REALM HIGH INCOME FUND

REALM INVESTMENT HOUSE

FEBRUARY 2024

FUND OBJECTIVE

The Realm High Income Fund is a fixed income strategy, that invests in domestic 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 $1.75 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

NET PERFORMANCE

Period	Ordinary Units (incl. franking)	Wholesale Units (incl. franking)	RBA Cash Rate Return
1 Month	0.71%	0.74%	0.34%
3 Month	3.58%	3.69%	1.07%
6 Months	5.77%	5.99%	2.10%
1 Year	9.22%	9.69%	4.07%
3 Years p.a	4.87%	5.31%	1.97%
5 Years p.a	4.68%	5.12%	1.43%
10 Years p.a	4.33%	4.78%	1.63%
Since Inception p.a*	4.80%	4.89%	1.78%

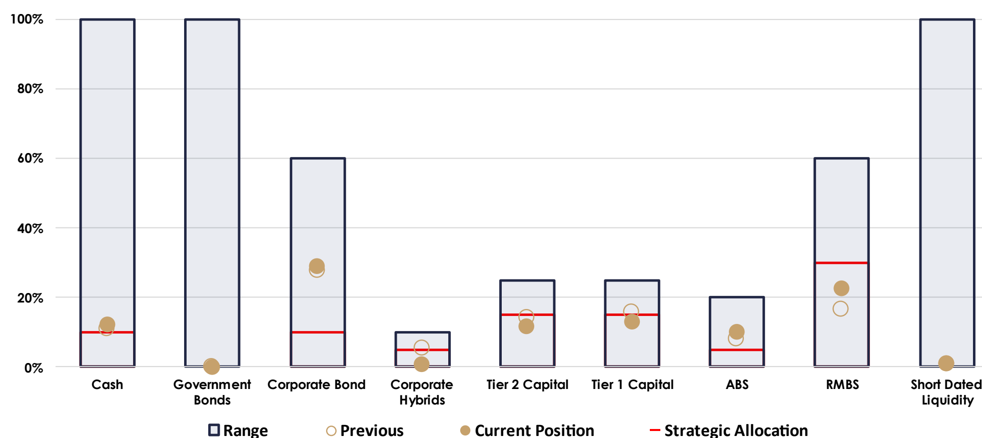
* Past performance is not indicative of future performance. *Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.

FUND STATISTICS

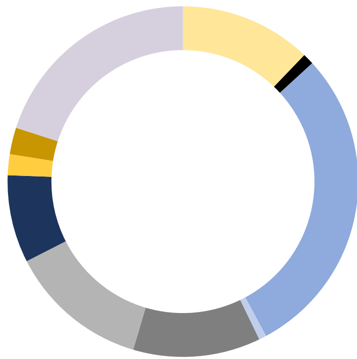
Running Yield	5.84%
Yield to Maturity	7.01%
Volatility†	2.54%
Interest rate duration	0.52
Credit duration	2.99
Average Credit Rating	BBB+
Number of positions	391
Average position exposure	0.12%
Worst Month*	-1.99%
Best Month*	2.09%
Sharpe ratio∂	2.13

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

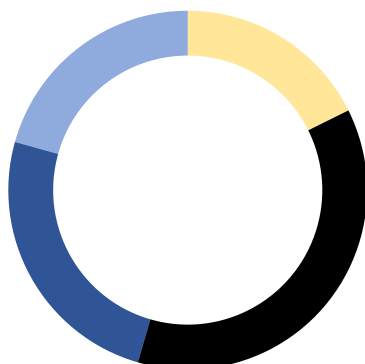


PORTFOLIO COMPOSITION



- Cash (12.17%)
- Commercial Paper (1.03%)
- Government Bonds (0.00%)
- Corporate Bond (28.94%)
- Corporate Hybrids (0.69%)
- Tier 2 Capital (11.75%)
- Tier 1 Capital (12.92%)
- ABS Public (8.08%)
- ABS Private (1.93%)
- RMBS Private (2.46%)
- RMBS Public (20.03%)

MATURITY PROFILE



- At Call to 6 Months (17.67%)
- 6 Months to 3 Years (36.81%)
- 3 Years to 5 Years (24.85%)
- 5 Years to 10 Years (20.67%)
- 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 11.92% to 13.20%. This mainly reflected lower allocations corporate hybrids, T1 capital and T2 capital which was partly offset by higher allocations to public RMBS/ABS and corporate bonds.

Corporate & Subordinated Debt: ↓ Weighting to corporate bonds and subordinated debt (corporate hybrids and T2 capital) decreased from 47.54% to 41.38%. Global credit spreads firmed for a fourth consecutive month, despite higher government bond yields and volatility. This provided the opportunity to meaningfully take profits across the corporate hybrid book and reallocate to higher quality corporate bonds, including new AUD corporate deals from Perth Airport and Region Retail Trust. Within the T2 capital book, the fund rotated from USD into new AUD deals from NAB and Macquarie. March has seen a meaningful return of primary issuance from Australian corporates across currencies. Notable deals include Stockland, Aurizon Networks, and Victoria Power Networks in AUD; Melbourne Airport, Brisbane Airport, and Transurban EUR; and CBA and ANZ T2 deals in USD.

Interest Rate Duration Position: ↓ IRD positioning decreased from 0.60 to 0.52 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. However, overall credit risk in the portfolio was reduced to realise gains and as such, the portfolio IRD was wound down appropriately.

Residential Mortgage-Backed Securities (RMBS): ↑ Weighting to RMBS securities increased from 16.75% to 22.49% over the month. Structured markets continued the considerable rally throughout the month of February, with many issuers looking to tap into the market strength to issue securitised product. As a result, dealfow for the month was substantial, with 11 transactions coming to market across Regional, Prime, Non-conforming and auto asset types. Transactions remain very well bid, with very high demand indicated by very high rates of oversubscription throughout the mezzanine (AA-B rated) tranches. Secondary markets remain overbid and continue to trade very tight relative to primary spreads. With respect to market performance, Prime arrears as reported by S&P's SPIN index for December weakened 6bps to 0.97% as is seasonally expected over the Christmas period. Nonconforming arrears also weakened, increasing to 4.02%. Both results remain strong in comparison to both market expectations and historic index levels.

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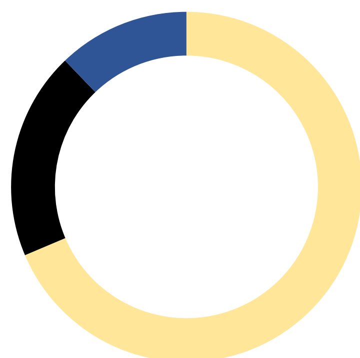
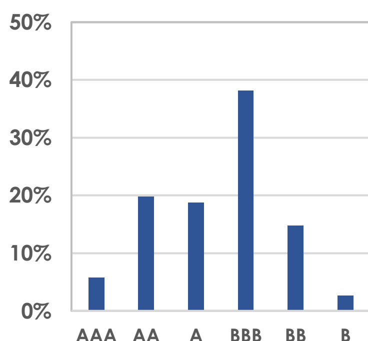
ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (68.62%)
- Foreign Domicilied Issuer (19.21%)
- Cash (12.17%)

CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Portfolio Exposure	Portfolio Limit
Fossil Fuels	3.19%	10%
Non-Renewable & Nuclear Energy	0%	10%
Alcohol	0.22%	10%
Gambling	0.14%	10%

Tier 1 Capital: ↓ Weighting to T1 capital decreased from 15.72% to 12.92%. The strong outperformance of global T1's over the past four months saw the fund meaningfully de-risk its strategic overweight which has been in place since March 2023. The lower allocation was largely expressed through profit taking of USD T1's issued by Australian banks and the partial reallocation to ASX-listed T1's. 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.

Asset Backed Securities (ABS): ↑ ABS allocation increased from 8.08% to 10.01%. 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 from 2.23% to 1.88%. This partly reflected lower allocations to higher beta sectors such as corporate hybrids, T2 capital and T1 capital as well as lower interest rate duration (from 0.60 years to 0.52 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

- 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/

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's settings remain towards the defensive side of our general practices. Whilst credit markets appear to be providing limited margin for error in aggregate, the corporate debt component of the portfolio is held in names which still offer value. The high volume of issuance is also providing the opportunity to extract new issue concessions.

AUD denominated corporate bond holdings are a notable area of portfolio risk exposure presently. These exposures are held in the senior debt of A-REITs backed by high quality assets. Nonetheless, the portfolio is adequately diversified via exposures to the resource extraction value chain and development.

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The portfolio's RMBS exposures are another area of notable risk deployment. As mentioned earlier, arrears are rising along the lines expected for the current economic environment. None of this is surprising or concerning. With a shortage of housing stock and, due to a lack of available skilled labour, limited ability to build new homes at a rate which is sufficient to address this in the near term, the vast majority of loans have positive equity beneath them. With next to no loss exposure, the credit risk associated with these holdings remains negligible. The portfolio is overweight ABS exposures where generous net interest margins and subordination provide strong buffers against potential loss.

The sub-Investment grade exposures are mostly held in a diversified portfolio of significant Europe/UK banks and structured credit exposures where we assess credit risks as remote. Some were affected by the recent bout of aversion associated with US CRE exposures, but credit risks for these were not assessed as having altered in any material way.

Interest rate duration was reduced slightly. This was largely driven by risk composition considerations as portfolio aggregate risk was wound back further. We have also adjusted portfolio hedges to allow for lower credit risk exposures.

The foreign issuer exposure remains close to the upper limit of 20% as good relative value can be found across corporate and bank capital asset classes. CLOs are also offering comparable opportunities relative to domestic structured credit. The foreign currency exposure is higher than this as selected Australian companies have attractive USD denominated bonds on issue.

As credit spreads are now tighter, return expectations relative to the RBA rate are towards the lower end of our historical experience. As per our contrarian approach, we will not boost risk taking to improve yields at a time when spreads offer lower than average value. The portfolio will be well placed to withstand a market re-assessment of economic risks, or pricing of existing risks, should that emerge for any reason. Meanwhile the yield to maturity of 7% offers attractive risk bearing in absolute terms and carries a low risk of producing a negative return over a six-month or one-year horizon.

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. 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.

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%.

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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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