Realm High Income Fund

February 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	0.31%	0.34%	0.11%
3 Month	1.20%	1.30%	0.37%
6 Months	2.46%	2.68%	0.74%
1 Year	6.73%	7.19%	1.65%
2 Years p.a	4.31%	4.77%	1.85%
3 Years p.a	4.82%	5.29%	2.06%
4 Years p.a	5.68%	N/A	2.21%
Since Inception p.a*	5.87%	5.57%	2.29%

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	3.94%
Volatility†	0.83%
Interest rate duration	0.48
Credit duration	1.99
Average Credit Rating	A-
Number of positions	109
Average position exposure	0.72%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio†	4.31
Information Ratio†	4.47

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

Fund Update

Our **cash weighting** increased to just over 26% at month end, in addition short term liquidity sits at close to 8.5%. The major change came in the form of a reduction in the funds RMBS allocation which reduced to 25% from over 32% as at the end of February. This was largely due to market buoyancy, and willing buyers hitting our levels.

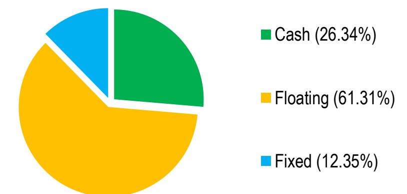
The fund is maintaining an **interest rate duration** position of approximately 0.6 years, with our technical overlay moving the position between 0.5 and 0.7 of a year. There was no change to our core position versus last month. Rates largely round tripped ending February where they started. Over the month however we note that a pickup in economic momentum globally has pushed our fair levels for yield higher, with the Australian long end just on fair and the US moderately expensive. Here domestically a number of concerns around heat in the property market have hemmed in the RBA and likely puts them in a position where they are unlikely and unable to cut in the absence of APRA and ASIC cracking down and taking heat out of the market using macro -prudential influence. It is indeed looking like the near terms low in cash rates is upon us, however equally household vulnerability to rate rises means that we can be assured of a very gradual rise in rate. Globally the momentum in data out of every major economic center is positive and in some cases even strong. Geopolitical risks abound, however in the absence of a trigger it will be hard to see how long term rates globally don't rise again from here in the shorter to medium term. We would view a sell off in rates from current levels as an opportunity to increase portfolio duration, our current position means that we would fair reasonably well in an environment where rates increase versus peers.

Our **corporate** and **subordinated debt** allocation remained more or less in line with last month. We took the decision to roll in NAB's new listed tier 2 transaction, while simultaneously closing our position within the subordinated debt of Bendigo Bank, in the senior unsecured book, we remain focused on senior debt of large Australian institutions at the shorter end of the curve. This market is very strong at present, excess cash coupled with strong competition for assets out of the syndicated loan market means supply is anemic. We note that 5 year Aussie big bank paper tightened another 10 points over the month, with recent 5 year transaction trading at 0.9% over bills. The market has an extremely strong bid tone to it, perhaps as strong as we have seen in the funds life. One thing we have noted of recent times is the strong pro-cyclicality of liquidity and market direction, it is very hard to buy in this kind of market just as it is extremely hard to sell when markets are weak. We believe this kind of market lends itself to a contrarian approach to investing, which is exactly how we are approaching it, our focus remains in the short end in low beta names with a view to protecting carry while minimizing our exposure to a market correction.

Our **AT1** exposure remains more or less in line. We participated in the CBA's new PERLS 9 transaction, however outside of that there was very little activity. The market did widen ever so modestly as new supply was announced, however given the nature of scale backs and over subscriptions we can naturally assume that the AT1 market has further to run. The longer end remains fair , the shorter end a little dear, however these assets still compare very favorably to other parts of the market that remain on balance expensive. While we are running a position below benchmark it is in longer higher beta names. This still seems like a reasonable place to take risk versus the rest of our available markets. Needless to say as this market continues to perform we will reduce exposure. Also of note was Macquarie's USD T1 issue, which was ridiculously over-subscribed and issued at something near 400 over swap for 10 years. This provides context, given that the banks are once again talking up the chances of getting concessions out of the ATO which would allow them to issue AT1 more freely off-shore.

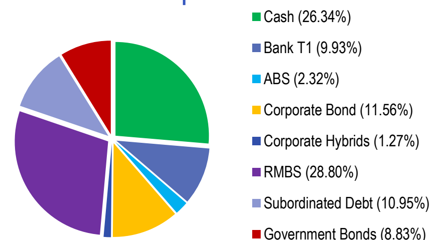
Our **RMBS** allocation reduced materially over the month by close to 8%. We have stated previously that regulatory changes and the absence of value in any other conventional credit market is likely to put structured credit in the slot to outperform. We continue to believe this, however sometimes investors are just happy to pay up. This environment saw us axe a little over $16 million in assets, a good portion of which were rated around BBB and BB attachment point. Despite this reduction we remain positive on the sector and believe that coming supply will allow us to restock, in all likelihood at higher credit quality. We believe the regulatory environment will improve liquidity and demand in parts of this market next year, something we intend to be positioned to capitalize on. In the meantime, if the market wants it at overs, we are more than happy to fill them there.

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 Outlook

Benchmark credit indices rallied all over the globe through the month of January. High beta indices such as US HY and EM continue to plough tighter, meanwhile Australian big bank CDS tightened by a further 5 basis points. Meanwhile cash credit also ground in tighter as new benchmark Aussie 5 year big bank credit came in another 10 points (0.5% in capital price appreciation over the month). Equity markets also responded in sympathy, while volatility more or less remained in line. All in all market complacency continues to rise, in the absence of any credible market threats (as far as the market is concerned).

The discussion relating to systemic risk seems to be front and center at present as the housing market has come out of the holiday hiatus with a full sail. Rates of change in collateral prices and healthy increases in unsecured debt point to the level of risk within the system rising, just as the economy which supports the ability for the populous to support this leverage coughs and splutters. This is in some way's a redux of 2015 for APRA and the RBA. At that time aggressive action by the Banking systems regulator drove risk weights higher, capped speculative lending and focused on sustainability and lending practices more generally. This provided the RBA with welcome cover fire that lead to the decision to cut cash to 1.5%. The question is what can APRA and perhaps ASIC do now? In the absence of a credible solution the pressure is on the RBA to do something. While this can't be discounted we believe that APRA and ASIC will be given an opportunity to have a real bash at it first. APRA's unquestionably strong mandate must lead them to stymie the strength in household credit growth, and instead encourage financial institutions to take the kind of risk the economy needs right now.

Collateral prices are getting to levels where total losses in the event of a cyclical recession could be a lot worse than what stress test scenarios contemplate, something we are now contemplating within our own fair value modelling. The integrity of the system is a non-negotiable and will mean that banks and perhaps non-banks who have sucked up the over flow have a very interesting year ahead of them.

In terms of what this means to the economy, we note that wages and investment remains weak, indeed it is hard to see how households can engage in any real increase in consumption in the absence of stronger economic growth. At the same time corporates are struggling to see the upside in allocating new capital in this kind of market. Indeed the reporting season wasn't poor, however outlook statements are not focused towards any real increase in capacity either. This kind of environment would seem to lend itself to some form of fiscal activity, whether it be in the form of tax concessions or outright spending, something that will almost certainly put the final nail in the Australia AAA discussion, however do they have a choice, especially if monetary policy has finally found its natural limits in this country.

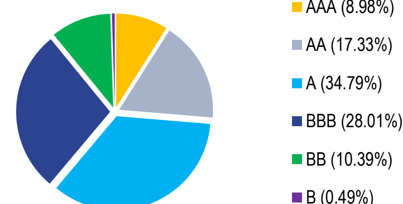
Most of last month's note was dedicated to off-shore developments, on this front not a lot has changed. Trump continued to espouse grandiose detail light statements, Europe is continuing to slide towards what looks like a political cross road and as yet the likelihood of a broader Sino-American trade confrontation is no clearer than it was a month ago.

On Europe now, we recently saw the release of the EU's White paper on the future of Europe. This paper basically examines 5 potential ways forward for the European union, ranging from reducing European centralised power, back to a common market to full integration. One of the scenarios also allows for certain states to become "connected cars", e.g. tighter unions within the union. They are all very interesting scenarios, that would point to nations that are more harmonized economically and socially coming closer together as others stay as they are. Could this document be the forerunner to a broad and grand referendum? The more relevant question for investors is whether this is even contemplated and what it would all mean anyway. No one knows for sure, however it could certainly introduce uncertainty to an otherwise complacent market.

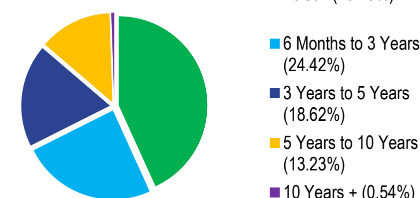
To the US now, all eyes are on the Feds March meeting. The rates market seems to remain unconvinced of three rate hikes being a possibility this year, which makes the March meeting a particularly interesting one that could drive the narrative for rates in the nearer term. On the Trump wildcard, his presentation in front of congress was chock full of grandiose statements and absent detail, however there was enough there for those that continue to anticipate enormous tax cuts and infrastructure spend and plenty of questions for the rest of us including how is all of it going to be paid for, assuming it is even possible.

To the fund now, we continue to maintain a low beta profile within the portfolio, with cash and liquidity remaining high. While the low hanging fruit has been well and truly picked there are pockets of value that remain and should continue to see us deliver a competitive rate of return despite the portfolios current posture. At the same time we are well positioned to capitalize on volatility in credit or rates as things stand.

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
- Praemium

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