

# ARCO Investment Management

## ARCO Absolute Trust

Monthly report: October 2017

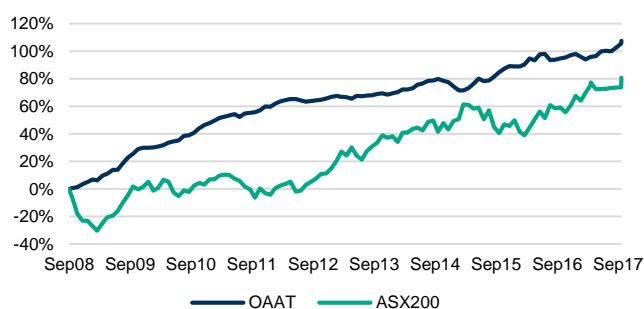
The recent tight trading range for the local equity market gave way in October as the market rallied 4%. Economic data and bank reporting season offered an insight into the headwinds for local consumers and earnings growth and we moved to trim positions and reduce risk exposure.

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	1.08%	3.60%	6.23%	5.16%	8.32%
Positive months			75%	70%	80%
Worst month					(2.3%)
Volatility					3.8%
Sharpe ratio					1.45

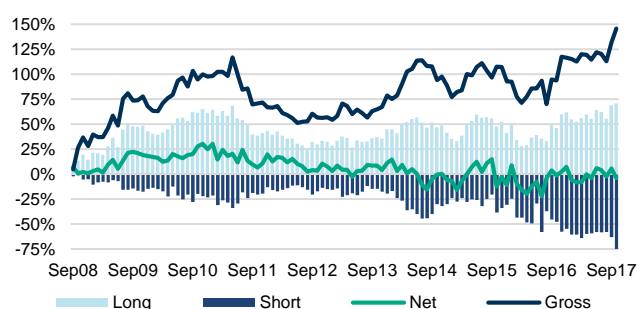
### Monthly key contributors – by sector

Longs	
Positive	Resources, banks, media, retail
Negative	Banks, material, energy
Shorts	
Positive	Resources, banks
Negative	Index Futures, REITs, NBFIs

### Cumulative performance



### Fund investment profile (% NAV)



### Portfolio settings

% of NAV	Long	Short
Equities	70.9%	-42.0%
Debt/ Hybrids	0%	0%
Derivatives		-32.7%
Gross exposure		145.5%
Net exposure		-3.7%
Concentration by position	Long	Short
Top 5	27.8%	(21.7%)
Top 10	46.1%	(36.5%)
Top 15	58.1%	(42.9%)

### Fund strategy and outlook

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

The Trust recorded a net return of +1.1% for the month, +3.60% for the quarter.

During October, the local market broke out from its recent trading range and even outpaced several global equity markets as it rallied 4% for the month, compared to +2.6% for the MSCI Developed Markets index.

Offshore markets continue to reward data that shows decent growth coupled with still-subdued inflation, although we do wonder just how many times US investors can price the same tax-cut thematic. In Australia, economic growth remains positive but uninspiring, with increasing risks due to high household indebtedness and rising interest rates.

Banks have aggressively repriced investor credit this year due to regulatory pressure, and Australian borrowers have switched almost c\$100bn in previously interest-only mortgage loans to an amortising basis. These changes in credit directly impact consumer cash flow, at a time when wage growth remains under pressure, real estate prices are plateauing, and politics farcical. The consumer outlook continues to be very much at odds with the strength in equity markets and prevailing valuations, which are seem much more directly influenced by international markets.

Our strategy continues to focus on managing investor risk, as well as compounding their returns, and our fair value screens are now flashing increasingly expensive for the majority of the stocks in our universe. Conversely, these same screens are throwing up plenty of short opportunities that we continue to work through.

Our portfolio hedging was a drag on investor returns for October, but we continue to believe it is appropriate for current market conditions. Our total net market exposure moved to a modest negative at -3.7% by the end of the month.

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### Performance review

The Trust participated in the strong market return for the month. As has consistently been the case, our strategy typically rewards investors more when equity markets trade flat-to- downward, rather than when they rally hard. This pattern is again evident in the past quarter.

Unsurprisingly, the fund's long positions drove the positive performance this month, with the short positions broadly detracting from the month's performance, with some exceptions.

We have recently added Fairfax back into the portfolio, and it was a strong

performer in October as the market better appreciated the implications of its spin-off of Domain.

Whilst our negative view on the major banks did not aid overall performance, our long positions in each of CYBG and MQG together added 50bps to our return.

ORE and PLS were again strong contributors to the fund as we saw the market continue to re-rate ORE (which we have now held for almost 2 years) in particular. Having recently exited GXY and reduced our position in PLS, the Fund's exposure to the lithium sector is

now below 7% as the group has rallied so hard.

Long positions in Link, Caltex and Woolworths also made useful contributions for the month. Our short exposure to select banks and other financials were detractors, while portfolio hedging via Index Futures was obviously an expensive exercise for the month.

At current stock prices, we have become more defensive with the portfolio settings for investors as we seek to protect capital from the higher downside risk of the market.

### Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY18	0.24%	(0.29%)	2.79%	1.08%									3.84%
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	\$10.939	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	\$127m	ISIN	AU60OPT0014
		Fund Inception	15/9/08 (@ \$10.00 per unit)

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