REALM SHORT TERM INCOME FUND

REALM INVESTMENT HOUSE

AUGUST 2023

FUND OBJECTIVE

The Realm Short Term Income Fund seeks to produce a return (net of fees) that exceeds the total return of the RBA Overnight Cash Rate by 1.50%-2.00% p.a. over rolling three-year periods.

FUND DETAILS

Distribution Frequency: Monthly

Liquidity: Daily

Buy/Sell: 0.00% / 0.00%

Direct Minimum Investment:

Ordinary Units - $25,000

mFunds Units - $25,000

Inception Date: 21.12.2017

Fund size: AUD $1.08 billion

APIR Codes:

Ordinary Units - OMF3725AU

mFunds Units - OMF8160AU

Management Costs (Net of GST):

Ordinary Units – 0.3075%

mFunds Units – 0.3634%

NET PERFORMANCE

Period	Short Term Income Fund	RBA Cash Rate Return
1 Month	0.60%	0.34%
3 Month	1.64%	1.01%
6 Month	2.86%	1.93%
1 Year	5.08%	3.36%
3 Year p.a	2.67%	1.29%
5 Year p.a	2.71%	1.16%
Since Inception p.a*	2.71%	1.20%

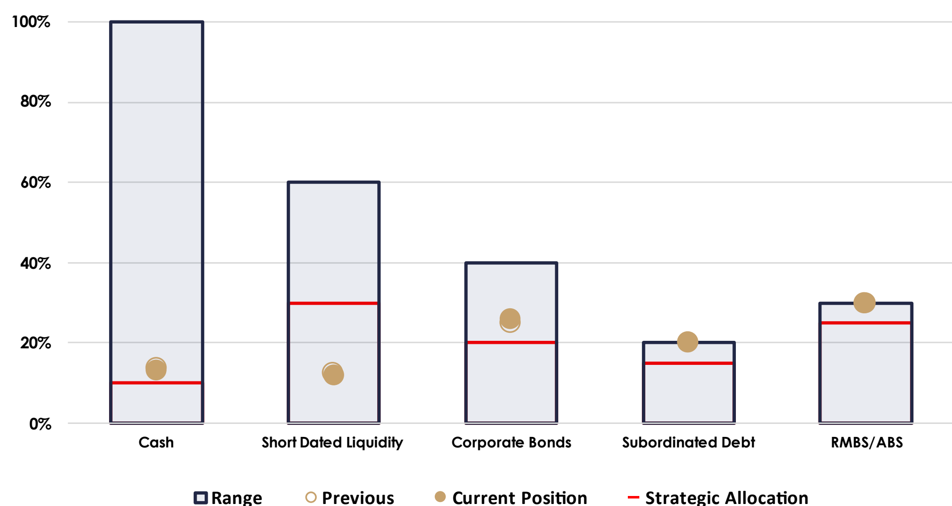
*Past performance is not indicative of future performance. Inception date is 21 December 2017.

FUND STATISTICS

Running Yield	5.55%
Yield to Maturity	5.96%
Volatility†	0.39%
Interest rate duration	0.09
Credit duration	1.48
Average Credit Rating	A
Number of positions	290
Average position exp.	0.27%
Worst Month*	-0.26%
Best Month*	0.60%
Sharpe ratio∂	4.45

Calculated on Ordinary Units unless otherwise stated. *Since Inception 21 December 2017.
†Trailing 12 Months Calculated on Daily observations. ∂Since Inception Calculated on Daily observations

SECTOR ALLOCATION



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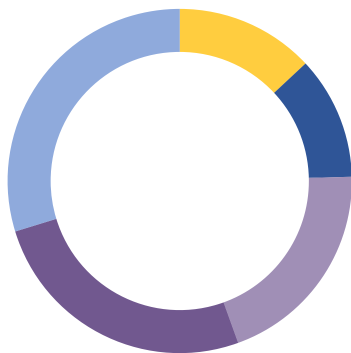
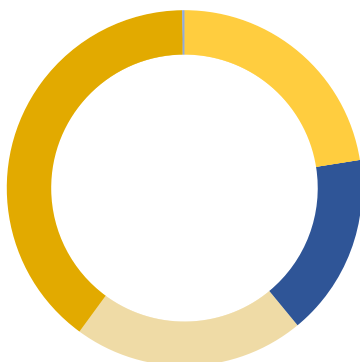
PORTFOLIO COMPOSITION



- Cash (13.04%)
- Short Dated Liquidity (11.57%)
- Sub Debt (19.88%)
- Corporate Bond (25.77%)
- RMBS & ABS (29.74%)

MATURITY PROFILE



- At Call to 6 Months (22.49%)
- 6 Months to 1 Years (16.54%)
- 1 Years to 2 Years (21.04%)
- 2 Years to 3 Years (39.73%)
- 3 Years to 3.5 Years (0.21%)

FUND UPDATE

Cash and Short-Term Liquidity Weighting: ↓ Cash and Short dated liquidity decreased from 25.77% to 24.61%.

Interest Rate Duration Position: → 0.09 years. The strategy will maintain interest rate duration of approximately 3 months as an average. Having a low IRD number limited the realised volatility and losses in the fund from government bond volatility over the month (39 basis point trading range for AU 3-year bonds). The strategy will, as a rule, only take modest interest rate risk.

Corporate & Subordinated Debt Allocation: ↑ Increased from 44.62% to 45.65%. Optimisation within the corporate bond sector was skewed towards financials due to primary issuances in the market. Corporate bonds, traditionally, present modest relative value over bank senior bonds due to the rating differential; and this relative value was maintained over the month as both financial and corporate bond spreads tightened. Corporate bond volatility, albeit small, was driven partly by movement in swap spreads from hedging activity. Subordinated debt was optimized towards Australian banks in EUR. The short, conservative nature of the sector and diversification aided in cushioning the market volatility over the month.

Residential Mortgage-Backed Securities (RMBS) & ABS: → Allocation to structured credit securities remained in line with last month at 29.77%. As at month end, the portfolio maintained an A- average credit rating and a relatively short weighted credit duration of 1.74 years.

Public structured credit market yields continued to tighten over the month of August, with the strong offshore bid maintained in the senior and higher rated mezzanine tranches. Margins across lower credit grade portions of the capital structure also tightened, especially around the A and BBB rated tranches, as investors began to compete for supply as margins continued to tighten. Issuers continue to utilise the cheaper funding margins to issue transactions at more economic levels. This has led to a large number of new transactions seeking to price over the period across a wide range of subsectors including regional bank trades, both prime and non-conforming RMBS, and asset backed securities.

With respect to market performance, Prime arrears as reported by S&P's SPIN index improved 1bp over the month of July to 0.96%. Nonconforming arrears weakened slightly, widening 16bps to 3.63%. Both results remain very strong in comparison to both market expectations and historic index levels.

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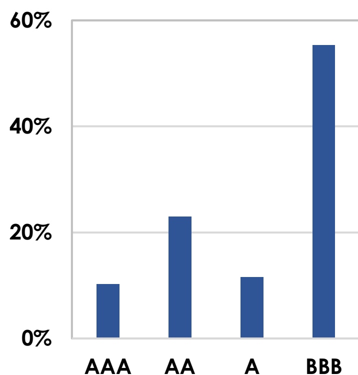
CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Direct Exposure	Direct Limit	Indirect Exposure	Indirect Limit
Fossil Fuels	0.0%	0.0%	0.0%	2.5%
Non-Renewable & Nuclear Energy	0.0%	0.0%	0.0%	2.5%
Alcohol	0.0%	0.0%	0.14%	2.5%
Gambling	0.0%	0.0%	0.0%	2.5%

OTHER FUND DETAILS

Responsible Entity: One Managed Investment Funds Ltd

Custodian: Mainstream Fund Services Pty Ltd

Unit Pricing and Unit Price: https://www.realminvestments.com.au/our-products/realm-short-term-income-fund/

Targeted risk across the Fund: ↓ Targeted risk decreased from 0.90% to 0.87%, reflecting the increase in market volatility and optimisation within portfolio limits. Meanwhile, realised standard deviation is at 0.39%. This has risen over the short term due to increased volatility in mark to market valuations. The portfolio remains defensively positioned although despite this, the fund has performed relatively well over the last 12 months, delivering 5.08% after fees. This is evidence that the strategy is well designed, delivering a reasonable premium over cash while maintaining a very tight distribution of returns month on month. The fund remains compliant with the portfolio ESG risk limits.

FUND OUTLOOK

Credit markets continue to offer spreads which provide above average risk-adjusted returns. However, as markets have rallied following the US regional banking crisis, some segments have become much less attractive. Medium term investors are still expected to benefit from elevated risk aversion associated with a slowing economy.

Bank debt in the key US and European markets continue to offer value as spreads have not fully recovered from the shocks related to the invasion of Ukraine, Trussonomics and the US regional banking crisis which also brought the demise of Credit Suisse. The immediate outlook depends on forecasts of the cash rate path and would turn bearish if projected rate cuts in 2024 should fail to materialize. CRE related risks remain relevant, particularly as a wall of refinancing is approaching in 2024, however they are not considered to be a threat to the financial system. Australian bank system risk was more resilient during recent risk episodes and offers less opportunity. Domestic banks are also refinancing their Term Funding Facilities which will create higher than usual issuance volumes, dampening the outlook.

Corporates are responding to tighter monetary conditions by improving balance sheets where possible and deferring refinancing. The US and European markets offer modest premia for an economic slowdown. Australian corporate debt offers more value than offshore markets in aggregate with investment grade spreads to the larger markets remaining relatively wide.

As cash rates and government bond yields have risen, market behaviour is increasingly focused on securing all-in yields. This creates a dynamic where spreads in segments of the credit market move increasingly inversely to bond yields. This dynamic is most notable in high yield segments where balance sheets are nonetheless considered to be strong enough to comfortably travel through the coming period of below trend growth. The dynamic is supported by relatively low issuance at present and limited immediate re-financing needs. These technical considerations have created spreads which offer less value here than other segments of the credit market.

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PLATFORM AVAILABILITY

- Australian Money Market
- AMP North
- BT Panorama
- eXpand
- Firstwrap
- Hub24
- Macquarie Wrap
- Mason Stevens
- MLC Navigator/Wrap
- Netwealth
- Powerwrap
- Praemium
- Rhythm
- mFund code: RLM02

Whilst senior structured credit has rallied in line with bank senior debt, the mezzanine components have lagged and this creates opportunities to secure returns from further compression. Primary transaction volumes have increased again as spreads have tightened, creating greater incentives to recycle warehouse and balance sheet financing. Within domestic markets, access to deals remains an issue for most investors who do not have pre-emptive rights or cornerstone positions. Realm is well placed in that regard. Despite a slowing economy, arrears rates remain low and regular seasonal factors have reduced these figures in recent months. National property prices have been rising since March, decrease potential loss exposure in RMBS. CLO markets are benefiting from scarcity effects as spreads remain wider than levels where most managers have incentives to issue new structures although we appear close to a turning point. Markets are strongly favouring programs offered by top-tier managers who have the best capacity to restructure distressed deals in the underlying portfolio.

The portfolio continues to operate within well defined boundaries. The traded margin of 208bps remains favourable. Along with a yield to maturity of 6% and conservative portfolio positioning, the risk of a negative monthly return is presently very low. The portfolio remains likely to produce competitive returns against term deposit alternatives whilst providing daily access to liquidity.

Following month end, the portfolio commenced introducing foreign currency denominated bonds. These are fully hedged back to AUD. The recent expansion of the effective investible universe to include foreign currency denominated bonds improves the portfolio's likelihood of meeting its investment objectives.

By way of example, the portfolio recently sold a basket of AUD denominated Australian regional bank subordinated debt exposures with spreads averaging close to 200bps. These were replaced with Australian major bank subordinated debt, issued in EUR, of similar maturity at spreads of 250bps. These trades improved credit quality, diversified market risks, and lifted expected returns. Adding foreign issuers provides even greater scope to achieve these gains.

MARKET DEVELOPMENTS

Credit synthetics weakened during the month as major Chinese property developer Country Garden missed a bond payment. Equities were lower with price performance and the VIX moving in concert with credit. Ten-year government bond yields in major markets were unchanged overall. USD strength was notable, driven by surprising economic resilience in the US and risk aversion. Despite a stronger USD, oil prices also spiked as Saudi Arabia and Russia extended their voluntary production cuts. A weaker than expected Chinese economy is contributing to lower copper prices.

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OTHER DEVELOPMENTS

The outlook for growth in the US strengthened following a strong core retail sales outcome, higher than expected industrial production and robust ISM readings. Nonetheless, new orders and expectations for job creation are easing. Whilst spending on tourism remains elevated, discretionary spending is declining. The stock of excess savings has been largely depleted. Inflation readings were favourable, with core inflation at 4.7% yoy which was slightly below expectations. Whilst the labour market remained tight and wage growth remained robust, leading indicators like vacancies, quit rates and temporary help hiring suggested a turning point has been reached. Growth is expected to trough in H1 2024 as consumption, investment and industrial activity soften. The probability of recession remains elevated. Nonetheless, markets expect modest increments in unemployment through to 2025 which limit the expected severity should this transpire.

Fed Chair Powell's speech at the annual Jackson Hole symposium suggested further rate rises were possible. The Fed minutes for the July meeting were also received in a hawkish manner with staff revising away expectations of a recession. Fitch downgraded the credit rating for US federal debt to AA+ and the US Treasury also surprised markets with a stronger issuance schedule. Some indigestion of a 30 year bond auction provided support for a view that the outlook for US bonds is challenging.

Australia's economic performance was weaker with PMIs in both manufacturing and services pointing to an economic contraction. Retail sales readings provided some relief, supported by school holiday spending and the FIFA Women's World Cup. The Q2 GDP figures showed weak consumer discretionary spending whilst corporate and government spending remained firm. Trade was also supportive. Nonetheless, Australia is in an economic recession in per-capital terms and the outlook is challenged with household savings rates at 3.2% (lowest since the GFC period) with a considerable amount of monetary tightening yet to reach households. Notably, banks are not reporting unusual arrears levels amongst mortgagees coming off fixed rate arrangements. Unemployment is gradually rising, as required to maintain price stability. Consumer confidence is very weak, although business conditions remain resilient for now. The housing market rose by 1% in August according to CoreLogic, extending the record of sequential positive monthly returns since March. The approvals pipeline suggests no relief is in sight for home buyers.

RBA Governor Philip Lowe's term ends on 17 September. His final speech outlined the need for independent fiscal levers to help meet economic goals and an expectation that inflation will be more volatile due to structural changes. The RBA left rates unchanged in August and September. It expects that inflation can be brought back to target levels in 2025 whilst holding on to employment gains.

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China's growth trajectory continues to be hampered by precautionary saving amongst households. This has been attributed to uncertainties relating to property and governance. Activity indicators were weak. Credit growth, retail sales, fixed asset investment and official PMIs point to a tepid growth rate which is being supported by the official sector. Efforts to stimulate the economy include reducing deposit requirements for property, providing window guidance to banks on loan volumes, and lowering selected interest rates. The questionable credit quality of property developers is affecting risk sentiment, but the financial system appears capable of withstanding this whilst property prices remain stable. In contrast to much of the world, Chinese consumer inflation was negative on an annual basis. Unemployment was recorded at 5.3% and the publication of youth unemployment statistics was discontinued.

China is responding to the strength in the USD via currency fixes which are more supportive of the Yuan. State owned banks are also engaging in activity which discourages efforts to short-sell the Yuan.

Manufacturing activity in Europe is plummeting with German PMI readings akin to levels during the first wave of covid. Imports have dropped in response. Services PMI in the EZ also infers economic contraction. ECB President Lagarde continued to warn that inflation has not been contained and that rates may need to be raised and retained at elevated levels for some time. She re-iterated a belief that the world economy will be more supply-constrained and experience higher inflation volatility. The ECB's balance sheet is shrinking and, along with weak loan growth, has created an overall reduction in the stock of M3 money. This is associated with weak economic outcomes historically. The BoE raised rates by 25bps to 5.25% and Governor Bailey indicated that these were close to the top of the cycle.

The Japanese economy is performing strongly. Retail sales remain robust at 6.8% yoy. Economic activity is also supported by an ongoing clearance of the backlog of car manufacturing. Inflation levels remain elevated, with the core reading at 3.1% yoy. Unemployment remains low at 2.7%. The BoJ made unscheduled interventions in the 10-year bond market to protect the yield from rising towards the new upper limit of 1%. Governor Ueda recently commented that sufficient data may arise by the end of the year to re-evaluate Japan's negative interest rate policy.

The web of global interactions remains intriguing. Trade relations between Australia and China are normalizing with anti-dumping and anti-subsidy tariffs on barley exports removed this month. China and the US opened new lines of communication to tackle thorny issues following US Secretary of State Blinken's visit to Beijing. Nonetheless, the US, Japan and Sth Korea announced a deepening of security ties to deter China's regional encroachment.

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China's President Xi elected to skip the G20 meeting but attended the BRICS summit where membership was expanded to include Argentina, Ethiopia, Iran, Saudi Arabia, Egypt and the UAE. Reduction in the reliance on USD was on the agenda. Meanwhile Russian investors became increasingly concerned for capital controls as the Rouble depreciated further and the Argentinian peso declined 18% against the USD following the election of a libertarian President, Javier Milei. Turkey abandoned notions that low interest rates would solve inflation and lifted official rates by 7.5%. The Lira has depreciated 48% against the USD over the year.

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