Realm High Income Fund

July 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	0.30%	0.34%	0.13%
3 Month	0.90%	1.02%	0.38%
6 Months	1.94%	2.16%	0.74%
1 Year	5.00%	5.45%	1.50%
2 Years p.a	4.67%	5.13%	1.72%
3 Years p.a	4.24%	4.71%	1.92%
4 Years p.a	5.19%	N/A	2.07%
Since Inception p.a*	5.70%	5.44%	2.23%

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	3.56%
Volatility†	0.50%
Interest rate duration	0.43
Credit duration	1.65
Average Credit Rating	A
Number of positions	134
Average position exposure	0.61%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio†	3.19
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

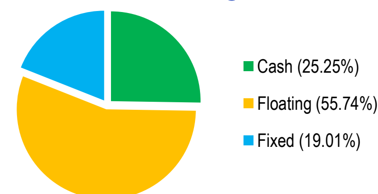
Our **cash and short term liquidity weighting** increased to approximately 50% at month end. There were wholesale reductions in risk, with RMBS (down 4%) and AT1 (down approx. 2%) all being reduced. Market remains particularly well bid which has driven a further decline in aggregate market exposure. Within the cash allocation we are holding a number of senior corporate bank names (12 months and less) and are also holding a number of AAA RMBS lines that are particularly short (less than 12 months). This is protecting running yield while allowing the portfolio to maintain its defensive market posture.

The fund is maintaining an **interest rate duration** position of approximately 0.4 years into month end, with our technical overlay moving the position between 0.3 and 0.5 of a year. Rates markets range traded and were largely unchanged over the month, with the exception of some volatility at the short end of the Aussie curve as RBA minutes stated that a neutral policy setting for rates sits at 3.5%, RBA deputy Guy Debelle straightened everything out later the same week, however the intermittent volatility did move the 3 year rate closer to 2.1%, this is materially high than the 1.65% level that the Aussie 3 year hit in early June. The story around Fed balance sheet reduction, ECB tapering and Fed rate rises are all well understood, however geopolitics and softer US data is providing a counter balance. Rates remain poised to break out, the question is whether a geopolitical event sends them lower before a central bank does something to send them higher. Our fair level continues to sit 20 to 30 basis points wider than current levels at the long end, however given prevailing risks maintaining a small allocation continues to make sense.

Our **corporate** and **subordinated debt** allocation ended the month close to 24%. We traded out our Australian 5 year senior bank exposure as well as our holdings within Telstra in addition to reducing our exposure to a couple of names around the BBB/BB attachment point. All in all the better part of 8% of the portfolio was traded out and replaced with shorter paper. The corporate market remains very aggressively bid. Generally speaking banks are struggling to fill the trading cupboard and issuance remains particularly soft. In this environment we have remained active, ringing what we can out of the corporate book and replenishing opportunistically as stock becomes available. The book continues to improve in credit quality and to reduce in duration. In terms of value, ECB/BOJ credit buying continues to push money to reach for yield all over the world. We are seeing continued strong interest for all credit product out of Europe and Japan. The market is being distorted by this liquidity, if this bid were to dissipate you could have a very different environment take hold very quickly. The market is underestimating liquidity risk at present on our numbers, with investors happy to take credit carry in size to maintain returns. This is an asymmetric game which will have consequences at some stage.

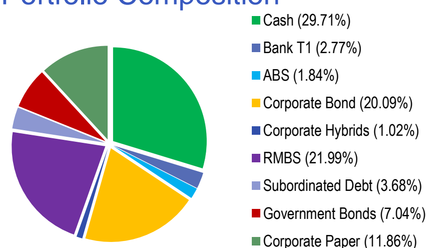
At the time of writing our **AT1** exposure decreased again to approximately 2.77% at month end. The commentary around unquestionably strong was on balance positive for the sector, given that these instruments will now enjoy greater subordination and are likely to be notched back into investment grade territory. APRA have delayed their final statement around total capital, however at this stage it would seem likely that any increase in AT1 is only likely to be proportional to the increase in total capital. All of that said the nature of the security and how it behaves in times of increased market volatility has not changed. Very simply the assets bare a great similarity to low exercise price options. They are vulnerable to periods of increased and more specifically rising volatility and of course the illiquidity that is inherent in these markets. Happy buyer at a price, however most of the curve isn't providing enough meat here. Happy to be opportunistic on a name specific basis, however not enough there to justify a more meaningful increase to the allocation.

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

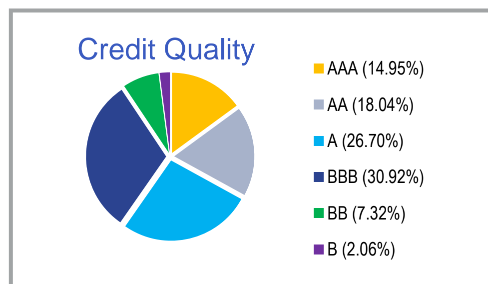


Sector limits

	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%

We remained particularly active within our **RMBS** allocation over the month. While the exposure reduced, this was largely due to a good portion of the book being switched into AAA RMBS with less than 6 months to mature. The funding came from longer dated A rated instruments. Structured credit remains well supported with issuance on track to eclipse recent records, strong buying in primary from Japanese and European accounts combined with the re-entry into secondary RMBS trading (both Senior and mezzanine) of large Japanese and European banks is having a genuine impact. Secondary activity has improved out of sight and is likely to continue to support the relative performance of structured credit in the shorter term. The attractiveness of this asset class in yield terms vs unsecured debt, combined with an improvement in liquidity has led us to allocate the majority of our market risk budget to the sector.

Credit Quality



Fund Outlook

Itraxx tightened significantly over the month, tearing in by almost 8 basis points to be sitting at 0.75%. Bank names are particularly tighter. Synthetic markets are particularly well supported, the absence of cash issuance might be driving a good portion of this overflow to use sold CDS to maintain market exposure. At any rate, it was a very strong month, made more noteworthy by how tight CDS was trading already. Higher beta credit also continued its grind tighter with EM moving sub 2%, while US HY looks to break below 3%.

The crunch tighter in cash credit continued un-abated, with corporate credit well bid and market inventories running particularly low. A shortage of primary issuance has exacerbated this further, as the syndicate loan market coupled with general corporate balance sheet conservatism continues to drive a reduction in general supply. With credit continuing to crunch tighter investors are becoming more reliant on credit market performance for their return. The root of this environment remains central bank meddling, with the ECB's corporate bond buying program adding 6 billion of demand for corporate credit a month and the BoJ remaining an active buyer of credit and many other risk assets for that matter.

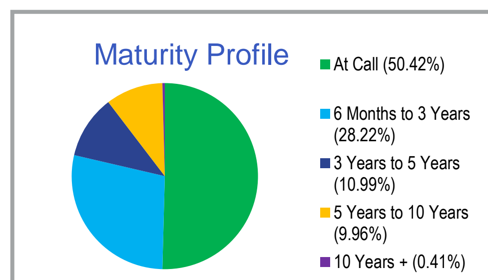
These markets are driven by the centrifugal force of central bank intervention and this has now unequivocally hit our shores, this has been particularly evident in the RMBS markets where we have seen the re-entry of a number of large American, European and Japanese banks into the secondary market of mezzanine RMBS. This is changing the liquidity dynamics of this market significantly. This new demand has been met with record issuance in the sector, however spreads have continued to crunch tighter. Despite this there are still pockets of value. Our exposure has primarily focussed on AAA and AA rated assets with a maturity of approximately 3.5 years. In addition, we have continued to opportunistically invest in secondary markets. While this market has tightened it continues to present excellent value compared to unsecured markets and bank capital. At present RMBS is the biggest source of portfolio risk, granted that total portfolio risk has never been lower.

We continue to focus on our market making activities in certain markets to augment returns while remaining focussed on managing risk at a lower level. The fact remains that spreads cannot be justified on through the cycle fundamentals, central bank meddling has in this regard been particularly disruptive. Just as we believed that the introduction of the ECB bond buying program would be positive, we equally believe that it's withdrawal will have the opposite effect. It is very easy to sell assets at present and very often for a decent profit over marked levels, this can drive an increase in complacency.

Closer to home, APRA's unquestionably strong was a bit of a fizzer with announcements relating to concentration of mortgages, and comments around capital composition delayed to later in the year. What we do know is that CET1 of 10.5 percent will be enough to accommodate any changes to concentration, in the meantime this will also mean that there will only be a moderate commensurate relative increase in AT1, at the same time the discussion around TLAC has been pushed out further. The fallout of more capital is that AT1 ultimately gets bumped back into investment grade and investors enjoy a broader buffer (technically at least). The decision around concentration was soft and will clearly incentivise banks to do everything they can to change their loan mix towards lower LVR owner occupied P&I mortgages and away from business lending. Expect to see the likes of ANZ and NAB crack down on unused facilities and price corporate loans higher, and expect them to reallocate that capital to take share off the likes of CBA and WBC in mortgages. System loan composition for mortgages is at about 50 percent, for reference CBA is closer to 59 and ANZ/NAB sit in the low 40s.This might lead to house prices remaining supported even as general speculation subsides as IO and investor restrictions bite. The other change related to APRA being given open and ambiguous powers to deal with non-banks, clearly the intention will be that speculative loans do not get written in size by the non-bank sector, something which could be a greater concern now that the likes of KKR are about to enter our loan market. All of that said the fact remains, we are a heavily indebted society suffering from tepid growth, while the infrastructure revolution will drive investment and underpin the numbers in the short term, household balance sheets remain the real problem for use here in Aus longer term. That said our current environment seems stable enough and doesn't look like it will be the source of concern within the next 12 to 24 months.

The portfolio remains defensively positioned with targeted volatility sitting well below the funds historical average. This is consistent with the output of our top down metrics that speak to a market that remains complacent and also recognizes the fact that market prices are being very definitely distorted by central bank primacy. All in all we believe a passive bet on credit beta is rather asymmetric at current prices. We will continue to remain active within the book , the objective being to generate a return over and above the running yield for the benefit of unit holders while we remain cautiously positioned.

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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