Realm May Update

6th June 2018

Portfolio Positioning

- Portfolio risk bottomed in the last quarter of the 2017 calendar year, as credit reached its absolute tights.
- Since then we have seen an increase in most risk products as credit began to weaken through quarter one 2018.
- The month of May saw us take the largest increase in portfolio risk in approximately 2 years.
- Targeted portfolio standard deviation now at 1.05% which is benchmark and translates to the fund currently targeting 3% over cash after fees.
- By comparison targeted risk was down to 0.58% in March 2018.
- This is consistent with our contrarian and opportunistic portfolio approach

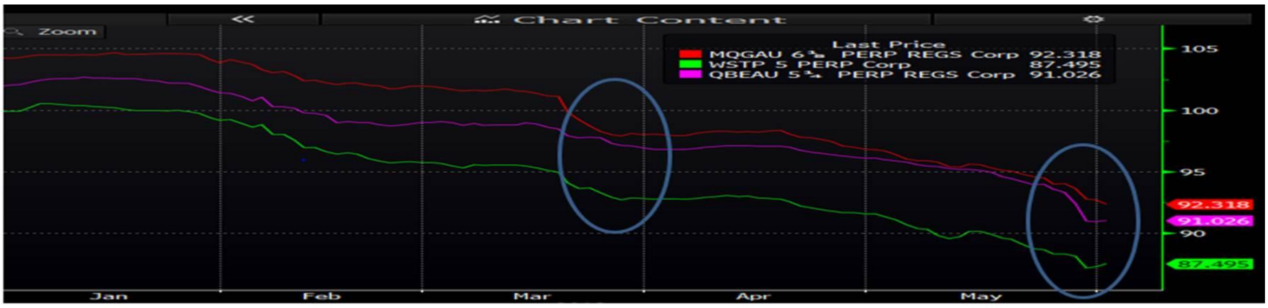
	March '16	June '17	September '17	December '17	March '18	April '18	Now	Strategic	Over Under
Cash & Short Dated Liquidity	13.8%	40.1%	47.9%	35.8%	34.9%	39.9%	32.0%	10.0%	22.0%
Corporate Bond	8.3%	12.7%	13.4%	25.0%	28.0%	22.9%	24.0%	10.0%	14.0%
Subordinated Debt/Corp Hybrid	24.8%	7.0%	7.1%	4.5%	7.5%	9.4%	9.9%	20.0%	-10.1%
Bank T1	23.6%	5.9%	4.4%	6.0%	7.8%	9.2%	10.4%	15.0%	-4.6%
RMBS	25.3%	26.7%	21.7%	20.9%	15.7%	16.7%	18.3%	30.0%	-11.7%
ABS	3.9%	2.1%	2.5%	2.9%	3.1%	2.9%	5.4%	5.0%	0.4%
Government Bonds (IRD Position)	0.50	0.25	0.29	0.22	0.20	0.18	0.14	1.00	-0.86
Credit Duration	3.79	2.01	1.94	2.35	2.11	2.30	2.64	3.00	-0.36

Current Themes – Asian Crowding Out

- Forget Italy, in our time-zone something much bigger is happening that is having a much more meaningful impact on secondary performance of Aussie credit names. Chinese Issuance in USD has surged taking the attention of Asian real money investors and driving Aussie names in USD (in particular Perp and bank capital product), to trade meaningfully weaker.
- Look at two grabs below, issuance by Chinese names in USD has increased more than 6-fold compared to same time last year. A great number of the issues have been very low rated (U/R, up to high single B). Paying double digit yields in USD with sales incentives which can approach 2%.
- Issuance is being driven by Chinese crackdown on leverage in the economy supporting speculation. Interestingly book builds being primarily taken down by real money investors out of Asia. Shadow banking crackdown is forcing risk into more conventional channels.
- Showing the rising impact of the Asian bid into our credit market and the importance of keeping a close eye on this market.
- Primary performance has stabilised recently which gives us some comfort that we have found a near term bottom. That said another leg higher in rates will see absolute prices drop, however we are hedging these positions for rate movement which would act to protect the downside in the event of a duration driven sell off.

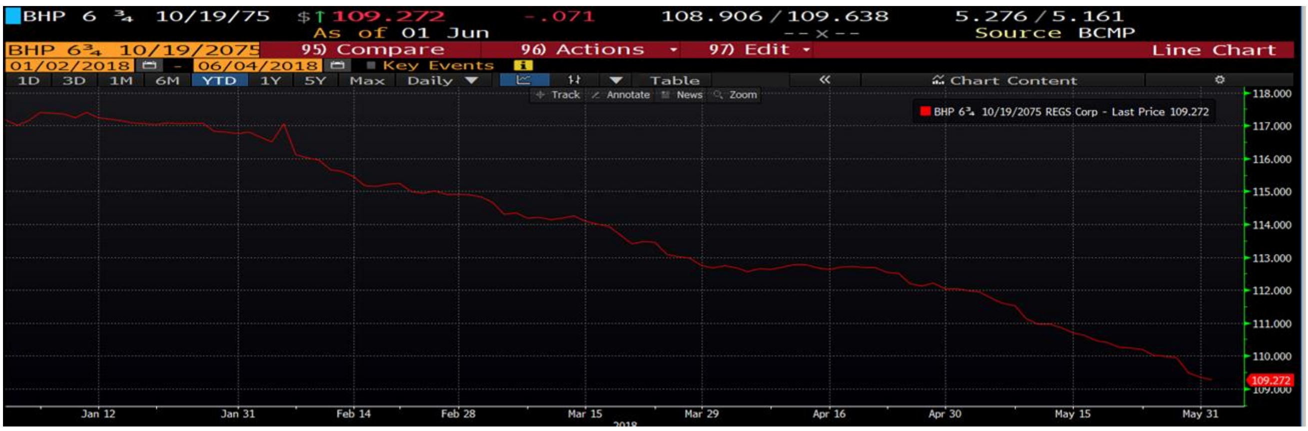
Current Themes – USD AT1

- Aussie name USD perps have been particularly hard hit. Worst performing credit sub-sector (with EM) at the moment.
- Took first bite at theme in late March at prices well below quoted marks and have increased theme exposure in late May. We maintain headroom to double our allocation to the theme from here and are likely to do so as opportunities present.
- Street is now square after having dragged along an overhang for most of this calendar year.



Current Themes – USD Corp & Sub

- Weakness is broader than USD AT1, we are also seeing meaningful underperformance in other more seasoned USD perpetual securities. Case in point is BHP sub below.
- This security exhibits a lot of what Asian investors dislike. A high capital price and negative price momentum is a turn off and now sees this security trading at 245 over treasury. Not bad for an absolutely pristine credit. Indeed, this spread is wider than what second rate Aussie corporates are raising money at on the ASX.
- More recently we have also seen a material weakening in IG corporate, Bluescope, Santos, Asciano to name a few have all leaked wider as crowding out and negative price momentum has seen these names meaningfully underperform.



Current Themes – Unsecured, The Rest

- The FRN market remains extremely tight when one considers what is going on overseas. In particular our floating Tier 2 market.
- Virgin issued in AUD two weeks ago, wasn't out of choice, but rather a function that a USD line would have needed to yield much more than 8.25% at a single B rating.
- If foreign markets snap back our market may cruise through without being disrupted, however if it persists expect Aussie FRN product to leak wider.
- On listed Tier 1, this market now sits between 380 and 410 over at the mid to longer end of the curve. These are level which we believe are fair. Focus on securities that are less exposed to a change in government (NPV cash-flows, increasing post June 19 discount).
- Portfolio transitioning, stock selection being moved to attach itself to specific themes and away from maintaining risk at a portfolio level. Reduce fillers, increase killers.

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