

# ARCO Investment Management

## ARCO Absolute Trust

Monthly report: December 2017

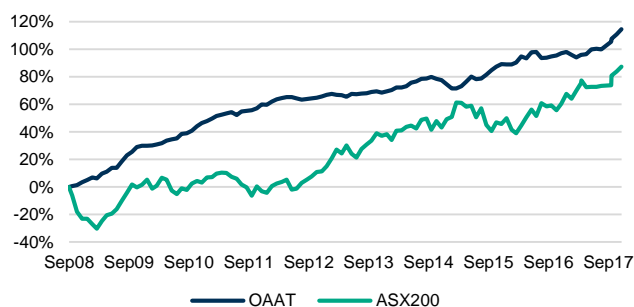
December capped a very strong quarter for the equity market, supported by significant M&A activity, rising commodity prices, US tax policy (again) and traditional festive cheer. The new year's party will likely flow into 2018, but so might the hangover!

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	1.76%	4.47%	8.45%	7.06%	8.55%
Positive months			75%	75%	80%
Worst month					(2.3%)
Volatility					3.8%
Sharpe ratio					1.26

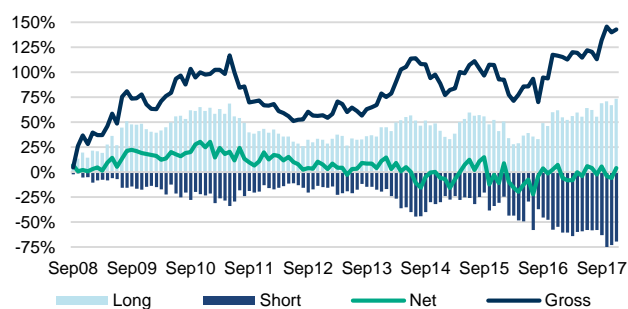
### Monthly key contributors – by sector

Longs	
Positive	Resources, REITs, telecommunications
Negative	Retail, transport
Shorts	
Positive	Building materials, REITs
Negative	Insurance, industrials

### Cumulative performance



### Fund investment profile (% NAV)



### Portfolio settings

% of NAV	Long	Short
Equities	73.5%	-36.4%
Debt/ Hybrids	0%	0%
Derivatives		-32.9%
Gross exposure		142.8%
Net exposure		4.2%

Concentration by position	Long	Short
Top 5	25.6%	(18.7%)
Top 10	43.5%	(31.3%)
Top 15	56.7%	(36.4%)

### 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 +1.8% for the month, ending the calendar year up 8.45%, the 10<sup>th</sup> consecutive calendar year of positive returns since its inception in 2008.

Moving into 2018, the key themes that have driven markets may continue: better global growth and higher employment in developed economies prompting long-overdue household income growth, promising higher business investment in more tax-advantaged jurisdictions. This remains a solid backdrop for equities, but one that is substantially priced-in in our view, given very high valuations. What could derail this rosy picture? Watch bond yields carefully, and inflation indicators even more so, in view of the break-out in commodity prices and tightening in labour markets over the last six months. Watch geopolitics, which could again cut across the recovering Japan/China narrative.

Locally, commodities remain one of the very few bright spots. We remain mindful of little-to-no real wages growth for local households burdened by high debt levels, and now confronting a much weaker (or negative) wealth effect from softening property prices. The AUD-USD 10 year yield spread at c15bps signals investor expectations of continuing low inflation. If correct, this affords little room for companies to lift pricing, unless they produce retail energy. (Alternatively, a reversion in this spread reverts to more normalised levels will exacerbate the impact of a rising USD yield curve: an ugly outlook for the yield-based darlings of our equity market). Local employment numbers, while solid, point to a significant 'casualisation' of our workforce with the banking sector indicating around 20,000 job losses in their near-term plans which is hardly supportive of wage growth. RBA action (inaction) continues to be a balancing act between supporting a broad-based economic growth agenda and supporting inflated property (and equity) values.

In this market, there are almost as many short (expensive stocks) opportunities as there are long (cheap stocks) and we would not be surprised to see the ASX200 (price) Index repeat 2017's 50% negative performance months over 2018.

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### Performance review

We extended the Trust's gross market exposure during December, and retained its overall neutral net market exposure.

Unsurprisingly, the portfolio's long positions dominated December's performance result.

We initiated a position in BHP, which has looked increasingly attractive on our fair value model for some time – despite our concern over spot iron ore pricing. In combination with our positions in LYC, ORE, and TAW, the Fund's resources exposure drove solid returns.

Our long-held exposure to WFD was rewarded by its price rally on the back of Westfield's announced sale to Unibail-Rodamco. TLS was also a notably positive contributor as the stock recovered some of its previous sell-off, which was well-overdone in our view, despite an indifferent medium-term outlook.

AHG and QUB were modest negative performers in our long portfolio though we retain our conviction in these stocks with a positive outlook fuelled by the relative strength of each in their respective sectors and earnings growth expected from both.

The Fund's short portfolio was a negative contributor to performance overall. However, 60% of our individual stock short positions were positive performers during December, with select insurance and industrial shorts being the principle detractors.

We retain our cautious view of the local banking sector which we expect to continue to struggle in 2018 with low earning growth, adverse credit quality, restructuring and political risks representing headwinds blowing strongly in the face of still attractive dividend yields.

### 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%							7.33%
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	\$11.306
Strategy	Long-short Australian equities
Objective	Positive returns in all market conditions. Overarching focus on capital protection
Firm AUM	\$138m

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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