Realm High Income Fund

June 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	0.28%	0.14%	0.14%	0.31%
3 Months	2.05%	0.46%	1.59%	2.16%
6 Months	2.45%	0.95%	1.50%	2.67%
1 Year	4.24%	1.97%	2.27%	4.71%
2 Years p.a	3.77%	2.16%	1.61%	4.25%
3 Years p.a	5.25%	2.28%	2.97%	N/A
Since Inception p.a*	5.83%	2.43%	3.40%	5.33%

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

Fund Statistics

Running Yield	4.88%
Volatility*	1.18%
Interest rate duration	0.05
Credit duration	3.23
Average Credit Rating	BBB+
Number of positions	77
Average position exposure	1.30%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio*	2.87
Information Ratio*	2.89

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

Fund Update

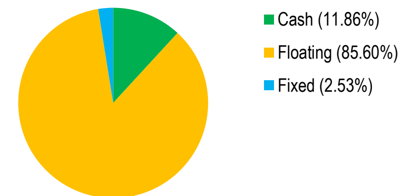
Our cash weight remained broadly in line with the prior month, ending at 12%. From a sectoral perspective, moderate changes coming in the form of an increase in Additional Tier 1 exposure and a moderate reduction in RMBS.

Our **fixed rate** exposure sits near enough to zero as at month end, with interest rate duration sitting 0.05 years long. Long rates performed strongly over the month as Brexit drove a significant rally in long bonds. Brexit created a flight for safety driven bid, post the event bonds have remained well bid as markets are seemingly forming a view that Brexit will likely put a stop to any Fed activity in the current year. We didn't hold any net rate exposure going into the decision preferring to use equity puts to portfolio protect. Where that leaves rates now though is an interesting question, on our numbers markets are implying growth levels well below prevailing nominal rates. Brexit seems to have exacerbated the disconnect between rates, which are rushing ahead to price in heavy deflationary market forces, and market data which while uninspiring are trending in line with historical nominal rates in most jurisdictions. On our numbers the spread to a fair rate level is significant, at approximately 40 to 50 basis points at the long end both here in Australian and the US.

Our **corporate bond** and subordinated debt allocation remained broadly in line with the prior month. We looked to actively increase our exposure to market risk on the back of Brexit, however the reality is that the credit market was largely unfazed by the event, with bank trading books and investors more inclined to hold on to assets. While Credit Default Swaps did show some real weakness (credit derivatives), this was not reflected within the cash markets. For credit investors, the challenge was to make a call around the systemic risk posed by Brexit while reconciling it against a continued reach for yield in a low rate environment in addition to considerations relating to the ECB's corporate bond buying program. Like the majority of our peers we preferred to simply ride the bump, with markets working normally and rallying to a little below pre-Brexit levels as at month end.

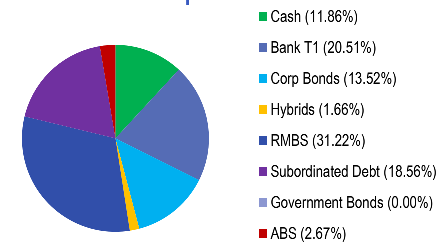
Our **Hybrid allocation** increased through the month, driven by investments into the new Tier 1 offering of Westpac, NAB and the ANZ USD Tier 1 issue, and by exposure to a handful of bank and non-bank names post Brexit as listed markets sold off. Over the month, we saw a number of long dated names push into trading margins of around 5.5% over bills. We took advantage by adding such names as CBAPD and WBCPE. We increased our corporate Hybrid exposure through the month with WOWHC (Woolworths Sub Debt) added and our position within CTXHA (Caltex Sub Debt) increased. We also took a position within CNGHA (Colonials Subordinated Debt), all of these securities have a term to call of less than one year. The month of June proved to be important with Westpac and NAB both launching on a heavily oversubscribed basis, at the same time ANZ launched the first foreign denominated tier 1 in the better part of half a decade with the deal being 18 times oversubscribed. ANZ's USD deal was also an eye opener as demand came in at multiples of transaction size. Indeed the total rate of 6.75% for 10 years could be considered expensive by Aussie retail terms, which might surprise many and makes a mockery of the notion some pundits and fund managers have put forward that the retail hybrids are expensive at or around current rates. In addition to ANZ's ability to issue offshore we will likely see the rollover of their own ANZPA security later in the year turn into a smaller transaction.

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: OMF0009AU-Wholesale
APIR Code: OMF0018AU- Adviser

Fund Update Continued

With a combination of foreign issuance, coupled with new institutional interest and lower rates in addition to a notable sea change among how investors compare and contrast the value of bank equity versus hybrids will in our view continue to provide a supportive environment for the sector at current prices. This dynamic is making the value of AT1 noticeable to many, not only versus other forms of credit but indeed in comparison to other traditional asset classes.

Our **RMBS allocation** reduced from 34% to approximately 31% over the month. This reduction was a function of assets paying down. Half of our RMBS exposure is rated AA or higher and is naturally reducing on a monthly basis which will provide a natural drag to our sector weighting over the months to come in the absence of replenishment. Our additions over the year to date have been overwhelmingly sourced through secondary markets and have almost been exclusively focused on the AAA market. We have seen a significant reduction in market supply with most regional banks viewing RMBS as a marginal proposition at best at or around current market levels, with BOQ, Suncorp and Bendigo Bank all preferring covered bond and unsecured markets to meet funding challenges. We do feel the highest rated RMBS tranches seem to present very good value, with AAA rated securities delivering spreads of between 130 and 150 over bills depending on the issuer. This is excellent compensation for these kinds of assets. If the status quo prevails you will continue to see our average credit quality increase within this sector.

Portfolio Insurance was increased going into Brexit with S&P 500 put options used to reduce market exposure. The notional value of protection approximated 2.6% of total fund assets, and on our correlation assumptions reduced market exposure by approximately 10%. Our view was and remains that a Brexit vote was likely to have an impact on the UK however, the potential for broader contagion was limited. In light of this and given our view that a Brexit impact was likely to have a temporary market impact, we decided to ride the bump so to speak with only a more moderate level of cover. Insurance added approximately 0.04%, while our credit portfolio was impacted by a negative movement of only 0.15% on the day. The portfolio performed largely as expected over the period, with the majority of the volatility driven by a selloff in the funds AT1 and AT2 holdings (eg the higher beta exposure).

Fund Outlook

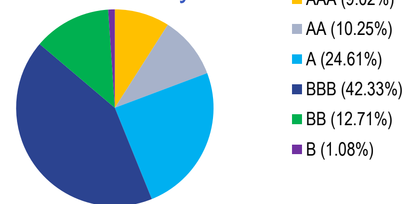
Credit markets ended the month in line with where they started as Brexit related volatility subsided into quarter end. ITRAXX did experience a high level of volatility with spreads widening by close to 20 basis points in the days immediately following Brexit, but by month end as Hedge positions were closed for profit and investors re-emerged we saw a sharp rally in risk. Outside of Brexit there is plenty going on which maintains a high level of relevance for fixed income and credit markets. The European Central Banks corporate credit buying has now commenced and it hasn't disappointed, with the ECB buying approximately 5 billion Euro worth of securities in the 3 weeks into month end, this remains a key driver of market performance at present

Here in Australia June was a busy month for AT1 investors, with 3 issuers launching and closing billion dollar plus deals. We used this supply to increase our exposure to this market, on the grounds that we believe supply will be muted in the shorter to medium term just as demand increases on the back of higher institutional participation, the launch of foreign currency securities and lower rates driving a reach for yield. This month saw this market widen, which was a function of Brexit and the bump in supply, however over the medium we expect this sector to be a solid return contributor.

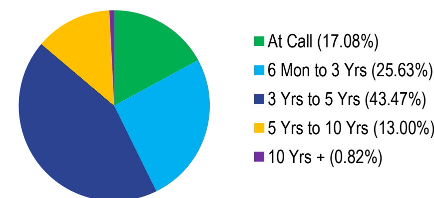
On rates, we think they are expensive at current levels, despite Brexit and quite separate of whether the Fed is done and dusted for 2016. We note the last BIS annual report which notes the increasing disconnect between rate markets and growth rates. This is consistent with our own stochastic modelling which speaks of the same disconnect between economic performance and what rates imply both in terms of the projected rate path and the probability of rates rising. Ultimately it's all a question of what's in the price from our perspective and in our opinion, the market has run ahead of itself. The sequence of events now leaves rates at levels that look as dear as they have been over the funds life. The impact of this at a fund level is that we are likely to maintain a very low weighting to government securities and fixed rates.

We remain comfortable with how the fund is positioned. Our focus remains on delivering on our return profile in the shorter to medium term. While we accept that there are a number of near term challenges, we believe that the support provided by the ECB through its bond buying program in addition to a reach for yield as rates decline will drive nearer term fund returns. Among our investable sectors AT1, Bank senior and A1 AAA rated RMBS seem to present the best relative value on our metrics. Investors need to remember that our process is dynamic and allocation will be adjusted in line with risk or price movements on an ongoing basis.

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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