Realm High Income Fund

June 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%	0.36%	0.12%
3 Month	0.82%	0.93%	0.37%
6 Months	1.98%	2.21%	0.74%
1 Year	5.43%	5.89%	1.52%
2 Years p.a	4.83%	5.30%	1.74%
3 Years p.a	4.32%	4.79%	1.95%
4 Years p.a	5.29%	N/A	2.09%
Since Inception p.a*	5.74%	5.47%	2.24%

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	3.76%
Volatility†	0.53%
Interest rate duration	0.40
Credit duration	2.03
Average Credit Rating	A
Number of positions	125
Average position exposure	0.65%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio†	3.19
Information Ratio†	3.23

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 below 32% at month end with a further 5% invested within cash like instruments. We saw a moderate reduction in our AT1 exposure which now sits below 5%, while our RMBS and corporate debt increasing modestly.

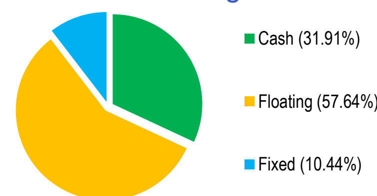
The fund is maintaining an **interest rate duration** position of approximately 0.4 years into month end, with our technical overlay moving the position between 0.3 and 0.5 of a year. Rates markets sold off into month end as the ECB, The Bank Of England and The Bank Of Canada all took a Hawkish tone. The market is now focused on a coordinated central bank retreat and its potential impact on interest rate markets. At the same time the month of June saw deterioration in US economic data, with US economic surprise indices and data more generally continuing to soften. The long end of the Australian curve now sits 0.20% from our fair value level. The rates market continues to be caught between two equally strong opposing forces, one is driven by a view that rate normalisation is very likely, this view is based on the belief that current rate levels are overly accommodative given that data in the US has returned to a trend level, at the same time there are those who point to the fact that US data is softening as enthusiasm relating to a Trump fiscal response fades, for this camp the belief is that growth will decline from current levels. Add to this continued concerns relating to China's debt load and it's fair to suggest both camps maintain valid arguments. As such it is no surprise that the market remains polarized, in this kind of environment the prospect of a break out is heightened and leads us to remain cautious in our positioning.

Our **corporate** and **subordinated debt** was increased moderately to approximately 20% over the month. We added weight to our short dated corporate debt, while also participating in NAB's new senior five year issue. Our focus within the allocation remains on shorter dated corporate debt and senior bank debt, with risk remaining low on balance within this allocation. We remain underweight bank subordinated debt. This is consistent with our top down market risk measures which continue to speak to market complacency remaining high.

Our **AT1** exposure decreased again over the month and now sits below 5% of total fund assets. After intra month weakness, we saw a recovery of prices into month end which we took advantage of to reduce total market exposure once again. We have recently downgraded our big 4 price to book assumptions to account for an expectation of slower asset growth, while also allowing for a deterioration in asset performance, this has increased our fair value yield targets for this market. From a qualitative perspective we continue to maintain a view that supply will increase from here. This combination of factors coupled with what has been an exceedingly strong period of price performance leaves us rather cautious on this sector. As things stand we feel risks within AT1 are weighted to the downside, indeed we feel the same can be said for bank equity also. Given the strong correlation of AT1 to bank equity in drawdowns we believe caution is warranted.

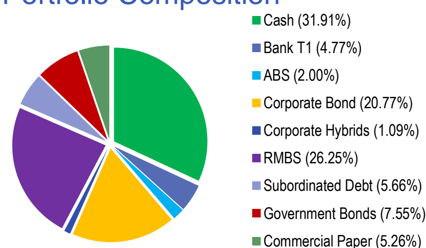
Our **RMBS** allocation increased by approximately 2% to 26.5%. We note that excluding short dated AAA securities our exposure is lower still, sitting at approximately 23% as at the end of June. The weighted average credit rating is at a high investment grade rating. New transactions continued un-abated through June as a collection of small regional banks and non-banks issued successfully into what remains a particularly well bid market. European and Japanese investors continue to provide solid demand for senior tranches which is likely to continue to encourage smaller players to issue while the going is good. For our part we believe that supply side consideration will lead this market to widen over the back half of the year. The imposition of the bank levy is likely to encourage the big 4 to increase full capital relief RMBS transactions which should increase supply within mezzanine RMBS materially. So far 2017 has only seen CBA come to market, however we would expect to see at least two out of the remaining three issue into year end. Given this markets sensitivity to excess supply we feel comfortable in continuing to run underweight versus our long term strategic benchmark. We expect that we will have the opportunity to invest in quality issuance at healthy spreads going into year-end which will justify our current defensive posture within this sector.

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: OMF0018AU- Adviser

Fund Outlook

ITRAXX Aus tightened over the month in line with US and European synthetic indices. Despite this we did see a widening in US High Yield and Emerging market CDS as weaker oil prices took their toll. These two markets remain particularly tight, however we are starting to see some early signs of option volatility creeping higher, this isn't enough for us to forecast an imminent reversal however it is a sign that this run seems to have pushed its natural limits and is beginning to exhaust itself, making the market more vulnerable to a correction.

Closer to home domestic bank equity consolidated at lower levels, while bank volatility also moderated after pushing higher through May, with the initial shock of the bank levy wearing off.

We also had Wayne Byres speak at the Productivity commission roundtable in June, and the transcript made for interesting reading. On the face of it, it seems likely that regulatory risk will persist, be it increased macro-prudential regulation, the need for additional capital or increased competition. The way Byres spoke to the softening of licensing requirements and the creation of an environment that can be more supportive of innovation is very interesting. Ultimately the biggest advantage the domestic banks have is their size, diversity and their depth in funding. Could this be the beginning of a concerted push to reduce this entrenched competitive advantage and what could this ultimately look like? We are speculating of course, however the situation is uncertain and does not seem to favor the status quo. In addition, the question of what APRA will do to bolster the system remains outstanding (but not for long). It is expected that an imminent release will give color on direction and intent around bank capital, we expect to see an increase in capital requirements for mortgages and mortgage concentration, in addition to an increase in supply in bank debt and capital instruments such as additional tier 1 and tier 2 debt.

In other regulatory news we saw the State government of South Australia engage in a ham fisted approach to fiscal repair through the imposition of a bank tax, the banks in turn have responded with the reduction of a small amount of the State's debt (this was done for headlines more than anything). That said it seems consensus in the business community and even in the South Australian electorate is that this is just a bad idea, meaning that treasurer Koutsandonis and Premier Wetherall have miscalculated the populist anti bank fervor. A sad day indeed for the state that brought us Farmers Union Iced Coffee, West End Bitter, bad Mitsubishi cars and worst of all: Port Adelaide supporters. The banks have enough problems without needing to worry about B grade State politicians taking a Ned Kelly approach to State fiscal repair.

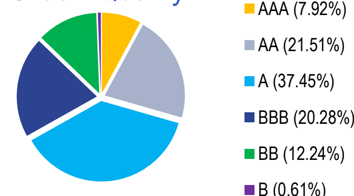
Moving on to the rest of the world, the big news is the central bank narrative shift. Out of Europe the feeling is that language changes now speak to a plan to reduce QE and potential normalize rates as inflation recovers. The ECB bond buying program has been a real driver of credit markets, the loss or reduction of this accommodation could have a material impact. Meanwhile the Canadian central bank suggested that a rate rise is on the cards, while in Great Britain, Carney spoke to the debate around rates heating up. This is in addition to the impending reversal of US QE through balance sheet reduction and the potential for more rate rises. This change turned the rates market on its head, leading to the long end of the government bond curve selling off materially over the back end of the month. That said, risk markets remained benign.

On to the macro environment now, our top down score moderated ever so slightly as US weakness was offset by an improvement in Asia Pac data, while European numbers remained solid. On the US data, employment measures seemed to lose some momentum and retail weakened further. The numbers hardly make for dire reading, however there is very certainly a loss of some momentum. As we stated in the rates section of this flyer, this has lead to a real polarization in rates markets, between those that are betting big on normalisation and those backing the idea that deflation is entrenched because of unsustainable debt and the structural impact of technology on inflation and employment. One thing is for sure, if one side capitulates it could lead to a significant move which could create its own problems, especially if that move leads to yields climbing higher.

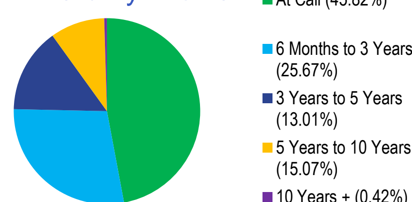
In regulatory news, we saw the Spanish knock over Banco Popolare, selling the book to Santander for 1 euro and bailing in Tier 1 and Tier 2 capital holders at the same time. Later in the month, the Italians also rolled two Venetian Banks, but went about effectively bailing everyone out through providing the acquirer with a big blank check to take on the problem. So what did we learn? I would argue what we already knew, that if your systems are weak and you cannot protect it, others will make the rules for you, which is why we have seen senior bond holders wiped out in Portugal, depositors shot in Cyprus and banks accounts frozen in Greece, and AT1/T2 instruments wiped out in Spain. Technically it was interesting to see Tier 2 and Tier 1 both get wiped out together but you need to be careful extrapolating the European experience and applying it to an Australian scenario.

To the portfolio now, our current portfolio risk level remains as low as it has been in the life of the portfolio. We feel this is justified by the general level of complacency in global markets, in addition we feel that Australian regulatory risk around bank capital is being underestimated as can be seen in the pricing of AT1/ T2 and even RMBS. We feel the opportunity cost of being under-invested is low right now and we believe that regulatory conditions, market events or both will give us the opportunity to replenish our risk reserves at more generous spreads than are currently available.

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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