

Optimal Australia Absolute Trust

Optimal
FUND MANAGEMENT
AUSTRALIA

Monthly Report | October 2016

	Month	Qtr	Year	Life (p.a.)
Fund returns	0.4%	0.9%	4.4%	8.6%
Series 1 NAV				\$10.723
Positive months			75%	90%
Worst month			(2.3%)	(2.3%)
Volatility				3.8%
Sharpe ratio				1.2

Monthly key contributors - by sector

Longs

Positive Chemicals, gaming, resources

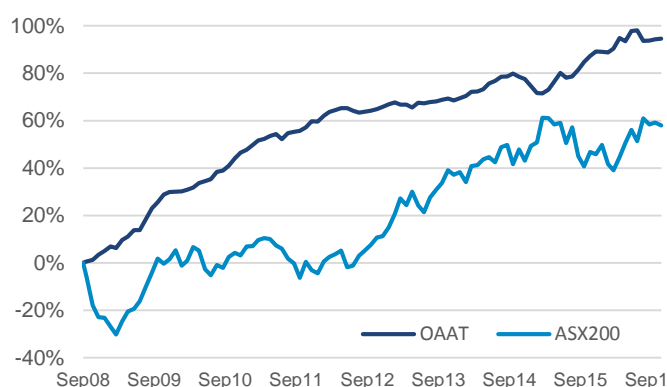
Negative Insurers, diversified financials

Shorts

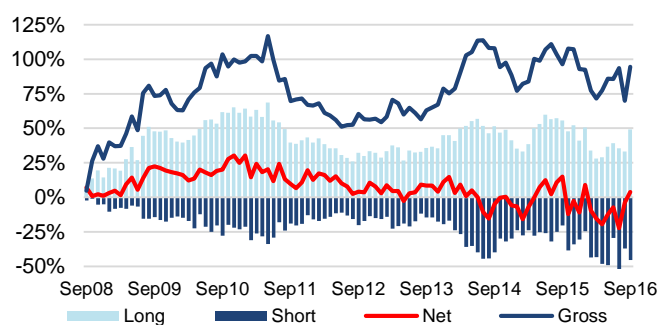
Positive REIT's, health care, infrastructure, index futures

Negative Diversified financials

Cumulative performance



Fund investment profile (% NAV)



Risk settings

% of NAV	Long	Short
Equities	46.2%	-23.1%
Debt / Hybrids	0%	0%
Derivatives		-24.6%
Gross exposure		93.9%
Net exposure		-1.5%

Concentration by position	Long	Short
Top 5	24.3%	-14.1%
Top 10	37.8%	-21.9%
Top 15	44.9%	-21.8%

Performance Review

The Trust recorded a net return of +0.4% (Series 1 units) in October.

The Australian equity market fell by 2% in October, caught between growing concerns over the direction of interest rates, the general malaise in the final run-up to the US presidential election, and a series of earnings bombs going off during the AGM season.

US election uncertainty will be resolved pretty soon, but as we have stressed for some time, markets will remain highly sensitised to signals on interest rate reversion. Financial repression as practised by central banks (and the vast 'risk-parity' and 'structured product' liquidity flows associated with it), have had a fundamentally distortive effect on equity pricing in general. A further back-up in bond yields still seems likely, such that elevated volatility may be with markets for a while, and this process could well turn disorderly.

Higher bond yields weighed heavily on so-called defensive sectors in October, some of which had been treated by investors as 'bond proxies'. REITs and Health Care were the worst performing sectors over the month, with the latter also impacted by a substantial earnings downgrade by Healthscope.

The Fund had some short exposure to Health care, and was otherwise largely unaffected by the more notable 'land mines' during the month, including gaming (Crown employees detained in China; Sky City profit warning), and China-facing growth stocks (Bega/Blackmores).

Our returns were negatively affected by continued GBP currency weakness, which impacted two of our high-conviction longs in Hendersons and Clydesdale Bank. We believe the investment case for Hendersons to be stronger again with the nil-premium merger announced with Janus, but the market has entirely discounted the value of ~US\$110m in cost synergies. Our investment and view on Tatts Group was endorsed by Tabcorp's merger proposal, although the market is similarly now discounting the indicated ~\$130m in cost synergies.

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Fund Strategy

Our view remains that the investment landscape is unusually dangerous at present, as central banks come to the end of their experimental policies of financial repression across the entire global yield curve. As a consequence of these policies, any form of coupon income has been revalued up in terms of capital value, and huge amounts of yield-seeking liquidity have clustered in strange places – certainly in many Australian dollar equity and debt securities.

There are now clear signs that these policies have extended well beyond their natural limits, in terms of economics, politics, damage to the credit creation process, and even logistics. A reversion to a somewhat more normalised yield curve appears to be upon us, at least in its early stages, as bond yields have been breaking out for some months.

Markets are rightly sensitised to these early signals, as blind adherence to financial repression has been key to the 'central bank put' so beloved by equity markets in general, and to the extraordinary overweighting of yield in any multi-factor valuation approach.

It's possible that all the market distortions resulting from this vast liquidity creation over recent years can unwind smoothly. However, given the massive investment flows into equity markets of structured yield or 'risk-parity' products (which typically use leverage to juice-up coupon returns), any bond yield-based unwind has the potential to turn disorderly. We'd be more inclined to expect at least some dislocation, and perhaps quite a bit of it. There are good reasons at present to maintain a defensive posture towards market risk.

Optimal Australia Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY17	(2.28%)	0.02%	0.56%	0.35%									(1.34%)
FY16	0.31%	1.52%	1.79%	1.42%	1.01%	(0.11%)	0.02%	0.77%	2.34%	(0.69%)	2.29%	0.11%	11.2%
FY15	1.03%	0.06%	0.64%	(0.71%)	(0.53%)	(1.53%)	(1.88%)	(0.08%)	0.98%	1.96%	2.04%	(1.09%)	0.80%
FY14	0.36%	0.14%	0.43%	0.32%	(0.52%)	0.54%	0.57%	1.06%	0.04%	0.57%	1.38%	0.63%	5.64%
FY13	(0.54%)	0.26%	0.29%	0.37%	0.57%	0.66%	0.46%	(0.50%)	(0.06%)	(0.70%)	1.22%	(0.18%)	1.86%
FY12	1.69%	0.29%	0.29%	0.97%	1.63%	(0.09%)	1.51%	1.03%	0.46%	0.46%	0.00%	(0.60%)	7.88%
FY11	2.34%	0.36%	1.45%	2.23%	1.66%	0.86%	1.36%	1.26%	0.50%	0.74%	0.57%	(1.38%)	12.57%
FY10	4.00%	3.88%	2.00%	2.68%	0.78%	0.09%	0.17%	0.52%	0.68%	1.45%	0.59%	0.57%	18.75%
FY09			0.67%	0.59%	2.19%	1.47%	1.81%	(0.56%)	3.10%	1.37%	2.43%	0.09%	13.90%

Note: returns are net of all fees and assume reinvestment of distributions. Fund inception date 15/9/08

Optimal Australia Absolute Trust – distribution history

Y/e June	2009	2010	2011	2012	2013	2014	2015	2016
Series 1 units	\$1.23	\$1.31	\$2.03	\$0.41	\$0.12	\$0.34	\$0.46	\$0.71

Fund facts

Initial series NAV	\$10.723	Distribution frequency	Yearly (bi-yearly in FY 2016)
Strategy	Long-short Australian equities	Minimum investment	Wholesale investors only, \$100k
Objective	Positive returns in all market conditions. Overarching focus on capital protection	APIR Code	OPT0001AU
		ISIN	AU60OPT0014
Firm AUM	\$100m	Bloomberg	OPAUSAB AU Equity
Last distribution	\$0.265 per unit (July 2016)	Fund inception	15/9/08 at \$10.000 per unit

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