

# ARCO Investment Management Absolute Trust (Optimal Australia Absolute Trust)

Monthly report: July 2017

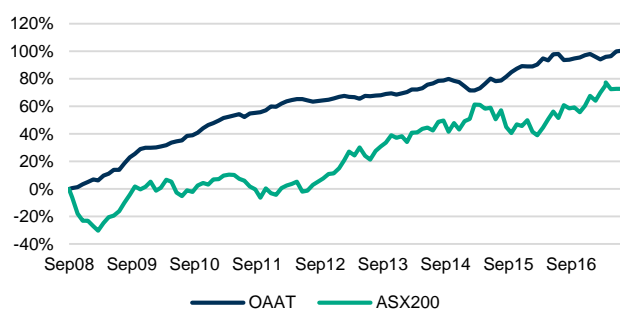
Currency headwinds impacted the market and our fund in July. The Absolute Trust delivered investors another positive performance month and we continue to be conservatively positioned, mindful of broadly expensive stock prices and the usual trials of the company reporting season.

Performance	Month	Qtr	1 Year	3Yr pa	Life (pa)
Fund return (net)	0.24%	2.29%	3.48%	3.93%	8.14%
Positive months			83%	70%	80%
Worst month					(2.3%)
Volatility					3.7%
Sharpe ratio					1.14

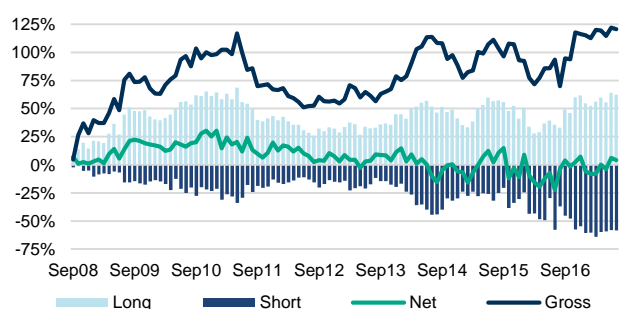
## Monthly key contributors – by sector

Longs	24 stocks
Positive	Retail, resources, energy
Negative	Banks, healthcare, diversified financials
Shorts	12 stocks
Positive	Transport, healthcare
Negative	Banks, REITs, index futures

## Cumulative performance



## Fund investment profile (% NAV)



## Portfolio settings

% of NAV	Long	Short
Equities	62.3%	-27.0%
Debt/ Hybrids	0%	0%
Derivatives		-31.3%
Gross exposure		120.5%
Net exposure		4.0%
Concentration by position	Long	Short
Top 5	25.4%	(16.7%)
Top 10	41.5%	(25.3%)
Top 15	51.3%	(27.0%)

## Fund strategy and outlook

The Trust's objective is to compound investor returns over time through stock alpha generation, with an overarching focus on capital preservation.

July was not an easy month for the Fund, primarily due to the impact of currency movements. Pleasingly, our stock selection delivered a positive return to investors. Our focus for some time has been on structural and cost-out drivers of earnings growth, with something of an aversion to the Australian consumer. As a result, the portfolio is materially exposed to non-AUD earnings and asset values, and suffered from the strong rise in the AUD. The currency also hit the broader market, which was weighed down by the pervasive influence of (unhedged) "carry" investors, who were (and probably are still) selling to lock-in very strong returns in USD terms.

Our thinking on markets and risk has not changed much recently. GMO's James Montier sums it all up pretty well:

*"My perspective is that we have a bubble of complacency, and people are acting as if there are no risks, while I see a world full of them... And yet pretty much all assets look to be priced for perfection..."*

July saw central banks execute any number of 10-point degree of difficulty linguistic contortions around the "neutral rate" debate, and in trying to reassure investors that they don't really mean what they say when earlier floating the possibility of withdrawing monetary stimulus.

So it was in Australia with the RBA, no doubt horrified by the economic impact of a rampant AUD, urging that "no significance" should be read into the discussion of a "neutral nominal cash rates of 3.5%" in its July minutes. Better hope so – consumer mortgage stress is evident (albeit so far in only certain demographic pockets) despite interest rates at generational lows, and the general consumer slow-down in the June quarter highlighted this broader sensitivity to interest rates.

The Fund is positioned with close to flat net exposure, and our focus remains squarely on stock alpha.

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## Performance review

As noted, July's performance was solid in view of the headwind of the stronger AUD on the Fund's weighting to offshore earnings. While generally not fans of the Australian consumer economy, we have been invested in several retail stocks where the discount to our fair value assessment seemed excessive. Company stock prices in this sector have been heavily influenced by short selling, and a deep fear that no local retail business model can survive Amazon's imminent arrival. In July, Harvey Norman, Woolworths, and Auto Group were among our better performers, and we continue to believe there to be more to the investment case for all three stocks than just a valuation discount.

The Fund's commodity and energy exposure, while small, also generated positive returns, with strong stock price gains from Santos, BHP, and our smaller positions in the emerging lithium sector.

Our short positions also made a small positive net contribution to performance in July. Our selective financial shorts were negatively impacted by the slight downward move in the yield curve, and also by the market's interpretation that APRA's 'unquestionably strong' capital buffers for the Australian banks (CET1 ratios of at least 10.5% by Jan-2020) implied lower than expected capital shortfalls.

We are now immersed in the August company reporting period: "the moment of truth" for many stocks. It is early days, and the market has been typically unforgiving of any earnings or guidance miss, such as for Crown Resorts or James Hardie. So far, the Fund has only had one earnings report for a larger portfolio holding (CYBG), which the bank passed with flying colours. The full earnings season is unlikely to be so easy.

## Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY18	0.24%												0.24%
FY17	(2.28%)	0.02%	0.56%	0.35%	0.95%	0.29%	(1.00%)	(0.98%)	0.94%	0.07%	0.17%	1.88%	0.93%
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%	11.21%
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 15/09/08.

## Absolute trust – distribution history

Y/e June	2009	2010	2011	2012	2013	2014	2015	2016	2017
Series 1 units	\$1.23	\$1.31	\$2.03	\$0.41	\$0.12	\$0.34	\$0.46	\$0.71	\$0.43

## Fund facts

Initial series NAV	\$10.559 (ex-July 2017 distribution)	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
Firm AUM	\$117m	ISIN	AU60OPT0014
		Fund Inception	15/9/08 (@ \$10.00 per unit)

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