# Realm High Income Fund

April 2016

## Investment Objective

- Provide a Net Return of 3% over cash.
- Preserving the value of your investment.

## Net Performance

| Period | Ordinary Units (incl. franking) | RBA Cash Rate | Excess Return (incl. franking) | Wholesale Units (incl. Franking) |
|---|---|---|---|---|
| 1 Month | 1.22% | 0.16% | 1.06% | 1.26% |
| 3 Months | 1.85% | 0.49% | 1.36% | 1.95% |
| 6 Months | 2.00% | 0.99% | 1.01% | 2.24% |
| 1 Year | 3.14% | 2.01% | 1.13% | 3.61% |
| 2 Years p.a | 3.99% | 2.22% | 1.77% | 4.47% |
| 3 Years p.a | 5.36% | 2.34% | 3.02% | N/A |
| Since Inception p.a* | 5.87% | 2.46% | 3.41% | 5.32% |

Past performance is not indicative of future performance.
*Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013

## Fund Statistics

| | |
|---|---|
| Running Yield | 4.07% |
| Volatility* | 1.19% |
| Interest rate duration | 0.10 years |
| Credit duration | 2.80 years |
| Average Credit Rating | BBB+ |
| Number of positions | 70 |
| Average position exposure | 1.43% |
| Worst Month* | -0.47% |
| Best Month* | 1.22% |
| Sharpe ratio* | 2.85 |
| Information Ratio* | 2.87 |

Calculated on Ordinary Units unless otherwise stated
*Since Inception 26 September 2012

## Fund Update

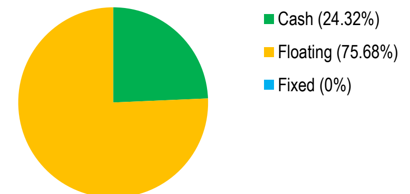
Our **cash** weighting increased to approximately 25% from 21% over the month. The increase in cash came from a reduction in the funds Bank T1 exposure and bank subordinated debt exposure, as well as a further reduction in the funds non-bank corporate debt exposure.

Our **fixed rate** exposure ended the month near zero. The long end of the Aussie curve traded in a 0.25% range over the month, which is large and illustrates the volatility rates continue to experience. Rates rallied through the first weeks of the month on the back of Yellen's March dovishness, before a turnaround in commodity prices and some better Chinese Data sent the long end of the curve wider. The FOMC stuffed the rally into month end with their decision to hold, with Aussie bonds also impacted by a particularly weak CPI number which took annualized Aussie nominal growth below 2%. Our bond allocation added approximately 0.10% to the monthly return. Our own nominal target for the Australian economy remains a dash above 4% with our fair 10year target just above current rates at 2.56%. Our US nominal growth target remains around 3.34%, while our fair level for the US long end sits a touch under 2%. On the nearer term outlook for rates, China remains the key determinant both here in Australia and offshore. The month of April saw a moderation in Chinese economic weakness, with PMI's and PPI's both showing signs of improvement which positively impacted our own internal metrics, however it is still too early to call a bottom. Given the uncertainty and market polarization around the outlook for rates we are not hitching our wagon to any broader thematic trend, as we expect the only thing for certain is that rate volatility persists. This volatility presents an opportunity to add positive return attribution to the fund through the use of our fundamental and technical models.

Our **Corporate bond** allocation reduced moderately over the month with a decision to divest all of our subordinated debt of BHP witch has been a key overweight position taken through the worst of the commodity sell off in January. In addition, we closed our position in the senior debt of Aurizon, which rallied after having its credit rating re-affirmed and Woolworths which caught a bid as credit markets continued to rally on the back of proposed ECB activity. We also reduced our exposure to the subordinated debt of the big 4 banks, as this part of the market rallied strongly through the month. Proceeds were reinvested within the senior debt of ANZ, ME and Bendigo Bank, as well as the subordinated debt of ME Bank, Suncorp and IAG. We note that the subordinated debt of certain regional names have underperformed the rally in the big 4 names which drove this decision to switch, in addition this exposure is shorter which reduces our exposure to market price volatility while maintaining yield to maturity. Our decision to take a strong position in senior unsecured debt is reflective of our willingness to maintain exposure to this ECB induced rally, while also wanting to lock in profits and reduce portfolio beta. This activity is most evident in the funds credit duration which is back to 2.8 years.

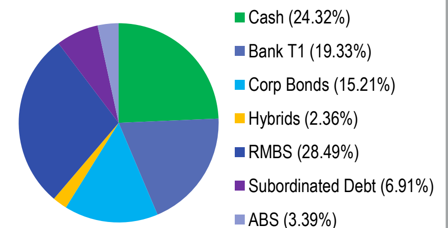
Our **Hybrid allocation** was reduced over the month by approximately 3%. After having increased our Tier 1 exposure to our capped sector limit through January and February, the strong rally over the last two months has presented an opportunity to reduce total exposure. We have seen the longer dated names come back off levels approaching 6% over bills to just under 5%.

## Fixed and Floating Breakdown




The fixed rate exposure is calculated based on the portfolios interest duration expressed as a percentage of the Bloomberg 0+yr Composite Bond Index.

## Portfolio Composition




## Sector limits

| | Asset Allocation Range | SAA Target |
|---|---|---|
| Cash | 0% - 100% | 10% |
| Government Bonds | 0% - 100% | 10% |
| Corporate Bonds | 0% - 60% | 10% |
| Corporate Hybrids | 0% - 10% | 5% |
| Bank Tier 1 Hybrids | 0% - 25% | 15% |
| Sub Debt Hybrids | 0% - 25% | 15% |
| RMBS | 0% - 60% | 30% |
| ABS | 0% - 20% | 5% |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APIR Code: OMF0018AU- Adviser

## Fund Update Continued

Near term we note that there are a couple of pending roll-overs which will add to market supply, this is unlikely to be overly disruptive given the strength in price performance of the recent CBA issue. With the deterioration in outlook for our banks, investors have shown an increasing preference for the relative security of a capped equity or hybrid type return. In the event that we do see lower rates into year end, this tier 1 spread is likely to be considered a too good to refuse proposition for many investors who seem at an absolute loss as to how to meet their income and retirement objectives. A number of pundits and asset allocators have long held the view that the Hybrid was a poor alternative to the equity, and a fool's trade. It has always been our view that this was not a belief built on any fundamental reasoning, but was rather the result of a conditioning driven by supernormal Aussie Bank performance coupled with an inability to understand the complexity of tier 1 securities. Indeed the inability of Australian retail investors to access alternatives coupled with renewed institutional interest in the space, sets the sector up for above average performance, especially versus bank equity.

Our **RMBS allocation** increased to approximately 28% over the month, through a single transaction into AAA rated mortgages with less than 1 year to maturity. We maintain a healthy allocation to higher rated securities which will see us benefit from any secondary market repricing while also maintaining head room to invest where and when securities trigger our own internal targeted levels. Over the funds life the decision to maintain a steadfast discipline around price and quality, while not allowing ourselves to be infected by the fear of missing out has driven good outcomes for our investors. Ultimately, we are ambivalent and will actively reduce our portfolio into strength or increase it into weakness basis our own entrenched fundamental view around what is a fair price for risk.

**ABS** allocation reduced to 3.43% over the month, being a function of existing holding paying down. Subject to availability, transaction structure and pricing we are open to increasing this allocation back to a benchmark position.

**Portfolio insurance** over the month was provided through the use of S&P 500 Index Equity put positions as well as maintaining a rate duration position of approximately 12 months for most of the month. With cash close to 25% we have maintained a moderate level of hedging which equates to approximately 3% of our at risk market exposure.

## Fund Outlook

Over the month we saw cash credit markets catch up to CDS, as a recovery within the commodity complex coupled with the release of the particulars around the ECB bond buying plan provided a natural bid for all forms of credit.

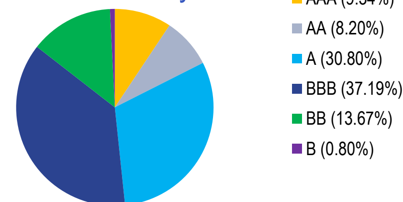
Domestically, our market grinded in tighter. This was most evident within the resource complex where the big names re-rated and moved back towards more normal levels that are consistent with their prevailing credit ratings. For example RIO Tinto's 5 year CDS has come in from close to 300 over back to 170 within a little over 2 months. Key contributing factors have been a strong bounce in bulk commodities and the ECB announcement.

More broadly the tone in credit remained very positive, with all names bid and market participants under-invested in the aggregate, we also note a slow primary response here domestically which has seen the few deals that leaked through perform very well, of particular note was the performance of Bank Of Queensland's subordinated tier 2 over the counter issue, which traded in from 3.4% to close to 3% over bills upon launching. Equally Bluescope steel launched a senior deal which was subordinated to secured facilities in the USPP market which priced at levels near where BHP issued their own subordinated debt in October of last year. Amcor and Sydney Airports also issued within this US Private Placement market, also performing well on listing.

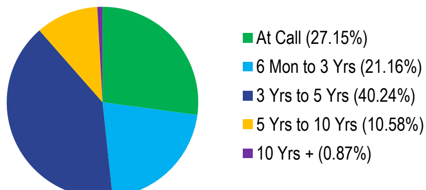
The thaw in credit markets is overdue and follows a difficult 12 month period for the asset class which has been beset by a myriad of issues. This move seems to hold momentum and a good level of volume behind it and will likely see credit assets well bid in the shorter term absent any external shocks. Our fund had been well positioned for this event with risk having been added into the back end of last year as well as the first two months of this year. So for us this is a period of harvesting and reaping rather than planting, consistent with our contrarian approach.

In the current month this has seen us moderately increase cash, while reducing credit duration (portfolio maturity) and simultaneously improving credit quality. This is targeted at maintaining asset class exposure to this rally while reducing the exposure to a market sell off. We feel we are well positioned to take advantage of the strength in the bid for credit assets currently, in addition we note that the RMBS and Tier 1 market continue to present good fundamental value on our analysis and are finally starting to benefit from a change in sentiment. Meanwhile a 25% cash balance also provides a war chest in the event that market volatility delivers new opportunity.

## Credit Quality




## Maturity Profile




## Fund details

- Distribution Frequency: Monthly
- Liquidity: Daily
- Ordinary Units Management Fee: 1.20% (inc. GST)
- Wholesale Units Management Fee: 0.77% (inc. GST)
- Adviser Units Management Fee: 0.77% (inc. GST)
- RE: One Managed Investment Funds Ltd
- Custodian: JP Morgan
- Unit Pricing and Unit Price History: www.realminvestments.com.au/media/4

## Platform Availability

- BT Wrap
- Macquarie Wrap IDPS
- Powerwrap
- Hub24
- IAS
- UBS
- Credit Suisse (HSBC)
- CFS FirstWrap (Private Label)
- Netwealth (Private Label)
- Praemium

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