Realm High Income Fund

Ordinary Class

September 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	-0.11	0.20	-0.31
3 Months	0.71	0.62	0.09
6 Months	2.94	1.25	1.69
1 Year	6.53	2.50	4.03
2 Years	7.52	2.70	4.82
Since Inception p.a*	7.53	2.71	4.82

*Since Inception 26 September 2012

Fund Update

Cash balance reduced to 8.6% at month's end. Re-weighting primarily driven by a meaningful increase in the portfolios Hybrid Tier 1 exposure and further reduction in our RMBS allocation.

Maintain zero weighting to Government Bonds as at month end. However, we maintained an active view in the first half of September with rate positioning generated approximately 0.17% for the month. We maintained portfolio protection going into September in the belief that a substantial steepening in rates could potentially have negative ramifications for risk markets more generally. These positions were largely closed through to the middle of the month as the Australian 10 year bond rate surged to over 3.7%. Our models illustrate an expectation here in Australia that the economy will weaken by more than is currently foreseen by the majority of forecasters. While in the US, there doesn't seem to be a great deal of buy in around GDP rising to the consensus estimate of 3%yoy. As a consequence, the pay-off within bond markets seems asymmetric which continues to support our neutral to bearish posture in long bonds.

Corporate Bond allocation moderated further over the month ending at 24.25%. No changes on a name basis, with ANZ, ME and CBA remaining the primary sector exposures. We remain overweight to the subordinated debt sub-sector, which impacted performance negatively over the month. A broader widening in spreads reduced the positive contribution to the fund to only 5 basis points which reflects the widening in credit risk spreads. The Tier 2 sub-sector presents good relative value on our estimation versus senior bank paper as well as that of infrastructure, industrial and property debt securities. We maintain a fully hedged fixed rate corporate bond position and Put exposure to US 10 year rates. This position seeks to protect the credit portfolio from a potential fall out to risk assets driven by a steeper than anticipated rise long bond yields.

Hybrids exposure increased by approximately 29% over the month in line with a broader sell-off within the Tier 1 market. As at month end our valuation on a value for risk basis stood at mid-2012 levels. A number of factors conspired to drive the sell-off including generally weaker risk markets. However, the key driver seemed to be the scale of issuance over the month with the new CBA, Macquarie, Bendigo and Challenger deals driving switching out of existing securities. The disorderly nature of the sell down was also of interest with weakness peaking in line with the cut off for the settlement date of the new CBA issue. Our security value scores for Tier 1 securities increased markedly during the month, which drove our full allocation in Listed T1 exposure, with value particularly evident within the shorter part of the curve.

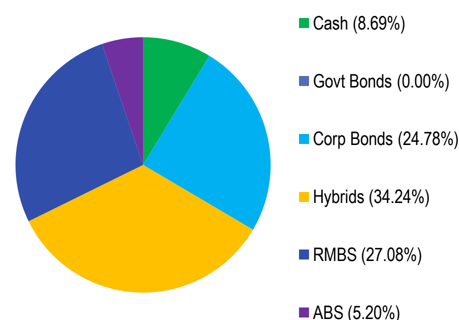
Names added over the period include NABPA, CBAPC, WBCPC, WBCPD, BENPD, BOQPD, SUNPC, ORGHA, IAGPC, CNGHA, WBCHB and ANZPA. Our view is that investors should limit term exposure and invest where compensation better reflects the inherent risks. Given price movement over the last month had little to do with the re-pricing of risks to the system or to a widening in fair compensation to credit, this essentially drove our increase in conviction.

Fund Statistics

Running Yield	6.77%
Volatility*	0.99%
Interest rate duration	0.16 years
Credit duration	3.25 years
Average Credit Rating	BBB+
Number of positions	39
Average position exposure	2.68%
Worst Month*	-0.11%
Best Month*	1.12%
Sharpe ratio*	4.84
Information Ratio*	4.88

*Since Inception 26 September 2012

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

RMBS exposure has decreased from 40 to 24% over the last 2 months. Furthermore, our sub-investment grade RMBS allocation was further reduced to 5.44% of the portfolio. A confluence of regulatory factors combined with extremely strong property market performance has driven an active review of our exposure. In addition, the strength in interest only lending and investor vs. owner occupier splits have also given rise to early concern in relation to property market speculation. Going forward, pool composition; the seasoning (age) of loans and the structure of transactions will be the primary considerations when seeking to invest. The ratings changes muted last month, combined with a FSI inquiry that is likely to drive the need for more capital should also drive a steady increase in issuance over the years to come. The decision to divest has primarily been driven by relative value and demand for our existing RMBS assets from third party investors which has presented the opportunity to lighten portfolio exposure.

ABS Fund weighting is just under 6%. 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.

Fund Outlook

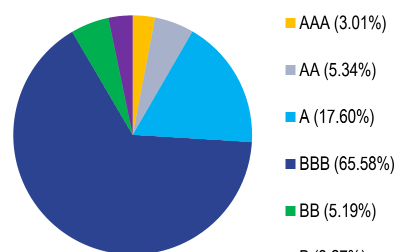
Strengthening US economy and the spectre of rising rates and a sell-off in bond markets remains one of the primary near term risks to markets. It has been our key narrative that US dollar strength could be a powerful risk off driver, impacting credit markets, bond markets, currencies and equities. In many ways, September acted to validate this view. Looking forward, the potential for rising bond yields to continue to play a disruptive role for risk markets remains our primary concern. Our stochastic monitoring points to a high level of conviction around a moderation in economic prospects and inflation both here in Australia and to some degree in the US. Putting it in context, a weakening outlook seems to be in the price, ably assisted by a weak European economy which is suppressing yields and lowering CPI expectations.

The idiosyncratic price movement within the listed hybrid market price movement in September was akin to a tail risk event highlighting the behavioural elements that drive pricing within the sector. Of particular interest was how the sell off peaked to the cut off for settlement within the CBA PERLS 7. Going forward, we expect that this event is likely to drive a reduction in speculation at the point of primary issuance and may drive a moderate widening in spreads of new issuance. However, existing securities that were sold in a largely indiscriminate manner means reversion is expected with specific names exhibiting strong performance over the coming months. Outside of that, we have maintained our Tier 2 OTC exposure. S&P's rating outcome was to leave the ratings of Australian T2 securities unchanged, in recognition of the lower risks of a bail in regime being applied here in Australia (unlike Europe and the US). To that end, we believe that our existing overweight in the Lower Tier 2 corporate bond sector will deliver outperformance in the shorter term.

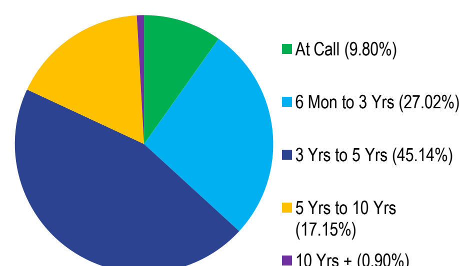
On RMBS, idiosyncratic risks are front of mind, with the regulator and rating agencies giving rise for concern around certain attachment points. In addition, it remains our view that there is a causal and fundamental relationship with Bank cost of capital and RMBS subordinated credit spreads. Add to this, increase in interest only and investor lending has motivated us to drive a further reduction in our net exposure.

Given the current level of market risk exposure, we have increased our allocation to cross asset hedges with risk protection being held against currencies, equity indices and rates. These positions would act to protect the portfolio from broader systematic market volatility. However, we are mindful that the first line of defence is always our dynamic asset allocation. To that end, deterioration in the relative value scores of sectors, or weakness in our top down macro scores, will see us reduce portfolio risk exposure. It is important to note that the fund maintains the mandate to exploit instances of mispricing when they occur and to be selectively opportunistic. On this basis, we believe that our decision to increase our risk weighting through a material increase in our listed hybrid allocation is entirely defensible and consistent with our stated approach to managing the portfolio.

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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