

ARCO Investment Management

ARCO Absolute Trust

Monthly report: February 2018

Early-month volatility was a reminder of the rising global inflation and interest rate reality and the vulnerability of markets. Corporate results were another 'mixed bag', favouring those with solid self-help or offshore strategies as pressure continues to mount on the local consumer sector.

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	-1.16%	1.49%	10.34%	7.68%	8.37%
Positive months			83%	78%	79%
Worst month					(2.3%)
Volatility					3.8%
Sharpe ratio					1.21

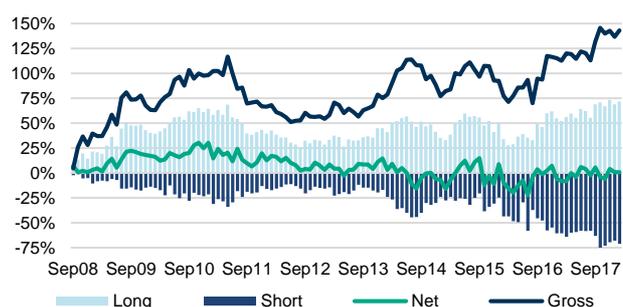
Monthly key contributors – by sector

Longs		27 positions
Positive	Resources, retail, building materials	
Negative	Financials, telecommunications	
Shorts		13 positions
Positive	REITs, transport	
Negative	Media, Insurance	

Cumulative performance



Fund investment profile (% NAV)



Portfolio settings

% of NAV	Long	Short
Equities	71.9%	-32.4%
Debt/ Hybrids	0%	0%
Derivatives		-38.7%
Gross exposure		143.0%
Net exposure		0.9%

Concentration by position	Long	Short
Top 5	24.3%	(16.3%)
Top 10	43.3%	(27.8%)
Top 15	56.6%	(32.0%)

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 -1.16% for the month.

The local equity market defied the trend of global peers and recovered some ground in February (+0.4%). Volatility also spiked early in the month, principally sponsored by US payroll data that was 'too-strong' with the consequent rise in US bond yields and the knock-on effect into our bond and equity markets. Our equity market staged a broad sell-off and subsequent recovery, with significant equity flows being redirected into a number of the interest rate sensitive stocks considered a defensive harbour in choppy waters.

We retain our view that the best days of passive beta are behind us in this cycle and that too much money is placed on the same equity 'bets' with global inflation and interest rates trending upward. More volatility spikes are the likely outcome looking forward - or worse.

Further, we continue to look at market data that points to a local property market correction that is already underway, albeit in slow motion. This will accentuate volatility in our markets as it applies increasing pressure to a heavily indebted consumer sector as well as on those institutions that extend credit to them. A slump in residential building approvals, declining consumer sentiment and still-falling credit supply are recent economic indicators of this.

February's company reporting season added further 'spice' to our markets, wrapping-up neutral-to-positive in our view and further highlighting that company 'self-help' and non-AUD strategies are a better recipe for improved shareholder returns than a significant exposure to the local economy.

We finished February with a neutral market exposure and believe that the local equity market has a downward bias. We further diversified our long positions, extended our exposure to Index Futures as additional portfolio 'insurance' and remain busy with short-theses as prices track back to an unhealthy premium to their fair value.

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Performance review

February was a disappointing month for the Fund as the long portfolio recorded its first negative return in several months. The short portfolio also gave back some of its January gains.

The market volatility did afford us the opportunity to extend the gross exposure of the Fund by month-end as a number of our high conviction holdings retraced to the cheaper-end of our fair value range.

More specifically, JHG, CYB, ORE and LNK were notable detractors from the Fund's performance in February. We actively rebalanced the long portfolio in their favour as their prices retreated and

our analysis re-affirmed the upside potential of their 'self-help' return strategy, (along with QUB, LYC and BHP).

After more than 18 months in the portfolio, we exited WOW from the Fund as it edged to the top-end of our fair-value range, having rewarded shareholders with the strategy refresh under Banducci but now under pressure to sustain its recent performance in the face of resurgent competition.

The short portfolio had been dominated by interest rate sensitive names leading into February, which we believed were priced at an unwarranted premium to

their underlying value. These positions negatively impacted the Fund though as the market gave their 'defensive' yield offer the benefit of the doubt, for now, and directed flows into these names as volatility rose.

We also moved to exit a number of short positions into the company reporting season, which is often a time for sentiment and new information to upset a well-researched short thesis.

The Fund continues its focus on minimising investor drawdown exposure, the risks for which we believe are steadily rising.

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%)					7.05%
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	\$11.277
Strategy	Long-short Australian equities
Objective	Positive returns in all market conditions. Overarching focus on capital protection
Firm AUM	\$140m

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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