

ARCO Investment Management

ARCO Absolute Trust

Monthly report: April 2018

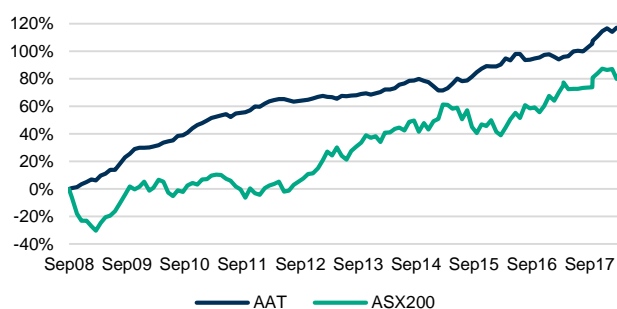
Global trade concerns eased and the local equity market recovered all of March's fall, (though is still down 2018 to date). The Royal Commission turns-up the heat on major banks and insurers, while house price growth slows, giving the RBA further reason to keep rates at a record low.

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	-0.54%	-0.32%	10.16%	6.94%	8.31%
Positive months			75%	75%	79%
Worst month					(2.3%)
Volatility					3.8%
Sharpe ratio					1.22

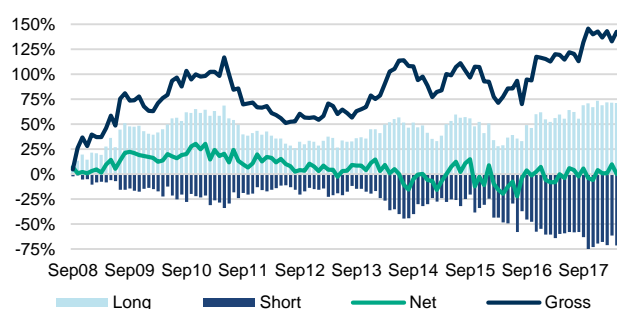
Monthly key contributors – by sector

Longs		26 positions
Positive		Resources, REITs, transport
Negative		Healthcare, building materials
Shorts		15 positions
Positive		Banks, packaging
Negative		Index futures, resources, NBFIs

Cumulative performance



Fund investment profile (% NAV)



Portfolio settings

% of NAV	Long	Short
Equities	71.3%	-33.9%
Debt/ Hybrids	0%	0%
Derivatives		-37.3%
Gross exposure		142.5%
Net exposure		0.0%
Concentration by position	Long	Short
Top 5	26.2%	(17.2%)
Top 10	44.1%	(28.9%)
Top 15	56.7%	(34.3%)

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 -0.54% for the month.

April was a better month for the Australian equity market which managed to recover the loss recorded in March (and record its first positive month for 2018). In fact, the local bourse went from global laggard in March to one of the global leaders in April (again), sponsored primarily by energy, healthcare and material stocks, (and significantly fuelled by M&A activity alongside rising metal and oil prices).

Market fears of a broadening trade war subsided in April, allowing more attention to focus on the best reality show on tv – the Royal Commission. Unsurprisingly, financial stocks were the notable underperformers for the month with allegations of misconduct broadening from irresponsible lending practices to include poor advice practices and lax governance standards.

Riveting as these disclosures have been, our major concern is the nexus between slower bank lending (either as a result of tighter credit assessment standards or direct regulatory intervention) and broader property market conditions. As with every property cycle, credit creation has been a key accelerant, and the punch bowl has been leaving this particular party for some time. Our guess is that loan refinancing sought by formerly interest-only borrowers fearful of their ability to handle the cash flow impact of principal amortisation are becoming much more difficult to secure. This is another reason why the RBA remains pinned on interest rates, leaving the cash rate on hold for the 19th consecutive month.

Whilst the April rally in the market was a tailwind for a number of our long-positions, we also moved to increase our level of risk protection for the portfolio through short exposure. The 'price to fair value' methodology underlying our stock selection gives us little confidence to support a more bullish outlook for the majority of local stock prices.

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Performance review

Over 70% of the long positions in the portfolio were positive contributors to performance during April, most notably BHP, Alumina Ltd, Nufarm, Westfield and Lynas. We increased the Fund's exposure to BHP and Nufarm over the month as our analysis continues to highlight further upside potential from their respective capital and asset management strategies.

On the downside, a downgrade by Boral (compounded by a notably poor IR response) detracted from portfolio performance. Price weakness in a number of our other industrial company holdings, including Link (confusion and dilution flowing from a capital raising) and AHG (ongoing uncertainty over

completion of a key asset sale) were also a drag on the month-end result.

Having done most of the heavy lifting for the Trust's performance in recent months, the portfolio's short positions were broadly detractors from performance in April, with the exception of select short positions in the banking sector.

We continue to view this sector as a short-side trade, with revenue fundamentals (low loan growth, margin pressure, and weaker non-interest income) already pretty weak prior to the Royal Commission disclosures, which can only be expected to further slow credit growth and increase compliance and remediation costs — with some

doubt becoming evident over just who will eat the loss in a default arising from failing to meet responsible lending standards.

We initiated a position in Mineral Resources (MIN) during the month, as the company came under sustained pressure in the wake of its takeover offer for Atlas Iron, and so traded at an attractive discount to our assessment of its fair value. The industrial logic stemming from MIN's existing footprint in the Pilbara for Atlas, plus the anchor tenancy that Atlas represents for MIN's BOSS infrastructure project seems pretty sound to us.

The Trust finished the month with a 0% net market exposure.

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%	(1.16%)	1.39%	(0.54%)			7.95%
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	\$11.372
Strategy	Long-short Australian equities
Objective	Positive returns in all market conditions. Overarching focus on capital protection
Firm AUM	\$145m

Distribution frequency	Yearly (bi-yearly in FY 2016)
Minimum investment	Wholesale investors only, \$100k
APIR Code	OPT0001AU
ISIN	AU60OPT0014
Fund Inception	15/9/08 (@ \$10.00 per unit)

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