Realm High Income Fund

August 2015

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	0.08%	0.17%	-0.09%	0.11%
3 Months	0.22%	0.50%	-0.28%	0.33%
6 Months	1.02%	1.05%	-0.03%	1.24%
1 Year	3.18%	2.28%	0.90%	3.64%
2 Years p.a	5.42%	2.39%	3.03%	NA
Since Inception p.a*	6.28%	2.57%	3.71%	5.59%

*Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013

Fund Statistics

Running Yield	5.54%
Volatility*	1.13%
Interest rate duration	0.02 years
Credit duration	4.02 years
Average Credit Rating	BBB+
Number of positions	68
Average position exposure	1.47%
Worst Month*	-0.47%
Best Month*	1.12%
Sharpe ratio*	3.30
Information Ratio*	3.32

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

Fund Update

Cash weighting has decreased to approximately 14.4% driven by a decision to allocate to credit as market stress lead to all parts of the credit spectrum experiencing heightened volatility and price weakness. This was complemented by an aggressive use of protection to counteract market stress over the month.

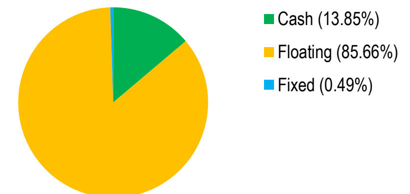
Government Bonds remain near zero. Economic performance relative to expectations is likely to improve from here (due largely to expectations plummeting). All of this would normally point to wider yields, however market volatility combined with the likelihood of a hiatus on rate rises could see rates supported in the near term. That said given the absolute level of rates we are more likely to use other forms of insurance in the near term in preference to a long bond position.

Corporate bond exposure increased to over 20% in the form of investment into the Tier 2 debt of regional names. Tier 2 levels had widened across the board, bringing the sub sector back towards fair value. In the corporate market, the index widened moderately however in the aggregate senior corporate debt remains fundamentally expensive on the basis of our default probability based assumptions. Going into year end, it will be interesting to see how the new Basel rules (Basel IV) impacts senior investment grade credit. In addition, we believe that a large swathe of the Australian senior investment grade universe is rated to perfection. In certain sectors, we maintain some genuine structural concerns, while in others, we believe that an environment of low rates coupled with an institutional reach for yield has led to a goldilocks environment for revenue and asset revaluations (the property sector in particular comes to mind).

Hybrid allocation increased to approximately 25% over the month. The CBA and ANZ rights issues had set the scene earlier in the month, with bank stocks catching down to reflect imminent dilution, driving behavior of hybrid liquidation as a funding source for bank equity. This is based largely on the premise that bank dividends and hybrid coupons are interchangeable. Price action late in the month was particularly noteworthy with a good cross section of the bank tier one trading at levels North of 500 over bills. Rights issues and higher risk weights to mortgages deliver hybrids with increased subordination and make them fundamentally safer, however ultimately investors will be more concerned by the market weakness they have experienced. The asset class has been beset by over-supply, heavy underperformance of bank equity (which maintains a causal relationship basis investor behavior) and increased market volatility in general. Right now, the liquidity multiplier delivers a healthy discount in price (and premium in yield), which would drive any contrarian investor worth his or her salt to take a second look. On that basis, bank Tier 1 remains a tactical overweight. We are cognisent of the impact on volatility and will continue to use insurance to counteract our exposure to market risk, however at prevailing levels we are happy with this weighting based on our total return modelling and downside assessment.

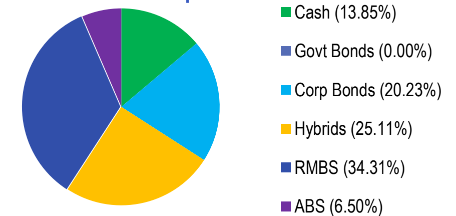
RMBS allocation increased by 2.5% over the month through an investment within a couple of tranches in a prime securitization issued by Resimac. Our environmental RMBS system score has improved slightly off the June lows. While average mortgage size continues to creep higher, we note offsetting factors that have included a lull in house price appreciation and a continued reduction in average mortgage rates. On a bigger picture basis, the low level of interest expense to income has offset the weakness in wage growth.

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: OMF0001AU- Retail
APIR Code: OMF0009AU-Wholesale

Fund Update Continued

In past cycles, the RBA has been able to adequately deal with exuberance through the use of monetary policy, this was most evident in 2004, however this time around the central banks hands are tied, meaning that APRA will need to continue to exert not so subtle pressure to drive good behaviors, aimed at slowing household debt and collateral price appreciation. If banks fail to act or if their efforts are unsuccessful, expect implicit pressure to turn into explicit direction through the imposition of hard limits and capital based penalties. We maintain a high level of confidence in APRA's ability to enforce good behavior which is positive for the system and investors alike.

Our **ABS** allocation remained static over the month remaining at approximately 6%. As we have stated previously the structure of these securities deliver meaningful subordination further supported by large levels of excess trust income. Our competence in assessing the sub sector equips us well to review risk and price accordingly. We will continue to move towards our strategic benchmark of 10% depending on issuance quality and margin.

On **insurance and hedging**, we note that protection strategies yielded approximately 18 basis points over the month. Ultimately this counteracted increased volatility driven by the higher hybrid allocation that would have otherwise seen the fund deliver a negative return. We have stated previously that we reserve the right to act decisively and meaningfully when we feel that market risks are elevated. This will remain the case.

Fund Outlook

In our previous monthly we noted the following: "***Over the last twelve months we have seen the likes of Swiss Franc, Oil, Iron Ore, Copper, Gold, Silver and Chinese Equities to name but a few move in a manner which makes a mockery of the mathematical assumptions of a normal distribution. Our view remains that this volatility is the status quo, indeed we view these releases in pent up energy as positive, as they are driving progressive deleveraging in dangerous positional concentration and leverage.***"

While the seeds of the weakness had been planted by the threat of impending US rate hikes and Chinese economic and equity underperformance, the severity of the movement was driven by a combination of technical factors which led to an out-sized market response. All in all the month could only be described as an ugly one, and symptomatic of the fact that trade concentration and leverage can combine to deliver price action which makes a mockery of value at risk assumptions. We are not surprised by the movement or its severity, in our mind this represents a new normal. The question for many will be whether the volatility of August is the precursor to a more sustained and severe market event.

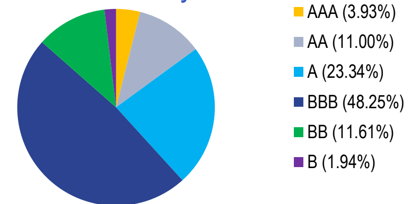
History tells us that leverage, un-naturally low volatility and strong performance in risk prices provides fertile ground for un-anticipated market weakness (increased probability of a tail event). All that is required to set off a heavy correction in such an environment is a trigger or an event, which has the ability to drive losses and destabilize systemic confidence. A loss of control by Chinese authorities and a continued decline in economic and market performance has the ability to seriously impact market performance. While we believe that central banks, regulators and governments are highly motivated to do as much as they can to mitigate such a risk, no one should believe this is an absolute or a hard put. Central bank action is showing diminishing returns which in turn leads central banks and regulators to fall back in an attempt to preserve their powder in the event that circumstances deteriorate further.

For many years now investors have benefited off strong equity market returns despite the absence of economic strength. As accommodation is withdrawn, it is only natural that the market turns introspective and makes a call on what risk assets are worth as the environment transitions. This is true for all risk assets as well as certain safety trades, such as government bonds. All of that said, an environment where prices correct, leverage reduces and volatility rises can be perversely thought of as a positive, in that it illustrates that market participants are actively pricing risks.

The conundrum is of course to balance the risk of further instability with the fact that asset prices are presenting a more generous reward than they have in some time. In our case this has driven us to reduce cash and invest basis our concept of fair value and risk for reward while simultaneously maintaining an increased level of protection which has an objective of mitigating the impact of broad market weakness on the portfolio.

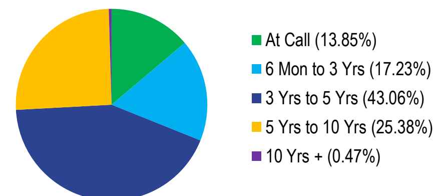
We are comfortable with portfolio composition and believe the fund well positioned to deliver on its objective over the medium to longer term, reflected in the rise in yield to maturity to approximately 5.5%. That said in the short term our focus will remain on managing existing volatility through the use of our cross asset hedging program.

Credit Quality



- AAA (3.93%)
- AA (11.00%)
- A (23.34%)
- BBB (48.25%)
- BB (11.61%)
- B (1.94%)

Maturity Profile



- At Call (13.85%)
- 6 Mon to 3 Yrs (17.23%)
- 3 Yrs to 5 Yrs (43.06%)
- 5 Yrs to 10 Yrs (25.38%)
- 10 Yrs + (0.47%)

Fund details

- Distribution Frequency: Monthly
- Liquidity: Daily
- Ordinary Units Management fee: 1.20% (inc. GST)
- Wholesale Units Management fee: 0.77% (inc. GST)
- RE: One Managed Investment Funds Ltd
- Custodian: JP Morgan
- Unit Pricing: www.oneinvestments.com.au/Realm
- 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)

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