Realm High Income Fund

September 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	-0.14%	0.16%	-0.30%	-0.10%
3 Months	0.55%	0.50%	0.05%	0.66%
6 Months	0.53%	1.02%	-0.49%	0.75%
1 Year	3.14%	2.23%	0.91%	3.60%
2 Years p.a	4.83%	2.37%	2.46%	NA
3 Years p.a	6.07%	2.55%	3.52%	NA
Since Inception p.a*	6.05%	2.55%	3.50%	5.30%

*Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013

Fund Statistics

Running Yield	5.56%
Volatility*	1.12%
Interest rate duration	0.08 years
Credit duration	4.01 years
Average Credit Rating	BBB+
Number of positions	67
Average position exposure	1.49%
Worst Month*	-0.47%
Best Month*	1.12%
Sharpe ratio*	3.12
Information Ratio*	3.14

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

Fund Update

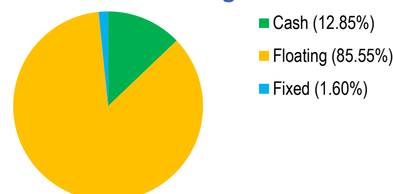
Our cash weighting reduced moderately to approximately 12.2%. The largest portion of new cash was allocated to two new RMBS deals originated by People's Choice and Liberty, with additional amounts allocated to the Hybrid and corporate market to maintain relative market exposures.

Our **Government Bond** exposure was little over half of 1% over the month. The fund maintained a small trading position as rates markets ended moderately tighter. 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. There are various extreme views expressed in relation to rates. Some go so far to call current long bond rates indicative of a bubble, while others point to near term deflationary risks that could see bonds well supported from here. In our view, fundamentally speaking long bonds could be characterized as being moderately overvalued.

Our **corporate bond** exposure reduced by approximately 1.5%. The fund invested within the Tier 2 debt of QBE and divested a portion of its holding within MyState's Tier 2 security at a profit. Mainline credit indices had a particularly difficult month, with broad based weakness across Senior Bank, Corporate, Tier 2 and high yield markets. The month could be characterized as eventful as market volatility was exacerbated by the Volkswagen debacle and a blow out in Glencore's CDS spreads. While equity markets have stabilized into month end credit markets remain circumspect. Australian major bank 5 year CDS increasing by .2% of a percent in a week, this roughly translates to a 1% loss on 5 year major bank senior debt in a very short period. The last time Aussie big bank 5 year CDS sat at these levels was in the midst of the taper tantrum. Credit market participants remain skittish and have not, participated in the late September or early October equity mini-rally. This is a function of the fact that Credit investors must take a longer term view, given considerations relating to liquidity and the finite pay off for a debt investor. This is not great news for corporates who will need to coax investors out with higher spreads and bond friendly corporate activity. Look no further than Origin for a cogent example, who sacrificed their equity holders at the credit market alter. All in all credit doesn't look expensive here, bank senior is fair to even moderately cheap now, while big bank and regional tier 2 sits at fair value (which isn't to say it can't or won't get cheap). We remain underweight the sector, however weakness from here will drive a re-assessment of portfolio positioning.

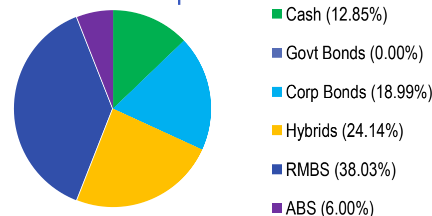
Our **Hybrid allocation** slipped moderately to 24% over the month. The Hybrid market continued to push into stiff headwinds with both equity and credit markets lower over the month. We added to various lines over the month, most of these purchases were conducted at spreads north of 500 over. As stated in the previous monthly the holding remains a tactical overweight position. While this allocation does act to increase fund volatility and has certainly impacted returns more recently, the securities continue to rate well on a risk/return perspective using our fundamental default probability framework. While other parts of the credit market have blown out to 2013, Taper Tantrum type levels, we note that the Australian Bank Tier 1 market is trading at GFC levels on a yield to call basis. The risk implied by current spreads, even after allowing for the recent spike in volatility sees these securities trade over 100 basis points wider than a conservative fair assessment.

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 **RMBS** allocation increased to 38%. This came through an investment in the primary issue of Liberty's SME Trust and a People's Choice RMBS prime pool. In the case of The Liberty Trust, the pool was made up of well-seasoned lower LVR loans to small to medium enterprises. The loans are collateralized by residential mortgages with a smaller proportion made up of commercial property. People's choice are a bi-annual originator, with a BBB+ unsecured corporate rating. While the domestic economy is weak and collateral prices have been strong, we note that interest expense is down to approximately 20% of average weekly earnings. This is as low as it's been in the last 20 years. We will continue to cherry pick and selectively invest on a deal by deal basis, given the merit of individual deals and market prices.

Our **ABS** allocation remained static at approximately 6%. As we have stated previously the structure of these securities deliver meaningful subordination further supported by large levels of excess trust income. The value proposition can vary meaningfully from deal to deal, meaning the assessment of risk especially for subordinated securities can be particularly complex. Our competence in assessing the sub sector equips us well to review risk and price accordingly.

On insurance and hedging, we have stated previously that we reserve the right to act decisively and meaningfully when we feel that market risks are elevated. The insurance book didn't make a positive contribution over the month, while markets weakened, relative positioning was targeted at counteracting a sell off that surpassed prior month lows. The recovery over the last couple of days of the month saw any hedging gain dissipate, however we note that the insurance book was positioned aggressively to benefit off the sell-off. While the fund remains heavily invested we will continue to deploy an above average sum towards protecting the portfolio.

Fund Outlook

Globally this month was really all about credit, with first Volkswagen and then Glencore driving an explosion in spreads that is yet to ebb. In the previous monthly we noted that equities had benefited well in an environment of central bank accommodation despite the absence of growth. This has indeed also been true for credit markets, which have seen a reach for yield in a low rate environment drive corporate spreads to record and ultimately unsustainable lows.

Failing global growth and higher debt levels have led some to speculate that we are seeing the dawn of a broad based solvency crisis. In essence those that hold this view are implying that the current chain of events will overwhelm firewalls and that central banks will largely shoulder arms.

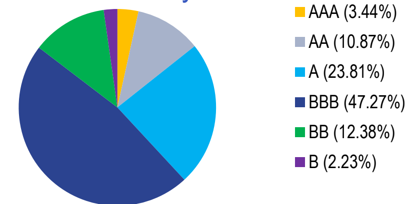
The specific question in the medium term is whether central banks will ante up again to stave off a deflationary spiral. While the US is sidelined for now, it is highly likely that Japan and Europe will do more in the medium term. In the case of the US, rates may rise, however it will be no surprise to see an act of forbearance in the student debt market (1 trillion of debt at last count) or perhaps even in a more unconventional form that acts to drop bags of cash on main street (think K-Rudd's cash for nothing 09 initiative).

Ultimately the world is still dealing with the imbalances of the GFC, in places like China the response to the crisis created enormous overcapacity which has sown the seeds of the current EM and commodity sell offs. We expect that there will very definitely be losers here, and we do not expect that all risk will simply mean revert to some long term average. Indeed for the likes of Brazil, Saudi Arabia, Russia and Turkey the cost could be significant if governments fail to re-adjust to weaker current and capital accounts.

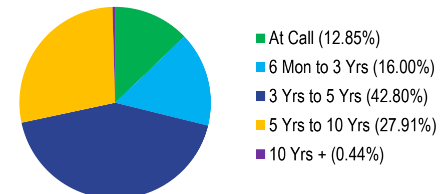
That said the global financial system which acts as the central nervous system, will be protected through a myriad of measures and counter measures. As such, we expect that Investment grade indices and financial sector indices will trend tighter as volatility gradually dissipates.

On those grounds we remain fully allocated to risk, we accept that this will (and has) come at the cost of higher volatility in the short term. However, the portfolio now carries a healthy running yield, spread across a cross section of sectors and securities. We will continue to pay up to protect the portfolio through our insurance portfolio given current fund positioning with the focus being the minimization of monthly draw downs, the higher carrying yield also acts as a first line of defense in this regard. Poor sentiment has allowed us to collect assets which position the fund well for the medium term.

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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