ARCO Investment Management
ARCO Benchmark Independent Fund

Monthly report: October 2017

The recent tight trading range for the local equity market gave way in October as the market rallied 4%. Economic data and bank reporting season offered an insight into the headwinds for local consumers and earnings growth and we moved to trim positions and reduce risk exposure.

Domestic equities rally hard | Market risk further elevated | Reporting season opens the banks

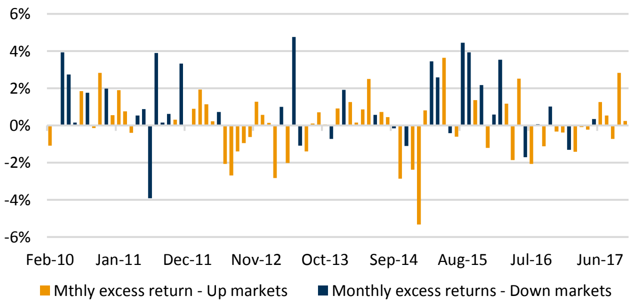
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.1202				
Fund (a)	4.26%	7.3%	16.7%	12.1%	13.3%
ASX300 Accum	4.05%	4.7%	16.1%	6.8%	7.1%

(a) Gross returns from the long portfolio of the Optimal Australia Absolute Trust to Jun 16; actual Fund returns thereafter.

Monthly attribution and top active investments

Attribution	
Positive	Resources, banks, media, retail
Negative	Banks, materials, energy
Top Active	O/w - CYB, WOW, TLS, JHG U/w - WBC, ANZ, NAB, BHP

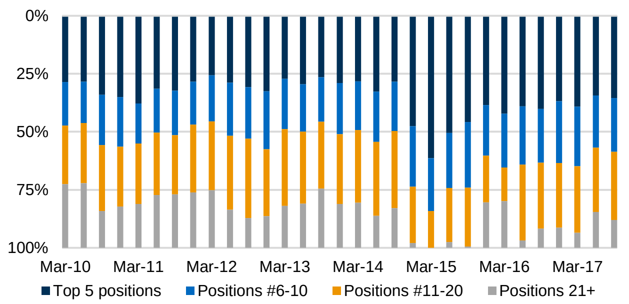
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	4.8%	10.6%	5.8%
Consumer staples	7.2%	7.9%	0.6%
Energy	4.4%	4.0%	-0.4%
Financials	36.7%	33.8%	-2.8%
Healthcare	7.0%	0.0%	-7.0%
Industrials	7.5%	6.0%	-1.5%
IT	1.8%	5.9%	4.1%
Materials	16.9%	15.2%	-1.7%
Real Estate	8.4%	9.5%	1.1%
Telecommunications	3.1%	7.1%	4.0%
Utilities	2.1%	0.0%	-2.1%

Stock concentration - % of equity exposure



Fund strategy and outlook

The ARCO Benchmark Independent Fund aims to deliver investors consistent growth over time, with a strong focus on capital preservation and low downside capture.

During October, the local market broke out from its recent trading range and even outpaced several global equity markets as it rallied 4% for the month, compared to +2.6% for the MSCI Developed Markets index.

Offshore markets continue to reward data that shows decent growth coupled with still-subdued inflation, although we do wonder just how many times US investors can price the same tax-cut thematic. In Australia, economic growth remains positive but uninspiring, with increasing risks due to high household indebtedness and rising interest rates.

Banks have aggressively repriced investor credit this year due to regulatory pressure, and Australian borrowers have switched almost c$100bn in previously interest-only mortgage loans to an amortising basis. These changes in credit directly impact consumer cash flow, at a time when wage growth remains under pressure, real estate prices are plateauing, and politics farcical. The consumer outlook continues to be very much at odds with the strength in equity markets and prevailing valuations, which seem much more directly influenced by international markets.

Our strategy continues to focus on minimising investor draw-downs, as well as compounding their returns, and our fair value screens are now flashing increasingly expensive for the vast majority of the stocks in our universe, though certainly not all of them. Our cash-flex again rose during the month to 12% which we remain keen to deploy into market weakness.

The recent bank reporting season gave us no great incentive to change our negative view on their near-term earnings outlook, and we remain actively underweight the major banks. We have maintained our significant positions in CYBG and MQG for different, non-consumer driven, reasons.

ARCO Investment Management
ARCO Benchmark Independent Fund

Monthly report: October 2017

Performance review

The Fund posted a +4.3% return for October, slightly outpacing the broader equity market.

Fund alpha contribution was pleasingly broad-based for the month, with solid returns from a number of our long-held positions – BLD, LNK, WOW, CTX, BXB.

We have recently added Fairfax back into the portfolio, and it was a strong performer in October as the market better appreciated the implications of its spin-off of Domain.

The lithium sector again assisted the Fund's return. While slightly increasing our weighting in ORE, we took the opportunity to exit Galaxy and down-weight PLS as their prices pushed above our fair value ranges. We remain fundamentally very bullish on trends in electronic vehicle (and battery storage) technology, and we continue to actively research structural changes flowing from these developments.

Underweight major banks was a modest detractor from performance, although we remain unconvinced on sector earnings growth, and have seen nothing in the recent earnings reports to change that disposition. We exited an underweight position in ANZ just ahead of the earnings result, and retain large active weights in CYBG and MQG which we have held for a number of months now.

Though we don't manage the Fund to sector parameters, our fundamental stock analysis has us completely out of the healthcare and utilities sectors at this point, with a positive weighting toward selected industrials where we see better value in a broadly expensive market.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	7.3%	16.7%	12.1%	15.1%
Market (ASX300)	4.7%	16.1%	6.8%	10.2%
– Excess return	2.6%	0.6%	5.3%	8.0%
– Correlation		-0.23	-0.35	-0.39
Analytics				
Information ratio – OBIF		0.16	0.74	0.74
Tracking error		4.0%	7.2%	6.5%
Sharpe ratio – OBIF		3.53	1.34	1.85
Sharpe ratio – market		1.93	0.44	0.62

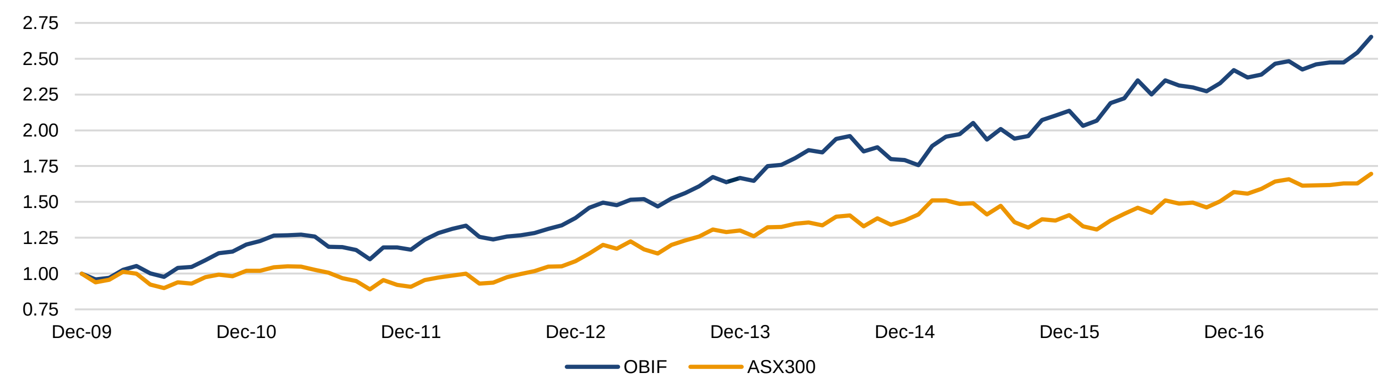
Key portfolio changes

Additions/up-weights
Additions
HT1
Up-weights
TLS, ORE, WOW, RRL, AHG

Deletions/down weights
Deletions
GXY, ANZ
Down-weights
VCX, PLS

Note: Gross returns from the long portfolio of the Optimal Australia Absolute Trust to Jun16, actual Fund returns thereafter.

Cumulative returns since inception



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