REALM SHORT TERM INCOME FUND

REALM INVESTMENT HOUSE

OCTOBER 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 $1.20 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	0.62%	0.34%
3 Month	1.73%	1.02%
6 Month	3.24%	2.02%
1 Year	6.00%	3.64%
3 Year p.a	2.91%	1.50%
5 Year p.a	2.84%	1.25%
Since Inception p.a*	2.83%	1.28%

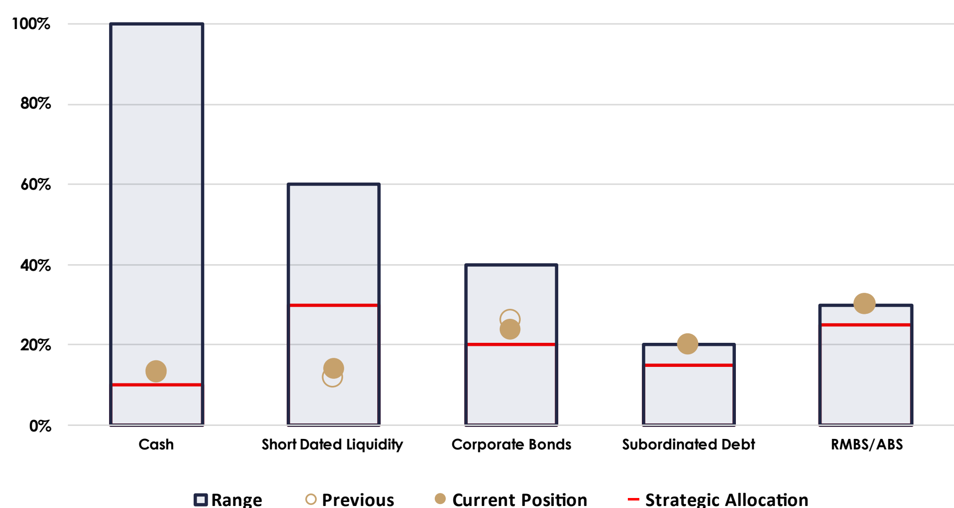
*Past performance is not indicative of future performance. Inception date is 21 December 2017.

FUND STATISTICS

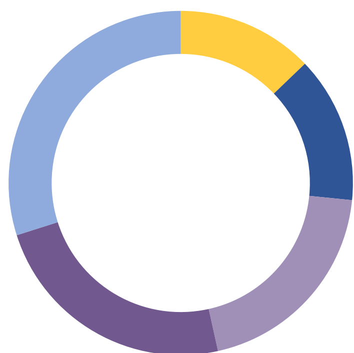
Running Yield	5.22%
Yield to Maturity	6.24%
Volatility†	0.34%
Interest rate duration	0.10
Credit duration	1.48
Average Credit Rating	A
Number of positions	297
Average position exp.	0.22%
Worst Month*	-0.26%
Best Month*	0.62%
Sharpe ratio∂	4.54

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

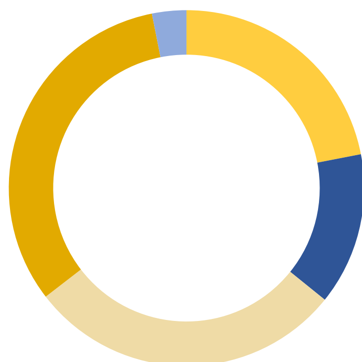


PORTFOLIO COMPOSITION



- Cash (12.82%)
- Short Dated Liquidity (13.77%)
- Sub Debt (19.94%)
- Corporate Bond (23.56%)
- RMBS & ABS (29.91%)

MATURITY PROFILE



- At Call to 6 Months (21.95%)
- 6 Months to 1 Years (13.85%)
- 1 Years to 2 Years (28.75%)
- 2 Years to 3 Years (32.33%)
- 3 Years to 3.5 Years (3.12%)

FUND UPDATE

Cash and Short-Term Liquidity Weighting: ↓ Cash and Short dated liquidity decreased from 27.41% to 26.59%.

Interest Rate Duration Position: → 0.10 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 - 36 basis point increase for AU 3-year bond yields and a trading range of 58 basis points over the month. The strategy will, as a rule, only take modest interest rate risk.

Corporate & Subordinated Debt Allocation: ↑ Increased from 43.31% to 43.5%. Optimisation within the corporate bond sector was skewed towards foreign issuers in foreign currency due to modest relative value. 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 remained stable. Corporate bond volatility was relatively muted over the month of October. Subordinated debt optimisation mirrored corporate bond allocations. The short, conservative nature of the sector and diversification aided in cushioning any intra-month market volatility.

Residential Mortgage-Backed Securities (RMBS) & ABS: → Allocation to structured credit securities remained in line with last month at 29.91%. As at month end, the portfolio maintained an A average credit rating and a relatively short weighted credit duration of 1.79 years.

Structured credit markets rallied over the month of October, with market participants continuing to bid strongly for stock, driven by the continued lack of supply from dealer inventory sheets. New transactions in primary markets remain substantially overbid, which has continued to drive markets tighter. The new deal flow pipeline remains very healthy, with issuers electing to use the tighter margins to bring new trades to market prior to the Christmas period.

With respect to market performance, Prime arrears as reported by S&P's SPIN index for September remained in line at 0.92%. Nonconforming arrears weakened slightly, widening 16bps to 3.86%. Both results remain very strong in comparison to both market expectations and historic index levels.

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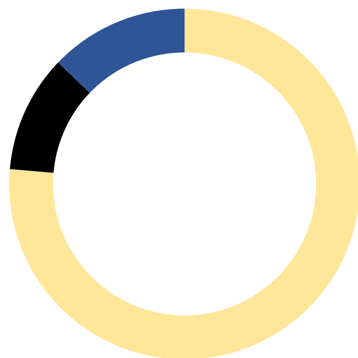
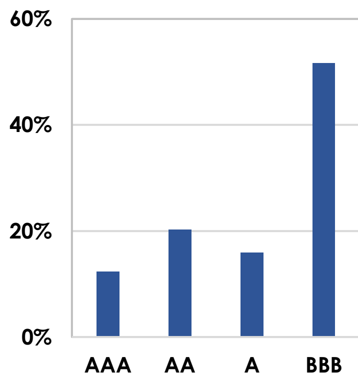
ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (76.35%)
- Foreign Domicilied Issuer (10.83%)
- Cash (12.82%)

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%	0.12%	2.5%
Gambling	0.0%	0.0%	0.0%	2.5%

Targeted risk across the Fund: ↓ Targeted risk decreased from 0.80% to 0.71%, reflecting the optimisation within portfolio limits. Meanwhile, realised standard deviation is at 0.34%. 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 5.99% 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

Global investment grade spreads are at around historical average levels. This arguably offers limited value in an environment where economic activity is expected to slow in the near term. However, the shallow trajectory of the anticipated deceleration, expectations that monetary policy will be highly responsive to adverse developments and corporate flexibility to strengthen fundamental metrics produce a modestly positive outlook in our current assessment.

The longer-term outlook depends materially on whether inflationary pressures will create a need to keep rates higher for longer than is presently projected. If so, credit metrics will deteriorate and become uncomfortable for sub-investment grade floating-rate borrowers. Indeed the potential for this outcome to arise is visible at the lower end of sub-IG credit and the dispersion of spreads within this universe of assets is presently elevated. This contrasts to a calmer picture amongst investment grade corporates where spread dispersion is unremarkable. The levered loan market is trading cautiously and although conditions have become more favourable for CLO creation, primary issuance of mezzanine lines is challenging to place.

It is notable that the sensitivity of the system to failures of regional banks has evolved such that Citizens Bank and Heartland Tri-State Bank can be resolved without fanfare. Further, the AT1 market, which became acutely distressed when Credit Suisse wrote off its junior regulatory debt, found a strong bid again when a hybrid issued by its acquiror, UBS, was more than 10-times oversubscribed. These give support to official statements that the banking system is sound. If so, which is a viewpoint supported by recent earnings releases, the offshore bank regulatory capital market presents value.

Funding concerns for US Treasuries and stickiness in services inflation have created a positive correlation between bond yields and credit spreads again. This may persist for a while and the inverted US yield curve is contributing to yield compression in levered loan and high yield markets. Nonetheless, the eruption in the Gaza strip has not created a spike in oil prices as the presence of two US carrier battle groups has reduced the prospect of regional escalation.

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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

Domestic structured credit spreads continue to compress with the senior part of the complex benefiting from the return of foreign buyers. This effect is permeating through to lower parts of the investment grade universe where our assessment is spreads are now closer to fair. Asset backed spreads have also narrowed further than RMBS, and this relationship is reverting towards historical norms. These effects are less obvious in the sub-investment grade issues. Credit quality remains very strong despite the considerable erosion of household spending power. Major bank reporting and structured credit data does not indicate material distress is occurring. In the event, housing prices are near all time highs, with ongoing high migration rates and constrained supply inferring that rising arrears would not result in worrisome collateral losses. The dynamics of the structured credit market continue to be influenced by competition for prime mortgages amongst the banks and more constrained credit growth. ABS issuance volumes are more elevated. Additionally, supply of new public securities is accelerating now that spreads in the public market have become more competitive compared to warehouse funding.

The portfolio continues to operate within well-defined boundaries and, apart from incrementally increasing foreign exposures, was relatively unchanged. The traded margin of close to 200bps remains favorable. Along with a yield to maturity of over 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.

The addition of foreign issuers and foreign currency bonds (all hedged to AUD) has greatly improved the prospects for this portfolio. Expected returns have materially improved without altering the general nature of the unit price performance. Underlying liquidity risks, which were always tightly managed, have receded further.

MARKET DEVELOPMENTS

Bearish sentiment towards bonds was a key market driver. Stronger than expected economic and inflation outcomes, concerns about funding coupon issuance associated with an unsustainable trajectory of federal debt and ongoing conditioning by Fed officials combined to push US 10-year bond yields through 5% for a time. Australian 10-year bond yields rose to match US yields again for the first time since late August. The BoJ's softening stance on yield curve control saw their 10-year bond yields rise closer to the guideline of 1%. European yields were more stable as economic outcomes were weaker in this region. Equities fell with key indices down 3 to 4% over the month and the VIX rose to levels last experienced during the aftermath of the US regional banking crisis. Major currency crosses were stable but the AUD fell vs USD on rising risk aversion, trading over a 2% range. Gold performed as a geopolitical hedge, but oil prices fell. Credit spreads reflected the risk-off sentiment.

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OTHER FUND DETAILS

Responsible Entity: One Managed Investment Funds Ltd

Custodian: State Street Australia Limited

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

OTHER DEVELOPMENTS

Economic activity was stronger than expected in the US. Retail sales, industrial production, core durables and personal spending all came in ahead of expectations. The first GDP estimate for Q3 was reported at a very strong 4.9% saar, which was supported by household spending, private investment and inventory build. The ISM PMI readings for October showed that manufacturing activity is slowing more quickly, whilst services continued to expand and have a positive outlook. Core PPI was ahead of expectations as was the employment cost index reading. Although core inflation was in line with expectations, the contribution from pricing of shelter concerned the market. The labour market tightened with JOLTS job openings stronger than anticipated. Non-farm payrolls were very strong at 336k (subsequently revised to 297k), well ahead of the estimated 160k. Unemployment was at 3.8%. The quits rate remains similar to pre-covid levels. The outlook suggests recession can be avoided in the coming quarters. Unemployment is expected to rise slowly and a wage-growth spiral should be avoided. Inflation is expected to return to target in 2025.

The Fed Minutes suggested another rate hike is probable although the balance of risks in the economy had become more balanced. Whilst no meeting was held in October, no change to settings were announced in the November meeting. Moody's downgraded the outlook for US federal debt to negative whilst retaining the AAA rating. One reason was ongoing political dysfunction. However the House elected Trump ally Michael Johnson as Speaker and he has secured passage of a bipartisan bill to keep the government funded. The Commander-in-Chief of the Ukraine military has indicated the conflict is close to stalemate at present, a comment which may reduce enthusiasm for ongoing US support. Odds-makers have Trump leading Biden for the 2024 Presidential Election.

Australian economic activity outcomes slowed. The NAB Business Survey saw current conditions readings fall from 14 to 11, still a healthy level, with each of the sub-components (sales, profitability and employment) falling. Labour and purchasing costs also eased. Whilst the Westpac Consumer Survey reading improved slightly, concerns for family finances remained elevated. The overall reading remains at very low levels. Lending to the private sector slightly accelerated. Labour force figures suggested that conditions softened. The workforce grew by 6.7k, below the expected level of 20k. Whilst unemployment fell slightly to 3.6%, this was the result of falling participation rates. Employers were responding to a softening in economic activity by offering fewer hours. Job advertisements were slowing. Although the RBA paused in October, it indicated low tolerance for slippage in the timeline for inflation to return into the target band. Subsequent Inflation readings came in ahead of prior projections, with the trimmed mean reading at 5.2% yoy. The RBA lifted rates in November in response. Updated economic projections showed a generally stronger outlook than previously expected. The overall size of the workforce is not expected to fall over the projections to 2025.

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Australia's PMI readings pointed to a shrinking economy. In the immediate term, economic growth is expected to slow under the pressure of tighter monetary policy and higher cost of living. As inflation declines, real household incomes are expected to expand and lift aggregate growth off lows albeit still below trend levels over the next few years. It is possible that the RBA will require another rate rise to achieve its desired inflation trajectory. However, if productivity does not recover, more may be required. Housing prices continued to rise and are close to new highs.

The outlook for China's economy will be governed by government policy decisions which have been relatively restrained thus far. After a slow start to the year, more recent readings have surprised to the upside. GDP growth was 4.9% yoy, ahead of the 4.4% previously expected. Credit creation was robust, as was household spending. Consumer inflation fell to 0% over the year and PPI fell 2.5%, slightly below expectations. PMI indicators suggest the economy is treading water. The economy continues to face challenges relating to the financing of property developers as buyers have become scarce. Authorities are seeking to support completions of housing currently in the development pipeline to create cashflow for these entities. Whilst this has downstream impacts on the financial condition of local governments, the prevailing belief is that China can prevent a credit calamity for now. The prime loan interest rates were unchanged over the month. China dismissed its defense minister.

The European economy appears to have contracted in Q3 with the flash estimate at -0.1%, below expectations for a flat outcome. Retail sales and industrial production shrank by more than expected. PMI readings suggest a very poor outlook. This is reflected in surveys of credit intentions where both demand and standards attached to lending suggest a difficult economic environment ahead. Core CPI came in at 4.5% yoy, which was in-line with expectations. The ECB is expected to have reached the peak rate for this cycle and President Lagarde is pushing back on discussions relating to the prospect of rate cuts. The BoE appears to be at the peak rate for this cycle and cutting in 2024 is likely.

The immediate outlook suggests technical recession is on the verge of probable. Lending surveys do point to the potential for downside risk. However, the consensus is for inflation to trend relatively quickly towards target levels from here although the last mile could be challenging. Unemployment levels are only expected to rise modestly.

The Bank of Japan has been softening its position on yield curve control over the 10-year bond yield. Markets have pushed yields up towards 1% as Governor Ueda's commitment to restraining the yield has been progressively withdrawn. Whilst the BoJ loosened the parameters in July, expressing the 1% level as an upper limit, this has now become a reference point. An exit from negative interest rates on official cash rates is expected in 2024. The economy performed well over the month with retail sales at 5.8% yoy and core inflation at 2.8%. Unemployment remains relatively tight at 2.6%. Along with the pass-through effect of a weaker currency, these have contributed to the BoJ's increase in inflation expectations for the 2024 Fiscal Year from 1.9% in July to 2.8% most recently. Sustaining inflation at the target 2% level over the long term remains an elusive goal.

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