REALM HIGH INCOME FUND

JUNE 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 $1.34 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

NET PERFORMANCE

Period	Ordinary Units (incl. franking)	Wholesale Units (incl. franking)	RBA Cash Rate Return
1 Month	-1.99%	-1.97%	0.06%
3 Month	-2.80%	-2.70%	0.10%
6 Months	-3.59%	-3.39%	0.12%
1 Year	-2.84%	-2.42%	0.17%
3 Years p.a	1.91%	2.34%	0.33%
5 Years p.a	2.40%	2.84%	0.79%
Since Inception p.a*	4.02%	3.96%	1.49%

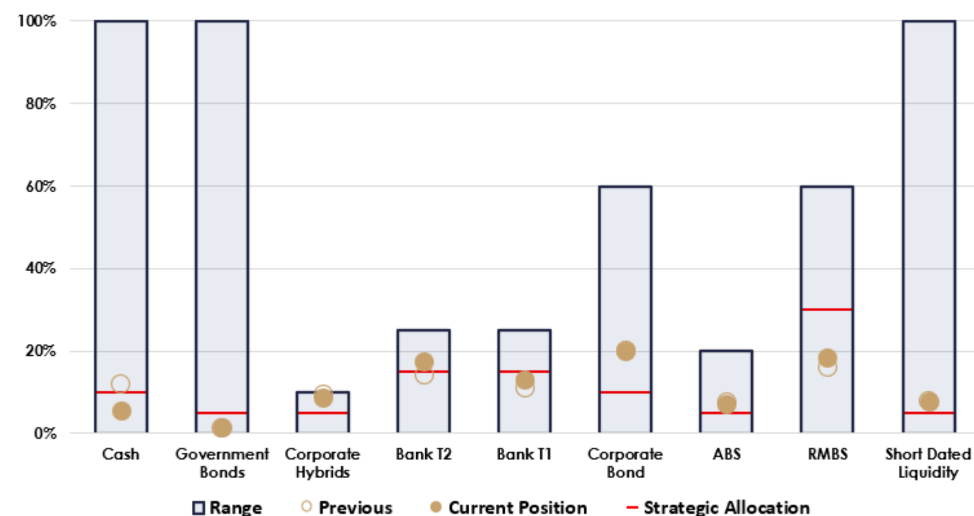
* Past performance is not indicative of future performance. *Ordinary units Inception 26 September 2012. Wholesale units Inception 2 October 2013.

FUND STATISTICS

Running Yield	4.23%
Yield to Maturity	5.23%
Volatility†	1.76%
Interest rate duration	1.43
Credit duration	3.44
Average Credit Rating	BBB
Number of positions	345
Average position exposure	0.60%
Worst Month*	-1.99%
Best Month*	1.22%
Sharpe ratio∂	2.23

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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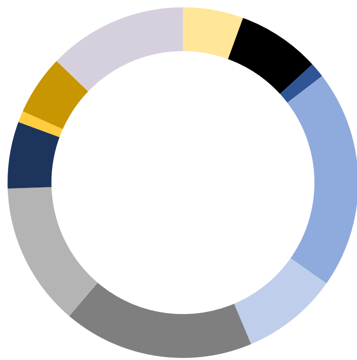
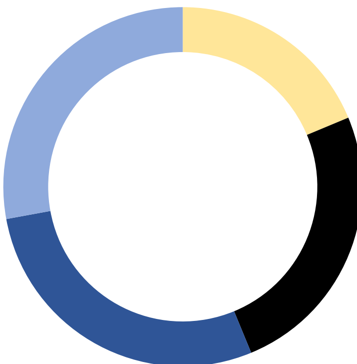
PORTFOLIO COMPOSITION



- Cash (5.57%)
- Commercial Paper (7.65%)
- Government Bonds (1.38%)
- Corporate Bond (20.15%)
- Corporate Hybrids (8.89%)
- Bank T2 (17.59%)
- Bank T1 (13.23%)
- ABS Public (6.16%)
- ABS Private (1.05%)
- RMBS Private (5.53%)
- RMBS Public (12.80%)

MATURITY PROFILE



- At Call to 6 Months (18.71%)
- 6 Months to 3 Years (25.05%)
- 3 Years to 5 Years (28.35%)
- 5 Years to 10 Years (27.88%)
- 10 Years + (0.00%)

FUND UPDATE

Cash and Short-Term Liquidity Weighting: ↓ The allocation to highly liquid assets (cash, commercial paper and government bonds) reduced from 21.33% to 14.60%. This was largely allocated to bank T2 & T1, RMBS private and ABS public as we continued to increase risk across the portfolio.

Corporate & Subordinated Debt Allocation: ↑ Weighting to corporate bonds and subordinated debt (corporate hybrids and bank T2) increased from 43.79% to 46.63%. Global credit spreads underperformed (widened) over the month as recession headlines moved to the fore with the market continuing to navigate through the impacts of the rising interest rate environment and inflationary pressures. Domestically, credit spreads widened for a fifth consecutive month while both USD and EUR credit markets closed at YTD wides. We continue to tilt towards offshore markets, particularly in EUR, which we view as providing exceptional relative value. Notably, we increased allocations to Bank T2 in EUR and rotated the corporate bond book from AUD to EUR. Amidst the general market weakness, there was a positive development for our high conviction position in Crown hybrids (CWNHB) which will be redeemed at $102.75. Given the market volatility, new issuance activity was muted over the month.

Interest Rate Duration Position: ↑ IRD positioning increased from 1.41 to 1.43 years. Government bond volatility did not subside over the month and as a result provided opportunity to be slightly active in positioning. The upward trend in inflation surprises continued to force the hand of central bankers to hike interest rates globally - most notably in Australia, where the RBA hiked rates by 50 basis points surprising most pundits. Volatility in rates were amplified by shocks to oil and gas prices caused by the Russian invasion of Ukraine, increasing concerns of stagflation. Rising levels in Australian real yields allowed us to increase our IRD slightly towards the longer end of the curve.

Residential Mortgage-Backed Securities (RMBS): ↑ Weighting to RMBS securities increased from 16.12% to 18.33% over the month. Public Structured credit markets continued to drift wider, with credit spreads weakening alongside global credit markets as recession headlines continued to weigh on sentiment. Several transactions were issued into primary markets ranging across both prime and nonconforming asset classes. Supply continues to push markets wider, mainly across the senior mezzanine (Junior AAA/AA rated) and mezzanine (A/BBB rated) markets as investors weigh up the relative value of allocating to higher volatility asset classes that have widened much further than Australian public structured markets, primarily offshore markets.

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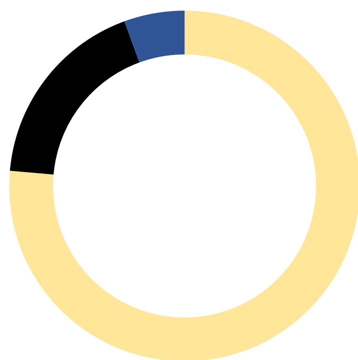
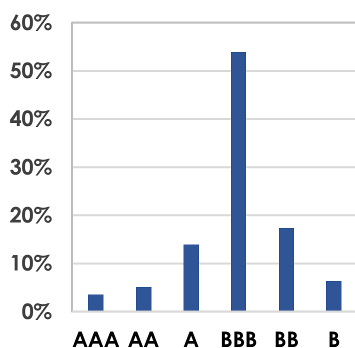
ISSUER DOMICILE



- Australian/NZ Domiciled Issuer (76.38%)
- Foreign Domicilied Issuer (18.04%)
- Cash (5.57%)

CREDIT QUALITY



PORTFOLIO ESG RISK LIMITS

Sector	Portfolio Exposure	Portfolio Limit
Fossil Fuels	8.35%	10%
Non-Renewable & Nuclear Energy	0%	10%
Alcohol	0%	10%
Gambling	1.12%	10%

In terms of market performance, average prime arrears levels (SPIN) improved in March by 5 basis point to 0.73%, with non-conforming arrears also improving 17bps to 2.41%. Both data prints remain strong in comparison to historical arrears levels.

Additional Tier 1 (AT1) Exposures: ↑ AT1 exposure increased from 11.13% to 13.23%. We continued to increase allocations to AT1s in EUR and USD as valuations remain very attractive. Domestically, we saw a cluster of listed AT1 deals come to market for refinancing purposes. First was the NAB Capital Notes 6 (NABPI; 7.5 years to first call; 3.15% margin), followed by the shorter Westpac Capital Notes 9 (WBCZZ; 6.2 years; 3.40% margin) and finally, the Macquarie Capital Notes 6 (MQGPF; 7.2 years; 3.70% margin). We participated in the WBCZZ's which was the only line of value identified by our RV process. We expect limited AT1 supply until year end when the CBAPD's are due for first call in December.

Asset Backed Securities (ABS): ↓ Our ABS allocation decreased from 7.63% to 7.21%. Each of the ABS exposures within the fund continue to perform well, with shorter duration assets limiting the impact of weaker credit markets, which makes them highly sought by market and well bid.

Targeted risk across the Fund: ↑ Targeted portfolio risk increased from 1.98% to 2.36% as we added risk through lengthening both credit duration (from 3.12 years to 3.44 years) and interest rate duration (from 1.41 years to 1.43 years). The fund remains compliant with the Portfolio ESG risk limits.

MARKET OUTLOOK

The risk-off tone in markets became more pronounced in June. The VIX remained elevated and spiked towards one-year highs. Equity markets were lower again, with the S&P 500 in bear market territory. Industrial commodities also fell well below levels recorded merely a quarter ago, whilst oil prices softened partly on USD strength. The US Dollar index climbed to levels last seen in 2002 and this contributed to a decline in AUDUSD despite a strong trade situation and Australian yields remaining above that of the US.

Bond markets continued their historic sell-off, with the total return movement since mid-2020 being worse than that experienced during historic events like the Great Bond Massacre in 1994 and Taper Tantrum of 2013.

In some ways, the month was a tale of two halves. The month began with upside surprises to growth and inflation, which led the RBA and Fed to raise rates by 50bps and 75bps respectively. Later, recessionary concerns came to the fore with the Atlanta Fed nowcast for the US inferring a negative GDP figure in Q2. With such large shifts in outlooks, bonds traded over a particularly large range and the outlook was complicated further by concerns that European sovereign bond markets were fragmenting.

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/

Australian corporate bond spreads are now at levels that approximate their worst point during covid in April 2020 and also during the period where the Chinese economy appeared to be at risk of unravelling in 2015/2016. The only other times it has been wider in the last 20 years were during the GFC and the immediately subsequent years where ongoing concerns for sovereign solvency in Europe were front of mind. This is less relevant today. The more significant US and European credit markets sold off significantly on heightened recessionary fears.

In Europe, markets are very concerned about the outlook for Russian gas supply. Whilst the scenario that supply does not restart after the maintenance period of Nordstream 1, on 21 July, would be a significant setback, analysis by the ECB suggests a significant buffer remains to protect against a banking crisis. Similarly, the US Fed finds that their banking system can withstand much larger setbacks than the recession in 2023 which the market currently fears. As a result, we do not expect that credit spreads will test the GFC-related levels.

Whilst property prices may fall between 15-30% from recent highs in the coming years, the credit quality of the structured securities we consider for the portfolio can withstand scenarios which are even more challenging. Nonetheless, the Australian structured credit market is also weakening along with international market pricing.

In general, particularly for investment grade debt, it appears to us that pricing is overcompensating for the increase in credit risk. Indeed, many issuers are now holding back or tapping alternative funding sources because the market is showing signs of becoming disorderly. Given the sensitivity of markets to threshold news is presently very high, and the economic readings are towards extremes, predicting near term moves is fraught. However, these circumstances are usually followed by very strong investment returns for those who can look through the near-term volatility.

We are seeing conditions in supply chains ease and there is some evidence that retailers are liquidating inventory. These were significant early drivers of inflation. Nonetheless, labour markets remain tight. We note that medium term inflation expectations, as visible via bond market pricing, have recently reverted towards the levels before the hypothesis of transitory inflation was set aside late last year.

Over the course of the month, we increased exposure to markets where prices appeared to deteriorate faster than underlying medium term fundamentals. Spreads on European and USD-denominated bank capital widened significantly and we built positions into AT1 and Tier 2 assets accordingly. We have now reached the intended medium-term utilisation of our flexibility to invest in non-AUD/NZ issuer exposure at slightly less than 20%.

We have kept our RMBS exposure low throughout this part of the market cycle, which has helped the portfolio avoid a significant deterioration. Spreads have only now reached a level where we are prepared to consider mezzanine lines again. More private credit exposure will be added as negotiations and documentation conclude.

REALM INVESTMENT HOUSE CONTACTS

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We successfully varied our interest rate duration over the month. Overall credit duration, credit quality and liquidity levels were largely unchanged. These settings are comparable to those we had in place during 2015/16 and the initial covid period in 2020 where very strong returns were subsequently generated. Yield to maturity and estimated volatility varied with market conditions, increasing in both cases.

Our medium-term view suggests that the premium available for bearing credit risk is consistent with previous highs where market risks were also not particularly related to bank system and sovereign default. Nonetheless, given the uncertainty, we are electing not to hold any exposures where we have any meaningful concerns for credit quality on a multi-year view. Credit markets will eventually regain their footing and the forward-looking returns on a medium-term basis are towards the highest end which we have observed. Additionally, absolute returns will be assisted by expectations of further interest rate rises.

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