# REALM HIGH INCOME FUND

**JANUARY 2022**

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 $1.39 billion
**Management Fees (inc. GST):**
Ordinary Units - 1.20%
Wholesale Units - 0.77%
Adviser Units - 0.77%
mFunds Units – 0.77%
**Direct Minimum Investment:**
Ordinary Units - $25,000
Wholesale Units - $1,000,000
Adviser Units - $25,000
mFund Units - $10,000

Zenith
RECOMMENDED

## NET PERFORMANCE

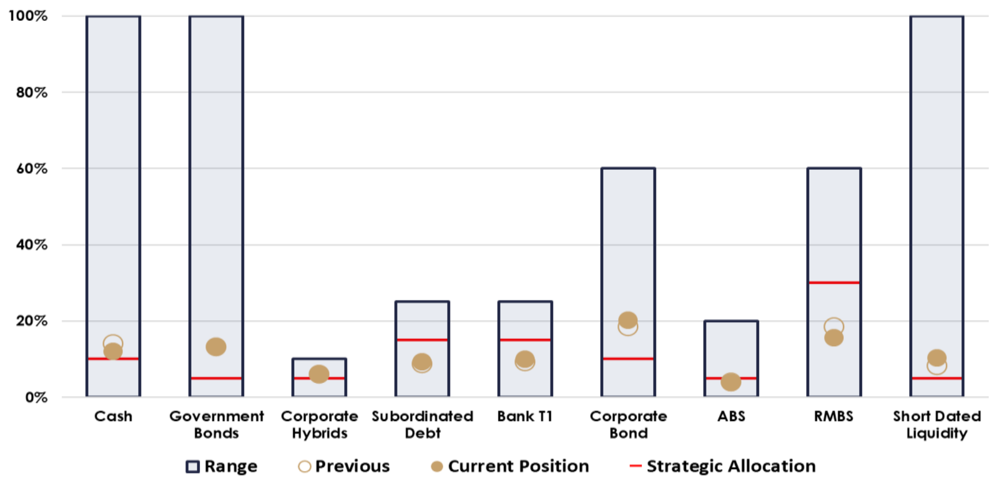
| Period | Ordinary Units (incl. franking) | Wholesale Units (incl. franking) | RBA Cash Rate Return |
|---|---|---|---|
| 1 Month | -0.06% | -0.02% | 0.01% |
| 3 Month | 0.68% | 0.79% | 0.03% |
| 6 Months | 0.25% | 0.48% | 0.05% |
| 1 Year | 2.23% | 2.67% | 0.10% |
| 3 Years p.a | 4.06% | 4.50% | 0.49% |
| 5 Years p.a | 3.47% | 3.92% | 0.89% |
| Since Inception p.a* | 4.60% | 4.59% | 1.55% |

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

## FUND STATISTICS

| | |
|---|---|
| Running Yield | 3.50% |
| Yield to Maturity | 2.62% |
| Volatility† | 1.12% |
| Interest rate duration | 1.07 |
| Credit duration | 1.87 |
| Average Credit Rating | BBB+ |
| Number of positions | 295 |
| Average position exposure | 0.63% |
| Worst Month* | -1.19% |
| Best Month* | 1.22% |
| Sharpe ratio∂ | 3.17 |

## SECTOR ALLOCATION



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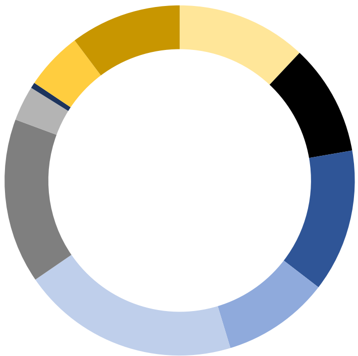
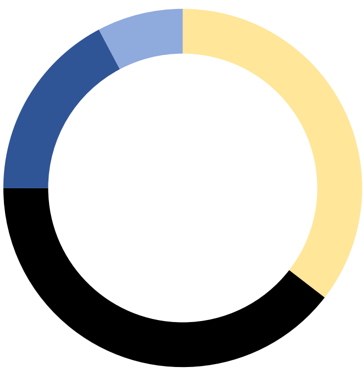
## PORTFOLIO COMPOSITION



- Cash (12.00%)
- Commercial Paper (10.26%)
- Government Bonds (13.18%)
- Bank T1 (9.88%)
- Corporate Bond (20.10%)
- Subordinated Debt (15.23%)
- ABS Public (3.23%)
- ABS Private (0.53%)
- RMBS Private (5.35%)
- RMBS Public (10.24%)

## MATURITY PROFILE



- At Call to 6 Months (35.47%)
- 6 Months to 3 Years (39.50%)
- 3 Years to 5 Years (17.28%)
- 5 Years to 10 Years (7.74%)
- 10 Years + (0.00%)

## FUND UPDATE

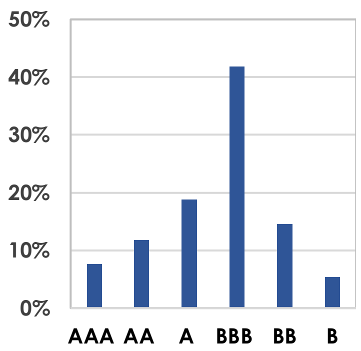
**Cash and Short-Term Liquidity Weighting:** ↑ The allocation to cash, commercial paper and government bonds increased slightly from 35.37% to 35.44%. Compositionally, the reduction in cash holdings (-1.93%) was reallocated to commercial paper (+2.02%), while government bond holdings were largely unchanged.

**Corporate & Subordinated Debt Allocation:** ↑ Weighting to corporate and sub debt increased from 32.99% to 35.33%. Credit markets weakened over the month (and continued into February) as the sell-off in global government bonds dragged credit spreads wider. USD and EUR credit markets gapped wider, reversing the outperformance experienced in December, while AUD outperformed relatively. There was an uptick in issuance in the first half as market sentiment held firm. Notably, CBA and Westpac issued 5-year senior unsecured bonds domestically, while NAB issued multi-trance senior unsecured and Tier-2 bonds in USD. We are starting to see improved relative value, particularly in USD and EUR credit markets and have been selectively adding risk accordingly.

**Interest Rate Duration Position:** ↑ IRD positioning increased to 1.07 from 0.99 years. Inflation data released in the US and Europe surprised to the upside, prompting hawkish commentary from central bank members. Narrative in the US was centred around predicting the number of rate hikes and market pundits' opinions ranged from 4 to even 6 rate hikes in 2022. Aggressive rate hike opinions and the formal end of US QE in March caused significant volatility in Australian markets. Opportunities were once again presented, and the fund extended IRD on the back of external market drivers.

**Residential Mortgage-Backed Securities (RMBS):** ↓ Weighting to RMBS decreased this month from 18.5% to 15.6%. January was a quiet month for issuance as is seasonally expected, with only a small handful of new transactions sounding the market in the last week of January. There remains a strong bid in the secondary market for high quality assets, with mezzanine (A and BBB rated) and junior mezzanine (sub investment grate) notes remaining very well bid in secondary markets. These bonds remain very tightly held by market participants, with significant appetite continuing to support pricing. Within the senior part of the capital structure (AAA and AA rated), pricing has moderated from market tights, with low coverage rates indicating continuing to indicate a lack of demand for this part of the structure, which continues to weigh on market pricing.

## CREDIT QUALITY




## PORTFOLIO ESG RISK LIMITS

| Sector | Portfolio Exposure | Portfolio Limit |
|---|---|---|
| Fossil Fuels | 7.70% | 10% |
| Non-Renewable & Nuclear Energy | 0% | 10% |
| Alcohol | 0% | 10% |
| Gambling | 1.01% | 10% |

**Additional Tier 1 (AT1) Exposures:** ↑ AT1 exposure increased from 9.26% to 9.88%. We selectively added risk as market volatility modestly improved the relative value across the sector. The supply/ demand dynamics of the AT1 market was supportive with no new issuance during the month. ANZ have announced a potential new issue to refinance the ANZPE AT1's which are callable in March. We anticipate CBA could also announce a new deal to refinance the CBAPF AT1's which are also callable in March.

**Asset Backed Securities (ABS):** → Our ABS allocation remained in line with last month at 3.8%. Fund exposures continue to perform well, with strong yield profiles exhibited by shorter duration assets, which makes them highly sought by market while pricing remains tight.

**Targeted risk across the Fund:** ↑ Targeted portfolio risk increased from 0.83% to 0.87% as we reduced our cash holdings and modestly increased interest rate duration and credit duration. The fund remains compliant with the Portfolio ESG risk limits.

## MARKET OUTLOOK

The year opened eventfully. Markets became more convinced that Omicron would have lower health effects and far less economic impacts than Delta. The outlook was re-assessed and materially upgraded from expectations in place heading into Christmas. Economic releases relating to labour and inflation surprised strongly to the upside in aggregate. Bond yields rose sharply again, the third wave since the US elections brought the Democrats to power in the 2020 Elections and, with the Blue Sweep, Biden's policy agenda of an exceptionally large fiscal (over) stimulus. Equity markets suffered significant falls as this round of extraordinary monetary support is ending. Credit traded softer and the AUD fell against a surging USD which was buoyed by the abandonment of the Fed's previously dovish stance. US CPI recorded a 7% yoy outcome, the highest for nearly 40 years.

Rising energy costs have been a significant contributor to inflation and January provided little respite as OPEC production fell short of targets against a rapidly improving economic backdrop. Markets were also skittish with the elevated geopolitical risks, focussed primarily on Ukraine this time. A shortage of gas in Europe, coal export bans in Indonesia and production issues for Iron Ore in Brazil set the stage for generally strong commodity prices. Labour shortages continued to be widely reported. The VIX rose to levels not seen for almost a year and this contributes to rising concerns we have for the stability of cross-border flows, particularly to non-China emerging markets where covid has left economies more impaired and with less fiscal space than developed markets.

## 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/

Forecasting during a covid outbreak brings more than the usual level of uncertainty. During the month, economic outcomes were generally far stronger than had been anticipated just a month earlier. In Australia, the underemployment rate fell to levels which are firmly within the range where stronger wage rises can be expected. Trimmed inflation printed at a level which was well beyond what the RBA expected just in November and well through even the upper range of estimates. The RBA was forced to subsequently abandon a narrative that rates were very unlikely to rise in 2022. The expected path of Australian rates tightly tracked the movement in the US Fed expectations. A seemingly unlikely 4 rate rises have been priced for the RBA in 2022. Just a few short months ago, only the hawkish forecasters saw the possibility of a rate rise in Q4 2022.

A similar pattern was noted in several other central banks and the prospect of a rate rise for the ECB, it's first for over 10 years, became a real likelihood. QE programs were anticipated to be quickly wound down and the focus now turns to how fast the bloated balance sheets will be reduced. The Bank of England has already flagged that it will actively consider a sell down of the large government bond holdings in the coming months. For the Fed and Australia, some form of staged run-off pursuant to maturation of the books seems more likely at present.

As the yield curve rose, banks lifted fixed rate mortgages and bank senior issuance sprang to life again after a 2-year period where balance sheet financing was largely left to the RBA and deposit growth arising from fiscal support. This marks the beginning of a multi-year window where banks will need to wean themselves off official support and adjust to more stringent liquidity management. The size of this refinancing is significant and will dampen the outlook for high grade credit. Corporate treasurers also moved to lock in rates and this affected the swap markets as well, with spreads widening as bond yields rose. Semi-government spreads widened despite a limited issuance burden. Finally, the structured credit market had a late start to the year and recorded no issuance activity. This provided little price guidance to a market which otherwise traded flat over the month.

Strong turning points bring additional risks and our portfolios are conservatively positioned. Within our investment universe, the best value continues to be found in mezzanine structured debt, and private debt. These can withstand extremely severe developments in housing and asset-backed markets.

We are noting that there are signs that supply chain difficulties may be close to a peak, but remain far from reversion. Nonetheless, a well-worn path of creating excess supply seems to be in train with large investments into increasing manufacturing capacity in Asia, including for semi-conductor chips, setting the stage for a return to disinflationary settings later in the year when inventories rebalance again. If wage rises do not become entrenched, we might readily find ourselves in a situation where inflationary outcomes are not especially elevated and on a meaningfully downwards trajectory. With Australian borders now open for immigration, and significant inertia build into the wage-setting process for many industries, the likelihood of a sustained wage breakout appears low. However, this may not be the case in the US.

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Although the portfolios are running risk levels which are towards the lowest end for several years, we are finding selected opportunities in the corporate book in individual names and in Australian bank capital issued into offshore markets which have been sold off too aggressively. As the rate tightening cycle continues, more opportunities will develop and we can expect a progressive rebuilding of risk in these areas. We are holding very high levels of liquidity which is ready to deploy should there be a policy error (over tightening by central banks) or some other risk event like instability of international capital flows or Ukrainian incursion.

The rapidly improving economic environment has led to losses arising from our government bond holdings. Whilst we think that the market has run well ahead of reasonable expectations for rate rises from the RBA in 2022, our interest rate duration remains around long-term average and our risk management has protected the portfolios from more significant losses that might otherwise have occurred over these challenging bond sell-offs. Our interest rate duration exposure is now focused heavily on the maturities of 3 years or less, largely avoiding the expected effects of the quantitative tightening to come.

Whilst forward looking returns remain below long-term averages, they remain reasonable in the context of an extremely low rate environment. We remain contrarian in our approach and will not take steps to boost near term yield where risk bearing would be disproportionately high for the small gains which can be found. We are eagerly seeking quality exposures to the mezzanine layers of structured assets in public and private markets. Our deal flow remains active, and the quality of the opportunities continue to be favourable.

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