REALM HIGH INCOME FUND

SEPTEMBER 2023

REALM | INVESTMENT HOUSE

FUND OBJECTIVE

The Realm High Income Fund is a fixed income strategy, that invests in domestic investment grade asset backed securities, bank-issued securities and corporate & government bonds. The objective of the Fund is to deliver investors a consistent return (net of fees and gross of franking) of 3% over the RBA cash rate through a market cycle.

FUND DETAILS

Distribution Frequency: Monthly

Liquidity: Daily

Buy/Sell: 0.05% / 0.05%

Inception Date: 26.9.2012

Fund size: AUD $1.57 billion

Management Fees (Net of GST):
Ordinary Units - 1.1182% Wholesale Units - 0.7175% Adviser Units - 0.7175% mFunds Units – 0.7175%

Direct Minimum Investment:
Ordinary Units - $25,000 Wholesale Units - $1,000,000
Adviser Units - $25,000 mFund Units - $10,000

Zenith RECOMMENDED

NET PERFORMANCE

Period	Ordinary Units (incl. franking)	Wholesale Units (incl. franking)	RBA Cash Rate Return
1 Month	0.22%	0.26%	0.33%
3 Month	1.75%	1.86%	1.02%
6 Months	4.32%	4.55%	1.97%
1 Year	9.60%	10.03%	3.51%
3 Years	3.36%	3.80%	1.39%
5 Years	3.72%	4.16%	1.20%
10 Years p.a	4.17%	4.52%	1.56%
Since Inception p.a*	4.47%	4.52%	1.68%

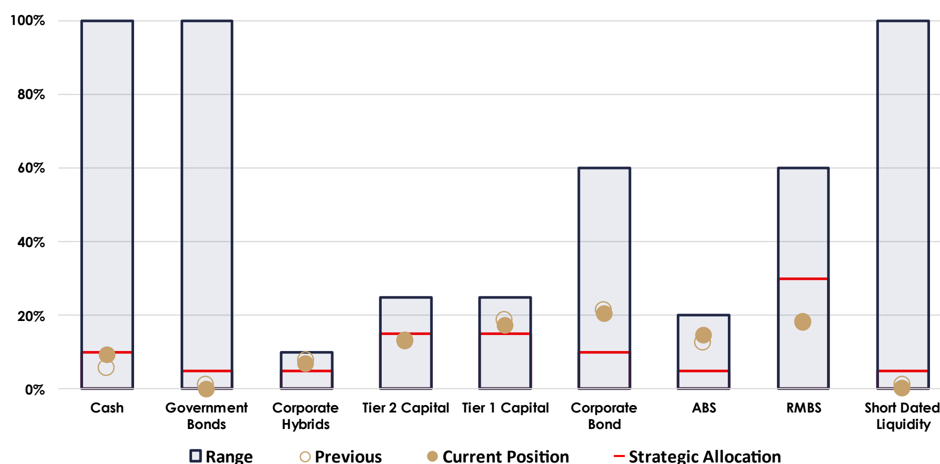
* Past performance is not indicative of future performance. *Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.

FUND STATISTICS

Running Yield	6.02%
Yield to Maturity	8.08%
Volatility†	2.90%
Interest rate duration	1.00
Credit duration	3.17
Average Credit Rating	BBB+
Number of positions	323
Average position exposure	0.14%
Worst Month*	-1.99%
Best Month*	2.09%
Sharpe ratio∂	1.98

Calculated on Ordinary Units unless otherwise stated. *Since Inception 26 September 2012.
†Trailing 12 Months Calculated on Daily observations. ∂Since Inception Calculated on Daily observations

SECTOR ALLOCATION



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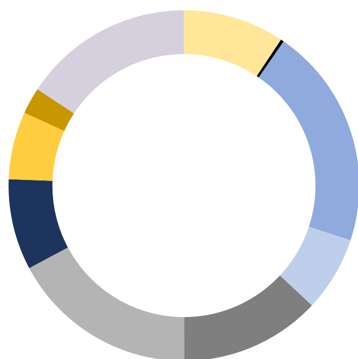
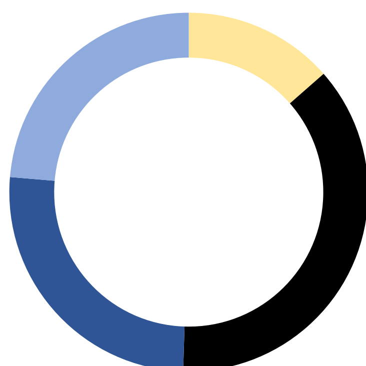
PORTFOLIO COMPOSITION



- Cash (9.34%)
- Commercial Paper (0.29%)
- Government Bonds (0.00%)
- Corporate Bond (20.43%)
- Corporate Hybrids (6.92%)
- Tier 2 Capital (13.00%)
- Tier 1 Capital (17.22%)
- ABS Public (8.38%)
- ABS Private (6.24%)
- RMBS Private (2.44%)
- RMBS Public (15.74%)

MATURITY PROFILE



- At Call to 6 Months (13.54%)
- 6 Months to 3 Years (36.95%)
- 3 Years to 5 Years (25.84%)
- 5 Years to 10 Years (23.66%)
- 10 Years + (0.00%)

FUND UPDATE

Cash and Short-Term Liquidity Weighting: ↑ The allocation to highly liquid assets (cash, commercial paper and government bonds) increased from 7.91% to 9.63%. This mainly reflected lower allocations to T1 capital, corporate bonds and corporate hybrids; which was partly offset by increased allocations to ABS.

Corporate & Subordinated Debt Allocation: ↓ Weighting to corporate bonds and subordinated debt (corporate hybrids and T2 capital) decreased from 42.49% to 40.35%. A tale of two halves in global credit with credit spreads firmer over the first half of September before closing wider month-on-month as concerns over higher government bond yields and rates volatility came to the fore. In the first half, the fund took profits into firmer markets, reducing allocations to EUR denominated corporate bonds and corporate hybrids; this has since been reallocated to USD denominated T2 capital in the start of October on the wider credit spread bias. Domestically, credit spreads remained resilient and continued to firm over the month. In terms of new issuance there was a range of deals from Australian corporates, including Westpac, Suncorp T2 and WestConnex in AUD, and Santos, NBN and BHP in USD.

Interest Rate Duration Position: ↑ IRD positioning increased from 0.86 to 1.00 years. Positioning reflected the continued sell-off in global government bond rates. Nominal yield increases were matched by real yield rises - reflecting the resilient global economic data releases. Market sentiment reflected the investors' acceptance of central bank commentary of higher cash rates for longer. Further hawkish comments by global central banks only pointed to potential upside risks for further tightening. While monetary policy decisions in AUS, US and UK saw cash rates steady, the ECB tightened by 0.25%. In addition to terminal cash rates increasing over the month, the extent and timing of rate cut expectations were delayed, contributing to steepening yield curves. Consequently, our IRD positioning reflected overall moves and sentiment.

Residential Mortgage-Backed Securities (RMBS): ↓ Weighting to RMBS securities decreased from 18.32% to 18.18% over the month. Public structured credit market yields continued to rally over the month of September. This was driven by both the offshore bid into structured markets continued, along with a lack of supply on dealer inventory sheets. New primary transactions remain significantly overbid with public market interest, leading to secondary markets trading at tighter yields than to newly issued stock. Issuers continue to utilise these tighter margins to issue new transactions at more economic levels, with a healthy pipeline of new public trades expected to come to market over the next month.

With respect to market performance, Prime arrears as reported by S&P's SPIN index improved 4bp over the month of August to 0.92%. Nonconforming arrears weakened slightly, widening 7bps to 3.70%. Both results remain very strong in comparison to both market expectations and historic index levels.

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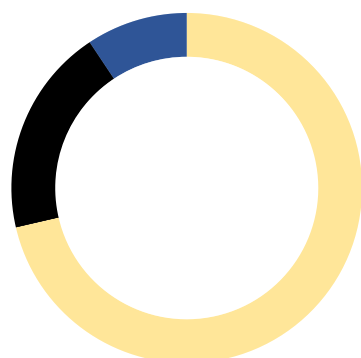
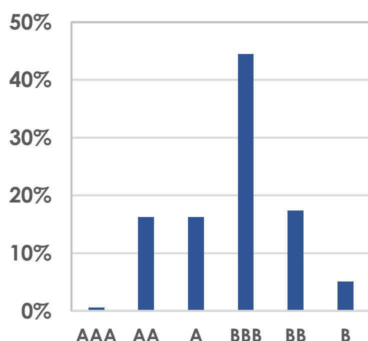
ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (71.37%)
- Foreign Domicilied Issuer (19.28%)
- Cash (9.34%)

CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Portfolio Exposure	Portfolio Limit
Fossil Fuels	2.17%	10%
Non-Renewable & Nuclear Energy	0%	10%
Alcohol	0.26%	10%
Gambling	0.17%	10%

Additional Tier 1 (AT1) Exposures: ↓ Weighting to T1 capital decreased from 18.74% to 17.22%. We continued to take profit and reduce our strategic overweight to global AT1's as global credit markets firmed into the first half of September. Valuations have since cheapened somewhat as global AT1's weakened into month-end, providing an opportunity to modestly increase allocations in early October. Domestically, ASX-listed AT1's outperformed and firmed over the month as the supply/demand dynamics remains supportive with no new issuance to note. On the regulatory front, APRA has released a discussion paper to "enhance banking resilience" by assessing the effectiveness of ASX-listed AT1's. We consider the list of potential policy options to be generally positive for the fund by way of improved financial resilience in the Australian banking system as well as a potentially larger investible universe of higher yielding over-the-counter AT1's.

Asset Backed Securities (ABS): ↑ ABS allocation decreased from 12.54% to 14.62%. Each of the ABS exposures within the fund continue to perform in line with expectations. These assets are typically very short dated, continue to offer healthy yields and remain highly sought after by market participants.

Targeted risk across the Fund: ↓ Targeted portfolio risk decreased slightly from 2.79% to 2.76%. This reflected higher cash holdings and lower credit duration (from 3.21 years to 3.17 years); partly offset by higher interest rate duration (from 0.86 years to 1.0 years).

FUND OUTLOOK

Global investment grade markets offer modestly elevated value for medium term investors. Within the sub-investment grade universe, spreads are benefiting from the higher all-in yields on offer, a technical supported by flat to negative sovereign yield curves around much of the world. However, spreads do not offer much of a margin to compensate for any material deterioration in the near-term economic outlook. Whilst markets may experience weakness if the expected path of cash rates is revised further in the higher-for-longer direction, balance sheets and capacity for repayment remain highly favorable for the exposures in the portfolio.

We expect central banks will react meaningfully to support the economy if monetary policy proves to have been overly tight. We are inclined to selectively act in a contrarian fashion should dislocations arise. Our inclination to do so would be tempered if market weakness arises from an elevation of supply side issues associated with geo-political tensions, including oil production. Given the significant rise in bond yields, we are also alert to the possibility of additional disruption from portfolio losses building in the balance sheets of US regional banks. Share prices here are not far off their most acute lows following the failure of Silicon Valley Bank. This has contributed to a widening of spreads on bank capital of very strong institutions which we perceive as an opportunity.

PLATFORM AVAILABILITY

- Australian Money Market (Retail Units)
- BT Wrap
- BT Panorama
- Credit Suisse
- Crestone
- First Wrap
- Hub24
- Macquarie Wrap
- Mason Stevens
- MLC Navigator/Wrap
- Netwealth
- Powerwrap
- Praemium
- uXchange
- Xplore Wealth
- mFund: RLM03

OTHER FUND DETAILS

Responsible Entity: One Managed Investment Funds Ltd

Custodian: State Street Australia Limited

Unit Pricing and Unit Price History: https://www.realminvestments.com.au/ourproducts/Realm-high-income-fund/

Spreads on public structured credit securities continue to tighten. This move is being supported by a restocking of dealer inventories as two-way interest is broadening again. Recent portfolio auctions have been highly competitive. Although pricing in senior tranches tightened earlier, middle mezzanine spreads are now compressing. Issuance volumes have been healthy, but the composition remains more focused on secured loans other than prime RMBS. Mortgage volume growth remains at historically low rates, and competition amongst banks has resulted in greater supply of specialist and ABS collateral to the public market.

As spreads in public structured Australian RMBS/ABS compress, issuers are more likely to raise capital in this market preferentially to warehouse financing. Nonetheless, as corporate treasurers turn their minds to their funding needs for 2024, we anticipate some move to lock in warehouse capacity prior to the year-end slowdown. The outlook for deal volumes remains strong and we remain satisfied with the general quality available to us.

Rising bond yields and expectations for the path of cash rates has increased the pressure on commercial real estate valuations. It has also adversely affected the financial capacity to meet payments in levered loans. However, amend and extend activity has greatly reduced the refinancing task in 2024 and 2025, with maturities due in 2028 growing instead. The relationship between the spreads on levered loans and CLOs has effectively closed the market to all but the strongest CLO managers who have the in-house capacity to manage any deals that may falter. Scarcity effects have been supportive of spreads here. Levered loan issuers have sought to strengthen balance sheets where possible and weaker credits are increasingly raising capital via the rapidly growing private credit markets instead.

The portfolio continues to hold above average risk levels despite much of the credit market trading close to our assessment of fair value. This is because we continue to find good value in European bank capital and domestic structured credit. Furthermore, pockets of Australian corporate senior and subordinated issues also offer favorable relative value. The portfolio credit rating is a solid BBB+ and exposures are well diversified. The sub-investment grade exposures are dominated by structured credit and AT1 issued by very well-capitalised money center banks.

We have reduced AT1 exposures as markets recovered strongly from the SVB-related sell-off in March. We expect to trade exposures in a contrarian fashion and presently intend to increase exposures again should sentiment towards credit deteriorate and create excessive aversion premia for high-quality credits. We also see Australian Tier2 subordinated debt issued in foreign currency as attractive.

Our foreign issuer capacity utilization is close to the upper bound and we are preferentially utilizing this in AT1 where forecast returns are highest.

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Within structured credit, the portfolio is tilted towards ABS, reflecting the shift in lending activity towards auto and equipment finance amongst non-banks. The exposures can withstand extreme loss scenarios which are well outside those implied by economic projections from the RBA and private sector. Arrears rates for RMBS have been stable after experiencing a normal seasonal increment following the Christmas and Easter periods. Given house prices have almost recovered to all-time highs, even if foreclosures rise, loss exposures are very low. The majority of the RMBS book is held in bank issued and conforming debt. The potential for permanent losses in this segment of the portfolio remains remote. Exposures to CLOs remain a small part of the portfolio.

Portfolio IRD was lifted to 1yr as Australian 10-year bond yields reached 4.5%pa. This remains towards the low end of our 0-5yr allowable mandate range and is close to the historical average. Our risk allocation process has maintained IRD at low levels throughout the latest surge in yields. For context, IRD was merely 0.3yrs in March, when Australian 10-year bonds offered a yield of 3.3%pa. We are also maintaining material macro hedges via equity indices and single-name derivatives, which are screening as expensive relative to credit. Risks relating to China's economy, CRE refinancing, the potential for a disorderly tightening of financial conditions, ongoing geopolitical tensions, and the potential for a resurgence in the assessed likelihood of a hard landing all infer that caution towards tail events is warranted.

The portfolio's traded margin of close to 400bps is historically wide and being achieved with limited default risk. Given the credit quality of our exposures and a current yield-to-maturity of 8%, the portfolio has excellent forward-looking reward to risk characteristics. Bond and equity exposures will also provide meaningful downside protection in the event of a significant adverse development.

MARKET DEVELOPMENTS

Ten-year bond yields in the US, Europe and Australia rose by around 40bps over the month, boosted by the hawkish reception to the FOMC Statement of Economic Projections. The move was large enough to trigger a correlated sell-off in credit markets and equities. This drove the VIX to finish close to 4 points higher at 17.5. USD strength remained a dominant theme as the DXY rose another 2.5% on interest rate movements and increased risk aversion. Oil prices rose as Saudi Arabia and Russia extended planned production cuts to year-end. Gold fell as funding costs increased.

OTHER DEVELOPMENTS

Economic resilience in the US was a key theme during the month. The ISM Services PMI remained in solid expansion territory with elevated readings in employment and prices. Retail sales exceeded expectations, as did non-defence ex-air durable goods orders and industrial production. Whilst the final Q2 GDP reading was in-line with expectations at 2.1% SAAR, consensus estimates for Q3 are closer to 3% with the Atlanta Fed's Nowcast at 5%. The Beige Book reported robust spending on travel and tourism, but pointed to expectations for lower wage growth.

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Although non-farm payrolls grew faster than expected, an increase in the participation rate lifted the unemployment rate from 3.5% to 3.8%. Unit labour costs rose faster than expected at 2.2% QoQ. Monthly core inflation was ahead of expectations at 0.3% for the month.

The Fed left interest rates unchanged. However, the release of the latest projections resulted in greater market acceptance of a higher for longer trajectory. Much uncertainty exists on the ultimate neutral rate for cash with the stronger economic outcomes confounding prior estimates. The outlook was complicated by the United Auto Workers strike and another display of political dysfunction in the House which required a stop-gap funding package to delay a government shutdown. Importantly this did not include provisions which increased support for Ukraine. An impeachment enquiry was launched against President Biden and former President Trump's legal difficulties expanded to include being found liable for civil fraud. Moody's is the last of the major ratings organisations with a AAA rating for US debt and flagged that weaker fiscal policymaking would create a downward bias to their outlook.

The US engaged in a prisoner swap with Iran, an action which is now complicated by a dramatic escalation in the conflict between Hamas and Israel around the Gaza Strip.

In Australia, Q2 GDP was recorded at 0.4% and this was slightly higher than expected. The household savings rate fell to 3.2% and the Westpac Consumer Confidence Survey gave up gains it had made when the RBA first paused. Nonetheless, the NAB Business Survey saw an improvement in current conditions and confidence with capacity utilization near historical highs at 85%. Services PMI returned to growth territory with higher inflationary readings and strong new orders. Input costs are accelerating. Home prices rose again and are now just 1.3% below record highs recorded in April last year according to CoreLogic. The monthly CPI reading accelerated to 5.2% yoy as rising energy costs fed through, but readings which excluded volatile items and travel declined. The labour force reading surprised to the upside with 65k additional jobs created although these were almost entirely part-time. The unemployment rate remained at 3.7% as the participation rate rose.

In his final meeting, former Governor Phil Lowe left rates unchanged in September. Governor Michelle Bullock also left rates unchanged in her first meeting as well albeit with hawkish sentiments. Household consumption continues to slow as higher cost of living and monetary policy reduce spending capacity. The RBA continues to expect a favorable economic path whereby employment gains are retained whilst inflation returns to the target band in 2025.

The major data releases in China were more favorable this month. Balance of trade, credit growth, industrial production and retail sales were all stronger than expected. The official PMIs were consistent with modest growth. Unemployment dropped slightly to 5.2%. Inflation remained very low, dropping to 0.1% yoy, with PPI recording -3% over the same period. Key loan prime rates were left unchanged.

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The property sector remains a key point of focus. Major developer Evergrande, which defaulted in 2021 and re-listed in August, suspended trading and was not able to issue new debt when it was revealed the chairman was placed under surveillance. The machinations of the Chinese leadership attracted scrutiny as it was noted Defence Minister General Li Shangfu had not been seen in public for some time. China and Timor-Leste announced an upgrade to their cooperation.

European economic developments were generally below expectations. The most recent Q2 reading was 0.1%, below the 0.3% expected, which kept the growth rate barely above technical recession this year. Retail sales fell by 0.2% on the month and imports declined. Loans to companies, at 0.6% yoy, expanded at the slowest pace since December 2015. Loans to households, at 1.0% yoy, is the slowest since August 2015. Eurozone unemployment was at its lowest on record, at 6.4%. However, wage growth (4.6% yoy) and core inflation (5.2% yoy) both moderated.

For a time, risk markets were buoyed by the ECB's decision to raise rates by 25bps which was accompanied by statements inferring that this was likely to be the final move for this cycle. The Bank of England held rates unchanged in a closely contested decision. The spread between Italian and German bond yields increased as the Meloni government hiked its deficit target for 2023 to 5.3% of GDP, up from 4.5%, with virtually no debt reduction in prospect until 2026.

The Japanese economy produced mixed readings. GDP for Q2 was a solid 1.2% albeit slightly below expectations. However, business confidence as reported in the Tankan survey fell on weak domestic and foreign demand, and concerns over the geopolitical landscape. Retail sales were stronger than expected and core inflation was reported at 3.1% yoy. The BoJ made unscheduled bond purchases to defend the 10-year yield guidelines. The market is closely parsing Governor Ueda's statements in relation to whether the long-standing negative interest rate policy might be ended in the coming months. Monetary settings were left unchanged during the September meeting.

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