

ARCO Investment Management

ARCO Absolute Return Fund

Monthly report: January 2018

WELCOME to the first Monthly Report for the ARCO Absolute Return Fund.

This is the daily-priced companion fund to the ARCO Absolute Trust (monthly-priced). The same underlying investment strategy and holdings are used for both. Performance numbers may vary slightly due to different fee structures between funds.

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.

	Month	Qtr	1 Year	3 Year	Life (p.a.)
Fund return (net)	0.89%	4.38%	10.54%	8.07%	8.58%
Positive months			83%	78%	80%
Volatility					3.7%
Sharpe ratio					1.27

Note: The above return data for the month and quarter is for the ARCO Absolute Return Fund. Longer-term data is for the ARCO Absolute Trust. Fees charged by the Fund are not identical to the Trust and therefore would be slightly different over these longer time periods.

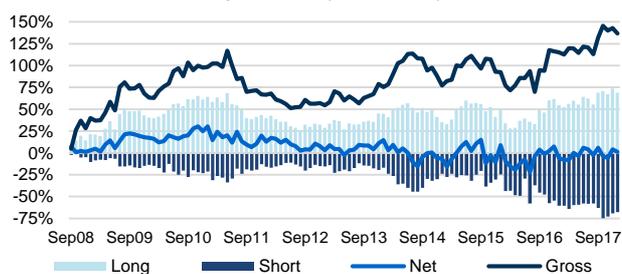
Monthly key contributors – by sector

Longs		26 positions
Positive	Resources, diversified financials, telecom	
Negative	Media, retail, transport	
Shorts		16 positions
Positive	REITs, Index Futures, transport	
Negative	Healthcare, media, building materials	

Cumulative performance



Fund investment profile (% NAV)



NOTE: The above data is for the ARCO Absolute Trust. Fees charged to the Trust are not identical to the ARCO Absolute Return Fund, net returns would therefore be slightly different.

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 Fund's objective is to generate consistent absolute returns through a market cycle, in excess of the RBA official cash rate, with an overarching focus on capital preservation.

The Fund recorded a net return of +0.89% 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 appear "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 Fund'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 Fund 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 return strategy – net monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY18	0.24%	(0.29)%	2.79%	1.08%	1.72%	1.77%	0.89%						
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: Monthly returns (net) are for the ARCO Absolute Trust (companion fund) to October, 2017 and the **ARCO Absolute Return Fund** thereafter.

ARCO Absolute Return Fund - Fund facts

Month end unit price	\$1.044
Strategy	Long-short Australian equities
Objective	Positive return in all market conditions Overarching focus on capital protection
Firm AUM	\$140m

Distribution frequency	Yearly
Minimum investment	\$25,000 (\$10,000 min addition/withdrawal)
APIR Code	OPT7628AU
ISIN	AU60OPT76287
Fund Inception	1/11/2017 (@ \$1.00 per unit)

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