

ARCO Investment Management

ARCO Benchmark Independent Fund

Monthly report: February 2019

Equity markets continued their sharp rally in February despite economic data and the reporting season pointing to weaker earnings momentum and quality. Faced with the prospect of lower interest rates, the market again appears willing to pay more for earnings...really!?

ASX rebounds 16% in 10 weeks!!

.....why?

Valuations stretched - again

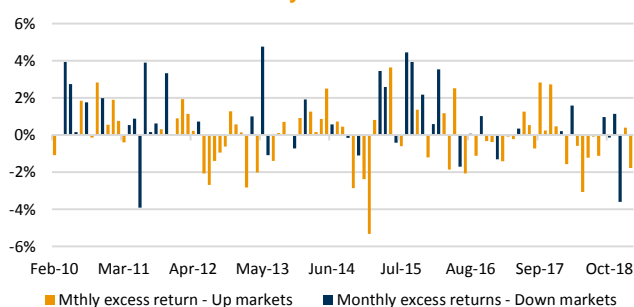
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	0.9830				
Fund (a)	4.24%	4.5%	-0.8%	10.3%	11.8%
ASX300 Accum	6.01%	9.9%	7.1%	12.8%	7.2%

(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	29 holdings
Positive	Media, resources, transport
Negative	Retail, building
Top Active	O/w – NEC, TAH, ALL, LNK U/w – BHP, WBC, CBA, CSL

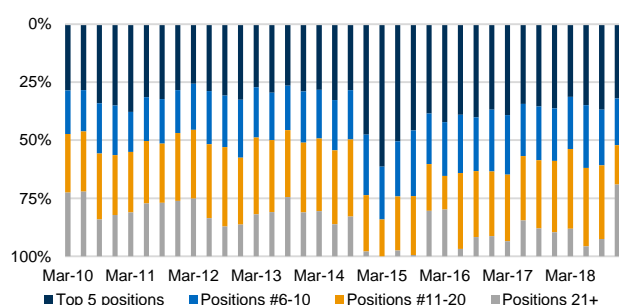
Performance: monthly excess returns



Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	6.4%	19.3%	12.9%
Consumer staples	5.7%	8.8%	3.1%
Energy	5.8%	6.5%	0.7%
Financials	31.0%	12.5%	-18.5%
Healthcare	8.8%	0.0%	-8.8%
Industrials	8.0%	13.5%	5.5%
IT	2.3%	8.8%	6.5%
Materials	18.4%	19.6%	1.2%
Real Estate	7.8%	2.2%	-5.6%
Telecommunications	3.6%	8.9%	5.3%
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 +4.24% for the month.

The equity market rebound continues to surprise us. From end-August, it took the Accum Index 16 weeks to fall 12.5% – after rising by a third over two years. We've now advanced 16% from the low in just over ten weeks. February's market was flattered by timing issues for two big sectors: financials (+8.1%) with a benign (vs expectations) final Royal Comm. report, and Resources (+6.1%) with the Vale supply shock. Leaving the issue of breadth, what exactly is going on?

Is it growth? Economic data in Australia continues to soften, with credit growth at a quarter-century low, and property-based wealth effects impacting activity. Internationally, markets have priced a happy ending to the US-China trade war multiple times this year, but actual US growth is softening. The ECB has cut its growth forecast, and reversed course on removing monetary accommodation.

Is it earnings? Ex-Materials (largely iron ore), aggregate earnings revision through February were slightly negative, with actual results also disappointing, with <30% earnings 'Beats', and the lowest Beat-to-Miss ratio in over five years. Ex-Materials, price advances were very much multiple expansion-based, a very consistent recent trend.

So it's interest rates – yet again? The power of interest rate compression resonates strongly in a world of very unusual liquidity. The RBA moved to a neutral policy bias during the month, and the A10Yr bond traded down to generational lows at <2.10%. Coupon returns were boosted by several companies distributing excess franking credits, ahead of a raft of broadly shareholder-unfriendly changes under active consideration by a future Labour Government.

ARCO Investment Management

ARCO Benchmark Independent Fund

Monthly report: February 2019

Performance review

This month's performance was driven substantially by strong contributions from a number of stocks where earnings growth is being driven by cost-out and digital revenue streams (NEC, TAH); or by factors other than the Australian domestic demand cycle (Brambles, Link, Worley, Downer).

Having been surprised by the strength of the market rebound in January, then into February, the result was also impacted by our decision to increase the cash weighting in the Fund as we exited a number of stocks.

During the month, we exited Caltex, Boral and Wesfarmers having lost conviction in their key strategic earnings drivers and so too Orora and Orocobre which we believe are at or near the end of their cyclical highs.

During the reporting season, we also initiated new positions in a number of stocks that we have been monitoring for some time, including Treasury Wines, where the price has retreated to within our fair value range for the first time in quite some time, and where recent evidence suggests that the risks around

the company's changes in distribution strategy in key markets are moderating.

We similarly initiated a position in Star Entertainment Group, where we felt consumer cyclical exposure was overly discounted in valuation.

In these market conditions that are characterised by relatively broad price swings, fuelled in some part by the earnings announcements during the past month, we have maintained a relatively high active share in the Fund which was 79% in February.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	4.5%	-0.8%	10.3%	9.6%
Market (ASX300)	9.9%	7.1%	12.8%	7.2%
- Excess return	-5.4%	-7.9%	-2.5%	2.4%
- Correlation		-0.38	-0.17	-0.31
Analytics				
Information ratio – ABIF		-1.41	-0.50	0.36
Tracking error		5.6%	5.1%	6.6%
Sharpe ratio – ABIF		-0.6	1.5	1.1
Sharpe ratio – market		0.6	1.1	0.5

Key portfolio changes

Additions/up-weights

Additions

TWE, SGR, SCG

Up-weights

COL, AMC, ALL, QBE, WOR, NUF

Deletions/down weights

Deletions

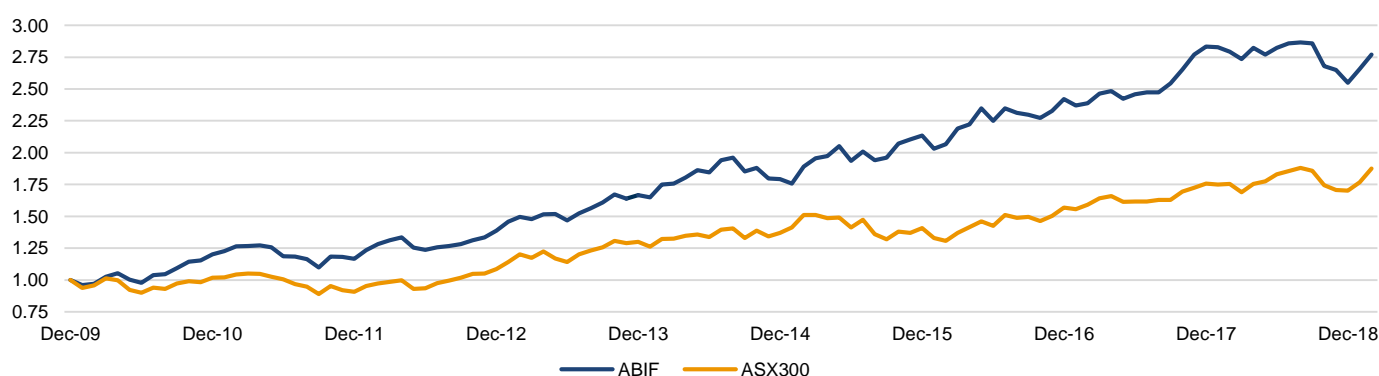
CTX, WES, BLD, ORA, ORE

Down-weights

RRL, QUB, MIN, OSH

Note (1): Returns from the long portfolio of the ARCO 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

This report is prepared for investors in the ARCO Benchmark Independent Fund. Returns and prices are quoted net of expenses, management fees, and accrued performance fees unless specified otherwise. This is neither an offer to sell nor a solicitation of any offer to buy Units in the Trust. Any such offering can only be made to qualifying 'wholesale investors' pursuant to the Fund's deed, and the relevant subscription application.