ARCO Investment Management
ARCO Benchmark Independent Fund

Monthly report: December 2017

December capped a very strong quarter for the equity market, supported by significant M&A activity, rising commodity prices, US tax policy (again) and traditional festive cheer. The new year's party will likely flow into 2018, but so might the hangover!

Strong December qtr for equities | 2017 - a solid result for the Fund | Downside risks rising

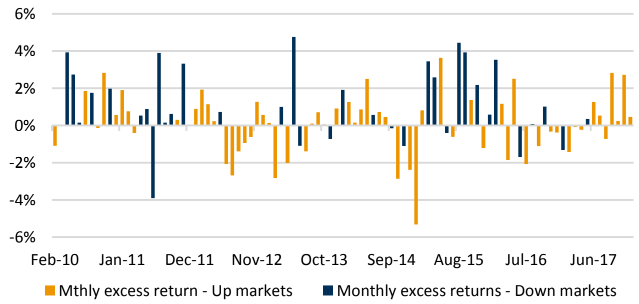
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.1968				
Fund (a)	2.33%	11.4%	17.1%	16.5%	13.9%
ASX300 Accum	1.86%	7.6%	11.8%	8.5%	7.4%

(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	Real estate, Telecom, Banks
Negative	Retail, energy
Top Active	O/w - CYB, WOW, AHG, TLS U/w - WBC, ANZ, NAB, CSL

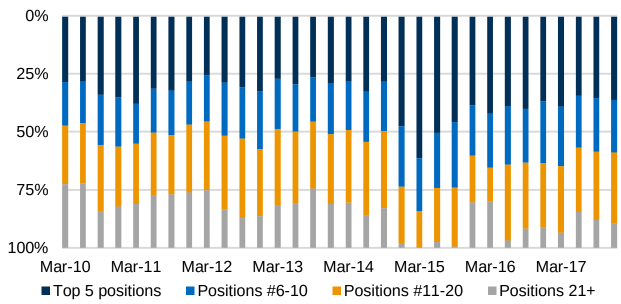
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	4.8%	8.3%	3.5%
Consumer staples	7.5%	7.9%	0.4%
Energy	4.9%	6.0%	1.1%
Financials	35.4%	29.2%	-6.2%
Healthcare	7.2%	0.0%	-7.2%
Industrials	7.5%	8.3%	0.8%
IT	2.0%	7.3%	5.3%
Materials	17.1%	18.2%	1.1%
Real Estate	8.4%	7.0%	-1.4%
Telecommunications	2.9%	7.8%	4.9%
Utilities	2.2%	0.0%	-2.2%

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.

Moving into 2018, the key themes that have driven markets may continue: better global growth and higher employment in developed economies prompting long-overdue household income growth, promising higher business investment in more tax-advantaged jurisdictions. This remains a solid backdrop for equities, but one that is substantially priced-in in our view, given very high valuations. What could derail this rosy picture? Watch bond yields carefully, and inflation indicators even more so, in view of the break-out in commodity prices and tightening in labour markets over the last six months. Watch geopolitics, which could again cut across the recovering Japan/China narrative.

Locally, commodities remain one of the very few bright spots. We remain mindful of little-no real wages growth for local households burdened by high debt levels, and now confronting a much weaker (or negative) wealth effect from softening property prices. The AUD-USD 10 year yield spread at c15bps signals investor expectations of continuing low inflation. If correct, this affords little room for companies to lift pricing, unless they produce retail energy. (Alternatively, a reversion in this spread reverts to more normalised levels will exacerbate the impact of a rising USD yield curve: an ugly outlook for the yield-based darlings of our equity market). Local employment numbers, while solid, point to a significant 'casualisation' of our workforce with the banking sector indicating around 20,000 job losses in their near-term plans which is hardly supportive of wage growth. RBA action (inaction) continues to be a balancing act between supporting a broad-based economic growth agenda and supporting inflated property (and equity) values.

The Benchmark Independent Fund strategy continues to focus on minimising investor draw-downs whilst compounding their returns over the long-term, across all market conditions.

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Performance review

The Fund posted a +2.3% return for December, ending the year up 17.1% and significantly outpacing the broader equity market, (ASX300 up 11.9% in 2017).

We put some more of our cash balance to work in December and initiated a position in BHP, which has looked increasingly attractive on our fair value model for some time – despite our concern over spot iron ore pricing. In combination with our positions in LYC, ORE, and TAW, the Fund's resources exposure drove solid returns. We have taken the opportunity to trim our holdings in ORE and LYC on the back of their recent price rallies.

Our long-held exposure to WFD was rewarded by its price rally on the back of Westfield's announced sale to Unibail-Rodamco. TLS was also a notably positive contributor as the stock recovered some its previous sell-off, which was well-overdone in our view, despite an indifferent medium-term outlook.

AHG and QUB were modest negative performers in our long portfolio though we retain our conviction in these stocks with a positive outlook fuelled by the relative strength of each in their respective sectors and earnings growth expected from both.

We retain our cautious view of the local banking sector which we expect to continue to struggle in 2018 with low earning growth, adverse credit quality, restructuring and political risks representing headwinds blowing strongly in the face of still attractive dividend yields.

Similarly, our fair value models also continue to screen us out of the healthcare sector for now as most stock prices seem fully valued to us.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	11.4%	17.1%	16.5%	15.3%
Market (ASX300)	7.6%	11.8%	8.5%	10.2%
– Excess return	3.8%	5.3%	8.0%	5.1%
– Correlation		-0.06	-0.36	-0.38
Analytics				
Information ratio – OBIF		1.13	1.13	0.78
Tracking error		4.7%	7.0%	6.6%
Sharpe ratio – OBIF		3.1	2.0	1.9
Sharpe ratio – market		1.3	0.6	0.6

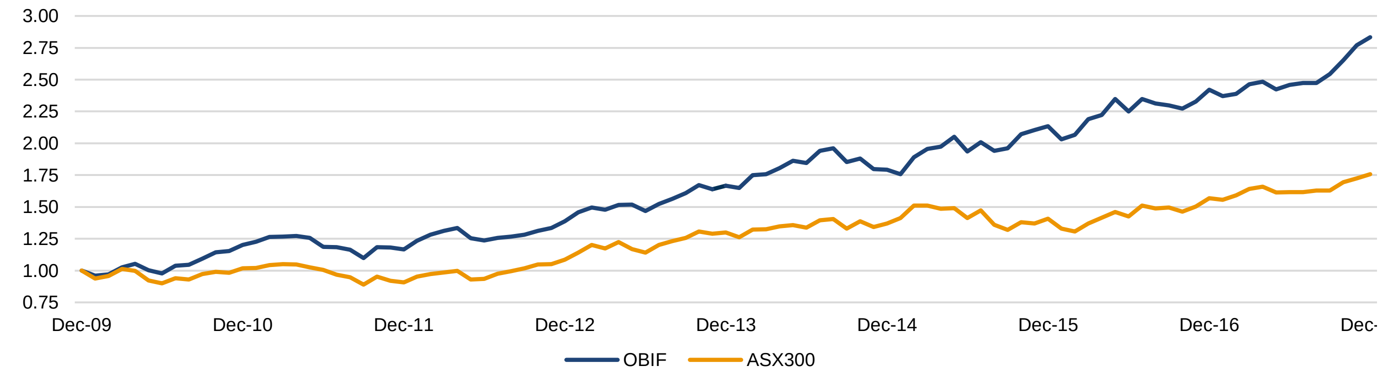
Key portfolio changes

Additions/up-weights
Additions
BHP, MQA
Up-weights
HT1, BXB, CTX, AHG, LNK, QUB

Deletions/down weights
Deletions
Nil
Down-weights
WFD, ORE, LYC

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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