# REALM HIGH INCOME FUND

**JULY 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 $1.52 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 | 1.28% | 1.31% | 0.34% |
| 3 Month | 3.40% | 3.50% | 0.99% |
| 6 Months | 3.66% | 3.90% | 1.83% |
| 1 Year | 7.60% | 8.01% | 3.17% |
| 3 Years p.a | 3.48% | 3.91% | 1.18% |
| 5 Years p.a | 3.74% | 4.18% | 1.12% |
| 10 Years p.a | 4.26% | #N/A | 1.53% |
| Since Inception p.a* | 4.49% | 4.54% | 1.65% |

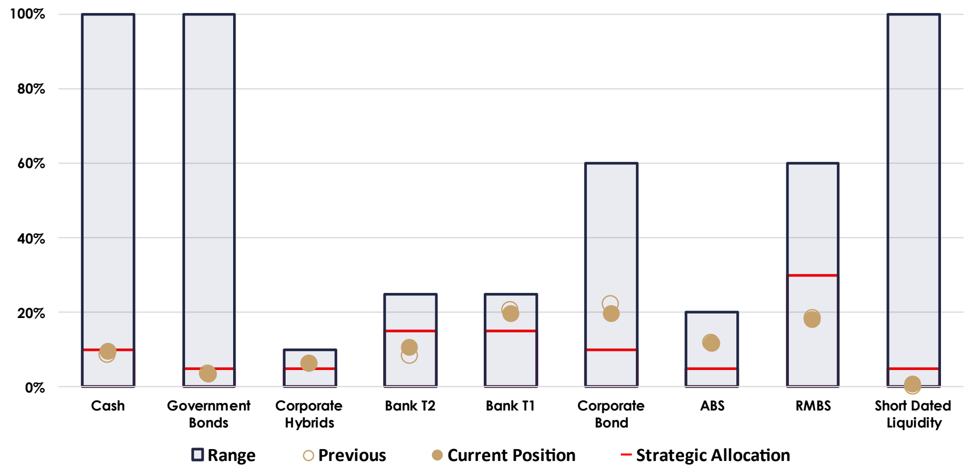
* Past performance is not indicative of future performance. *Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.

## FUND STATISTICS

| | |
|---|---|
| Running Yield | 5.61% |
| Yield to Maturity | 7.51% |
| Volatility† | 3.17% |
| Interest rate duration | 0.82 |
| Credit duration | 2.96 |
| Average Credit Rating | BBB+ |
| Number of positions | 328 |
| Average position exposure | 0.11% |
| Worst Month* | -1.99% |
| Best Month* | 2.09% |
| Sharpe ratio∂ | 2.01 |

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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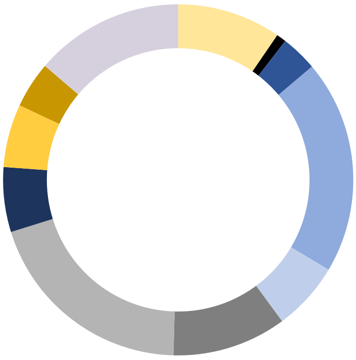
## PORTFOLIO COMPOSITION



- Cash (9.58%)
- Commercial Paper (0.89%)
- Government Bonds (3.37%)
- Corporate Bond (19.71%)
- Corporate Hybrids (6.34%)
- Bank T2 (10.54%)
- Bank T1 (19.77%)
- ABS Public (5.97%)
- ABS Private (5.81%)
- RMBS Private (4.26%)
- RMBS Public (13.76%)

## MATURITY PROFILE

- At Call to 6 Months (19.56%)
- 6 Months to 3 Years (33.44%)
- 3 Years to 5 Years (23.29%)
- 5 Years to 10 Years (23.71%)
- 10 Years + (0.00%)

## FUND UPDATE

**Cash and Short-Term Liquidity Weighting:** ↑ The allocation to highly liquid assets (cash, commercial paper and government bonds) increased from 12.15% to 13.84%. This reflected lower allocations to corporate bonds, bank T1 and ABS public; which was partly offset by higher allocations to bank T2 and ABS private.

**Corporate & Subordinated Debt Allocation:** ↓ Weighting to corporate bonds and subordinated debt (corporate hybrids and bank T2) decreased from 37.00% to 36.59%. July was a solid month for global credit as the risk sentiment continued to strengthen. This was partly attributed by the improved macroeconomic outlook in the US and positive developments in the US regional banking sector. As such, Financial sector credit spreads outperformed as they continue to recover post the March banking crisis, with ongoing strong outperformance from bank capital instruments (T2 and AT1). Noteworthy global issuance included a senior deal from Fifth Third Bancorp -- the first issuance from a pure US regional bank since the collapse of Silicon Valley Bank -- which has performed very strongly in secondary markets. Domestically, improved risk sentiment and muted new issuance saw credit spreads firm over the month, with notable outperformance from bank T2.

**Interest Rate Duration Position:** ↑ IRD positioning increased from 0.70 to 0.82 years. Volatility was divergent between Australian and US government bonds, with the trading range in the Australian 10 year remaining meaningfully higher than the US. During the month, the respective 10-year government bonds reached decade highs before contracting. Drivers of government bond volatility included a hawkish fed and a surprisingly strong ADP employment report. A weaker than expected inflation print and a cash rate increase of 0.25% as expected, led to the retracement of US bonds. Australian inflation was slightly lower than expected but printed a strong unemployment rate of 3.5%. However, the biggest driver of Australian bond volatility was the Bank of Japan's decision to increase the Yield Curve Control band of the 10-year bond to maximum of 1%. IRD positioning was influenced by these events.

**Residential Mortgage-Backed Securities (RMBS):** ↓ Weighting to RMBS securities decreased from 18.38% to 18.02% over the month. Public structured credit market yields began to tighten over the month of July, with reports of a strong offshore bid returning to the market. This was especially prevalent in the senior portions of the capital structure in prime transactions, with the bid tightening credit margins across the sector. Tighter yields continue to make transaction more economic for issuers, leading to a substantial amount of primary deal flow looking to price in markets over the next month, including several regional bank trades, along with both prime and non-conforming RMBS.

With respect to market performance, Prime arrears as reported by S&P's SPIN index improved 3bps over the month of June to 0.97%. Nonconforming arrears also improved, tightening 16bps to 3.47%. Both results remain very strong in comparison to both market expectations and historic index levels.

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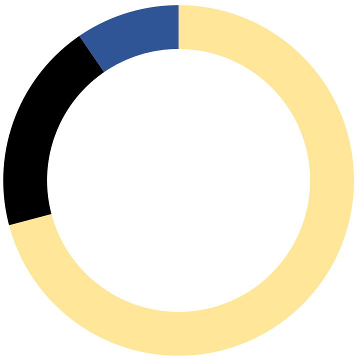
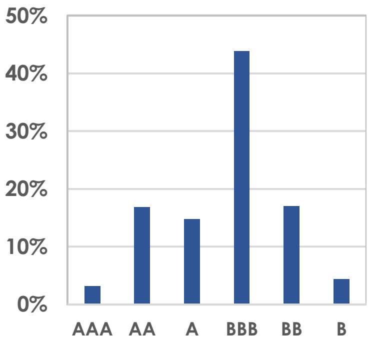
## ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (70.89%)
- Foreign Domicilied Issuer (19.53%)
- Cash (9.58%)

## CREDIT QUALITY




## PORTFOLIO ESG RISK LIMITS

| Sector | Portfolio Exposure | Portfolio Limit |
|---|---|---|
| Fossil Fuels | 4.84% | 10% |
| Non-Renewable & Nuclear Energy | 0% | 10% |
| Alcohol | 0.27% | 10% |
| Gambling | 0.18% | 10% |

**Additional Tier 1 (AT1) Exposures:** ↓ AT1 exposure decreased from 20.52% to 19.77%. Global AT1's continue to outperform strongly, supporting the fund's strategic overweight which has been in place since the March banking crisis. Confidence has dramatically returned to the sector as the call/redemption of several global AT1's have ameliorated near term extension risks. These include call notices from UK banks Barclays and HSBC and from Spanish banks BBVA and CaixaBank. We also saw the return of new issuance from Wells Fargo in USD - the first issuance from a Global Systemically Important Bank (G-SIB) in USD/EUR since the collapse of Credit Suisse. Domestically, ASX-listed AT1's were firmer over the month as the supply/demand dynamics remains supportive with no new issuance announced over the month.

**Asset Backed Securities (ABS):** ↓ ABS allocation decreased from 11.95% to 11.78%. Each of the ABS exposures within the fund continue to perform in line with expectations. 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 2.87% to 2.78%. This reflected increased cash holdings and lower credit duration (from 3.28 years to 2.96 years) which was partly offset by higher interest rate duration (from 0.70 years to 0.82 years). The fund remains compliant with the Portfolio ESG risk limits.

## FUND OUTLOOK

Credit markets remain favourably priced, on a risk adjusted basis, despite having rallied materially since the US regional banking crisis erupted. Spreads continue to reflect a higher-than-average risk aversion as monetary policy settings are restrictive in aggregate and the possibility of recession is elevated.

Hopes of a soft landing in the US and Australia are improving. Staff at the Fed have revised their prior expectations and no longer expect a recession to emerge in the coming year. The RBA continues to expect that inflation can be managed back to the target band within a reasonable timeframe, whilst preserving employment gains.

Energy prices are rising again, which may complicate the inflation outlook. Labour markets remain remarkably tight with many showing only early signs that wage inflation can expect to abate. Pockets of sub-investment grade markets are experiencing a material deterioration of fundamentals associated with a slowing economy and higher interest burden. The upcoming wall of maturity for high yield debt is a source of concern. Issuance of sub-IG corporate debt has been relatively low, as borrowers attempt to strengthen balance sheets, and this is producing scarcity effects which are creating a rally in spreads that cannot be fully attributed to an improving economic backdrop.

## 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:** JP Morgan
**Unit Pricing and Unit Price History:** https://www.realminvestments.com.au/ourproducts/Realm-high-income-fund/

The core of the banking systems we invest in remains very sound. An exceptionally favourable issuance of senior debt by US regional Fifth Third Bancorp signalled that concerns in this part of the market are receding despite the outlook for CRE not having improved.

As Australian banks report their earnings and additional arrears activity statistics are released, it is clear that distress amongst mortgagees remains generally well contained. Mortgagees rolling off fixed interest arrangements to higher variable rates are not showing unusual arrears performance. Given the rebound in property prices in recent months, any reasonable forecast for arrears does not produce projected losses within our structured credit exposures that concern us. Indeed, the foreign bid for private and public Australian structured credit has returned.

As the extreme mispricing of bank hybrids has now largely passed, portfolio risk bearing is becoming more diverse again. We have taken the opportunity to reduce our equity hedges in line with changes in the magnitude and distribution of risk in the portfolio. These still remain significant and will provide a material cushion to performance if the economic outlook should weaken.

To be clear, we continue to find good value in bank hybrids and our positions have recently been supported by calls made by several issuers. This provides greater confidence around the effective maturity date of these securities and is especially favourable for hybrids with lower reset rates. We also have a favourable disposition towards foreign currency bank tier 2 assets. Australian bank capital is less attractive given upcoming refinancing of TFF maturities and the resilience of the AUD bond market throughout the US regional banking crisis (plus Credit Suisse).

We are opportunistic amongst corporate names. We have been closely monitoring ongoing revisions to the carrying valuations of our REIT holdings as updates are reported. Our exposures remain highly secure. Australian corporate bonds have been supported by a very light issuance roster. In contrast, the pipeline for structured credit is strong. Given current favourable valuations, we will be taking this opportunity to add to portfolio exposures.

We have been trading the oscillations in bond yields in a contrarian fashion. Despite Australian 10-year bond yields reaching 4% again, the portfolio's interest rate duration remains relatively modest in the context of history and the elevated level of risk bearing in the credit holdings.

The portfolio is expected to experience further compression in traded margins in the medium term. With a yield to maturity above 7%, the portfolio characteristics and external environment suggest the forward-looking reward-for-risk remains above average.

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## REALM INVESTMENT HOUSE CONTACTS

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## MARKET DEVELOPMENTS

Markets were stronger over July as the peak of the cash rate cycle appears close to hand. Receding concerns for the US regional banking sector and the increasing likelihood of a soft landing helped to draw spreads lower. Equities markets were generally stronger. The VIX finished the month below 14, near lows recorded since the covid period. The index jumped during the month following the release of somewhat hawkish Fed minutes relating to the June meeting. Whilst bond yields subsequently rallied again, they generally finished wider. Notably, the Bank of Japan revised the management of the yield curve control policy relating to 10-year bonds and will allow yields there to trade as high as 1%. Yields rose immediately. As concerns for risk abated, the USD weakened. Whilst this contributed to higher commodity prices (which are quoted in USD), oil prices rose as the global economy remained resilient and industrial commodities benefited from rising expectations for further stimulus in China.

## OTHER DEVELOPMENTS

The Fed hiked in July with the key rate lifted by 25bps to a target range between 5.25% and 5.50%. A soft landing was seen as likelier than recession. A weaker than expected non-farm payrolls figure was reported and well received. The ISM survey and Beige Book point to expectations for normalisation of wage growth. Inflation outcomes were favourable. Used car prices declined and both CPI and PPI readings surprised to the low side. The Advanced GDP estimate for Q2 was 2.4% SAAR which was higher than the 1.8% expected. Consumer sentiment improved and house prices recorded their fourth consecutive positive monthly return. Fitch downgraded US sovereign debt to AA+ (stable), matching S&P's rating. This has refocused attention on the lack of sustainability of the US budget trajectory as the interest burden accelerates.

RBA Governor Lowe will depart having contributed to the best employment outcomes Australia has seen for many decades whilst expecting a soft landing. Michele Bulloch's appointment to the role was warmly received. The RBA held rates unchanged, citing the need to be patient to observe incoming data. It held again in August and mentioned evidence of easing labour market conditions. Rent inflation is becoming a complicating factor. The labour force grew by 32.6k jobs vs expectations of 15k and unemployment stayed low at 3.5%. There are limited signs that a wage-inflation spiral will become entrenched. The trimmed mean inflation reading and subsequent PPI were softer than expected. The outlook for consumer spending remains a key source of uncertainty. NAB transaction data suggests nominal spending remains robust yet consumer confidence did not improve materially despite the rate pauses. The NAB business survey continues to suggest that activity will moderate in an orderly manner. The CoreLogic property series recorded its fifth consecutive positive monthly return. Supply-side inflation now appears close to being fully resolved.

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High inflation is absent in the Chinese economic setting. The economic performance continues to underwhelm and the preparedness to create targeted stimulus has been announced, avoiding a big bang approach. Some attention is being directed towards the fragility of the financial system which, given its importance to the property market, presents a challenge as the property sector is a drag on growth. The labour market here is weak, with youth unemployment a significant social issue and low wage growth indicating that slack remains. GDP growth expectations for 2023 are being pared back.

The European outlook remains challenging. Core inflation for June accelerated although the PPI reading came in below expectations at -1.9% for the month. The economic growth outlook continues to be for modest growth in the coming year which is likely to avoid recession. The ECB raised rates a further 25bps to bring the Main Refinancing Operations rate to 4.25%. The post meeting communications were decidedly less hawkish.

Although inflation challenges in the UK imply that the Bank of England still has some way to run before concluding its tightening cycle, most other major central banks appear to have reached their terminal rate or will shortly do so. As central bank balance sheets (other than Japan) are being wound down, we expect the possibility of active quantitative tightening will be discussed further. The RBA's holdings of government bonds have a relatively extended maturity schedule making active QT a greater possibility.

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