# REALM GLOBAL HIGH INCOME FUND AUD

**JANUARY 2024**

REALM INVESTMENT HOUSE

## 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 | 2.15% | 0.36% |
| Since Inception | 6.15% | 0.89% |

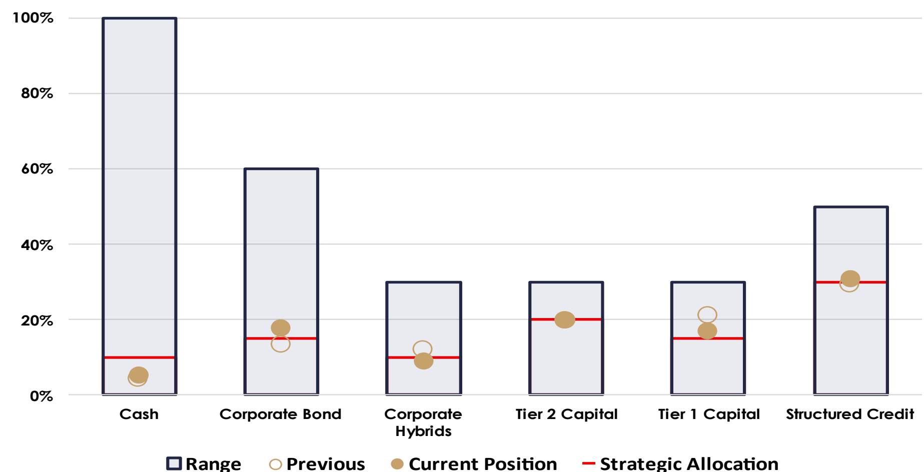
* Past performance is not indicative of future performance.
Inception 16 November 2023.

## FUND STATISTICS

| | |
|---|---|
| Running Yield | 6.19% |
| Yield to Maturity | 7.70% |
| Volatility† | N/A |
| Interest rate duration | 0.14 |
| Credit duration | 3.49 |
| Average Credit Rating | BBB |
| Number of positions | 61 |
| Average position exposure | 0.61% |
| Worst Month* | 2.15% |
| Best Month* | 2.22% |

†Trailing 12 Months Calculated on Daily observations. ∂Since Inception Calculated on Daily observations

## SECTOR ALLOCATION



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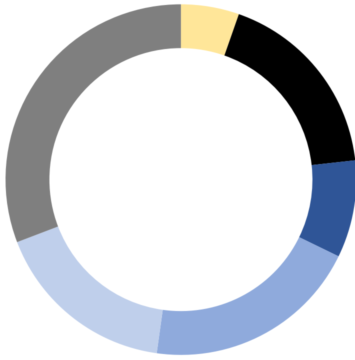
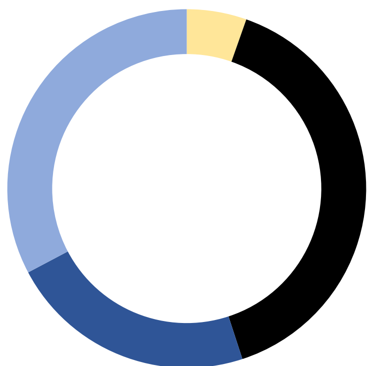
## PORTFOLIO COMPOSITION



- Cash (5.36%)
- Corporate Bond (17.88%)
- Corporate Hybrids (8.97%)
- Tier 2 Capital (19.99%)
- Tier 1 Capital (16.99%)
- Structured Credit (30.80%)

## MATURITY PROFILE



- At Call to 6 Months (5.39%)
- 6 Months to 3 Years (39.58%)
- 3 Years to 5 Years (22.28%)
- 5 Years to 10 Years (32.74%)
- 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 4.43% to 5.36%. This mainly reflected lower allocations to T1 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) increased from 45.07% to 46.84%. January 2024 was one of the busiest starts for global investment grade (IG) primary markets. Despite the deluge of supply, global credit spreads firmed for a third consecutive month, with T1 and T2 capital continuing to outperform. Corporate hybrids also performed strongly over the month, and provided the opportunity selectively take profits and switch into higher quality senior corporate bonds. Corporate bond allocations increased further due active participation primary markets, including new senior deals from UBS, ABN Amro and Credit Agricole. The fund also participated in new Tier 2 deals from Allianz and Spanish Bank BBVA, which modestly increased the Tier 2 allocation.

**Tier 1 Capital:** ↓ Weighting to T1 capital decreased from 21.13% to 16.99%. As global T1's outperformed for a third consecutive month, the fund has meaningfully reduced its sector allocation but continues to maintain a slight strategic overweight as various pockets within the global AT1 market remain attractive. We note that since the collapse of Credit Suisse in March 2023, global T1's have significantly recovered and credit spreads are now trading back at long-term averages. Global T1 primary markets were relatively active over the month, with notable deals from Credit Agricole and AXA in EUR. This has continued into early February with new deals from ING, Swedbank and UBS in USD.

**Structured Credit (ABS/CLO):** ↑ ABS/CLO weighting grew over the month from 29.37% to 30.80%. Global CLOs rallied strongly in January, particularly in the mezzanine tranches with technical demand in an improving rates outlook and investors looking to deploy new capital and reinvest amortisations. New issue was particularly active with US and Europe printing around $15bn in total, the US number of $13bn being the highest January on record. Technical demand is likely to remain firm in the short term with amortisations increasing and US banks becoming more active. With respect to loan collateral performance, median CCC assets in CLO portfolios remained stable at 6% in the US and stable at around 4% in Europe. The Morningstar LSTA US Leveraged Loan and European Leveraged Loan indices increased 4c and 100c respectively in January. A lack of new money loan issue continues to support loan indices in particular from CLO managers needed to access secondary markets to ramp portfolios.

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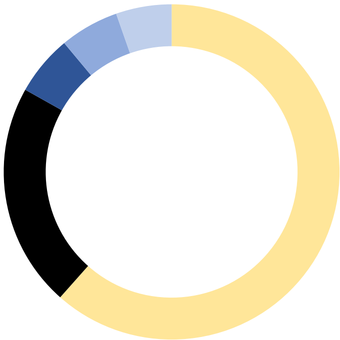
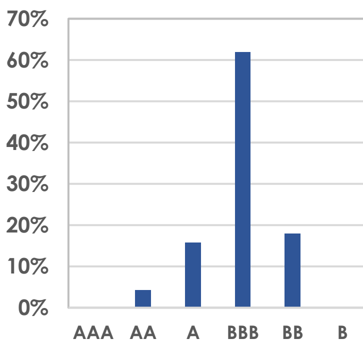
## GEOGRAPHIC EXPOSURE



- Europe (61.55%)
- North America (21.60%)
- United Kingdom (5.80%)
- Australia/New Zealand (5.69%)
- Cash (5.36%)

## CREDIT QUALITY




## PORTFOLIO ESG RISK LIMITS

| Sector | Portfolio Exposure | Portfolio Limit |
|---|---|---|
| Fossil Fuels | 4.15% | 10% |
| Non-Renewable & Nuclear Energy | 0% | 10% |
| Alcohol | 0.00% | 10% |
| Gambling | 0.00% | 10% |

**Interest Rate Duration Position:** ↑ IRD positioning increased to 0.14 years. Bond volatility during the month of Jan, represented by trading range, was almost half of the volatility of December. Driven by favourable economic data releases – resilience in labour markets but with easing inflation, revived the 'Goldilocks' narrative. The ripple effect from the shift downwards of the FED dot plots and a pause from global central banks, saw bond yields continue their rally. The OIS markets moved to pricing in almost six cash rate cuts in the US by the end of 2024. 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 2.79% to 2.04%. This largely reflected de-risking of the portfolio as lower allocations to T1 capital and corporate hybrids were largely reallocated to senior corporate bonds. The net impact was higher credit duration (from 3.07 years to 3.49 years), while interest rate duration also increased modestly (from 0.05 years to 0.14 years).

## FUND OUTLOOK

Key credit spreads finished the month at similar levels. The indicative ICE BofA BBB US Corporate Index Option-Adjusted Spread of 1.26% pa is tight by historical standards. Similar levels have existed only during periods of loose credit, overconfidence, or where search-for-yield effects were strong. In some ways, the high all-in yields presently available may also be encouraging this outcome.

Credit markets appear to be pricing an outcome which is similar to a no-landing scenario, where growth is at trend levels, inflation is in-line with targets and monetary policy is at around neutral. The consensus for 2025 points to this type of environment but, given the limited accuracy of economic forecasts and the many visible uncertainties, spreads are offering scant margin for error.

Although the trajectory of key Western economies is for a further slowdown during H1 2024, before recovering towards trend levels, confidence in avoiding recession is rising. Derivative pricing shows very low concerns for the possibility of a difficult market. Indeed, even oil and gold derivatives display inferred volatility expectations which are around average levels. This seems unusual given the number of active conflicts taking place, particularly in the Middle East where missile and drone strikes are being exchanged between the US and Iranian proxies. ISIS also claimed responsibility for a bombing attack in Iran which killed nearly 100 people during a memorial for former Quds Forces Commander Soleimani, who was killed in a US drone attack in 2020.

## 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/

The bond market remains volatile relative to equities. Derivative pricing infers that central banks have a significant capacity to stabilize the economy against adverse developments. The relative pricing of equity and bond volatility indices is reminiscent of the first part of the Greenspan era where the Fed cut rates to help the economy recover from the 1990-91 recession and enhanced the belief in the Greenspan Put. With cash rates now considerably above the nominal floor, the capacity certainly exists but this central bank tool is quite ineffective with supply side shocks. As a result, following a strong recovery in credit markets since the collapse of Credit Suisse, we are cautious on aggregate pricing, but still find pockets of opportunities where we are comfortable with risk deployment.

Primary markets have responded to the tighter spreads with heavy issuance since the start of the year. However, the ghost of Silicon Valley Bank remains near as a higher than expected write-down in US CRE exposures by New York Community Bancorp, which acquired Signature Bank, has focused attention on US Regional Banks operating in this market again. As with Credit Suisse, the distress in the US crossed the Atlantic and has affected German banks with material US CRE exposures like Deutsche Pfandbrief Bank and Deutsche Bank. Overall, we believe much of the US Corporate market exhibits lower relative value than credit issued from Europe where sub-ordinated debt continues to offer reasonable opportunities.

Bidding for structured credit assets has become intense with new deals heavily oversubscribed. Credit conditions were favourable enough to see a large funding trade by Westpac. The last one of its size from a major bank was in 2020. Warehouse exposures are also being termed out into the more favourably priced market with many prime RMBS deals in the pipeline. With property prices reaching new highs, the outlook for employment being for ongoing growth, real wages improving and the expected interest burden near its peak, the credit quality for RMBS assets is extremely strong. Despite a significant rally in spreads, Australian structured credit continues to trade with a favourable margin to comparable offshore structured credit markets.

Whilst spreads on levered loans have also rallied, current all-in yields remain high given they are floating rate. This will still produce difficult financial conditions for borrowers and hence spreads have not narrowed as far as for some other markets. However, liquidity has returned and many borrowers who turned to the private debt market in 2023 are refinancing in the levered loan market once again. Loan issuance and CLO issuance year to date is towards the highest experienced since 2010. CLO spreads have rallied more strongly and new money appears best placed into the top of tranches for now.

The portfolio is positioned with a measure of conservatism in mind, given the relatively tight spreads available for much of the credit market. However, the benefits arising from the flexibility of the portfolio's mandate is particularly evident in such circumstances. Portfolio risk is heavily skewed towards European names, where opportunities remain reasonable for medium term investors. The sub-IG exposures are concentrated into AT1 issued by European systemically important banks and European CLO exposures of Tier1 managers with modest credit duration.

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In aggregate, the available traded margin of 3.65% pa infers a significant likelihood the portfolio will outperform the RBA target for medium term investors. This is despite key US corporate bond markets offering spreads where the margin for error appears low.

Although the portfolio is weighted towards European source of risk, the currency denominations (all hedged to AUD) are well balanced between the USD and EUR. We hold a small exposure to AUD denominated debt via two Australian REITs whose expected returns are particularly favourable. The portfolio's AUD exposure is below 10%.

The allocation to CLOs is in-line with benchmark weights, although tilted into European pools which still offer reasonably favourable margins. We have a small overweight to corporate bonds, funded by a modest underweight in cash and corporate hybrids.

With US and European yield curves presently deeply inverted, interest rate duration is negligible.

The portfolio's yield-to-maturity of 7.70%, unremarkable credit duration of 3.49yrs 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.

## OVERALL COMMENTS

Credit synthetics were largely unchanged at month end. Equities were mixed. The Nikkei performed strongly as foreign flows supported the market and a better inflation outlook lifted the prospects for corporate earnings. In contrast the Chinese equity markets fell. Authorities there introduced curbs on short selling, increased bank lending capacity and were rumored to be planning direct intervention into the equity market via state-owned enterprises. The VIX traded in a choppy fashion with Fed's Waller's hawkish conditioning of the US rate path and the surprisingly high number of job openings in the US each producing moderate spikes. Moves on bond yields were mixed although the US and Australian 10-year bond yields were close to unchanged on the month. As expectations for rate cuts in the US diminished, the USD strengthened. Oil prices rose on the resilience of the US economy, concerns over the Middle East and a larger than expected fall in US crude inventories.

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## OTHER DEVELOPMENTS

The US economy continued to be resilient. The Advanced GDP came in at a robust 3.3% saar. Retail sales for December exceeded expectations at 0.6% (ex auto/gas) and the more comprehensive personal spending measure also beat at 0.7%. The ISM PMI reports pointed to robust outcomes with the Manufacturing measure at 49.1 with the new orders component at 52.5. Services jumped to 53.4 and new orders here were also robust at 55. The strength of the JOLTS openings figure of 9m moved the market. The Non-Farm Payrolls also surprised to the strong side on jobs, earnings and unemployment. Core inflation measures remained contained. Although Treasury borrowing requirements remain elevated, the latest refunding release was well received. The Beige Book pointed to an improved outlook and easing wage pressure. Tourism, leisure and travel spending remains strong, whilst manufacturing was softer.

The FOMC left settings unchanged again. Fed speakers expressed the need for patience and Chair Powell captured the sentiments when indicating that a March rate cut was 'not base case'.

The Republican Presidential race has been winnowed to two candidates with Trump well ahead of Haley. A Trump Presidency is likely to see increased import tariffs in general with Chinese trade likely to experience a much higher impost. The government remains mired in efforts to pass a spending bill to support Ukraine with efforts linked to that supporting border control, Israel and other priorities. A purportedly bipartisan $118bn bill failed to pass the Senate.

The Australian economy is showing signs of troughing. Retail sales and the PMIs were stronger than anticipated. Whilst the NAB Business Survey saw Conditions decline slightly, Confidence has recovered from -8 to -1. House prices rose another 0.4% in January. Consumer sentiment remained weak with households expecting interest rates to remain unchanged over the year. Inflation outcomes were to the favourable side, but not sufficient for there to be any doubt that the RBA would hold rates steady in February. The press conference revealed a fresh posture from the RBA as Governor Bullock avoided making strong projections and counselled against reading too much into short term economic outcomes. The employment figure was surprisingly low at -65.7k, although this seems to be the result of seasonal adjustment difficulties which now appear to have washed through. Loan data suggests housing activity may be picking up again. The revisions to the Stage 3 tax cuts are not expected to materially impact the course of the economy. However, the scrapping of the Significant Investment Visa and lower student visa intake, together with further incentives against foreign ownership of vacant houses in favour of build to rent projects, will have an impact on rental inflation and housing prices and improve living standards in years to come.

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The European economy is soft, although the flash GDP result for Q4 suggests a technical recession has been avoided by the barest margin. PMI readings point to a slowing economy. However, the Loan Officer Survey suggests that credit conditions may soon start to ease. The ECB kept monetary policy unchanged and commentary generally centered around it being too early to talk about rate cuts. Nevertheless, the ECB's Chief Economist Lane and President Lagarde indicated that the time to commence discussions may arrive in June. Manufacturing is being hampered by diversions in the Red Sea as both Tesla and Volvo announced production cuts. Container shipping costs have doubled from levels just prior to the conflict in Gaza erupting. Eurozone GDP is expected to experience a gradual recovery from a flat Q4 as real wage growth improves and supports household spending. The bloc managed to agree to a support package for Ukraine after taking extraordinary action against Turkey.

Official statistics suggest China's economy is performing adequately. GDP (Q4) was 5.2% yoy, slightly below expectations. However, Industrial Production and Fixed Asset Investment growth were robust, especially in tech, EV and green energy. Household spending was still impaired by lack of confidence in housing. Retail spending disappointed and unemployment crept up to 5.1%. The PBoC left interest rates unchanged, possibly to protect bank profitability and the currency, but reduced the RRR by 50bps to increase lending capacity. Beleaguered developer, Evergrande, was ordered to liquidate by the HK courts although it is unclear what this means for its inventory in China. Credit growth came in below expectations. Housing prices fell slightly. Year on year consumer inflation was -0.3%. China's export prices over the year have declined at the fastest rate since the GFC, placing downwards pressure on global inflation. The election of a pro-sovereignty President in Taiwan has complicated plans to re-unify. It is believed that President Xi's latest purge of the military relates to corruption in the Rocket Forces. Foreign investor confidence in China has been strained as Foreign Direct Investment (YTD) YoY declined by 8%.

Japan's economy is performing well with the Services PMI indicating moderate growth. Unemployment is at the lowest point since covid, beating expectations. Core inflation was 2.3% yoy. Although the BoJ kept monetary settings unchanged, Governor Ueda has indicated increasing confidence that inflation projections will be met and permit an exit from the Negative Interest Rate Policy which has been in place since 2016.

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