# Realm High Income Fund

Ordinary Class

October 2014

## Investment Objective

- Provide a Net Return of 3% over cash.
- Preserving the value of your investment.

## Net Performance

| Period | Net Return (incl franking) | RBA Cash Rate | Excess Return (incl franking) |
|---|---|---|---|
| 1 Month | 0.51% | 0.21% | 0.30% |
| 3 Months | 0.68% | 0.62% | 0.06% |
| 6 Months | 2.47% | 1.25% | 1.22% |
| 1 Year | 6.48% | 2.50% | 3.98% |
| 2 Years p.a | 7.18% | 2.67% | 4.51% |
| Since Inception p.a* | 7.47% | 2.70% | 4.77% |

*Since Inception 26 September 2012

## Fund Statistics

| | |
|---|---|
| Running Yield | 6.42% |
| Volatility* | 0.98% |
| Interest rate duration | 0.21 years |
| Credit duration | 3.24 years |
| Average Credit Rating | BBB+ |
| Number of positions | 41 |
| Average position exposure | 2.49% |
| Worst Month* | -0.11% |
| Best Month* | 1.12% |
| Sharpe ratio* | 4.83 |
| Information Ratio* | 4.83 |

*Since Inception 26 September 2012

## Fund Update

No major change to **Cash** weighting over the month.

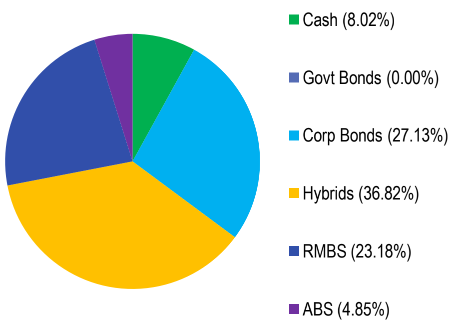
We continue to maintain a zero exposure to **Government Bonds**. October saw Government bond yields rally strongly driven by risk market uncertainty, Ebola concerns and a reduction in market inflation expectations. Australian 10 year yields roared in almost half a percent between the middle of September and the middle of October. Bond markets continue to price in an environment of benign growth and inflation despite market volatility largely dissipating which is reflective in the price. European outright asset purchases and an increase in Japanese QE can be expected to suppress yields globally. In simple terms the objective of the ECB and the BOJ will be to weaken their respective currencies, incentivising a meaningful re-engagement of the carry trade causing increasing demand for risk free assets in other currencies such as government bonds. The likelihood in the short term is that these asset purchases will continue to support risk free assets and keep long term yields lower. It is difficult to take a long view on bonds given prevailing fundamentals, however equally the flow will support prices in the short term. Given the dynamics at play, our involvement will continue to be close to neutral.

**Corporate Bond** allocation increased moderately over the month from 24% to 27%. We took advantage of the widening in spreads within the Tier 2 market adding Westpac, and CBA's new Tier 2 issue. The CBA issue drove a general widening in spreads and saw these tier 2 names meaningfully underperform the rest of the credit sector. While Credit indices ended the month flat, the big bank tier 2 sector ended the month around 10bp wider. The likelihood is that uncertainty relating to the new bank capital rules may restrain performance in the medium term.

**Hybrids** remain the key sector overweight within the portfolio, with the shorter dated Bank Tier 1 market currently presenting the best value within the credit and equity capital complex in our opinion. The fund is at its maximum tactical weighting for Tier 1's at 25%, with the total weighting to all sub-sectors sitting a little under 37%. Our view remains that these securities present very good value. This isn't to be confused with the much less probable condition of non-viability. Make no mistake, these securities are indeed complex and do present a greater risk to your capital than the generously priced natural person TD's. Equally though all risks have their price. The insinuation has been that investors play the fool in these structures, owing to their lack of sophistication. While there are certainly instances where the implied price of the insurance the investor sells to the system is cheap, now is not such a time. However, let's not be confused, optionality within these structures can be cheap at times and when those times occur they have a place in portfolios.

No real additions over the month, although we did add to our holdings within ORGHA, CNGHA and IAGPC. We largely avoided the carnage in new issuance with each of the CBA, Macquarie, Bendigo and Challenger Tier 1's giving up between $1 - $2.50. An allocation to Challengers CGFPA was our only exposure. Our Hybrid allocation was our biggest contributor to performance over the month.

## 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

## Fund Update Continued

Our exposure to **RMBS** reduced moderately to approximately 23% over the month. The current allocation is as low as it has been in the life of the fund. The end of October saw a flurry of issuance with Wide Bay, Bluestone and Resimac all coming to market. Prices have printed at levels that we would characterise as sharp. We expect proposed changes to S&P's rating methodology will provide headwinds to lower rated investment grade securities. Our decision to run down our allocation has been largely driven by the anticipation of this event. Our belief is that these changes will become evident in pricing at some point which will deliver us with an opportunity to move back towards our neutral strategic benchmark in RMBS over the coming quarters.

**ABS** weighting is just under 5%. High net interest margins, low rates and the amortising nature of the securities make them attractive. However, writing the volume which is necessary to drive increased securitisation remains a challenge in the short term for issuers.

**Insurance,** the fund maintained an active stance over the month. The fact that we were fully invested was the primary motivator in our decision to run an above average balance within our insurance book through October, at its peak the option P&L sat at 20 basis points of fund assets, consisting of bond options (10 year bond calls), currency options (Yen calls, AUD puts) and S&P 500 options (puts). The value of the insurance book was reduced moderately as risk markets stabilised. The book was brought back to a normal level after the release of the Euro bank stress test results.

## Fund Outlook

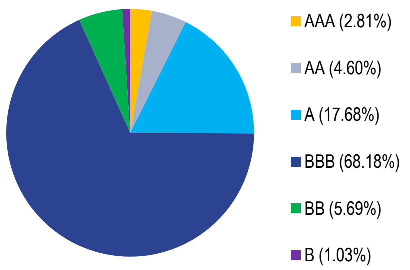
The last couple of months have allowed all of us to peer into what a market devoid of central bank support might look like. With US QE ending, Chinese rumours of stimulus falling flat and European asset purchases remaining opaque, the markets response was telling. With asset prices delivering their biggest sell-off of the year. It would be fair to suggest that the market lacks any fundamental belief in the ability of the global economy to propel markets sans monetization and accommodation. Equally, the global economy is in no shape to absorb a sharp deterioration in market confidence. This catch 22 remains the underlying driver of investor activity. While investors lack fundamental conviction, the view that central banks have no choice but to be "all in" seems to buttress market prices at a level. Indeed, end of the month saw accommodation stretched further with the Europeans using their balance sheet to engage in outright asset purchases. A much more potent response than their original TLTRO and perhaps the first real evidence that Draghi's "whatever it takes" statement may have teeth.

Meanwhile, Japanese faced with monetary accommodation that hasn't worked, upped the ante by increasing their plans for asset purchases, (or more of something that hasn't worked). This is counteracted to some degree by the end of the US QE program. However, we note that the voting membership of the Fed is skewed towards the doves, which increases the likelihood that the first rate rise is likely to occur in the second half of 2015 or perhaps even 2016.

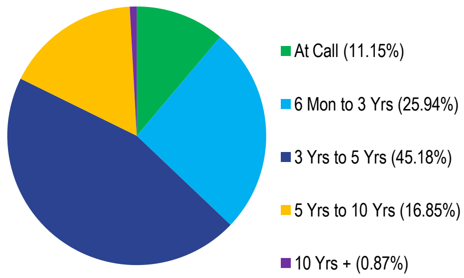
So the market enters November with everything in place to support strong performance within risk markets in the shorter term. Credit will also likely be a beneficiary of this dynamic as the compression of risk free rates, supported by increasing confidence and reducing volatility drives the all too familiar stretch for yield.

In terms of impending risks, as is always the case there is no shortage. Japan already wielding a bigger relative asset purchase program to GDP than any other nation on earth has failed, which poses some foreboding questions for 2015. Meanwhile, in Europe the question is whether what is being done is too little too late. In China, a slow property sector melt coupled with GDP limiting reforms will continue to press commodity prices. While in the US, the market still waits to see whether a strengthening labour market can make a difference on main street through wage growth and genuine corporate investment (both lacking up until now). However for now, our warning indicators are low. The fund is fully invested with the objective over the current quarter being the maximisation of unit-holder returns. Of course the dynamic mandate of the fund allows us to change posture at any time to reflect any deterioration in conditions or rising concern.

## Credit Quality




## Term Sheet




## Fund details

- Distribution frequency: Quarterly
- Liquidity: Weekly
- Minimum application: $25,000
- Management fee: 1.20% (incl. GST)
- RE: One Managed Investment Funds LTD
- Custodian: JP Morgan
- Unit Pricing: www.oneinvestments.com.au/Realm

## Platform Availability

- Powerwrap
- IAS
- UBS
- Credit Suisse (HSBC)
- CFS FirstWrap (Private Label)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