

ARCO Investment Management

ARCO Absolute Trust

Monthly report: January 2017

New year's celebrations were short-lived into 2018 as the local equity market paused to take stock. Market volatility rose in January as global growth tail-winds met rising inflation fears and the possibility of 'sooner-rather-than-later' quantitative tightening by some central banks.

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	0.91%	4.30%	10.54%	8.07%	8.58%
Positive months			83%	78%	80%
Worst month					(2.3%)
Volatility					3.7%
Sharpe ratio					1.27

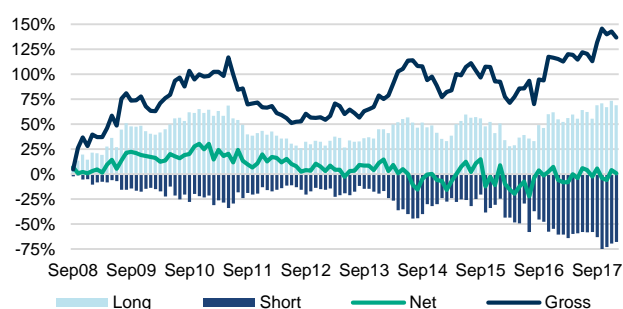
Monthly key contributors – by sector

Longs	
Positive	Resources, diversified financials, telcom
Negative	Media, retail, transport
Shorts	
Positive	REITs, Index Futures, transport
Negative	Healthcare, media, building materials

Cumulative performance



Fund investment profile (% NAV)



Portfolio settings

% of NAV	Long	Short
Equities	68.8%	-38.3%
Debt/ Hybrids	0%	0%
Derivatives		-29.4%
Gross exposure		136.6%
Net exposure		1.1%

Concentration by position	Long	Short
Top 5	23.9%	(19.0%)
Top 10	41.8%	(30.8%)
Top 15	54.9%	(39.0%)

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 +0.91% for the month.

The Australian equity market was a laggard in January, the ASX200 retreating 0.5% over the month while the rest of the world continued to rally strongly – at least up until February 2nd. Volatility has since risen sharply as QE-fuelled equity values globally face the ugly reality of rising bond yields and QT (Quantitative Tightening), which investors had previously accepted with quite some complacency as part of the “global growth” narrative.

Incipient inflationary pressures in the US (through higher employment and stronger wage growth, rising commodity and energy prices) remains an elevated risk for bonds, even at these higher yields. QT will eventually mean less liquidity creation sloshing around global markets and finding strange homes (such as in higher-yield Australian equity securities), and plenty of unpleasant technical pressure as attempts to juice-up returns (for example, through short-selling VIX) in a low-yield world come unstuck.

Compounding returns over time is best achieved by not having to make-up significant draw-downs, and both remain our focus. We have only very slightly increased market exposure (from close to nil) during the current risk liquidation, and we maintain conservative portfolio risk settings in levels of gearing and stock concentration.

The differentiated nature (and not in a good way) of the Australian economic cycle seems likely to be again evident in the current earnings reporting season, although investor expectations are on the whole quite modest – high equity valuations notwithstanding. We maintain a broadly offshore bias to earnings growth within our portfolio holdings, in terms of company domicile and/or commodity exposure, but hope that the season will throw up opportunities to selectively increase company exposure at better values. We retain a strong aversion to interest-rate sensitive stocks, although some of their underlying cash flows may be presented as “defensive”.

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Performance review

Our broadly cautious view of the local equity market was rewarded in January. Cheap stock prices for quality companies have been (and remain) difficult to find.

We reduced the Trust's gross market exposure during the month by trimming our long positions on the back of strong recent price rises. In some cases, these price movements have had the effect of significantly narrowing the discount at which many of our longs were trading relative to our assessment of 'fair value'.

With the broad market retreating in January, our short positions (mainly in interest-rate sensitive REITs; and in index futures) made the greatest aggregate contribution to performance.

Our long stock positions were also positive contributors to performance in aggregate, and were relatively broad-based across our materials, software and services (Link), telecoms (Telstra) and financial (Macquarie) holdings.

Long-held positions in CYB, AHG and WOW took a breather in January though we remain confident in the price to fair value relationship for each company.

The Trust continues to reflect our negative view of interest rate sensitive stocks, our favourable view of companies with clear earnings/margin growth paths, and our belief in the need to hedge broad market exposure into what we expect to be a more volatile period ahead.

ARCO 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%	1.57%	1.76%	0.91%						8.31%
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.

ARCO 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	\$11.409	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	\$140m	ISIN	AU60OPT0014
		Fund Inception	15/9/08 (@ \$10.00 per unit)

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