT can trade away from its NAV which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NAV, therefore, gains may not be crystallised.

LITs differ in several important ways from Listed Investment Companies (LICs). Of particular note, owing to the trust structure used by LITs, 100% of net trust income must be paid as a distribution in the year it is earned. As a company, LIC's will pay dividends at the election of the Board in accordance with the LIC's dividend policy. LIC profits may be retained in order to create a more even flow of dividends.

Australian Fixed Interest

The sector typically comprises funds investing in the Australian fixed interest market, specifically focusing on the corporate debt market. The sector incorporates both benchmark aware and unaware strategies. Managers typically add value through sector positioning and security selection.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index, which is reflective of the underlying benchmark used by the majority of managers in this category. Given funds in the sector typically invest in longer dated corporate securities they may display greater downside volatility than the Index, i.e. while the index is used as a performance benchmark it's not representative of the risks involved in investing in the corporate debt sector.

Demand for higher yielding corporate issues (including loans) has risen in more recent times owing to the co-ordinated effort by central authorities to maintain historically low cash rates. This has increased investor tolerance for lower-grade and higher yielding debt to enhance income generation.

PORTFOLIO APPLICATIONS

The term 'Corporate debt' refers to debt securities issued by non-government entities. These may include short term money market instruments and longer dated bonds, issued on fixed or variable terms. Corporate debt traditionally offers a yield premium to equivalently tenured (and structured) government or agency issued securities, the extent of which will reflect the market's perception of an issuer's risk of default. Demand for higher-yielding corporate issues has risen strongly in more recent times owing to the co-ordinated effort by central authorities to maintain historically low cash rates.

The Trust aims to provide investors with regular income i.e. monthly, through an investment strategy designed to be diversifying and complementary to other fixed income strategies. To achieve this, the Trust adheres to a high conviction strategy that invests in domestic investment grade and non-investment grade Asset Backed Securities (ABS), primarily Residential Mortgage Backed Securities (RMBS).

Zenith believes the Trust may be suitable for investors seeking exposure to a higher yielding portfolio, which may improve a portfolio's potential risk/return profile. However, given the Trust can invest in sub-investment grade securities up to a combined maximum of 50%, it may not be suitable for the more risk-averse investor.

From a portfolio perspective, the Trust may be suitable as a component in the income portion of a well-diversified portfolio. The Trust is considered appropriate as a satellite exposure to domestic fixed interest and for blending with international fixed interest strategies to produce a more balanced set of investment outcomes.

Notwithstanding the more conservative nature of the Trust, 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 timeframe. We caution against the Trust being used by investors requiring short-term (e.g. daily) liquidity.

Despite the relative merit of the strategy, investors should give consideration to the mode of access. While an unlisted fund structure may be less convenient for some investors, accessing a strategy via a listed vehicle will mean that the effectiveness of the strategy may be significantly diminished due to the vehicles own trading movements. That is, investors may not be able to benefit from the portfolio's performance, as the performance of the vehicle is driven by market sentiment.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the Australian Fixed Interest – Listed Investment Entities 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.

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 security). 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.

CREDIT RISK: Loans to borrowers involve risk that these borrowers may default on interest or principal repayments. Credit risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

INTEREST RATE RISK: May be derived from a number of sources including market interest rate movements, prepayment risk and overweighting to low yielding assets.

CAPITAL RISK: Occurs when loans default and the realisation of the security asset is insufficient to repay the debt.

PREMIUM / DISCOUNT TO NAV: The listed structure means that a LIC's share price may deviate substantially from its underlying net assets due to cyclical and/or sentiment driven factors. Movements in either premiums or discounts can be unpredictable and may have a significant impact on realisable value and the overall investment returns regardless of the investment managers skill.

REGULATORY RISK: The ASIC Regulatory Guide 97 'Disclosing Fees and Costs in Product Disclosure Statements and Periodic Statements' came into effect on 1 October 2017 and seeks to establish a common framework for disclosing fees with respect to registered managed investment schemes issued to retail investors.

In November 2019, ASIC released its final recommendations, with all proposed changes to be implemented by 30 September 2020.

In its current form, RG97 will not impact the actual costs (or after fee returns) on existing investments. Rather, the guide is focused on providing increased transparency with respect to the costs of management. Given this, it is feasible that under RG97, investors become more sensitive to the costs charged and seek lower cost alternatives, potentially leading to fund outflows.

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 and Steven Fleming to be critical to the successful management of the strategy. A loss of any of these individuals would be considered material and require a reassessment of our rating.

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 expected to comprise a majority allocation to RMBS and ABS exposures, including lower-rated tranches. These securities can become highly illiquid and with no direct avenue through which these exposures may be hedged through the use of derivative instruments, there is a risk they adversely impact Trust performance.

HEDGING RISK: The Trust is permitted to gain exposure to non-AUD denominated securities; however, the associated foreign currency exposures must be hedged back to Australian dollars. There is a risk that the Trust is not perfectly hedged at all times, or derivative instruments used for hedging purposes do not move in line with the underlying asset, therefore creating a hedging mismatch. The potential for unintended currency exposures resulting from hedging mismatches may be to the benefit or detriment of Trust performance.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Gryphon Capital Investments Pty Ltd (Gryphon) is a Brisbane-based boutique fixed interest manager comprising a total of 10 full-time employees. It was established in 2014 by Steven Fleming, Ashley Burtenshaw and Henry Cooke, and remains 100% owned by the three founders.

Despite its 2014 inception, Gryphon's heritage extends back to 2005 where Fleming and Burtenshaw worked together at Babcock and Brown. Continuing this arrangement until 2009, the team then moved to Columbia Threadneedle (Threadneedle) where they assumed responsibility for the management of Threadneedle's ABS portfolios. It was here that Henry Cooke joined the team, initially taking responsibility for European portfolios.

In 2014, the team separated and formed Gryphon, while maintaining management responsibility for their existing Threadneedle mandates under a newly established sub-advisory arrangement. Since then, Gryphon has expanded its product suite, currently managing over $A 2.1 billion (as at 31 March 2020) across several capabilities for both institutional and retail clients.

As at 31 March 2020, the Trust had a market capitalisation of approximately $A 340 million.

Zenith is pleased to observe that since listing on the ASX in May 2018, the Trust has been successful in attracting investor interest via three subsequent capital raisings. In our opinion, the efforts by Gryphon to grow FUM have been to the benefit of investors, noting the Trust possesses greater economies of scale and investor liquidity.

INVESTMENT PERSONNEL

Name	Title	Tenure
Steven Fleming	Chief Executive Officer (CEO)	6 Yr(s)

Name	Title	Tenure
Ashley Burtenshaw	Chief Investment Officer (CIO)	6 Yr(s)
Sergey Podzorov	Portfolio Analyst	6 Yr(s)
Shane Stanton	Portfolio Analyst	6 Yr(s)
Vijay Singh	Portfolio Analyst	1 Yr(s)
Warren Mellor	Portfolio Analyst	4 Mth(s)

Gryphon's Investment Team comprises six members, five of which are located in Brisbane and one in Sydney. The key senior personnel leading the team, and Gryphon more broadly, are Steven Fleming, Chief Executive Officer (CEO), and Ashley Burtenshaw, Chief Investment Officer (CIO). Burtenshaw retains ultimate responsibility for the Trust while Fleming contributes to the Trust's management through his role in Gryphon's Investment Committee (IC).

Fleming has over 26 years of industry experience, founding Gryphon in partnership with Burtenshaw and Henry Cooke in 2014, and prior to this working in several senior roles across Australia, the UK and the US. In addition to his investment-related responsibilities, Fleming is tasked with driving the strategic direction of Gryphon, risk management and operational oversight.

Burtenshaw is the Lead Portfolio Manager for all Australian dollar mandates managed by Gryphon which encompasses several large institutional strategies in addition to the Trust. Prior to founding Gryphon, Burtenshaw gained a depth of experience within the securitised segment of the fixed interest asset class. Notable prior roles include director, fixed income at Credit Suisse First Boston, senior ABS portfolio manager at Babcock and Brown, and prior to founding Gryphon, five years at Threadneedle Investments as the Australian co-head responsible for managing the firm's Global ABS portfolios. With over 26 years of industry experience, Burtenshaw is a well-regarded investor and in Zenith's view, key to the Trust's successful attainment of investment objectives.

The team is completed by four Portfolio Analysts who provide input into the investment process through varying avenues, albeit these members typically retain strong technical attributes either through programming or data management capabilities. In terms of experience within the team, Shane Stanton and Sergey Podzorov are the more senior members, each of whom worked at Threadneedle prior to the inception of Gryphon. The remaining members are new additions, joining in April 2019 and February 2020 to enhance the data management capabilities supporting the investment process.

Gryphon's investment process is centred around the IC which serves as an effective avenue through which Burtenshaw can generate ideas, establish a research agenda and ultimately drive the positioning of the portfolio. Furthermore, the IC is tasked with a broader set of responsibilities which includes risk monitoring and mandate compliance for all strategies managed by Gryphon, with members of the committee drawing on inputs provided by portfolio analysts. The IC meets on a weekly basis with decision making achieved on a consensus basis.

Gryphon's 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. For non-executive directors i.e. Fleming and Burtenshaw, remuneration is delivered primarily in the form of business distributions via their equity stake in Gryphon. In Zenith's opinion the remuneration structure is appropriate given the scale and nature of the Gryphon business. That said, we believe that as Gryphon matures by way of head count and funds under management, features such as deferred bonus schemes and co-investment provisions would be required to bring the structure more in line with peers.

Relative to peers the investment team is lean, yet appropriately resourced given the nature and complexity of the investment strategies falling within its remit. In Zenith's opinion, Fleming and Burtenshaw have progressively built an investment process that is efficient, with the team's design and level of resourcing reflecting this. While there remains material key person risk pertaining to Burtenshaw and to a lesser extent Fleming, we believe there are several factors that provides us with comfort in this area e.g. the team's long-standing working relationship pre-dating Gryphon and high levels of equity ownership.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

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.

The investment process is applied to the universe of securitised fixed interest assets, primarily comprising RMBS and ABS, issued in both domestic and offshore markets. Zenith notes for an investment to be considered in international markets, the underlying collateral must be domiciled in Australia, and all currency exposure hedged back to Australian dollars. In terms of return generation, Gryphon expects to attribute the majority of investment outcomes to security selection and sector rotation.

Driving Gryphon's 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 seeks to draw on the best available data in the market, subsequently applying their research-intensive process that has been developed over more than ten years of investment management in the RMBS and ABS sectors. While Gryphon believes they have a competitive edge over more generalist investors when assessing the relative attractiveness of securitised investments, they do not believe they possess the means to time optimal entry and exit decisions. As such, Gryphon employs a buy-and-hold investment strategy.

The investment process begins with idea generation, which is top-down in nature and conducted by the IC through periodic meetings conducted on a weekly basis. Included in this process is a detailed assessment of the portfolio, which 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. As with all elements of the investment process, idea generation is research intensive and draws on Gryphon's considerable database of RMBS and ABS securities, which includes comprehensive information on their underlying collateral pools.

Included in idea generation is an overlay process that considers a range of factors including macroeconomic environment, historical pricing and pricing of comparable assets, portfolio concentration by geography, changes in the regulatory landscape, supply and demand balances and portfolio composition. Ultimately, the role of idea generation is to identify a set of investment themes and opportunities which will support the Trust's investment objectives. Importantly, this stage of the process is not designed to seek out the highest yielding opportunities, but rather, identify securities with superior risk-adjusted returns.

The next step in the process is security selection. This begins with the IC directing the research team to conduct in-depth issuer and issue analysis, consistent with the themes and opportunities identified in the idea generation stage. With the view to gain an informational advantage, security selection requires further inputs on issues, which coupled with Gryphon's comprehensive data base is used to gain a sound understanding of the detailed characteristics of each security.

While thorough analysis is conducted on underlying collateral pools, investment protections, and several other specific focus points, Gryphon also deems it necessary to analyse potential securities under a range of stress and scenario tests. 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 for inclusion in the portfolio.

Zenith notes approval by the IC does not guarantee a security's inclusion in the portfolio. Rather, portfolio managers will assess each security, selecting only those that represent the team's 'best ideas' which are consistent with portfolio objectives and the respective risk budgets. At the conclusion of the investment process, the portfolio is expected to comprise a collection of high conviction ideas, characterised by attractive risk-adjusted returns and low correlation with other traditional fixed income asset classes.

Zenith believes the investment process is well-structured and designed such that the investment team can direct their efforts to the most attractive opportunities within the market. Furthermore, we believe the data-intensive approach adhered to by Gryphon provides Burtenshaw with a competitive advantage, with high conviction positioning made possible through comprehensive understandings of risk and return characteristics.

SECURITY SELECTION

Once the IC has identified a set of investment themes and opportunities, it is then the role of researchers to conduct detailed analysis of prospective securities, with the view to include these in the portfolio. This part of the process is bottom-up in nature, and draws on the specialised skillset of the team coupled with access to in-depth information on opportunities.

Given securitised assets are distinct from more traditional fixed interest securities, analysis tends to be more data-intensive and inclusive of a wider set of factors. As such, Gryphon reviews each security on multiple levels, first assessing broader considerations to an issue and then focusing on more nuanced details, with the goal of making an accurate assessment on the security's risk/return characteristics.

This process starts with a screen of the RMBS and ABS universe, which has been captured in Gryphon's proprietary database. To align with the investment themes identified at the idea generation stage, the research team will filter out securities displaying certain characteristics i.e. delinquency vs hard credit enhancement ratios, principal payment triggers, LMI recovery history, etc.

For those issues that have passed the initial screen, Gryphon conducts a detailed assessment which includes generating a credit underwriting report, deal modelling and stress testing. The credit underwriting report serves as a formalised medium for communicating the pertinent details of a prospective investment and includes an evaluation of the originator, servicer and underlying collateral.

Gryphon's assessment of originators/servicers includes periodic on-site and face-to-face due diligence reviews, which includes 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 condition, etc.

While Gryphon addresses the current state of originators/services through periodic reviews, the team also maintains continuous surveillance on several originators/servicers, regardless of portfolio exposure, with the view to build conviction in their practices through time. Zenith notes that this approach often excludes those originators/servicers that are new entrants to the market, with the basis for exclusion highlighting Gryphon's experience in this market segment.

The next step in the process is a detailed analysis of an issue's collateral pool. Here the team seeks to understand the inherent risks within the issue that aren't evident at a high level, believing there often exists conflicting indications of risk when assessing both high-level statistics and loan-level data. By understanding the nuances of each loan pool, Gryphon believes they can gain a competitive advantage over peers who take more of a generalist approach. Furthermore, by conducting detailed analysis of the underlying collateral, Gryphon are able to gain comfort when investing in lower credit quality tranches i.e. sub-investment grade and unrated securities, potentially leading to enhanced returns.

In terms of deal modelling, focus is placed on an issue's design features and its potential for credit rating migration i.e. upgrade/downgrades, issued by external ratings agencies. Zenith notes this area of analysis often presents potential for value-add, noting those with a specialist skillset in assessing security features can often benefit from opportunities where intrinsic risk has been mispriced.

With the ability to take meaningful exposures in sub-investment grade and non-rated securities, Gryphon conducts comprehensive stress testing to ensure the underlying collateral is sufficient to protect investors during stressed environments. This includes testing for significant declines in house prices (for RMBS) and large increases in default and loss given default rates (for ABS). For securities to be approved by the IC for inclusion in the portfolio, they must possess adequate protections to preserve investors interests during conditions such as those imposed during the stress testing process.

Once the investment team has completed its detailed assessment, all information is consolidated into standardised research reports, ready for submission to the IC. Zenith has reviewed samples of these reports and believes they provide a means for communicating a wide range of detail on each security in an effective and consistent manner.

Environmental, Social and Governance (ESG)

Gryphon assesses all prospective investments for material 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 subordinate to the respective mandate criteria for each strategy managed by Gryphon. The IC is responsible for the oversight of Gryphon's ESG policy framework, with Burtenshaw retaining ultimate responsibility for its implementation.

In sum, Zenith believes Gryphon adhere to a comprehensive approach to security selection, with the underlying research highlighting the specialist ability of the investment team. In our opinion, this is the strongest element of the investment process, and positions the Trust favourably to deliver on investment objectives.

PORTFOLIO CONSTRUCTION

The ultimate responsibility for the Trust rests with Burtenshaw in his capacity as CIO, however the IC is tasked with portfolio construction responsibilities.

The portfolio construction process combines the 'best ideas' generated by the IC, researched by the investment team, with the final output comprising a concentrated portfolio of securities expected to deliver attractive risk-adjusted returns, in line with objectives.

As mentioned previously, there is no guarantee those issues approved by the IC will be included in the portfolio. Rather, each issue will be assessed in the context of its risk/return characteristics at a portfolio level, and its relative value when compared to existing holdings. It is through this assessment that portfolio managers will consider factors, each centred on investment outcomes and the Trust's mandate, including:

- Portfolio diversification
- Correlation to traditional asset classes e.g. listed equities
- Relative value between existing holding and prospective holdings
- Counterparty credit quality e.g. LMI providers
- Drivers of mortgage performance i.e. borrower repayment speed

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 30% to an originator. Zenith notes that these limits are wide relative to more traditional fixed income strategies, and believe there is an elevated risk of mark-to-market volatility within the portfolio as a result.

While Zenith would prefer to see the portfolio managed to tighter limits, particularly with regards to sub-investment grade and unrated securities, we believe Gryphon's investment process is well structured to address the associated risks of investing in securitised assets. Furthermore, we believe it is increasingly unlikely that issue limits will be tested, particularly as the Trust grows in scale.

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 be comprised of Australian assets, and foreign currency exposure must be hedged back to Australian dollars. Zenith is supportive of this feature, noting it maximises the investable universe while remaining a true-to-label Australian fixed interest offering.

While the portfolio construction process is macro-aware i.e. conducted with consideration to several US-centric macroeconomic indicators, Zenith does not expect Gryphon to actively manage the credit duration of the portfolio as a means for generating returns. Rather, the portfolio is likely to retain duration at a level below 2.5 years as this allows the team to target excess returns through bottom-up security selection, while mitigating any adverse impacts of larger macroeconomic shocks. As such, the use of credit derivatives are not permitted.

Typically, Gryphon will hold securities to maturity, however portfolio managers will actively trade securities where superior relative value opportunities arise. Zenith notes that active trading is more likely to be opportunistic in nature, with the portfolio experiencing 35% turnover p.a. since listing in May 2018 (as at 31 March 2020).

In Zenith's view, Gryphon's approach to portfolio construction is suitable given the avenues through which the team seeks to generate outperformance.

RISK MANAGEMENT

Portfolio Constraints	Description
Investment Grade Securities (%)	50% to 100%
Sub-Investment Grade Securities (%)	max: 50% RMBS - 50%; ABS - 15%
Non-Australian Dollar Securities - Hedged (%)	0% to 20%
Originator Limit (%)	max: 30%
Tranche Limit (%)	max: 10%
ESG Constraints - Excluded Sectors	N/A

Risk management is key to Gryphon's investment approach and considered integral to the Trust delivering on its investment objectives.

In practice, risk management is incorporated into the investment and portfolio construction process through a range of constraints (outlined above) and activities, including – stress testing, pre and post-trade compliance, portfolio risk analysis, performance monitoring and performance attribution.

As mentioned previously, stress testing assesses the performance of RMBS and ABS securities against significant declines in housing prices and default rates, with increases in loss-given-default also tested. These tests are conducted on issues being considered for inclusion in the portfolio, in addition to existing holdings on a daily basis. The output of stress tests is included in research reports which are provided to the IC for review.

In order to accommodate the specialist nature of securitised assets, 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 e.g. early prepayment risks, soft and hard credit enhancements, priority cash flow provisions, etc. Zenith considers this to be an important feature of Gryphon's risk management process, as most mainstream risk systems are challenged in capturing the nuance of securitised assets given they are generally more focused on traditional fixed interest exposures.

Zenith views the formal constraints around the originator and tranche exposures to be wide, with permissible exposures of 30% and 10%, respectively. While this provides Gryphon with 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 sum, Zenith believes Gryphon's approach to risk management is appropriate and sufficient in addressing the pertinent risks associated with the management of securitised mandates.

INVESTMENT FEES

LICs/LITs can broadly be categorised into two groups from a management and fee standpoint on the basis of whether they are internally or externally managed (operating under an IMA). Typically, internally managed vehicles have lower proportional management costs due to a larger asset pool. Externally managed vehicles tend to have base management fees more in line with unlisted managed funds.

The Trust's fee structure comprises a 0.93% p.a. management cost with no performance fee payable. Zenith considers the Trust's base management cost to be lower than other fixed interest LICs/LITs in the peer group. However, this should be taken in the context of several specialist credit offerings with higher fees and return targets. Zenith considers Gryphon's fees to be reasonable based on the strategy and investment objective.

Investment Fees		
Product		Gryphon Capital Income Trust
Asset Class		Australian Fixed Interest
Sub-Asset Class		Aust. Fixed Interest - Specialist
Management Structure		Externally Managed
Management Cost		0.93%
Performance Fee		Nil
Annual Management Fee Comparision		**% p.a.**
Australian Fixed Interest	Peer Average - LICs/LITs (Internally Managed) [1]	N/A
	Peer Average - LICs/LITs (Externally Managed)	1.29%

[1] *Internally Managed LICs/LITs data use published Management Cost as a percentage of assets. All other vehicles quote management fees and costs inclusive of GST, less Reduced Input Tax Credits where available.*

PERFORMANCE ANALYSIS

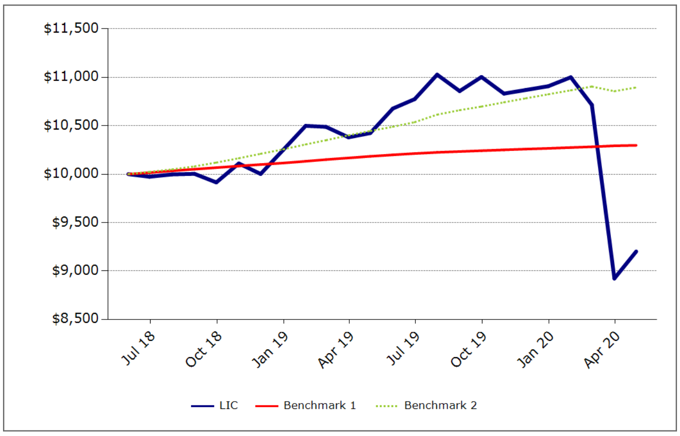
Report data: 30 Apr 2020, product inception: Jun 2018

Monthly Performance History (%, net of fees)

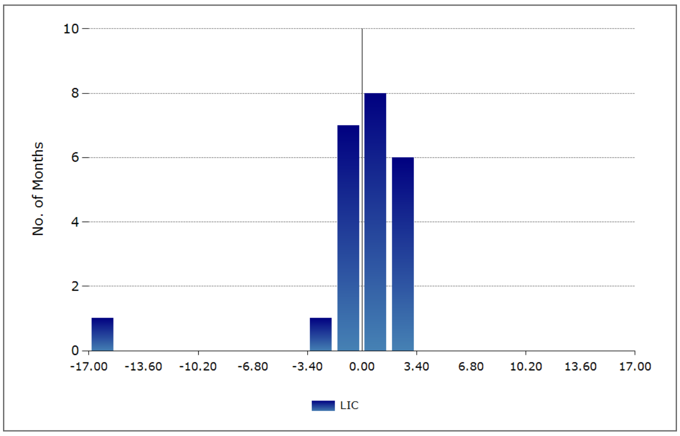
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	LIC YTD	BM1 YTD	BM2 YTD
2020	0.85	-2.60	-16.73	3.12									-15.65	0.30	0.65
2019	2.43	-0.10	-1.03	0.42	2.43	0.91	2.35	-1.54	1.34	-1.56	0.34	0.36	6.42	1.50	5.54
2018						-0.27	0.24	0.06	-0.88	1.97	-1.07	2.48	2.50	1.15	2.56

Benchmark 1: Bloomberg AusBond Bank Bill Index, Benchmark 2: GCI Net Portfolio Returns

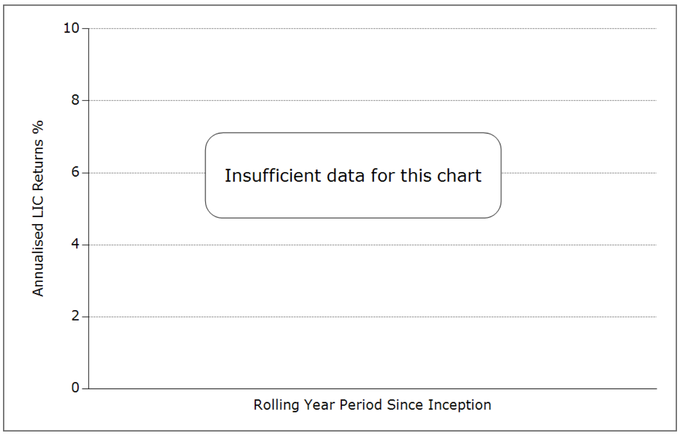
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



Return	Incpt.	1 yr	6 mth	3 mth
LIC (% p.a.)	-4.25	-11.74	-15.06	-16.36
Benchmark 1 (% p.a.)	1.54	1.12	0.46	0.22
Benchmark 2 (% p.a.)	4.57	4.30	1.43	0.27
Ranking within Sector	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Fund Ranking	2 / 3	2 / 4	3 / 5	3 / 5
Quartile	2nd	2nd	2nd	2nd
Standard Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	13.19	17.51	22.87	28.90
Benchmark 1 (% p.a.)	0.15	0.10	0.05	0.07
Downside Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	11.77	15.80	21.18	25.46
Benchmark 1 (% p.a.)	0.00	0.00	0.00	0.00
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Sharpe Ratio - LIC	-0.44	-0.73	-0.68	-0.57
Sortino Ratio - LIC	-0.49	-0.81	-0.73	-0.65

Readers should note that unless otherwise indicated, all performance, consistency and risk/return data is referenced to the Zenith assigned benchmark (as represented by Benchmark 1 in the above table) with the LIT returns representing those attributable to shareholders (i.e. unit price + dividends). Zenith typically includes the ongoing net returns of a LIT's *investment portfolio as we believe this is the best measure of the investment manager's skill.*

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.

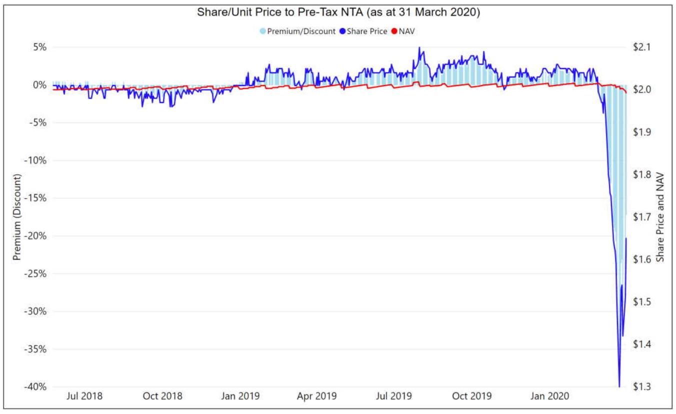
The following commentary is effective as at 31 March 2020.

Given the Trust's inception date of May 2018, there is currently insufficient performance history to conduct any meaningful analysis.

Share Price vs. NTA

The following chart shows the Company's premium/discount since inception.

ABSOLUTE PERFORMANCE ANALYSIS



RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	1 yr	6 mth	3 mth
Excess Return (% p.a.)	-5.79	-12.85	-15.52	-16.58
% Monthly Excess (All Mkts)	56.52	66.67	66.67	33.33
% Monthly Excess (Up Mkts)	56.52	66.67	66.67	33.33
Beta Statistics	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Beta	14.62	3.57	-324.47	-377.69
R-Squared	0.03	0.00	0.58	0.92
Tracking Error (% p.a.)	13.17	17.51	22.91	28.97
Correlation	0.16	0.02	-0.76	-0.96
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Information Ratio	-0.44	-0.73	-0.68	-0.57

The following commentary is effective as at 31 March 2020.

It is important to note that the Relative Performance Analysis shown above combines the Trust's unit price returns with distributions to give the reader detail on the investor experience.

Zenith typically seeks to identify funds which can outperform their index in greater than 50% of months as we believe this represents a persistence of manager skill.

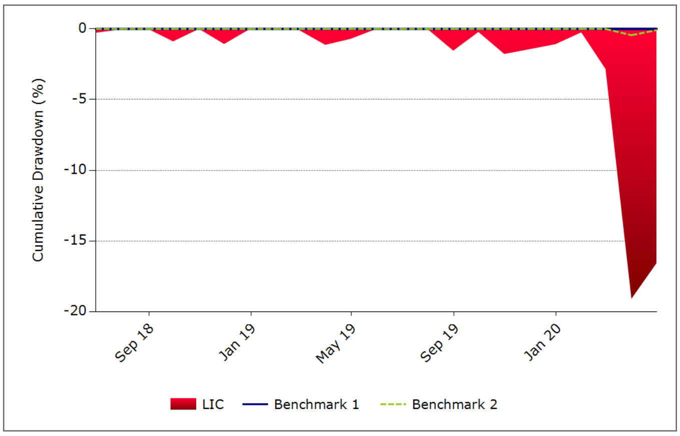
Given the Trust's inception date of May 2018, there is currently insufficient performance history to conduct any meaningful analysis.

DRAWDOWN ANALYSIS

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.

Drawdown Analysis	LIC	BM1	BM2
Max Drawdown (%)	-19.09		-0.45
Months in Max Drawdown	8		1
Months to Recover	-		-

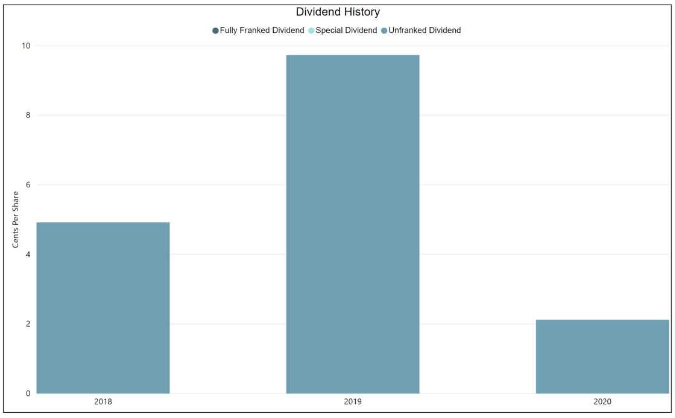
Worst Drawdowns	LIC	Benchmark 1	Benchmark 2
1	-19.09		-0.45
2	-1.13		
3	-1.07		
4	-0.88		
5	-0.27		



All commentary below is as at 31 March 2020.

Given the Trust's inception date of May 2018, there is currently insufficient performance history to conduct any meaningful analysis.

Despite the relative merit of a strategy, investors should give consideration to the method of access. While the unlisted Trust structure may be less convenient for some investors, accessing through a LIT will mean that the effectiveness of the strategy may be significantly diminished due to the Trust's own trading movements. That is, investors may not be able to benefit fully from the portfolio's performance, as the performance of the Trust may be impacted by market sentiment.



REPORT CERTIFICATION

Date of issue: 2 Jun 2020

Role	Analyst	Title
Author	Daniel Vinicombe	Investment Analyst
Sector Lead	Dugald Higgins	Head of Real Assets & Listed Strategies
Authoriser	Bronwen Moncrieff	Head of Research

RATING HISTORY

As At	Rating
2 Jun 2020	Recommended
23 May 2019	Approved
14 Mar 2019	Not Rated - Screened Out
Last 5 years only displayed. Longer histories available on request.	

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