Realm High Income Fund

October 2015

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	0.81%	0.17%	0.64%	0.85%
3 Months	0.75%	0.50%	0.25%	0.86%
6 Months	1.11%	1.01%	0.10%	1.35%
1 Year	3.45%	2.19%	1.26%	3.92%
2 Years p.a	4.97%	2.35%	2.62%	5.45%
3 Years p.a	6.16%	2.51%	3.65%	N/A
Since Inception p.a*	6.16%	2.54%	3.62%	5.51%

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

Fund Statistics

Running Yield	5.45%
Volatility*	1.12%
Interest rate duration	0.06 years
Credit duration	4.22 years
Average Credit Rating	BBB+
Number of positions	75
Average position exposure	1.33%
Worst Month*	-0.47%
Best Month*	1.12%
Sharpe ratio*	3.21
Information Ratio*	3.23

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

Fund Update

Our **Cash** weighting reduced to approximately 8% over the month. The reduction was due to an increase in our corporate bond allocation. This was primarily due to our participation in the BHP Subordinated debt issue as well as the senior unsecured debt of Westpac, NAB, Bank of Queensland and Macquarie Bank.

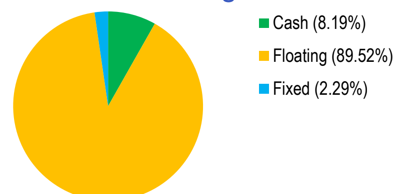
Government Bonds sat at a little over 0.5% over the month, with the fund maintaining a small trading position through October. The environment remains supportive to rates, with economic weakness combined with market volatility increasing fears of a deflationary spiral, countering that is the anticipation of the US Fed belatedly lifting rates. In our view, long bonds are still overvalued as at end October. Absent a meaningful sell off in rates, the portfolio will maintain interest rate duration of less than half a year.

Our **Corporate Bond** allocation increased by 7.5% over the month, driven by our participation in the new BHP US dollar sub debt issue (2%), as well as our decision to invest in the backlog of bank senior deals (5.5%). The increase in our exposure to bank senior is tactical in nature, we believe that the market for 5 year big bank senior sits 1% under fair value, with current spreads more a reflection of the market finding a clearing level for the backlog of transactions. All in all both senior and tier 2 markets can now be characterized as fair to moderately cheap, despite the moderate recovery through the month. On that basis we have increased the sub-sector towards our strategic benchmark. Our belief is that the sub sector will deliver a mark to market increase over and above yield to maturity in the shorter to medium term.

Our **Hybrid** allocation remains at 24% as at October month end. No changes over the month apart from our commitment to the new AMP tier 1. This transaction was interesting in that it was heavily oversubscribed (approximately 3 times), all things being equal we expect this issue could be the first in quite a while to open at a solid premium. This could also be reflection of what is the wide in spreads (and thus a low in prices). Over the month longer dated maturities outperformed, these names are well represented in the portfolio and saw the sub sector deliver an attribution of greater than 0.50% over the month. We note that we still view the sub sector as being undervalued and believe that our allocation will make a solid contribution to the total portfolio return over the medium term.

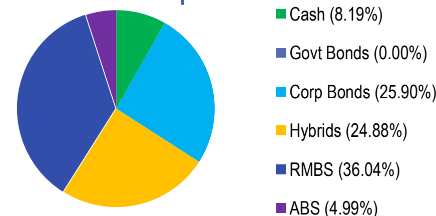
Our **RMBS** allocation reduced by approximately 2.5%. The portfolio is well positioned with an overweight to higher rated tranches of prime fully insured pools. Our focus going into year-end will be the release of APRA's policy statement 120, which is directed at the capital treatment of securitized assets, which encompasses RMBS. One of the anticipated changes is that APRA will apply skin in the game rules which is consistent with the European Central Bank. This rule could oblige issuers to retain 20% of mezzanine debt on their balance sheets. This is a hefty imposition and will effectively reduce primary mezzanine issuance out of APRA regulated ADI's by as much as 20%. In simple terms, this is a significant reduction in supply. Assuming this isn't replaced by additional issuance from alternative channels, which is not currently anticipated, we believe that primary spreads are likely to tighten to reflect this new demand/supply reality. If this materializes we believe that our allocation will deliver a return over and above running yield. This could materialize over the next six months.

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: OMF0001AU- Retail
APIR Code: OMF0009AU-Wholesale

Fund Update Continued

Our **ABS** allocation remained static over the month remaining at approximately 5%. The value proposition can vary meaningfully from deal to deal, meaning the assessment of risk especially for subordinated securities can be particularly complex. We will continue to move towards our strategic benchmark of 10% depending on issuance quality and margin.

Insurance and hedging, we reserve the right to act decisively and meaningfully when we feel that market risks are elevated. The negative attribution to insurance was moderate over the month. Our exposure was reduced as key risks subsided. Risk markets recovered materially over the month despite continued economic weakness. With cash and government bonds at a low level, investors can expect that insurance will be used in a more decisive fashion to deal with emerging risks. Equally as risk assets meet return targets investors can anticipate a reduction in risk and an increase in cash.

Fund Outlook

In our previous month we noted that the key question over the medium term would be whether central banks would remain active in the face of a rising deflationary tide. Fund positioning reflects our view that the ECB, BOJ, Fed and PBOC will remain focused on protecting systemic integrity at all cost. In the last month the PBOC reduced reserve requirements and rates just as the ECB expressed a view that more action might be required. Meanwhile the Fed continues to waver on their promise to normalize rates. All in all it could be characterized as a market supportive environment.

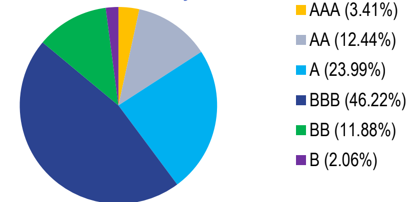
Contrasting this was a continued deterioration in economic data, with the US and core Europe both experiencing slippage. In the US manufacturing has stalled, which is starting to bleed in more broadly and can be expected to start to create labor market headwinds. In this kind of environment it is difficult to see the Fed raising rates meaningfully from current levels. In Europe we expect the ECB to ante up again as Germany slows and peripheral Europe struggles along in the face of necessary austerity. In the case of China our models point to nominal growth which sits closer to 5.5 to 6%. This is a number which would be the envy of any Western nation however it is not enough to offset developed world weakness, indeed manufacturing over capacity will see China export deflation which will further reduce the need for rates to rise. In the case of Japan data is ok, however inflation seems to be almost exclusively driven by higher import costs, which means the benefit would have dissipated in the next 6 months, which will in turn inevitably lead to the Bank of Japan increasing their unconventional policy response.

Slowly but surely the market is increasingly accepting the premise of lower nominal global economic growth for the foreseeable future. Rates are unlikely to meet terminal pre-crisis levels, indeed in such an environment one can expect weakness in private capital formation and tepid wage growth for the foreseeable future. In such an environment the focus will be on global governments to eventually discard fiscal prudence. Here in Australia we will not be exempt. If the US wavers and the rate path is gentler than anticipated the RBA may need to act more meaningfully to offset the collapse in private investment and wage growth. The Turnbull government has started in earnest by earmarking a cross section of necessary infrastructure projects to fill the growth hole, while APRA continues to do a reasonable job of controlling systemic risks with their macro prudential tool kit.

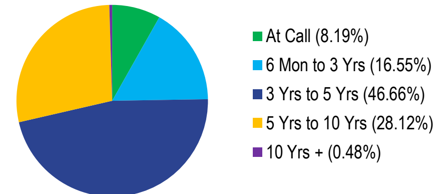
As things stand we expect a lower rate environment for longer, this will act to benefit credit and if anything intensify the reach for yield. Furthermore we believe central bank action will be largely accommodative over the next quarter or so, which will deliver further support for risk markets. Beyond that, significant imbalances remain, with the clear challenge being how to deliver inflation with an approach that has been ostensibly failing in places like Japan for almost three decades.

Given fund holdings and the current environment, we remain confident that we are well positioned to deliver on our return target over the medium term. That said we will equally act to reduce at risk exposure on strength as securities and sectors hit our target levels. The harvesting of profit is at the heart of the strategy, ultimately we expect that our activity will attribute a return over and above our yield to maturity through the cycle.

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)
- RE: One Managed Investment Funds Ltd
- Custodian: JP Morgan
- Unit Pricing: www.oneinvestments.com.au/Realm
- 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)

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