REALM GLOBAL HIGH INCOME FUND AUD

FEBRUARY 2024

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FUND OBJECTIVE

The Realm Global High Income Fund AUD is a fixed income strategy, that invests in global asset backed securities, bank-issued securities and corporate bonds. The objective of the Fund is to deliver investors a consistent return (net of fees and gross of franking) of 2.5 - 3.5% over the RBA cash rate through a market cycle.

FUND DETAILS

Distribution Frequency: Monthly
Liquidity: Daily
Buy/Sell: 0.05% / 0.05%
Inception Date: 16.11.2023
Management Fees (Net of GST): 0.7175%
Direct Minimum Investment: Ordinary Units - $25,000

NET PERFORMANCE

Period	Global High Income Fund AUD	RBA Cash Rate Return
1 Month	0.82%	0.34%
3 Month	5.29%	1.07%
Since Inception	7.02%	1.23%

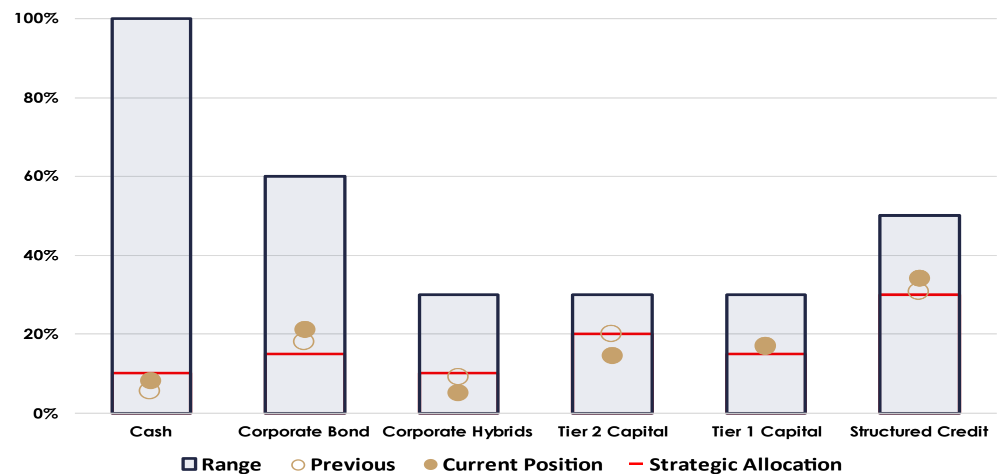
* Past performance is not indicative of future performance.
Inception 16 November 2023.

FUND STATISTICS

Running Yield	6.24%
Yield to Maturity	7.81%
Volatility†	N/A
Interest rate duration	0.07
Credit duration	3.42
Average Credit Rating	BBB
Number of positions	65
Average position exposure	0.61%
Worst Month*	0.82%
Best Month*	2.22%

†Trailing 12 Months Calculated on Daily observations. ªSince Inception Calculated on Daily observations

SECTOR ALLOCATION



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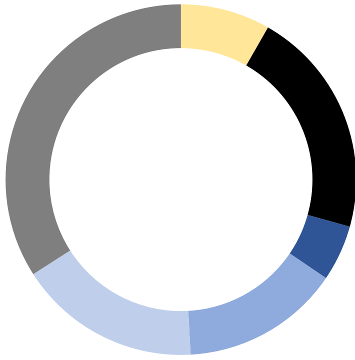
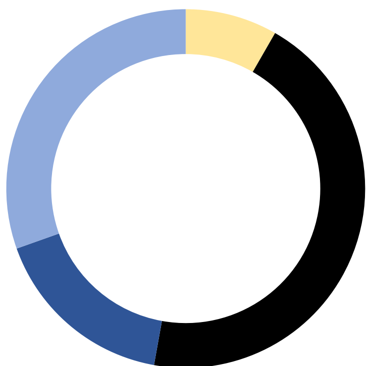
PORTFOLIO COMPOSITION



- Cash (8.27%)
- Corporate Bond (21.06%)
- Corporate Hybrids (5.16%)
- Tier 2 Capital (14.62%)
- Tier 1 Capital (16.82%)
- Structured Credit (34.06%)

MATURITY PROFILE



- At Call to 6 Months (8.30%)
- 6 Months to 3 Years (44.53%)
- 3 Years to 5 Years (16.74%)
- 5 Years to 10 Years (30.43%)
- 10 Years + (0.00%)

FUND UPDATE

Cash and Short-Term Liquidity: ↑ The allocation to highly liquid assets (cash, commercial paper and government bonds) increased from 5.36% to 8.27%. This mainly reflected lower allocations to T2 capital and corporate hybrids which was partly offset by higher allocations to corporate bonds and structured credit.

Corporate & Subordinated Debt: ↓ Weighting to corporate bonds and subordinated debt (corporate hybrids and T2 capital) decreased from 46.84% to 40.84%. Global credit spreads firmed for a fourth consecutive month, despite higher government bond yields and volatility. This saw the fund continue to de-risk the book by taking profits across T2 capital and corporate hybrids and partly reallocate to higher quality senior corporate bonds. This included new deals from United Utilities, Severn Trent and Engie in EUR as primary issue markets remained very busy.

Tier 1 Capital: ↓ Weighting to T1 capital decreased slightly from 16.99% to 16.82%. Fund performance has benefited from a strategic overweight to global T1's which have outperformed for a fourth consecutive month. The sector allocation remains largely unchanged as profit taking was rotated into various securities which cheapened over the month. This included the addition to Deutsche Bank T1's, as German banks sold off due to US CRE contagion concerns from New York Community Bank. This trade has performed well with impacted securities recovering back to pre-sell off levels. As we near the anniversary of the collapse of Credit Suisse (and the US$17 billion write-off of its T1's), the global T1 market has largely recovered from a both a valuations and activity perspective. There was a decent amount of supply over the month, with notable deals from ING, Swedbank, UBS, BNP, Standard Chartered in USD and ABN Amro in EUR.

Structured Credit (ABS/CLO): ↑ ABS/CLO weighting grew over the month from 30.80% to 34.06%. In general, Global CLO spreads were stable in February across the capital structure, however BBB tranches were slightly wider on average. New issue activity remained high printing $20bn for the month, dominated by resets and refinances. Technical demand remains firm for now, with AAA amortisations seeing US banks becoming more active. Median CCC loans in CLO portfolios fell to 5.7% from 6.3% in the US, and in Europe to 2.8% from 3.1%. The Morningstar LSTA US Leveraged Loan index increased 18c to 96.45, the highest since January 2022. In Europe the index fell 19c over the month to 96.83. Whilst M&A activity remains a small proportion of new deals, new issue activity increased as a growing number of loans return from Private Credit to refinance in BSL markets.

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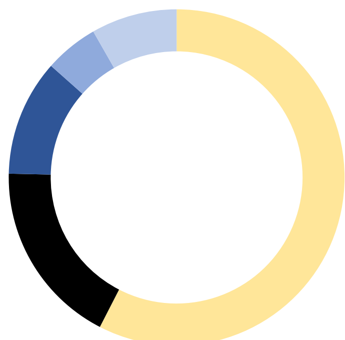
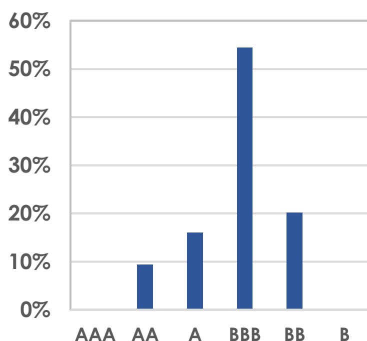
GEOGRAPHIC EXPOSURE



- Europe (57.55%)
- North America (17.80%)
- United Kingdom (11.19%)
- Australia/New Zealand (5.18%)
- Cash (8.27%)

CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Portfolio Exposure	Portfolio Limit
Fossil Fuels	6.25%	10%
Non-Renewable & Nuclear Energy	0%	10%
Alcohol	0.00%	10%
Gambling	0.00%	10%

Interest Rate Duration Position: ↑ IRD positioning decreased from 0.14 to 0.07 years. Bond volatility in the US was meaningfully higher than global bond volatility resulting from a significant upside surprise in the January nonfarm payrolls data. Further strength in the US CPI and ISM services data challenged the easing economic sentiment. The contrasting softer economic data releases in Australia led to AUS rates outperforming and highlighted the difference in the economic trajectory of Australia. Central bank concerns of early rate cuts drove the OIS markets to price in 90bps of rate cuts in 2024 for US and 40bps for AUS. The term premium and relative value on offer from credit instruments outweigh those offered by global government bonds, and as a result, the IRD of the portfolio was maintained at a minimum level.

Targeted risk across the Fund: ↓ Targeted portfolio risk decreased from 2.04% to 1.90%. This largely reflected de-risking of the portfolio as lower allocations to T2 capital and corporate hybrids were reallocated to senior corporate bonds and structured credit. This saw credit duration decrease across the portfolio (from 3.49 years to 3.42 years), while interest rate duration also decreased modestly (from 0.14 years to 0.07 years).

FUND OUTLOOK

Credit spreads tightened further over the month and reached historically low levels. Whilst the indicative ICE BofA BBB US Corporate Index Option-Adjusted Spread finished almost unchanged at 1.25%, bank capital and non-US corporate markets generally tightened further. Whilst US spreads rallied, heavy issuance saw these revert back towards their opening levels. This effect was less pronounced elsewhere.

The robustness of job creation in the US economy surprised to the upside whilst inflation expectations remained well behaved albeit the last mile of normalization is more challenging. Economists' expectations for the likelihood of recession declined further but still remains elevated and would infer more compensation should be required for risk. However, current spreads are detached from these estimates and are consistent with a near-certain achievement of very favourable economic conditions expected in 2025.

Technical factors may be contributing. Official cash rates are considered to be restrictive and the yields on US 10 Year Treasuries are favourable in the context of the last 20yrs. This is contributing to absolute yields on credit which are towards the highest observed in the post-GFC period. Capital is being drawn in for these reasons and may be creating less discerning pricing for credit. Should bond yields fall due to a modestly adverse economic outcome, some argue that spreads may receive some support for such reasons and not widen materially.

PLATFORM AVAILABILITY

- Netwealth IDPS
- Powerwrap

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/our-products/realm-global-high-income-fund/

Levered loans offer the highest all-in yield amongst key segments of the fixed income market as these are floating rate securities and cash rates are at restrictive levels. Some companies which had turned to the private credit market for funding in recent years are once again issuing levered loans as funding conditions have eased. As spreads on these loans compressed due partly to the attractiveness of the total yield available, the return to the equity tranche of CLOs has improved and issuance is at record levels year-to-date. Strong issuance is also noted in the domestic structured credit market as loans held in warehouses were sold to the term market at narrower spreads. Strong bidding for primary and secondary transactions has driven spreads down with international investor interest at robust levels. Although arrears have risen in RMBS, record house prices infer that actual loss exposures are minimal. Financial pressure from inflation and interest rates is expected to ease gradually.

Options prices continue to infer that potential movements in the US bond market remain in an elevated post-Ukraine state. For much of the year, policy-makers have been conditioning the market to unwind expectations of several, rapid rate cuts commencing in the near-term. However, the market and policy makers now appear to have converged on an expectation that rate cuts will commence around mid-year in the US and Europe. For Australia, the market considers the RBA will commence cutting rates a few months later. Markets continue to look to monetary authorities to ameliorate potential risk events. Whilst there is now considerable scope to defend against a demand shock, central banks are no better placed to assist with a supply shock.

A high level of optimism can also be found in equity markets. Following another strong run, valuations inferred by the Schiller P/E ratio for the S&P500 are at highs other than peaks associated with the deep earnings recession during covid and the Tech boom. Nvidia rose 26% on the month. Even BitCoin traded through USD 60k again following the US SEC's approval of spot ETFs.

Whilst credit markets appear to offer little margin for error in pricing, we continue to identify relative value opportunities. Narrow parts of the market reacted adversely to the higher than expected write-down of US CRE assets at New York Community Bancorp. As with the collapse of SVB, the risk aversion crossed the Atlantic and saw German banks with material CRE exposures trade weaker.

The portfolio remains defensively postured given our assessment that credit spreads offer limited margin for error. This still offers good opportunities for our relative value process to identify mispricings and the portfolio is concentrated into such circumstances. As a result, portfolio risk bearing is slightly above what might be imagined by reference to aggregate market pricing. The high volume of issuance is also providing the opportunity to extract new issue concessions.

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DISTRIBUTION

Broc McCauley
Head of Distribution
T: 0433 169 668
E: broc.m@realminvestments.com.au

Matthew Blair
Business Development Manager
T: 0424 837 522
E: matthew.b@realminvestments.com.au

Finbarr Warren
Business Development Analyst
T: 0405 543 196
E: finbarr.w@realminvestments.com.au

Rhys Kostopoulos
Client Services
T: 03 9112 1150
E: clientservices@realminvestments.com.au

LEVEL 17, 500 Collins street
Melbourne VIC 3000

LEVEL 6, 31 Market Street
Sydney NSW 2000

Although risk deployment is conservative, it is also well dispersed across corporate bonds, AT1, subordinated debt and structured credit. Corporate hybrids are playing a smaller role. The portfolio composition can be characterized as being driven more by idiosyncratic considerations than by broad thematics.

To that end, the corporate bond exposure consists of an eclectic mix of bank, insurance, property and water infrastructure assets. As Australian credit presently offers good value relative to global alternatives, the exposure to Australian REITs within this sector is notable. The AT1 exposures are in European/UK G-SIBS although the majority of risk bearing is in USD. The subordinated debt positions are all investment grade holdings in significant financials.

We have added to the CLO book as the amount of primary activity has eased frictions to position building. Risk bearing has increased as, somewhat contrary to the broader credit markets, mezzanine debt pricing has reached a point of buyer exhaustion. The book remains invested with top-tier managers who have extensive capabilities to recover value from distressed loans and this provides some downside protection. With spreads at relatively tight levels, extension risks are more elevated and our positioning is considering this closely.

All sub-investment grade exposures would require a historic systemic event to the banking and credit markets to risk impairment.

As economic conditions in Europe/UK are less favourable than for the US, it is unsurprising that our reversionary, relative value, approach should lead to the majority of portfolio risk being sourced from this region. Risk bearing by currency of issuance (all hedged to AUD) is more even as there is a significant USD market for European bank AT1. The portfolio also has USD risk exposures via CLOs and corporate hybrids.

Interest rate duration is close to zero as the term structure is negative for relevant government bonds making carry from this source unattractive for any risk deployment.

The portfolio mandate allows us to identify and deploy capital into a small fraction of significant mispricings from a large universe of potential investments. One key benefit of this flexibility is the portfolio is still comfortably positioned to deliver upon its objectives despite tightly priced credit markets and somewhat conservative positioning.

The portfolio's yield-to-maturity of 7.8%, unremarkable credit duration of 3.4yrs and solid BBB average rating suggests that the likelihood of a negative outcome over a six-month or one-year period is towards the lower end of its expected range. Indeed, the interests of medium term investors may be well served by a period of volatility which creates stronger relative value opportunities. The portfolio would generally move in a contrarian fashion to extract profits from other market investors with less capacity to bear risk in the shorter term.

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MARKET DEVELOPMENTS

Credit synthetics rallied further over the month with the CDX IG 4pts lower at 52. This is a level last observed when the Fed QE program was still accumulating assets. The CDX HY and iTraxx XO rallied over 20pts. Equities were strong with the ASX 200 and Chinese CSI 300 up 8%. The S&P 500 rose 5% to a new record along with the Nasdaq. Even the Nikkei 225 managed to surpass its previous all-time high recorded in 1989. There were relatively few market shocks during the month and the VIX traded within a narrow band around 14. Nonetheless major market bond yields (ex-Japan) rose with the US 10 yr bond yield up 35bps as markets took a rosier view on the economic outlook. This contributed to a strengthening of the USDJPY exchange rate. Australian 10-year bonds rose 12pts to 4.14%.

OTHER DEVELOPMENTS

The US non-farm payroll growth of +353k was well ahead of the +180k expected. Average hourly earnings growth also exceeded expectations. The preliminary Q4 GDP was 3.2% saar, close to expectations. Retail sales disappointed, but existing home sales are rising again. Whilst durable orders (ex air/defence) edged higher, industrial production fell and the ISM Manufacturing index disappointed at 47.8. The ISM Services index, at 52.6, was slightly below forecast at 53 but the New Orders component suggests accelerating growth is in store. The New York Fed Global Supply Chain Stress Index remains at near normal levels despite shipping diversions from the Red Sea. One clear indicator of supply chains easing is used car prices, which have fallen 9.2% over the year.

The Fed held the cash rate at 5.25-5.50% and also left other settings unchanged. Chair Powell explained that cutting rates in March was not his base case. Bank credit conditions appear to have reached their tightest point. The Treasury released its plans for refunding its debt. Indications that the rate of issuance would be stable in the immediate term were well received. Government dysfunction remained on display with Congress unable to pass laws ensuring that government agencies are durably funded. Biden is essentially unchallenged for the Democratic nomination for the Presidential election. Trump compressively defeated Haley and is the presumptive nominee for the Republican candidate but will have to endure a string of legal challenges.

The economic readings for Australia suggested activity had slowed further. Building permits fell 9.5% in December. Retail sales disappointed at -2.7% for December, which was well below expectations of -0.1%. However, seasonal adjustment has proved problematic for retail related indices due to the introduction of Black Friday sales events. Consumers nonetheless remain deeply pessimistic but are noticing easing inflationary pressure. The NAB Business survey indicates that current conditions have fallen below average with recreation and personal services leading the way. The outlook remains soft although manufacturing and construction sectors are more optimistic. Credit creation was steady.

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The labour force survey showed growth of only 0.5k when +30k was expected. Unemployment rose to 4.1% but the result is complicated by an unusually high number of people who had been employed but waiting to start work. Inflation indicators suggested that the path towards normalization remained on track. The PMIs indicate that manufacturing activity contracted, whilst services performed strongly. A $4.5bn writedown in BHP's WA Nickel operations highlighted that core materials required to support the energy transition megatrend can still become over-supplied.

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The RBA held rates at 4.35% and the associated release indicated that further rate rises could not be ruled out. Their outlook expects immigration to normalize but for housing to remain tight. Financial stress remains well contained albeit approximately 5% of households are struggling significantly. House prices rose 0.6% over the month and ANZ upgraded their forecasts for 2024 to 5-6%.

Europe's GDP was estimated to have been steady in Q4, continuing a record of outcomes which skim the edge of recession. The German economy shrank for the third quarter in a row. Economic surveys for this economy have assessed it as in the weakest condition since June 2020 which was heavily affected by covid. Despite weak economic growth, Eurozone unemployment was at a record low 6.4% and is not expected to rise materially as growth gradually normalizes into 2025. The PMIs confirmed that manufacturing output shrank, with supplies affected by shipping disruptions in the Red Sea. The services index recorded the first expansionary reading since July 2023. Given the rigidity of the labour market, the ECB's focus is on wage settlements. The timing of these releases suggests the first rate cut may be in June. The UK fell into recession as exports plunged in Q4 and BoE Governor Bailey indicated that he was comfortable with the outlook for rate cuts, which could occur ahead of inflation normalizing.

China's economic data surprised to the upside. Credit growth exceeded expectations, as did the official NBS PMI readings, albeit these point to modest growth only. Prices are falling with CPI down -0.8% yoy, faster than expected. The PPI was -2.5% lower on the year. Efforts to stimulate the economy continued with a record sized 0.25% cut in the 5yr Loan Prime Rate. Other key official rates were unchanged. House prices have fallen 0.7% over the year.

Japan's Q4 GDP was reported at 0.1 and was characterized by weak consumer spending. Core inflation was 2% for the year. The focus remains on the BoJ's plans for exit from its long-standing negative interest rate policy. To this end, wage settlements during spring will be a key determinant.

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