Realm High Income Fund

January 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	-0.22%	0.17%	-0.39%	-0.18%
3 Months	0.16%	0.50%	-0.34%	0.28%
6 Months	0.91%	1.00%	-0.09%	1.15%
1 Year	2.21%	2.07%	0.14%	2.69%
2 Years p.a	4.09%	2.28%	1.81%	4.57%
3 Years p.a	5.54%	2.42%	3.12%	N/A
Since Inception p.a*	5.73%	2.50%	3.23%	5.02%

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

Fund Statistics

Running Yield	5.01%
Volatility*	1.17%
Interest rate duration	0.38 years
Credit duration	3.60 years
Average Credit Rating	BBB+
Number of positions	74
Average position exposure	1.35%
Worst Month*	-0.47%
Best Month*	1.12%
Sharpe ratio*	2.76
Information Ratio*	2.79

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

Fund Update

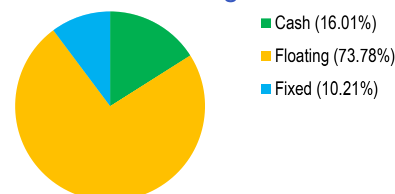
Our **cash** weighting increased to 16.01% over the month. Broadly speaking, sector weightings remained flat on a month over month -basis, despite some switching within relative allocations.

Our **Government Bond** exposure remains near zero. Bonds rallied into month end, with the Australian 10 year rallying 2.5% over the month. Plummeting oil prices and global economic weakness provided a solid bid under bonds, with the Bank of Japan's negative rates decision putting prices over the top. Meanwhile foreign holders continue to liquidate in an effort to stabilize currencies and meet hefty deficits. The short end of the curve both here in Australia and the US is implying a heavily reduced probability of any rate rises. In the US 1 year bonds now sit under the Fed Funds rate. This reflects the genuine lack of confidence in the economy at present. This thesis is currently supported by the weakness in Global economic data and in the price action in commodities, from an implied perspective however, we now have projected rate paths and implied rates of nominal growth at or below the low end of consensus expectations.

Our **corporate bond allocation** remained in line with last month, sitting just below 24%. As market volatility increased through mid-month we increased our allocation to the resource sector through the purchase of three senior instruments in the names of Rio Tinto and BHP, while also adding to our existing BHP Subordinated debt exposure. These positions were taken as the sell-off in commodities intensified mid-month and the credit default spreads of RIO and BHP approached 3%. Proceeds were sourced from our existing subordinated debt positions which showed a high level of resilience through the month despite heightened credit market volatility. With the generally supportive January hiatus disrupted by market instability and with a number of subordinated debt and Tier 2 deals set to hit the market over the next quarter we believe that an opportunity will present to re-establish a position within the Tier 2 financial space at wider spreads through primary issuance over the next couple of months. In the meantime, the position taken within the names of RIO and BHP has been engaged at levels last seen around the Global Financial Crisis. Our fundamental assessment is that the market is assigning a level of cumulative default probability above what is fair and reasonable in our analysis. Either way it is clear that RIO and BHP can remedy questions over credit quality by reducing capital expenditure and stepping away from their progressive dividend policy, something that we expect to materialize over the coming months.

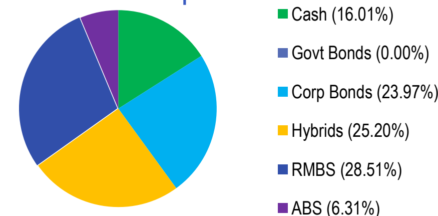
The funds **Hybrid allocation** remained in line with the prior month at 25% of fund assets. It was another weaker month for the sub sector with a good proportion of the Additional Tier 1 bank sector rating at yields to maturity of close to 7.5%. Our Hybrid target prices have been lowered over the last three months to reflect challenges to asset quality, bank earnings power and general market volatility, however in spite of this we still find most of the market universe sitting approximately 4% below our projected target price. In our modelling we have reduced bank Return On Equity to reflect challenges to asset quality relating to the resource sector as well as the cost of increased capital, this has driven us to reduce our targeted fair book value for the sector while also taking into consideration the heightened current level of volatility. Very simply, the likelihood of asset quality deteriorating to a point where it reconciles with prevailing spreads at prevailing interest rates is a stretch, On these grounds, we are very comfortable holding these assets at these elevated spreads, in spite of the volatility.

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

Current yield to maturity is undemanding on a risk adjusted basis, with current spreads providing in our opinion an approximate upper bound absent a significant deterioration in the market environment.

Our **RMBS** allocation reduced moderately to 28% over the month. There was an amount of switching with securities at an A and BBB rated attachment point sold, with proceeds allocated into AAA tranches. Our allocation has been run down by approximately 8% over the last couple of months, with our reweighting leading to a higher quality, shorter book within the RMBS allocation, this puts us in a position to take the market on our terms in 2016. Our view remains that supply out of regionals and non-banks will rise as the big 4 fall back at or below system growth, this additional supply underpins our view that the first half of 2016 will see spreads widen within this market, taking the sector from fair to attractive. Our portfolio positioning is based around this expectation and is anecdotally supported for the feel we are getting from market participants. As always, targeted levels and our decision to invest will be a function of deal quality, structure and of course price.

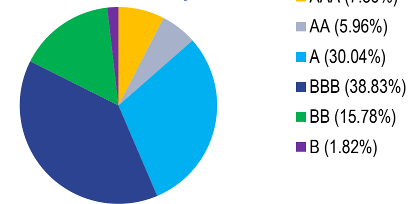
Portfolio insurance remained at an elevated level through the month with direct exchange traded and index puts engaged to provide a counter balance as equity markets plummeted. On a delta adjusted basis as much as 20% of our risk exposure was hedged in addition to a cash position of 15%, as at month end this position has been reduced. If the market re-tests previous month lows, put protection will be re-engaged to manage portfolio volatility.

Fund Outlook

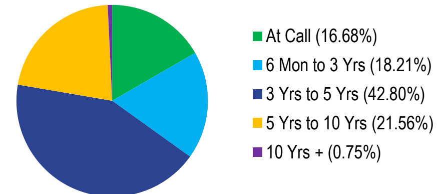
No real change to the narrative versus last month. A myriad of concerns drove Australia's benchmark CDS credit index more than 20 basis points wider, in the US investment grade markets widened by 20 basis points while the US high yield index finds its benchmark spread 50 basis points higher than where it started the year. All in all; a January out of the absolute box as plummeting oil prices set off a cascade of concerns around global economic growth, with China at the epicenter of concern. As the market lurched towards its lows the feeling of market anxiety was palpable, however equally it became clear that finding the momentum to drive the market lower started to wane. Positioning and leverage within risk markets indicates that prevailing risks are being accounted for. All parts of the credit market are now actively pricing a meaningful deterioration in asset quality, in many ways racing ahead of the market and assuming a slide towards a global recession. This view presupposes that central banks and governments have done all they can do and indeed the current tool kit is and will continue to be in-effective. While it is fair to suggest that the process of asset purchase, debt sterilization and interest rate manipulation by global central banks has failed to return us to a pre-GFC nirvana it has been effective in staving off any loss in systemic confidence. Indeed the BOJ's move to run into negative penalty rates into month end is a clear sign that central banks will continue to read off the existing playbook in dealing with this crisis.

The key concern for markets is seemingly China, indeed many market watchers are starting to reflect on the ability of the Chinese to absorb the excesses of their rampant investment binge in 2008 without endangering their own economy and the global financial system. This is based on a view around Chinese Bank asset quality and the wherewithal of the state to credibly provide a buffer. In our opinion, there is no question that Chinese asset quality is facing some significant challenges, however we expect the Chinese central bank to do what it has done in the past and absorb the consequences of state sponsored mal-investment. This will see Chinese debt levels end up in line with developed markets. That said, Chinese economic momentum remains unquestionably weak by historic standards, with the line between soft landing and hard landing rather blurry. Capital expenditure and manufacturing has slowed significantly, this is reflected across a number of markets, however ultimately as long as the People's Bank can manage this transition and preserve the systemic integrity of the Chinese banking system life will go on. This remains our base case and leads us to seek to invest within risk market at spread levels which have run ahead of the narrative. Stress levels are likely to remain higher in the short term which drives our focus on the fundamentals of issuers and the composition of the portfolio. In short, we anticipate that volatility will remain higher, however equally the portfolio is full of the highest quality Australian names at levels that would see us meet our objective taking even a passive approach.

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)
- 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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