# REALM HIGH INCOME FUND

APRIL 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 $1.47 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 | 0.42% | 0.46% | 0.29% |
| 3 Month | 0.25% | 0.38% | 0.84% |
| 6 Months | 5.17% | 5.40% | 1.59% |
| 1 Year | 3.88% | 4.28% | 2.35% |
| 3 Years p.a | 3.02% | 3.45% | 0.87% |
| 5 Years p.a | 3.18% | 3.61% | 0.99% |
| 10 Years p.a | 4.15% | #N/A | 1.50% |
| Since Inception p.a* | 4.27% | 4.28% | 1.59% |

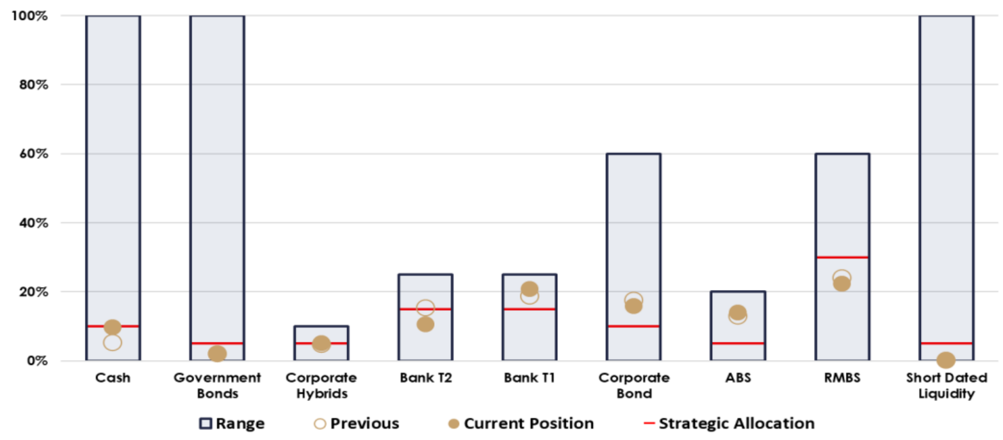
* Past performance is not indicative of future performance. *Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.

## FUND STATISTICS

| | |
|---|---|
| Running Yield | 6.11% |
| Yield to Maturity | 7.71% |
| Volatility† | 3.48% |
| Interest rate duration | 0.39 |
| Credit duration | 3.48 |
| Average Credit Rating | BBB+ |
| Number of positions | 365 |
| Average position exposure | 0.12% |
| Worst Month* | -1.99% |
| Best Month* | 2.12% |
| Sharpe ratio∂ | 1.53 |

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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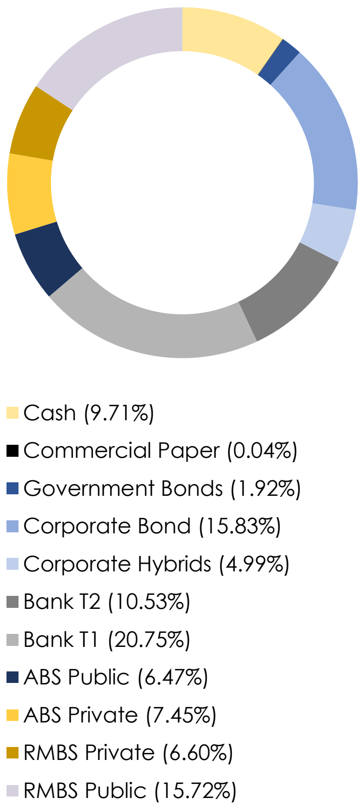
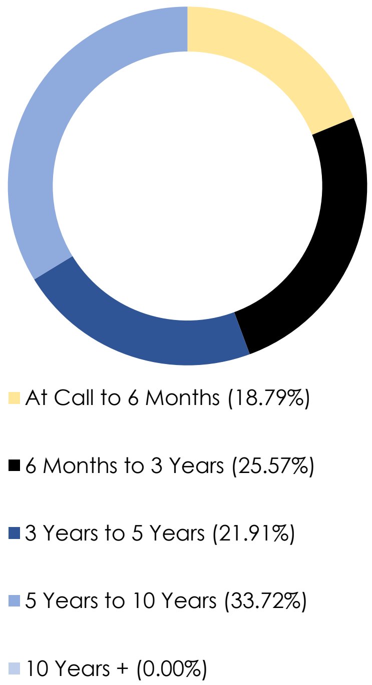
## PORTFOLIO COMPOSITION



## MATURITY PROFILE



## FUND UPDATE

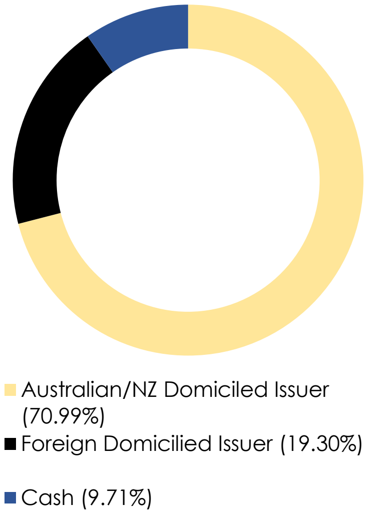
**Cash and Short-Term Liquidity Weighting:** ↑ The allocation to highly liquid assets (cash, commercial paper and government bonds) increased from 7.12% to 11.67%. This largely reflected lower allocations to bank T2, corporate bonds & RMBS which was partly offset by higher allocations to bank T1 and ABS.

**Corporate & Subordinated Debt Allocation:** ↓ Weighting to corporate bonds and subordinated debt (corporate hybrids and bank T2) decreased from 37.35% to 31.35%. Following the March banking crisis which saw the collapse of a couple of US regional banks and Credit Suisse, April felt like a relatively quiet month. Reduced volatility and solid first quarter earnings from the US major banks supported the continued recovery in global credit spreads over the first half of the month. This allowed us to take profits on bank T2's and crystalise the strong capital gain on our CS senior debt positions. Sentiment turned around in the second half of April, as concerns over US regional banking deposit flows re-emerged. Ultimately, this led the collapse of yet another US regional bank, First Republic Bank, on the 1st of May. While credit spreads have underperformed into the start of May, the sell-off has been modest compared to the moves witnessed in March. In terms of new issue supply, there was a pickup of new deals from Australian corporates including Worley and Stockland in AUD and Transurban, Sydney Airport and Telstra in EUR. This continued into the start of May with new deals from Australian Financials in AUD, including NAB, BEN and Suncorp issuing senior paper and ANZ issuing a T2.

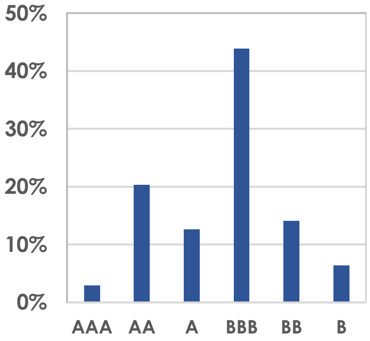
**Interest Rate Duration Position:** ↑ IRD positioning increased slightly from 0.38 to 0.39 years. Volatility in global government bonds was significantly subdued in the month of April, with trading ranges halving for the US and AUS 10-year bonds relative to the previous month. Risk sentiment was driven predominantly by deposit outflows in US regional banks and concerns around tightening in US bank lending. Additionally, US inflation and wages data highlighted its sticky nature, while PMIs aided in offsetting this. US debt ceiling came to the forefront of discussions with the timing of the pending 'X-date' questioned. Central bank action was mostly as expected and as a result, bond yields ended the month around where they began. Reflecting the market moves portfolio IRD positioning didn't deviate.

**Residential Mortgage-Backed Securities (RMBS):** ↓ Weighting to RMBS securities decreased from 23.93% to 22.32% over the month. Public structured credit market yields widened over the course of the month in line with other credit markets. Yields remain wide in comparison to historic market spread averages, all subsets of the capital structure widening. Whilst secondary markets were relatively quiet, primary markets saw several new trades issued including regional bank programs, two non-conforming transactions and several auto and personal loan programs. The pipeline of primary transactions remains robust, with a number of new trades looking to price in market over the next few weeks. With respect to market performance, Prime arrears as reported by S&P's SPIN index weakened 2bps over the month of March to 0.95%, with nonconforming arrears improving 29bps to 3.70%. Both results remain very strong in comparison to both market expectations and historic index levels.

## ISSUER DOMICILE



## CREDIT QUALITY



## PORTFOLIO ESG RISK LIMITS

| Sector | Portfolio Exposure | Portfolio Limit |
|---|---|---|
| Fossil Fuels | 3.37% | 10% |
| Non-Renewable & Nuclear Energy | 0% | 10% |
| Alcohol | 0.27% | 10% |
| Gambling | 0.19% | 10% |

**Additional Tier 1 (AT1) Exposures:** ↑ AT1 exposure increased from 18.66% to 20.75%. The strong recovery in global AT1's following the "banking crisis" in March, plateaued in April as sentiment weakened due to the ongoing concerns around US regional banks complex. This allowed us to further add to USD T1's issued by strong Australian financial institutions such as Macquarie and QBE. We continue to see exceptional value in global AT1's vs domestic ASX-listed AT1's.

**Asset Backed Securities (ABS):** ↑ ABS allocation increased from 12.94% to 13.92%. Each of the ABS exposures within the fund continue to perform well. 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 declined slightly from 2.73% to 2.69%. This reflected lower cash holdings which was offset by a decrease in credit duration (from 3.80 years to 3.48 years). Interest rate duration was largely unchanged (from 0.38 years to 0.39 years). The fund remains compliant with the Portfolio ESG risk limits.

## FUND OUTLOOK

With a yield to maturity exceeding 7% per annum, the forward-looking risk-reward outlook for medium term investors is favourable although expected market volatility in credit and bonds is higher than the 5-year average.

Credit spreads on cash bonds have remained elevated since the collapse of SVB in March, and while they are expected to revert towards pre-pandemic levels over time, immediate reversion is unlikely due to ongoing developments in US regional banks and rising concerns about a potential recession in the US. Lending standards in the US and Europe are becoming more conservative, with demand for credit also falling. The outlook for credit related to US commercial real estate is impaired, particularly for lower-grade buildings. Whilst stress tests do not point to systemic risk, this is contributing to weak sentiment.

Earnings reports from major banks worldwide, including Australia, confirm the portfolio's bank capital exposures remain secure. Whilst spread compression has stalled for AT1 bonds, the high carry available here and in Australian-issued subordinated corporate debt in offshore markets remains attractive. Portfolio exposures are being partially hedged with equity futures and total return swaps. Subordinated debt behaves increasingly like equities if distress develops. Exposures are well diversified across AUD, UK/EUR and USD markets. Non-conforming RMBS issuance has been strong and these are now available at more favourable prices. Arrears rates are normalizing. Portfolio liquidity remains strong.

## PLATFORM AVAILABILITY

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

## OTHER FUND DETAILS

**Responsible Entity:** One Managed Investment Funds Ltd
**Custodian:** JP Morgan
**Unit Pricing and Unit Price History:** https://www.realminvestments.com.au/ourproducts/Realm-high-income-fund/

## MARKETS AND OUTLOOK

Equity markets were generally stronger over the month although Chinese equities lagged. VIX declined from 18.5 to 15.8, a surprisingly low figure given the prevailing market conditions. Bond yields were largely unchanged in major markets, although UK 10-year bond yields were notably 23bps higher, driven by resilient wage inflation. US 2-year Treasuries traded over a wide 50bps range as the market's sensitivity to economic developments remained elevated. The JPY weakened following the first meeting for the BoJ's Governor Ueda where concerns over an imminent relaxation of yield curve control parameters were allayed. Although OPEC cut production guidance by 1mbpd, oil prices finished close to unchanged on the month. However, copper and iron ore traded lower as demand from China appeared weaker than expected. Investment grade credit markets were stable, trading over a much narrower range than last month. Australian senior bank debt rallied on limited supply.

## OTHER DEVELOPMENTS

In the US, core personal consumption was softer, but was more resilient than expected. Retail sales figures reflected the ongoing shift in consumption patterns from goods to services. Headline CPI benefited from the pass-through effects of lower energy prices. However, the core measure showed much less improvement with the key Core Services ex Shelter measure registering a reading that was similar to that over the prior 5 months. The Employment Cost Index surprised to the high side. Whilst the labour market remains tight, evidence pointing to a rebalancing can be inferred from vacancies and quits data both of which have retraced close to halfway towards pre-Covid levels. The implications are further confirmed by additional lead indicators like temporary help services employment, that have already declined to pre-Covid levels. PMIs indicated ongoing economic resilience.

Signs had emerged that the use of the Fed's emergency liquidity facilities had peaked following the demise of SVB. However, an outbreak of further instability amongst regional banks, including the ultimate sale of First Republic to JP Morgan, saw a further flight towards money market funds. Fed staffers predicted a mild recession, although their conclusions in this regard were not endorsed by the FOMC itself. Fedspeak continued to guide towards additional hikes and higher-for-longer settings although the outlook for credit supply is a key uncertainty. The Beige Book noted a tightening of credit availability which was confirmed by the Fed's Survey of Loan Officers.

The market remains fixed on X-date, the point at which the US may not be able to make scheduled payments to bond holders. Treasury Secretary Yellen indicated this could be as soon as 1 June. One-year sovereign credit default swaps traded at an 11-year high. President Biden announced he would contest the 2024 Presidential election.

Europe's resilience to the gas crisis remains impressive with storage levels well above the five-year average at this time of year. The Flash Q1 GDP was reported at 0.1%, which followed a 0% reading for Q4 2022, avoiding a technical recession by the barest of margins.

China's ongoing recovery was evident in the official PMI non-manufacturing survey which, at 58.2, continues the run of strong expansionary readings this year to date. Retail expenditure significantly outstripped expectations. Credit creation remains robust with long-term loans by the corporate sector driving demand. The troubled property sector is focused on completing pre-purchased homes. Pre-sales have largely recovered for state-owned enterprises but home-buyer confidence in privately owned developers remains highly impaired. The parlous state of balance sheets amongst some major developers is a key downside risk to activity. Plans were announced to curtail steel production, which impacted the price of iron ore. China remains burdened by a youth unemployment rate of 20%.

Australian retail sales are slowing, adding to evidence that household consumption is being wound back. The RBA paused during the April meeting, retaining a hawkish bias but opting to wait for a detailed update to forecasts that would be available for the next meeting. Subsequently, trimmed mean inflation came in softer than expected yet the RBA delivered a surprise hike in May. Concerns over productivity were added to the post-meeting release. Rents, which have risen 11% for the year according to PropTrack, are a source of inflationary concern. The RBA Review produced recommendations to improve the level of transparency and challenge during policy meetings, noting that every decision in at least the last 10 years aligned with recommendations produced by Bank officials.

The impact of rate rises will continue to strengthen as fixed rate mortgages roll off, bringing required payments to record levels as a proportion of household incomes. Despite this, residential property prices rose for a second month, supported by low vacancy rates and higher than expected immigration. The outlook for housing, as drawn from Westpac's Consumer Survey, is much improved and is now above the long-term average. In contrast, business surveys report declining activity off high levels and expectations for this trend to persist. The labour market continued to post strong results, with unemployment at 3.5%.

The Bank of Japan announced its own review which is expected to take between 12-18 months, buying time for the new Governor to determine the next policy moves. In the meantime, forward guidance was removed and forecasts for inflation in the medium term remain below the target of 2% per annum.

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Elsewhere, concern is growing for the visible fragmentation of foreign direct investment and settlement currencies into geopolitical blocs. Should this persist, ECB President Lagarde estimated that the impact could be as high as 5% to inflation in the near term accompanied with a weaker production outlook. US Treasury Secretary Yellen called for security to be prioritized over economic growth. Russia's economy is proving to be more resilient than hoped in the face of sanctions. India and China are purchasing 90% of oil exports, leading to an expectation of economic growth this year. A significant escalation of hostilities is expected in Ukraine. Finally, India is now the world's most populous nation.

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