

ARCO Investment Management

ARCO Benchmark Independent Fund

Monthly report: April 2019

Macro-economic policy settings continued to drive market direction during the month. Stock prices and data-based evidence from the real economy are giving wildly different narratives, pushing investor risk higher.

Stocks maintain rally on RBA hopes

ASX200 P/E expands 2 pts

Insights from mini-reporting season

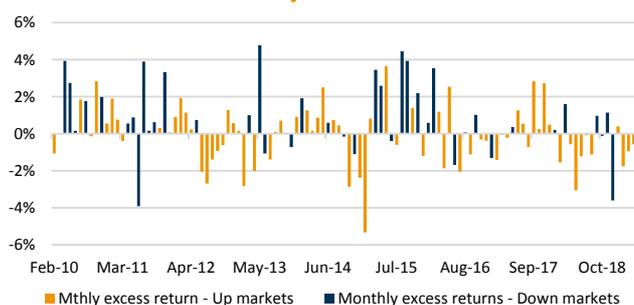
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.0415				
Fund (a)	1.88%	6.0%	-0.2%	8.2%	11.7%
ASX300 Accum	2.46%	9.4%	10.3%	11.0%	7.3%

(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	27 holdings
Positive	Food&beverage, gaming, media
Negative	Materials
Top Active	O/w – NEC, TAH, ALL, NUF U/w – BHP, WBC, CBA, CSL

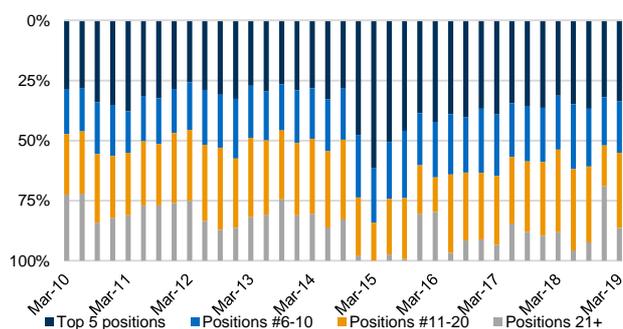
Performance: monthly excess returns



Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	6.4%	20.4%	14.0%
Consumer staples	5.5%	5.2%	-0.3%
Energy	5.6%	6.5%	0.9%
Financials	30.9%	12.2%	-18.7%
Healthcare	8.4%	0.0%	-8.4%
Industrials	8.2%	14.1%	5.9%
IT	2.5%	9.0%	6.5%
Materials	18.9%	20.3%	1.4%
Real Estate	7.9%	3.4%	-4.5%
Telecommunications	3.7%	8.9%	5.2%
Utilities	2.0%	0.0%	-2.0%

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.

The Fund recorded a net return of 1.88% for the month.

Our market continued its strong recent momentum in April, and has now gained 13.5% (total return basis) over four months. These gains are certainly impressive, but seem driven by factors other than company profits. Earnings have, in fact, continued to stagnate, so that the price-to-earnings multiple of the ASX200 Index has expanded by almost two full points, to 16.4 times over this period.

Importantly, we are now in the midst of the April/May mini-reporting season that includes most major banks and a handful of large industrials. Nothing we have seen so far changes our view that the engine room of the non-mining economy, being credit growth, is anaemic at best and the consumer appears to be tired. We have seen the profit outlooks for most building materials companies follow activity levels down as the building boom passes its peak. Retail sales have also softened materially and house prices continue their slide, albeit at a slowing rate. For balance, there have been earnings upgrades in bulk commodities, but spot iron ore prices are unlikely to command 16x multiples.

With a poor economic backdrop and the ASX200 at a 12-year high, our analysis highlights individual stock fair values at elevated risk levels and we retain relatively cautious risk settings for the Fund. Thus, while it may be attractive to chase the current momentum, we note that stock price volatility cuts both ways and we prefer to seek out shares in companies with longer term positive outlooks at advantageous prices. For example, our positions in Aristocrat and Treasury Wines were added after severe share price declines on news that, in our view, did not affect longer term fundamental value.

As the old saying goes, when valuation doesn't seem to matter...that's precisely when it matters most!

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Performance review

The fund modestly under-performed the index primarily due to our continued cautious risk settings (cash levels) and material under-weighting to financials, specifically banks. Nothing we saw during the month altered the view to either portfolio setting. Alternatively, it was very pleasing that bulk of the positions held in the portfolio contributed positively to the performance.

Few would argue that, while overall market volatility remains low, at the individual stock level it is elevated to levels rarely seen in our experience. Thus, it is reassuring when we see our longer term conviction rewarded in

holdings such as Aristocrat (ALL), Tabcorp (TAH) and Nine Entertainment (NEC). In addition, the individual stock price volatility also provides opportunities and it was notable that shares in recently added positions in Treasury Wines (TWE) and Star Group (SGR) were in our top five contributors.

Interestingly, two of our holdings in the battery materials space were our largest individual detractors as news of a delay in Galaxy (GXY) choosing a JV partner saw its shares punished harshly, taking the shares in fellow lithium miner Pilbara (PLS) with it. This was despite corporate behemoth Wesfarmers (WES) again

showing its appetite to enter the space: it followed up its bid for rare earths produce Lynas (LYC) by announcing an agreed bid for yet another lithium play, Kidman Resources (KDR). As such, we continue to note and take comfort from the very pronounced disconnect between private and public market prices for these assets.

Finally, with our patience rewarded in NEC, risk considerations dictated that we lighten what remains a significant position in the stock, while adding to SGR and Mineral Resources (MIN). The Fund's active share remains appropriately high at 81%.

Performance summary

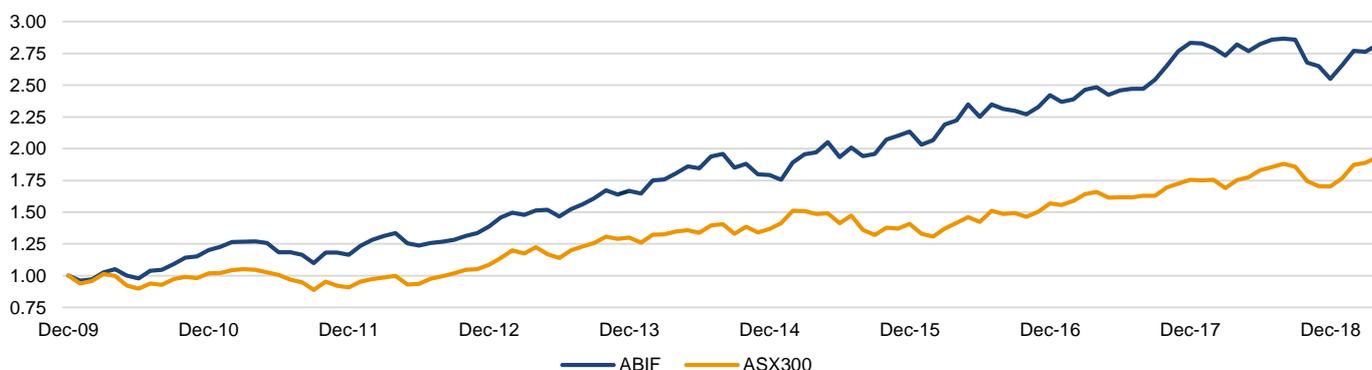
	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	6.0%	-0.2%	8.2%	9.3%
Market (ASX300)	9.4%	10.3%	11.0%	7.5%
- Excess return	-3.5%	-10.5%	-2.8%	1.8%
- Correlation		-0.27	-0.19	-0.31
Analytics				
Information ratio – ABIF		-2.09	-0.55	0.28
Tracking error		5.0%	5.0%	6.6%
Sharpe ratio – ABIF		-0.5	1.2	1.0
Sharpe ratio – market		0.7	0.9	0.4

Key portfolio changes

Additions/up-weights	
Additions	
Nil	
Up-weights	
SCG, NUF, MIN	
Deletions/down weights	
Deletions	
COL	
Down-weights	
ANZ, NEC	

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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