

ARCO Investment Management

ARCO Benchmark Independent Fund

Monthly report: April 2018

Global trade concerns eased and the local equity market recovered all of March's fall, (though is still down 2018 to date). The Royal Commission turns-up the heat on major banks and insurers, while house price growth slows, giving the RBA further reason to keep rates at a record low.

Equities rally. Still negative for CY18

Royal Commission hits financials

Value in materials

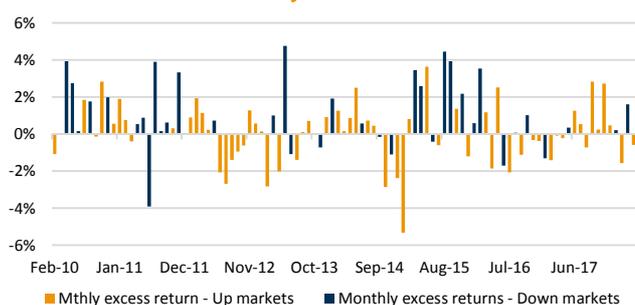
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.1918				
Fund (a)	3.20%	-0.2%	13.6%	12.7%	13.3%
ASX300 Accum	3.78%	0.3%	5.5%	5.6%	7.1%

(a) Returns from the long portfolio of the ARCO Absolute Trust to Jun 16; actual Fund returns thereafter.

Monthly attribution and top active investments

Attribution	
Positive	Materials, banks, media
Negative	Healthcare, energy, retail
Top Active	
	O/w - CYB, LNK, JHG, NUF U/w - CBA, WBC, ANZ, NAB

Performance: monthly excess returns



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.

The Fund recorded a net return of +3.20% for the month.

April was a better month for the Australian equity market which managed to recover the loss recorded in March (and record its first positive month for 2018). In fact, the local bourse went from global laggard in March to one of the global leaders in April (again), sponsored primarily by energy, healthcare and material stocks, (and significantly fuelled by M&A activity alongside rising metal and oil prices).

Market fears of a broadening trade war subsided in April, allowing more attention to focus on the best reality show on tv – the Royal Commission. Unsurprisingly, financial stocks were the notable underperformers for the month with allegations of misconduct broadening from irresponsible lending practices to include poor advice practices and lax governance standards.

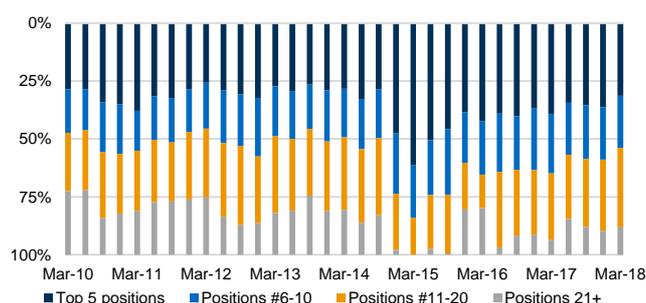
Riveting as these disclosures have been, our major concern is the nexus between slower bank lending (either as a result of tighter credit assessment standards or direct regulatory intervention) and broader property market conditions. As with every property cycle, credit creation has been a key accelerant, and the punch bowl has been leaving this particular party for some time. Our guess is that loan refinancing sought by formerly interest-only borrowers fearful of their ability to handle the cash flow impact of principal amortisation are becoming much more difficult to secure. This is another reason why the RBA remains pinned on interest rates, leaving the cash rate on hold for the 19th consecutive month.

We continue to see selective opportunities in local stocks significantly exposed to the global economy, less so in healthcare where sector rotation has driven up PE multiples appreciably, and more in the materials sector where the earnings outlook is supportive and current valuations more reasonable.

Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	4.9%	7.0%	2.1%
Consumer staples	7.8%	5.2%	-2.6%
Energy	5.2%	5.6%	0.4%
Financials	34.1%	14.5%	-19.6%
Healthcare	7.8%	0.0%	-7.8%
Industrials	7.4%	12.3%	4.9%
IT	2.4%	9.1%	6.7%
Materials	17.8%	35.2%	17.4%
Real Estate	8.0%	4.1%	-3.9%
Telecommunications	2.8%	6.9%	4.1%
Utilities	2.0%	0.0%	-2.0%

Stock concentration - % of equity exposure



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Performance review

Over 70% of the Fund's holdings were positive contributors to performance during April, most notably among them BHP, Alumina Ltd, Nufarm, Westfield and Lynas. We increased the Fund's exposure to BHP and Nufarm over the month as our analysis continues to highlight further upside potential from their respective capital and asset management strategies.

We initiated a position in Mineral Resources (MIN) during the month, as the company came under sustained pressure in the wake of its takeover offer for Atlas Iron, and so traded at an attractive discount to our assessment of its fair value. The industrial logic

stemming from MIN's existing footprint in the Pilbara for Atlas, plus the anchor tenancy that Atlas represents for MIN's BOSS infrastructure project seems pretty sound to us.

We also initiated a modest position in James Hardie, (consistent with our broader portfolio theme of exposure to offshore earnings), attracted by its dominant market position due to a technological advantage in fibre cement house siding, a segment which is taking share from other forms of siding.

A downgrade by Boral (compounded by a notably poor IR response) detracted from portfolio performance. Price

weakness in Link (confusion and dilution flowing from a capital raising) and AHG (ongoing uncertainty over completion of a key asset sale) were also a drag on the month-end result.

We continue to be zero weight the major banks, with revenue fundamentals (low loan growth, margin pressure, and weaker non-interest income) already pretty weak prior to the Royal Commission disclosures, which can only be expected to further slow credit growth and increase compliance and remediation costs — with some doubt becoming evident over just who will eat the loss in a default arising from failing to meet responsible lending standards.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	-0.2%	13.6%	12.7%	13.2%
Market (ASX300)	0.3%	5.5%	5.6%	7.5%
– Excess return	-0.5%	8.1%	7.1%	5.7%
– Correlation		-0.21	-0.37	-0.35
Analytics				
Information ratio – OBIF		1.80	1.19	0.89
Tracking error		4.6%	6.0%	6.5%
Sharpe ratio – ABIF		2.4	1.7	1.6
Sharpe ratio – market		0.4	0.4	0.4

Key portfolio changes

Additions/up-weights

Additions

JHX, MIN

Up-weights

WES, LNK, NUF, TCL, BHP

Deletions/down weights

Deletions

AMP, RRL, MGR

Down-weights

SUN, BLD, WPL, AWC

Note (1): Returns from the long portfolio of the ARCO Absolute Trust to Jun16, actual Fund returns thereafter.

Cumulative returns since inception



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