Realm High Income Fund

August 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	0.82%	0.12%	0.71%	0.86%
3 Months	1.82%	0.40%	1.42%	1.93%
6 Months	4.15%	0.88%	3.27%	4.38%
1 Year	5.12%	1.88%	3.24%	5.60%
2 Years p.a	4.15%	2.08%	2.07%	4.62%
3 Years p.a	5.32%	2.22%	3.10%	N/A
Since Inception p.a*	5.98%	2.39%	3.59%	5.59%

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

Fund Statistics

Running Yield	4.43%
Volatility*	1.16%
Interest rate duration	0.04
Credit duration	2.88
Average Credit Rating	A-
Number of positions	77
Average position exposure	1.30%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio*	3.08
Information Ratio*	3.09

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

Fund Update

Our cash weighting remained in line with the end of July sitting at approximately 17% as at the end of August. There were only moderate changes from an absolute asset allocation perspective with subordinated debt reduced and RMBS moderately increased.

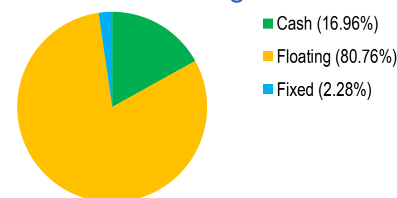
Our **fixed rate exposure** remains at zero as at month end. The long end of the curve sold off approximately 15 basis points in the month in the US while remaining broadly in line here in Australia, with the short end sitting largely unchanged despite the August 2nd rate cut. In the US all eyes were on Jackson Hole, where Yellen and Co struck a moderately hawkish tone. The Fed now seems likely to raise once before calendar year end in the absence of any significant market volatility or a deterioration in economic data. Our expectation remains that any rate normalization will be a long drawn out process. The rates market however has priced in a much more bearish scenario on our numbers. This is the reason that we remain near enough to zero interest rate duration within the portfolio. We believe long bonds sit 30-40 basis points from fair value here in Australia and in the US.

Our **corporate and subordinated bond allocation** declined by approximately 2% over the month. We saw a small reduction in our Bank Tier 2 debt and our Australian bank senior debt. In previous months we have spoken about the positive momentum generated by the ECB's corporate bond buying program and how in the absence of any unforeseen volatility that this was likely to continue to drive credit tighter. Well if that wasn't enough the Bank Of England decided to join the party as they announced their own corporate bond buying program in addition to a new bank lending facility which is driven at allowing banks to borrow at the risk free rate. Asset purchases trump fundamentals as such corporate credit continued to grind tighter over the month. Here in Australia brokers navel gaze as a shortage of corporate issuance coupled with a tightening market leads to very little happening. In the absence of anything unforeseen you can expect domestic credit to continue to grind tighter over the coming month.

Our **Hybrid allocation** remained in line with the prior month, however turnover was high with 6% of the fund rotated into new names. The event over the month was the launch of ANZ's new AT1 issue. As noted in previous months the ANZ had previously issued a US dollar AT1 note that allowed this issue to be kept to a more manageable size. Ultimately demand comfortably outstripped supply, and continues to support a thematic view that supply/demand dynamics are likely to remain supportive to this market over the medium term, this will only be further assisted by low rates and an absence of yield alternatives for retail investors. New and recent issuance remains in an approximate range around 4.5% over the bill rate, we still view this as an attractive level of compensation. At a certain point you can expect to see our allocation move back towards or even below our strategic allocation of 15%, however at current rates we are comfortable maintaining our overweight exposure.

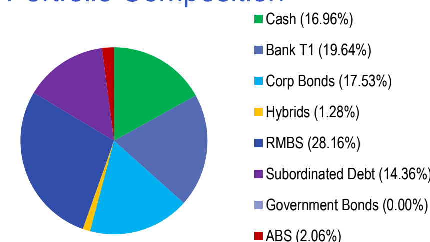
Our **RMBS allocation** increased by a little over 1% over the month. Approximately 5% was invested within new issuance with the vast majority of being invested with repo eligible AAA securities. At the same time, we divested a portion of our mezzanine RMBS exposure, the result being that our allocation remained largely in line with the prior month, just as the average credit rating of our RMBS exposure increased.

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%

Fund Update Continued

Last month we spoke of a lack of supply with the market registering the lowest level of issuance since 2008. However we are now seeing a thaw with a number of regional banks slated to deliver new deals over the next couple of months. It is likely that new stock will be well received given the shortage of new supply across domestic credit markets. Market appetite may well lead the next number of deals issuing above our fair market level. We will continue to take a patient approach to how we manage this allocation and will happily stand aside where prices trade above a fair levels and indeed sell into continued strength.

Fund Outlook

July's narrative continued through August as European bank stress tests in addition to new action out of the Bank of England underpinned credit market performance through the first half of the month, this grind tighter and higher continued unabated into month end despite Hawkish Fed undertones out of Jackson Hole. In credit markets in particular the rally in global corporate (non-bank) credit has been jaw dropping with a good portion of the Euro corporate market trading at negative yields, as the ECB struggles to find stock to buy. At the time of its introduction it was our firm belief that the ECB bond buying program would be credit positive as ultimately an act of pure monetization cares not for fundamentals or market particulars, it is a bulldozer that will take everything in front of it for a ride. The major event at the start of the month was the ECB bank stress tests and more specifically the failure of Italy's third largest bank, Monte De Paschi. This had been well telegraphed and had led to increased volatility within bank stocks and credit assets.

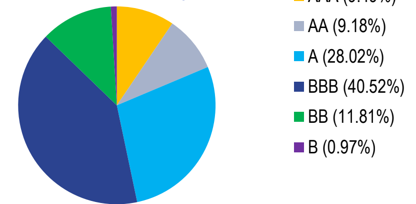
The reason why Europe remains a focus from a fund outlook perspective is that the European Banking system remains the largest stock of non-performing loans on the planet, what is also clear however is that the Europeans are in no realistic rush to resolve the issue where it pertains to the largest national banking systems (Germany, France, Netherlands, Italy, and Spain). The next point of global vulnerability is Japan, where an enormous Quantitative Easing program has barely managed to register an inflation reading. The Japanese approach to QE is astounding with the Bank Of Japan the largest holder of a multitude of Japanese companies through the purchase of equity ETF's in addition to already holding the majority of the nation's bond stock and corporate bonds.

Moving on from points of vulnerability and focusing on potential triggers, we note the US presidential elections, the potential for European fragmentation and armed conflict (Syria, South China Sea, Ukraine, and Nagorno/Karabakh). Concerns relating to a Trump presidency or European referendums could well drive market dislocations that could be large. That said central banks are showing a willingness to pull more and increasingly unconventional levers to counteract any negative impacts. In many ways investors have been groomed to see through bursts in volatility and anticipate central bank reaction as a panacea to all market ills.

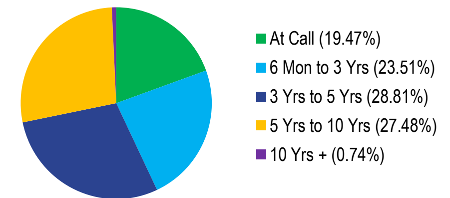
Touching on Australia, data remains tepid. In summary, private investment and weak wage growth is sending ripples through the economy which impacts producer prices and retail expenditure. What would normally happen in this kind of environment is that the AUD would weaken to compensate providing much needed productivity growth, however without a US rate rise this will not happen on this occasion meaning that the RBA is forced to cut to simply stop currency appreciation and driving a worsening of conditions. All of that said systemic risks have stabilized thanks largely to APRA acting in a very intrusive manner in driving better bank behaviors, this macro prudential approach to risk management works so well in Australia because of the concentration of risks within 4 large institutions (that's right, the oligopoly is a good thing when it comes to managing systemic risk).

In summary, the fund outlook should provide investors comfort that we actively monitor a myriad of risks with the focus being on how they can impact portfolio asset value. As we have stated to many clients in the past, the global financial system is intertwined, this isn't a theory it's a fact. Large financial sectors can create shockwaves that run through the fault lines which connect global commerce, meaning that a big enough loss anywhere on earth has the capacity to impact domestic financiers. Earning a return in a good market is ultimately the easy part, from that perspective while we are pleased with the recent performance of the Realm High Income Fund strategy our focus is on protecting the portfolio and balancing it appropriately to deal with building risks. Our portfolio currently maintains a moderately aggressive posture, with AT1 remaining the highest beta bet at approximately 19% of the portfolio, however outside of this position we have increased credit quality and moved cash back towards 20%. This trend will continue as the rally matures with the manager's focus remaining on the management and minimization of portfolio volatility.

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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