Realm High Income Fund

August 2017

Investment Objective

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

Net Performance

Period	Ordinary Units (incl. franking)	Wholesale Units (incl. franking)	RBA Cash Rate
1 Month	0.15%	0.18%	0.13%
3 Month	0.76%	0.88%	0.38%
6 Months	1.78%	2.00%	0.75%
1 Year	4.28%	4.73%	1.50%
2 Years p.a	4.71%	5.17%	1.70%
3 Years p.a	4.19%	4.65%	1.89%
4 Years p.a	5.06%	N/A	2.04%
Since Inception p.a*	5.63%	5.37%	2.21%

Past performance is not indicative of future performance.
*Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.
Adviser Units Inception 8 September 2016

Fund Statistics

Running Yield	3.75%
Volatility†	0.46%
Interest rate duration	0.31
Credit duration	1.94
Average Credit Rating	A-
Number of positions	139
Average position exposure	0.57%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio†	3.16
Information Ratio†	3.24

Calculated on Ordinary Units unless otherwise stated
*Since Inception 26 September 2012
†Trailing 12 Months Calculated on Daily observations

Fund Update

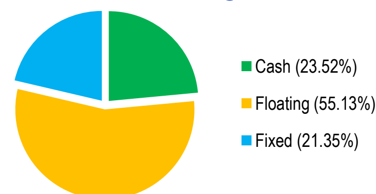
Our **cash and short term liquidity weighting** decreased to approximately 44% at month end (a 6% reduction). There were moderate increases across the board with bank AT1 and bank subordinated debt increasing moderately, with a more meaningful increase to corporate non-financial allocation. RMBS remained in line with prior months, despite further portfolio rotation.

The fund is maintaining an **interest rate duration** position of approximately 0.3 years into month end, with our technical overlay moving the position between 0.3 and 0.5 of a year. A confluence of geopolitical drivers and the re-emergence of debt ceiling concerns drove rates to rally intra month, however once again the concerns subsided and the long end softened, again leaving rates largely unchanged over the month. On data we note that the momentum of US numbers continues to soften, while European numbers are also starting to slow. That said, trend strength is still stable enough, with rates still sitting approximately 0.20% off fair for the Australian 10 year. We would need to see the Aussie long end move through 3% for our rates position to move towards our 1 year tactical position.

Our **corporate** and **subordinated debt** allocation ended the month close to 27% from approximately 24%. As Europe emerged from the summer hiatus primary markets re-opened. Our portfolio increased its exposure through primary and secondary activity, moderately increasing bank sub debt and corporate senior exposure. From a credit perspective, the reporting season didn't really throw up any concerns. The theme of balance sheet remediation remains the driver in materials and energy while industrials are for the most part playing reasonably tight. On balance the theme seems to be: protect your credit rating and where possible lengthen your maturities to take advantage of investor appetite. We found an opportunity to build positions in a handful of corporate names. Our approach to our corporate allocation is to focus on names or sectors that present a relative opportunity, in terms of their ability to be positively re-rated or in instances where they have been unfairly or over- zealously sold. In that regard the approach is opportunistic. Over the month we increased our exposure to shopping centers (specifically Vicinity and GPT shopping) as well as increasing our exposure to Downer EDI. Our rationale regarding these positions is available on request to clients.

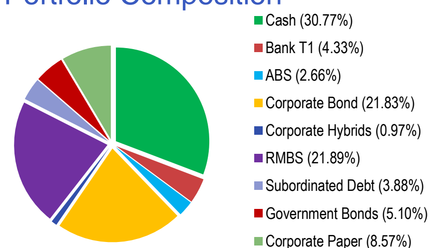
Our **AT1** exposure increased by 1.6% percent over the month. The increase in weighting was entirely opportunistic and name specific. CBA's smart ATM debacle led to a massive array of potential outcomes, we viewed assessments ranging from near enough $10 billion down to a couple of hundred million. On the back of the confusion created we saw larger blocks of specific CBA lines axed to the point that the securities traded in line with regional names. While there will be some kind of fine for CBA (perhaps even up to $1 billion), the bank enjoys an enormous franchise premium over the likes of ANZ and NAB. The big four are often judged on the same curve, however the reality is that CBA remains a much bigger franchise than the likes of ANZ and NAB, the type of hit CBA would need to take to bring it into line with those two banks would exceed any fine level that could be rationally calculated. We expect to trade these positions at a healthy profit. Beyond that we also saw ANZ announce a new AT1 transaction. ANZ Capital notes 5 will pay 380 over for 7 years. The level seemed about fair given where the market currently sits. That said we are still maintaining an underweight view on the sector. All things being equal the deal will perform reasonably. This has been a very soft year from a supply side perspective, this always drives a self-fulfilling virtuous circle. A lack of supply or scale backs drives increased secondary buying, which drives strong price increases (because the AT1 market lacks depth in liquidity), this in turn then drives new issues to list really well, and so the story goes. AT1 prices moderated over the month, however not enough to drive more meaningful action from us. Indeed we start to get a little nervous for the asset class when bank equity heavily underperforms. When grossed up equity dividends start heading towards high single figures the incentive to switch for retail investors starts to become rather powerful. Also we still need to hear APRA's final word on how they see AT1 working and its role moving forward.

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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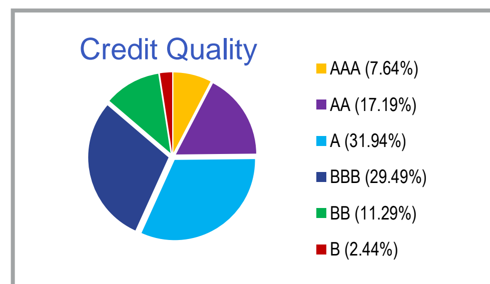
APIR Code: OMF0001AU- Retail
APIR Code: OMF0009AU-Wholesale
APIR Code: OMF0018AU- Adviser

We remained particularly active within our **RMBS** allocation over the month, despite the fact that the allocation remained static around 22%. Late August saw an increase in new deal announcements with ME Bank, AFG, Latrobe, Liberty and Firstmac all announcing new transactions. Secondary demand moderated because of this into month end. There is a great deal going on within the sector at present with foreign banks once again seeking to provide warehouse support while we have also seen a number of institutions opening up market making capability in Australian RMBS. This augers well for the performance for the sector over the medium term. These elements are all extremely constructive for liquidity of investment grade RMBS lines. Considering the fact that liquidity premium drives a good portion of the RMBS premium this could be expected to provide healthy support for this market. That said this liquidity will be concentrated on highly rated tranches, as such we have gradually managed our books average credit rating towards a AA rating. We maintain a healthy amount of capacity as things stand and are generally constructive on the sector versus other asset classes at present. We expect issuance to be strong into year end, which will allow us to replenish ourselves towards a neutral weighting.



Fund Outlook

Aus-Itraxx 5 year round tripped over the month, selling off mid-month before ending the month tighter than where it started. We saw heightened volatility in US and Euro high yield, with US high yield indices coming off almost 2% in the first couple of the weeks, however post Jackson Hole the market gradually tightened back to be largely unchanged on the month.

All of that said, volatility has begun to rise within the high yield complex, with increased price volatility evident in most forms of higher beta global credit. We note the 2% plus fall in US high yield within a week, the strength of this move is a real reflection of how tight this market and others are wound at present, which could present a risk in its own right.

Of particular interest is the weakness within the European banking complex, this seems to be a building story and has been noted by various parties including the IMF. Returns on Assets remain particularly weak. The inability of the sector to make hay while the sun shines is noteworthy. Normally banks would be benefitting from dropping asset provisions and rising rates, however in this case they are getting the benefit of neither.

We are once again starting to hear the words bank profitability and system risk being used in the same sentence. The need to go through real structural reform may be a necessity, equally this highlights the fact that the European rate environment is unsustainable and more importantly that European QE is closer to its end than its beginning.

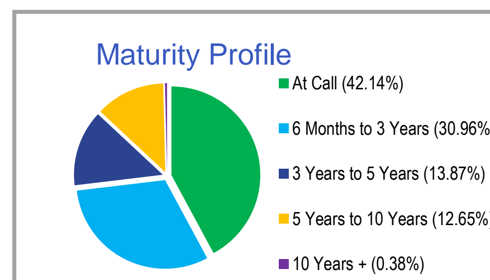
Our sense is that spreads have bottomed and despite the rally into month end it is our expectation that spreads will move wider from here. We accept that there is an absence of an obvious trigger (excluding geopolitical risk) that could drive market wider very quickly, however we do feel that a confluence of factors including the gradual withdrawal of asset purchases, rate rises and choppy growth will provide the inertia required to make markets widen from the current levels.

For context Aussie ITRAXX currently sits at levels last seen towards the end of 2007, there are certain sector based factors here at play also, for example the resource and energy sector has made a herculean effort to reduce leverage and break evens which has led to a significant increase in asset quality, meanwhile most Aussie names continue to play it tight. There is an absence of using debt to appease equity markets through buybacks and dividends, if anything its been much the opposite as underperforming businesses have looked to put their credit rating first, as such what we can say is that there has been no deterioration in credit quality over the last 12 months across the market, if anything the market is probably in better health in the aggregate.

To the fund now, targeted risk increased moderately as we took advantage of weakness in AT1 coupled with an increase in corporate issuance. At the same time we reduced our RMBS risk budget as we continued to increase credit quality despite maintaining the total portfolio weight. The portfolio is positioned to deliver a competitive return over the medium term, however we are still willingly taking a larger level of re-investment risk than we have taken in the funds life. Basis points of yield are as expensive as they have been in risk terms in the life of the fund which means it remains a time for caution.

This type of environment presents a real challenge to investors. It's a period in the cycle where high yield generally outperforms as investors gravitate towards higher running yields. This time is no different. It's hard to believe that a year and a half ago we had oil in the $20's, we were talking about the viability of the resource sector and most forms of subordinated debt were 10% lower than where they currently sit. It has taken only 18 months for the market to come to the other extreme. Confidence in central bank primacy is as high as it has been in the last 5 years. The absence of clear and present risk triggers has been sufficient to put markets over the top.

That said there are narratives forming that will challenge markets moving forward. As has been the case over the last 10 years, the primary driver will be central bank activity. Bank profitability is a real story, the smoothing of cycles and the flattening of yield curves makes it very difficult for banks to make money. Banks remain the primary economic intermediator, which poses some very interesting questions. Should they be? Or should central banks start to pull back, thus allowing cycles and market forces to drive the day to day narrative for markets.



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
- Praemium

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