

ARCO Investment Management

ARCO Absolute Trust

Monthly report: March 2019

Take two: carrying on from February, the Australian market completed its best quarterly advance in a decade despite the continued softening of economic data. With fundamental risks rising both at home and abroad, our market hovers at all-time highs. Something has to give!

Performance	Month	Qtr	1 Year	3Yr(pa)	Life (pa)
Fund return (net)	-1.50%	-1.26%	-7.88%	0.9%	6.8%
Positive months			33%	61%	76%
Worst month					(3.2%)
Volatility					4.1%
Sharpe ratio					0.8

note

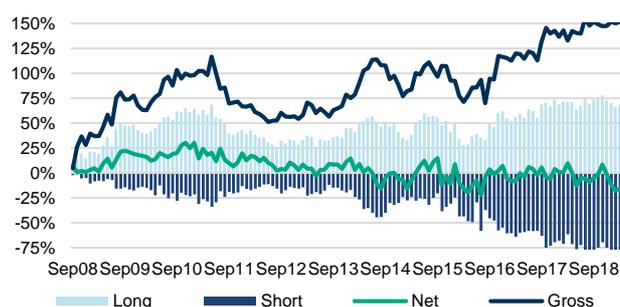
Monthly key contributors – by sector

Longs		24 positions
Positive	Media, industrials, battery materials	
Negative	Resources, chems/fertiliser, gaming	
Shorts		20 positions
Positive	Energy, banks	
Negative	REITs, resources, index futures	

Cumulative performance



Fund investment profile (% NAV)



Portfolio settings

% of NAV	Long	Short
Equities	68.0%	-44.0%
Debt/ Hybrids	0%	0%
Derivatives		-39.8%
Gross exposure		151.8%
Net exposure		-15.8%
Concentration by position	Long	Short
Top 5	27.2%	(20.2%)
Top 10	44.2%	(33.7%)
Top 15	56.5%	(43.1%)

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 -1.50% for the month.

As in February, the broad strength of the equity market in March remains a key focus, flying as it does in the face of worsening economic data. GDP barely grew in the December quarter, and was in fact negative on a per capita basis. Subsequent NAB surveys of business confidence, trading conditions and profitability have all softened. Of most concern to us is that growth in credit aggregates again slowed, to levels not seen since the early 1990's recession. It's not clear that a supply-induced iron ore price spike can be relied upon for economic performance or budgetary settings, although our Government seems to think so. Despite all this, our market had its best quarterly return in a decade, and like most world markets, has shrugged off any and all risks that caused the December quarter sell-off.

Our strategy aims to generate positive returns irrespective of market direction, and our Trust returns have a very low historic correlation with the equity market. As such, our macroeconomic view is an important input in our bottom up stock selection process. Perhaps this allows us to be a bit more sober when viewing the data and adjusting our forecasts and valuation ranges. The fact is we can clearly see empirical evidence of deteriorating economic statistics flowing through to declining earnings and, consequently, valuations. Yet the market still rallies.

The questions all investors are asking remain: "is the worst over, and will the policy response turn it around?" Markets always look forward, but we believe the margin for error is low for two main reasons. First, many markets are already trading at all-time highs. Secondly, with interest rates at record lows, policymakers just don't have many bullets left. In an economy with downside risks, we seek companies insulated from the domestic consumer at defensible stock valuations. We will increase such investment in correcting markets, while always seeking to sell domestically exposed shares that rise on what we deem misplaced optimism.

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Performance review

The Trust's long portfolio was effectively flat during March, with a net positive performance from our battery materials exposure offset by losses on a handful of other stocks. Our patience continued to be rewarded in Nine Entertainment, as February's very credible profit result was further digested. We remain believers that the shares represent compelling value in an expensive market.

Our view of the underlying value of rare earths producer Lynas Corp was endorsed by Wesfarmers non-binding, takeover proposal, at a c45% premium. This is a second recent example of a corporate buyer with a vastly different view on valuation and time-frame for the battery materials sector than that held by

the public market. We share Lynas' view on the Wesfarmers proposal as to both value and its highly conditional nature ("more a thought bubble than an offer"), and we remain invested – although on a much smaller scale, as we have found the uncertainties in the regulatory and political process in Malaysia difficult to quantify for some time.

The somewhat surprising continuation of the bond rally weighed on the Trust's short portfolio, as bond proxies such as REIT's and infrastructure companies outperformed the market despite some very fundamental business model challenges. In addition, the iron ore price spike saw shares in major miners Rio and BHP continue to rally strongly. We believe the

iron ore price is unsustainably high, reflecting a perception of a structural shift, as opposed to our view of a temporary dislocation brought on by Brazilian mine closures.

During the month we took the opportunity of a rally in the Wesfarmers share price to initiate a short position. Comprised primarily of retail exposures (Kmart, Target, Bunnings), we believe the consumer risk has not been appropriately priced with earnings risk skewed to the negative. Moreover, while strategic aspirations in battery materials make every sense to us, we doubt that Wesfarmers' existing investor base will be quite so supportive.

ARCO Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY19	(0.45%)	(2.73%)	1.30%	(0.68%)	0.79%	(3.20%)	0.00%	0.25%	(1.50%)				
FY18	0.24%	(0.29%)	2.79%	1.08%	1.57%	1.76%	0.91%	(1.16%)	1.39%	(0.54%)	(0.65%)	(0.67%)	6.53%
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 is 15/09/08. FY returns are compound returns over the stated period.

ARCO Absolute Trust – distribution history

Y/e June	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Series 1 units	\$1.23	\$1.31	\$2.03	\$0.41	\$0.12	\$0.34	\$0.46	\$0.71	\$0.43	\$0.93

Fund facts

Initial series NAV	\$9.655	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	\$141m	ISIN	AU60OPT0014
		Fund Inception	15/9/08 (@ \$10.00 per unit)

ARCO Investment Management Pty Ltd
ABN 48 129 937 837 AFSL 325 159

Level 2, 121 Flinders Lane
Melbourne VIC Australia 3000

T +61 (3) 9660 9500
F +61 (3) 9660 9599

E info@arcoim.com
arcoim.com

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