REALM SHORT TERM INCOME FUND

REALM INVESTMENT HOUSE

SEPTEMBER 2023

FUND OBJECTIVE

The Realm Short Term Income Fund seeks to produce a return (net of fees) that exceeds the total return of the RBA Overnight Cash Rate by 1.50%-2.00% p.a. over rolling three-year periods.

FUND DETAILS

Distribution Frequency: Monthly

Liquidity: Daily

Buy/Sell: 0.00% / 0.00%

Direct Minimum Investment:

Ordinary Units - $25,000

mFunds Units - $25,000

Inception Date: 21.12.2017

Fund size: AUD $1.16 billion

APIR Codes:

Ordinary Units - OMF3725AU

mFunds Units - OMF8160AU

Management Costs (Net of GST):

Ordinary Units – 0.3075%

mFunds Units – 0.3634%

NET PERFORMANCE

Period	Short Term Income Fund	RBA Cash Rate Return
1 Month	0.50%	0.33%
3 Month	1.62%	1.02%
6 Month	3.06%	1.97%
1 Year	5.40%	3.51%
3 Year p.a	2.80%	1.39%
5 Year p.a	2.76%	1.20%
Since Inception p.a*	2.76%	1.24%

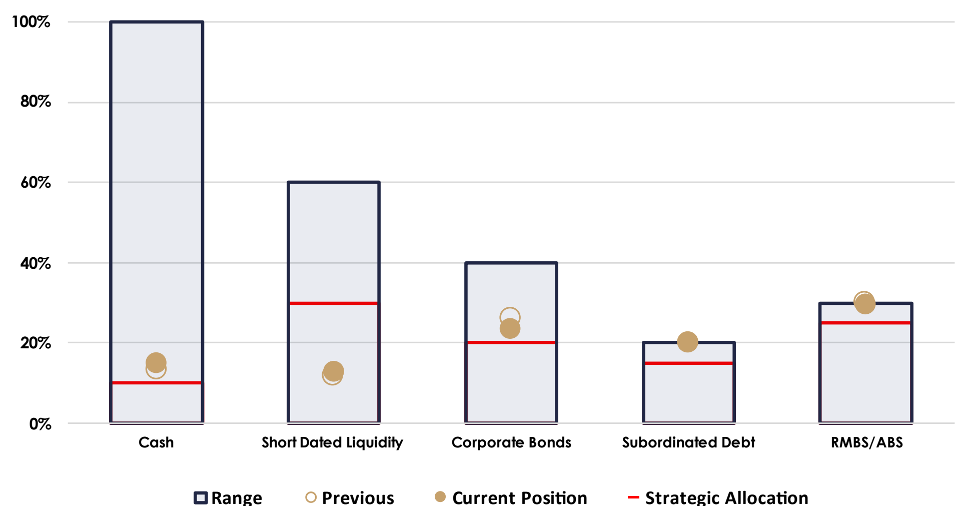
*Past performance is not indicative of future performance. Inception date is 21 December 2017.

FUND STATISTICS

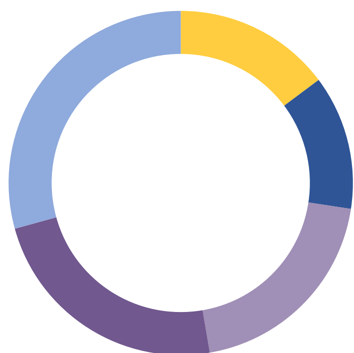
Running Yield	5.33%
Yield to Maturity	6.10%
Volatility†	0.40%
Interest rate duration	0.08
Credit duration	1.47
Average Credit Rating	A
Number of positions	292
Average position exp.	0.24%
Worst Month*	-0.26%
Best Month*	0.60%
Sharpe ratio∂	3.04

Calculated on Ordinary Units unless otherwise stated. *Since Inception 21 December 2017.
†Trailing 12 Months Calculated on Daily observations. ∂Since Inception Calculated on Daily observations

SECTOR ALLOCATION

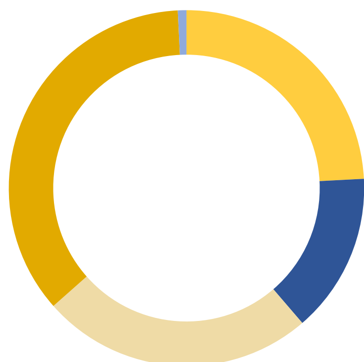


PORTFOLIO COMPOSITION



- Cash (14.78%)
- Short Dated Liquidity (12.63%)
- Sub Debt (19.89%)
- Corporate Bond (23.42%)
- RMBS & ABS (29.28%)

MATURITY PROFILE



- At Call to 6 Months (24.17%)
- 6 Months to 1 Years (14.53%)
- 1 Years to 2 Years (24.77%)
- 2 Years to 3 Years (35.75%)
- 3 Years to 3.5 Years (0.78%)

FUND UPDATE

Cash and Short-Term Liquidity Weighting: ↓ Cash and Short dated liquidity increased from 24.61% to 27.41%.

Interest Rate Duration Position: → 0.08 years. The strategy will maintain interest rate duration of approximately 3 months as an average. Having a low IRD number limited the realised volatility and losses in the fund from government bond volatility over the month (36 basis point increase for AU 3-year bond yields). The strategy will, as a rule, only take modest interest rate risk.

Corporate & Subordinated Debt Allocation: ↑ Decreased from 45.65% to 43.31%. Optimisation within the corporate bond sector was skewed towards AUD corporates and USD financials. Corporate bonds, traditionally, present modest relative value over bank senior bonds due to the rating differential; and this relative value was maintained over the month as both financial and corporate bond spreads remained stable. Corporate bond volatility was relatively muted over the month of September. Subordinated debt was optimized towards Australian and foreign banks in EUR. The short, conservative nature of the sector and diversification aided in cushioning the market volatility over the month.

Residential Mortgage-Backed Securities (RMBS) & ABS: → Allocation to structured credit securities remained in line with last month at 29.28%. As at month end, the portfolio maintained an A- average credit rating and a relatively short weighted credit duration of 1.72 years.

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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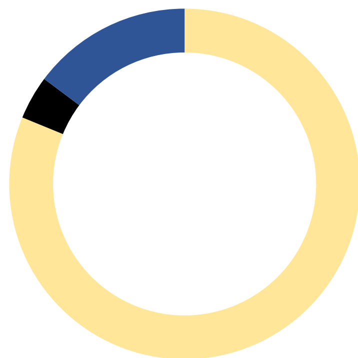
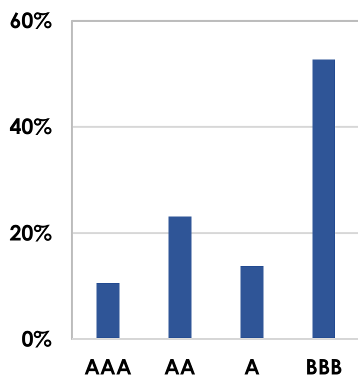
ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (81.20%)
- Foreign Domicilied Issuer (4.03%)
- Cash (14.78%)

CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Direct Exposure	Direct Limit	Indirect Exposure	Indirect Limit
Fossil Fuels	0.0%	0.0%	0.0%	2.5%
Non-Renewable & Nuclear Energy	0.0%	0.0%	0.0%	2.5%
Alcohol	0.0%	0.0%	0.13%	2.5%
Gambling	0.0%	0.0%	0.0%	2.5%

Targeted risk across the Fund: ↓ Targeted risk decreased from 0.87% to 0.80%, reflecting the optimisation within portfolio limits. Meanwhile, realised standard deviation is at 0.40%. This has risen over the short term due to increased volatility in mark to market valuations. The portfolio remains defensively positioned although despite this, the fund has performed relatively well over the last 12 months, delivering 5.39% after fees. This is evidence that the strategy is well designed, delivering a reasonable premium over cash while maintaining a very tight distribution of returns month on month. The fund remains compliant with the portfolio ESG risk limits.

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.

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.

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PLATFORM AVAILABILITY

- Australian Money Market
- AMP North
- BT Panorama
- eXpand
- Firstwrap
- Hub24
- Macquarie Wrap
- Mason Stevens
- MLC Navigator/Wrap
- Netwealth
- Powerwrap
- Praemium
- Rhythm
- mFund code: RLM02

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 operate within well-defined boundaries. The traded margin of close to 200bps remains favorable. Along with a yield to maturity of 6% and conservative portfolio positioning, the risk of a negative monthly return is presently very low. The portfolio remains likely to produce competitive returns against term deposit alternatives whilst providing daily access to liquidity.

The portfolio added foreign currency denominated bonds and foreign issuer bonds in an incremental fashion. All foreign currency exposures are fully hedged back to AUD. Foreign exposures will increase steadily over the coming months. Our decision to change the fund's custodian and administrator earlier this year has also reduced transactional frictions. The additional flexibility has materially increased the likelihood of achieving the performance objectives without notably changing the portfolio's aggregate risk characteristics.

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. 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.

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OTHER FUND DETAILS

Responsible Entity: One Managed Investment Funds Ltd

Custodian: State Street Australia Limited

Unit Pricing and Unit Price: https://www.realminvestments.com.au/our-products/realm-short-term-income-fund/

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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