Realm High Income Fund

March 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	0.48%	0.53%	0.13%
3 Month	1.14%	1.25%	0.37%
6 Months	2.74%	2.97%	0.75%
1 Year	6.70%	7.17%	1.61%
2 Years p.a	4.38%	4.85%	1.82%
3 Years p.a	4.79%	5.27%	2.03%
4 Years p.a	5.66%	N/A	2.18%
Since Inception p.a*	5.87%	5.59%	2.28%

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	3.96%
Volatility†	0.83%
Interest rate duration	0.51
Credit duration	2.14
Average Credit Rating	A-
Number of positions	111
Average position exposure	0.73%
Worst Month*	-0.47%
Best Month*	1.22%
Sharpe ratio†	3.21
Information Ratio†	3.25

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 22% at month end, in addition short term liquidity sits at close to 8.00%. There were moderate increases in the bank AT1 allocation, ABS and corporate debt which saw cash reduce by approximately 4.34%.

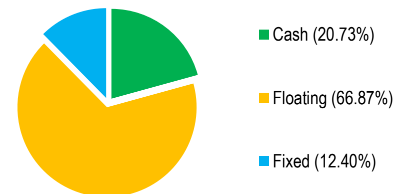
The fund is maintaining an **interest rate duration** position of approximately 0.5 years into month end, with our technical overlay moving the position between 0.5 and 0.7 of a year. Rates round tripped, ending March where they started, that said the range was significant and highlights the discount to the Trump reflation trade. The realisation that factional politics within the Republican party will provide anything but smooth sailing for the administration certainly seemed to knock the wind out of bond shorts. This comes at a time that the momentum in US economic surprise indices is particularly strong, underpinned by sentiment indicators, employment, housing, credit growth and retail in that order. Globally measures are also healthy, with European data momentum particularly noteworthy. Here in Australia data tailed off into month end, with key measures around wages and investment remaining soft and employment monitors also now weakening, complicating the matter however is a red-hot property market which has likely taken away the RBA's ability to cut further. All in all, our monitors are now indicating that long bonds are now once again beginning to look expensive. The market response to the Trump healthcare failure wasn't a surprise however our view was that the curve had already heavily discounted the prospect of rate normalisation. Our belief is that the market is not buying the prospect of two further rate hikes in the current year. Indeed the intra month performance of rates almost speaks to an expectation that the data is likely peaking. In our view it is too early to say, clearly the composition of data strength has been weighted to softer indicators (such as confidence measures), however the momentum still looks solid to us and will lead us to reducing our net rate exposure should yields continue to move lower from here.

Our **corporate** and **subordinated debt** allocation reduced moderately over the month. We sold the bulk of our 5 year bank senior unsecured debt as benchmark 5 year paper tightened below .90% over bills. We did increase our exposure to IAG's subordinated debt which has 2 years to call, in addition the NABPE commenced trading on the ASX at a premium, we have made a modest reduction to this holding. In the corporate Hybrid space we reduced our holding in the subordinated debt of QUBE by 2/3rds, while modestly increasing our exposure to Peet Group's senior subordinated listed issue. Outside of that we took a position of a little under 1.5% in the senior debt of Tattersalls, the note has two years to run, and was purchased at approximately 1.3% above bills a level that we identify as being close to fair. At the same time our holdings of NABHB and CNGHA matured, which lead to the broad allocation remaining in line with the previous month. Positioning within this sub-sector did lengthen however as short names were rolled into new issues or securities with a term to call of approximately 2 years.

Our **AT1** exposure increased over the month, by approximately 1.5%. This primarily came in the form of our decision to participate in the new issue of Suncorp and our commitment to CBA's new CBAPE deal, at the same time we sold off some minority holdings in ANZPF and reduced our exposure to ANZPG. Over the month Suncorp's AT1 issue also received healthy support, and continued the trend of deals being significantly over subscribed. The supply/demand dynamic remains supportive and the market continues to provide a very healthy pick up versus other unsecured liabilities. At current levels we are happy enough to maintain our current allocation, however where new deals provide a premium on current market levels we are likely to remain engaged, equally further strength from current level will see us reduce our net exposure.

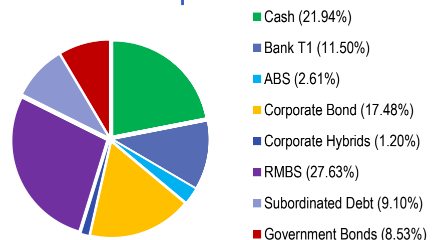
Our **RMBS** allocation remained in line over the month with turnover of approximately 10% of the portfolio. We participated between the AAA to A rated attachment point in new transactions while selling off a portion of our BB rated non-bank exposure. This continues the trend of us increasing general credit quality of the portfolio. The demand in this market has been as strong as it has been in the life of the fund, foreign investors out of Japan and large funds have a strong appetite and has seen this sector outperform going into month end. At the same time concern relating to the kind of risk the system is originating is clearly elevated right now, this is fair to a point. We will touch on APRA's changes in the fund outlook, however in the near term our monitors are leading us to increase our risk and loss assumptions for the sector. We will continue to assess opportunities on their merits, however our expectation around compensation and loan composition has become more demanding.

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

Australian credit CDS indices rallied again over the month, with the credit spreads of Australian bank 5 year paper trading tighter in sympathy, higher beta indices such as US High Yield and EM found a level however, and remained in line with February end levels. On the whole credit remains well bid, of particular note was the performance of the RMBS market which benefitted from a positive revaluation into month end.

Last month we spoke of the fact that our systemic monitors that measure Australian household risk were rising again, while APRA and ASIC had spoken to a heightened risk environment we did see their concerns manifest themselves into specific action as APRA looked to reduce the limits for interest only loans and how banks manage their non-bank warehouse relationships. This speaks to concern around the income buffer that many households have. At the same time the discussion around household cost assumptions in the mortgage approval process also came to the fore. We believe that these changes will likely have an impact, by acting to alter the economics of the interest only property carry trade, while also making sure that non-banks don't simply write the risk that banks refuse to. The market is split around whether these changes go far enough, however it is our opinion that it will dampen the strength in investor lending and likely see the change in collateral prices in key Victorian and NSW markets moderate. Add to this across the board out of cycle rate rises for all loans and it becomes clear that the regulator is directing institutions to do whatever they can to cool the market down. All of this will likely allow the RBA to stay put, unless of course the changes fail to drive any meaningful change in behavior in which case a hike in the cash rate cannot be ruled out.

In our modelling our concern is that potential losses on collateral prices could be higher than what the ratings based approach or historical experience speaks to in the event that system health deteriorates, this in turn leads us to take a more conservative approach in modelling within our RMBS allocation, but also impacts our fair value levels for other forms of system risk capital such as bank AT1 capital.

While we are not concerned to the point of looking to meaningfully reduce our Australian system risk exposure, we are monitoring developments very closely.

To global regulation now, and the trend away from tightening reg's continues. This time the loosening of the expectation around potential loss provisions for banks. The sector has once again been given wiggle room to stretch out the recognition of non-performing assets in the event of a crisis, this could ultimately allow banks to steer clear of non-viability events in most scenarios, which could be viewed as a positive for contingent capital instruments (eg AT1 and T2).

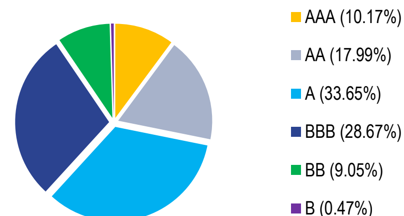
Out of the US the big news related to Trumps failure to repeal Obamacare, which seemingly jeopardises his tax plan, and as such the markets great hope behind the broader reflation trade. At the same time, US and global data continued to improve, bonds however are not buying it and if anything are speaking to a decline in economic indicators moving forward, with bonds once again moving into expensive territory into month end.

As far as risk markets are concerned, the mood remains rather complacent, with equities and cash credit remaining well bid and volatility remaining rather benign. At the very least it seems the absence of any headline risks in the shorter to medium term are not giving risk markets any reason to soften.

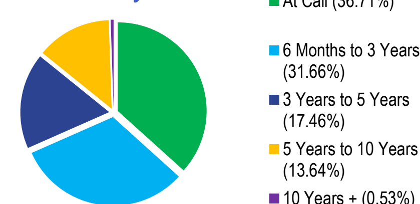
For our part, we believe current market risk levels imply a high level of complacency, this is driving our positioning to maintain a lower beta portfolio with a higher average weighted credit rating. While we did lengthen our exposure to certain markets over the month this was primarily to take advantage of new issuance premiums in the Tier 1 and Tier 2 market, rather than it being any kind of fundamental call.

As we have stated to many clients over the last couple of months our primary objective at this time is to protect portfolio value, however we continue to work hard to generate returns in all parts of our portfolio, with turnover in RMBS and corporate debt rising over the calendar year to date. At the same time we are well positioned to capitalize on volatility in credit markets as we maintain ample liquidity and headroom to add risk if market value justifies it.

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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