Realm High Income Fund

May 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	0.28%	0.32%	0.13%
3 Month	1.01%	1.11%	0.38%
6 Months	2.21%	2.43%	0.75%
1 Year	5.39%	5.84%	1.54%
2 Years p.a	4.42%	4.88%	1.76%
3 Years p.a	4.45%	4.91%	1.98%
4 Years p.a	5.35%	N/A	2.12%
Since Inception p.a*	5.77%	5.50%	2.25%

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	3.72%
Volatility†	0.53%
Interest rate duration	0.41
Credit duration	1.82
Average Credit Rating	A-
Number of positions	120
Average position exposure	0.66%
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 above 33.48% at month end. The reduction was broad based across the portfolio. Targeted portfolio risk remains at or around 0.83% going into month end, which is low by our historic standards.

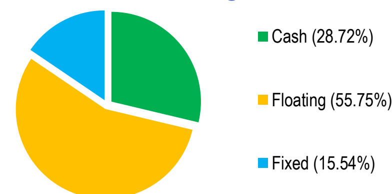
The fund is maintaining an **interest rate duration** position of approximately 0.4 years into month end, with our technical overlay moving the position between 0.3 and 0.5 of a year. Rates continued to grind tighter over the month as dovish rhetoric out of the ECB combined with softer US data has given heart to bond bulls. In our estimation, there are certainly signs that parts of the US economy are rolling over, most notably the softer measures, that said our monitors are showing rates as entering expensive territory, using current nominal growth assumptions. As is generally the case the bond market has moved ahead and is seemingly prognosticating a deterioration in economic conditions. We do not maintain a strong level of conviction either way. If the status quo prevails, rates are arguably too low at the long end of the curve, with the risk being that they sell off meaningfully from current levels. This of course pre-supposes an absence of any geopolitical events or continued deterioration of Chinese credit conditions.

Our **corporate** and **subordinated debt** portfolio reduced by approximately 3% over the month. A combination of maturities and a reduction in our financial subordinated debt allocation brought our total risk position to approximately 18.5%. Bank subordinated seems dear on our estimates, we also feel that there is potential for supply side disruptions to drive underperformance as APRA address the subject of unquestionably strong. In terms of the corporate market, not a lot of value there. The syndicated loan market continues to suck up supply the impact being a lack of general deal flow and when transactions do come to market they are generally very well bid. Outside of that the S&P ratings change pushed certain regional and small bank lines into sub investment grade territory while some regionals also dropped out of Repo eligibility, until the RBA shifted its criteria a week later. All in all the changes really didn't have a great deal of impact on the market. That said this is occurring in what remains a very well bid environment.

Our **AT1** exposure decreased again over the month and now sits at 6.2%. This is well below where our allocation to this market peaked (closer to 25% in quarter 1 2016) and speaks to our view that the market is sitting somewhere between fair and moderately dear on our fundamental screens. We feel that weakening bank equity could act to drive retail substitution in the short term and could be exacerbated even further if APRA elevate the importance of the leverage ratio or ratings based measures such as RAC in addressing unquestionably strong. Add to the fact that risk market continues to exhibit a higher level of general complacency and it all adds up to us being very comfortable minimizing our exposure to the highest beta sector within our investable universe. The S&P downgrade to the sector was another event over the month of May. Under S&P's methodology Australian major Bank AT1 now falls into the sub IG category into BB, which in turn increased our sub-investment grade allocation. While we don't think retail investors would have really been too perturbed by this change we do note that CBAPE / WBCPG and NABPD were all rated, we believe this was to accommodate institutional interest which arose as the AT1 market traded through 5% over bills. Will this impact the ability or willingness of insto's to support this market in the future? It's hard to tell, however it's fair to say it probably won't help.

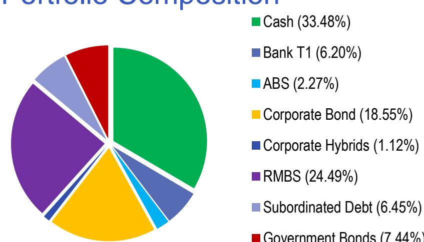
Our **RMBS** allocation reduced by a further 2% to 24.5%. We note that excluding short dated AAA securities our exposure is lower still, sitting at approximately 20% as at the end of May. The weighted average credit rating is at a high investment grade rating. May was a very big month for flow. With multiple issuers getting deals away into a well bid market. Most notable among them was CBA which announced a capital relief transaction of approximately $2bil. Capital relief RMBS are transactions where the issuer sells all of the notes (both senior and mezzanine). Over the last 8 years Big 4 capital relief issuance has been rare, with most of the mezzanine RMBS supply coming from Regional banks and non-banks. We feel that this might be the beginning of a broader trend, especially if the bank levy motivates the banks to reduce total liabilities. The fear is that this could in turn crowd out smaller players who are heavily reliant on the securitization market. We are constructive on certain parts of this market, however equally we have been patient. We believe the flow that will allow us to build our allocation to benchmark is coming and what is more, it is likely coming out of the big 4 which we view as a real positive for the RMBS market and is likely to increase the attraction of this market to a broader base of investors.

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%

Realm Investment House
ABN 34 155 984 955
AFSL 421 336

Level 17
500 Collins St
Melbourne VIC 3000

admin@realminvestments.com.au
www.realminvestments.com.au
Tel: 03 9008 7290

APIR Code: OMF0001AU- Retail
APIR Code: OMF0009AU-Wholesale
APIR Code: OMF0018AU- Adviser

Fund Outlook

Aus ITRAXX widened moderately over the month, although the cash market remained well bid by investors. Our monitors continue to point to a market that could be described as complacent, with volatility indices continuing to grind lower just as global equity indices make new highs. The ECB's affirmation that QE will continue unabated, coupled with some softening in US confidence indicators is all markets needed to find another leg higher.

Closer to home we note the outperformance of the bond proxies, with a number of infra names making higher, highs. Rates and risk markets are once again pointing to economic data turning over, with the long end speaking to a lack of conviction relating to a second hike in the US. The market now runs on the back of a benign rate outlook, just as the prospect of the Trump fiscal effect dissipates. All in all we believe that market prices are not allowing a lot of room for error. The other concern relates to absolute market levels, which create the risk of a spike in volatility in the event of a sell off. On these grounds we continue to target a lower absolute level of volatility, with market beta reduced further through the month.

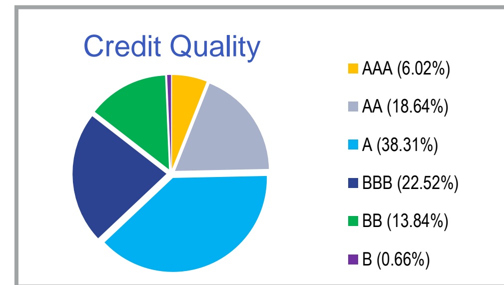
On the regulatory front we had the announcement of the Bank Levy which will hit the big 5 with a tax on liabilities, roughly equating to between 3-5% of earnings. Coupled with this were a range of powers to the ACCC and to APRA. In our estimation this is the bigger story. When combined with a liability levy and the recent restrictions around interest only and investor lending it's hard to see how the Big 4 don't grow below system over the next few years, as all things being equal the regionals should capitalize on this environment. Indeed, it would seem that the regionals and the Big 4 will now hold diverging agendas on how regulation affects their outlook. While the levy will likely be recouped, there seems to be a broader agenda here from government which may give rise to a new negative thematic for the Big 4 over the years to come. Unsurprisingly the response of equity has been negative. While this will not have an immediate impact on most parts of the credit complex, there is undoubtedly a high correlation between bank equity and AT1 securities in instances where bank equity weakness materially, the reason being that retail investors and their advisers will switch between the two in certain instances.

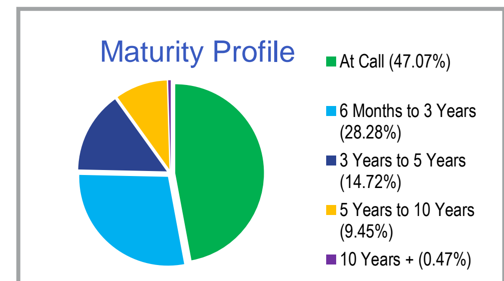
Following on from the budget we had S&P downgrade the Australian banking sector with all securities not benefitting from an implied capital guarantee impacted by one notch. These downgrades saw Australian Big 4 AT1 move into sub investment grade territory, while certain tier 2 names have also moved below BBB-, most notable among them being ME Bank. In addition, a number of smaller regionals slipped below the minimum repo rating, something which was addressed by the RBA, in the following week. While the impact seemed minimal, we believe this is contextual given how well bid credit markets are at present.

Moving on we now await the release of APRA's views around what will constitute "unquestionably strong", which has been articulated as an objective of Murray's Financial Services enquiry and has since been reiterated by Wayne Byres the head of APRA. The market is anticipating that the coming announcement will see an increase in mortgage risk weights to account for an environment in which risks are heightened. In addition, APRA have also pointed to the high level of concentration within mortgages. Additionally we note that APRA has also made comments that Australia must now push ahead with its own regulatory agenda, as the global regulatory effort becomes multi polar and disjointed. We expect that this will eventually lead to the creation of a tier 3 class of securities and may also lead to more issuance across the rest of bank capital structures. Equally we also believe that the imposition of the bank levy is also likely to energise RMBS capital issuance out of the big 4, meaning that we anticipate a rise in issuance in bank capital product.

With supply coming and market risk tightly priced, there isn't a lot of downside in running an underweight risk position. We maintain ample liquidity within the portfolio which will allow us to ramp risk up as excess supply drives spreads wider. If this coincides with a broader market correction, we could see some real weakness in a number of sub-sectors.

The nature of our approach is absolute in nature, as such we reduce volatility where risk compensation is low and increase risk exposure as compensation improves. This lead to us exploiting a disjointed environment through the first half of 2016 and equally is the reason why we are currently carrying less risk than at any point in the history of the fund. We believe we are well positioned given the current environment, the fund continues to deliver a competitive return while also being well positioned to take advantage of any weakness, if and when it occurs.





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

Realm Portfolio Managers

Andrew Papageorgiou
andrew.p@realminvestments.com.au

Rob Camilleri
rob.c@realminvestments.com.au

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