ARCO Investment Management
ARCO Benchmark Independent Fund

Monthly report: January 2018

New year's celebrations were short-lived into 2018 as the local equity market paused to take stock. Market volatility rose in January as global growth tail-winds met rising inflation fears and the possibility of 'sooner-rather-than-later' quantitative tightening by some central banks.

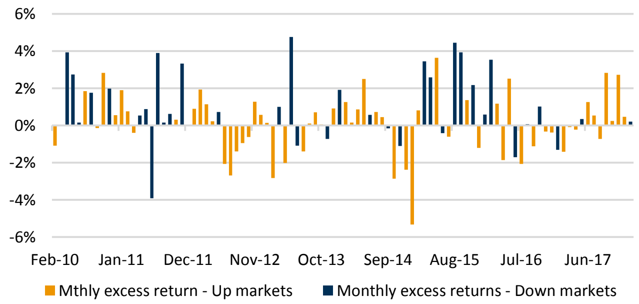
Australian equities lag global peers | Significant shifts in bonds / volatility | Direction from reporting season

	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.1946				
Fund (a)	-0.19%	6.6%	19.4%	17.2%	13.7%
ASX300 Accum	-0.39%	3.0%	12.2%	7.2%	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	
Positive	Software, Building materials, materials
Negative	Media, healthcare, retail
Top Active	O/w - CYB, WOW, AHG, JHG U/w - WBC, ANZ, NAB, CSL

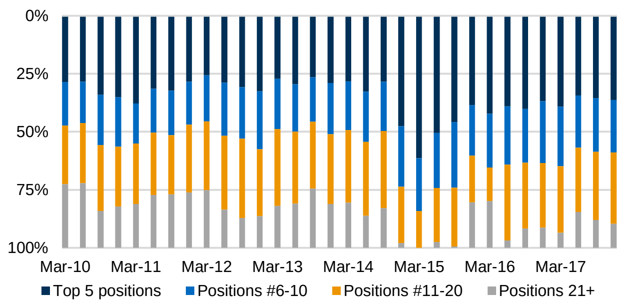
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	4.9%	8.8%	3.9%
Consumer staples	7.5%	8.0%	0.5%
Energy	5.2%	6.6%	1.4%
Financials	35.0%	28.3%	-6.7%
Healthcare	7.1%	0.0%	-7.1%
Industrials	7.4%	8.3%	0.9%
IT	2.1%	7.8%	5.7%
Materials	17.7%	19.5%	1.8%
Real Estate	8.2%	6.4%	-1.8%
Telecommunications	3.0%	6.3%	3.3%
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 Australian equity market was a laggard in January, the ASX300 retreating 0.4% over the month while the rest of the world continued to rally strongly – at least up until February 2nd. Volatility has since risen sharply as QE-fuelled equity values globally face the ugly reality of rising bond yields and QT (Quantitative Tightening), which investors had previously accepted with quite some complacency as part of the "global growth" narrative.

Incipient inflationary pressures in the US (through higher employment and stronger wage growth, rising commodity and energy prices) remains an elevated risk for bonds, even at these higher yields. QT will eventually mean less liquidity creation sloshing around global markets and finding strange homes (such as in higher-yield Australian equity securities), and plenty of unpleasant technical pressure as attempts to juice-up returns (for example, through short-selling VIX) in a low-yield world come unstuck.

The differentiated nature (and not in a good way) of the Australian economic cycle seems likely to be again evident in the current earnings reporting season, although investor expectations are on the whole quite modest – high equity valuations notwithstanding. We maintain a broadly offshore bias to earnings growth within our portfolio holdings, in terms of company domicile and/or commodity exposure, but hope that the season will throw up opportunities to selectively increase company exposure at better values. We retain a strong aversion to interest-rate sensitive stocks, although some of their underlying cash flows may appear "defensive".

Compounding returns over time is best achieved by not having to make-up significant draw-downs - both remain our focus.

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Performance review

The Fund posted a -0.19% return for January and is +19.4% for the past 12 months.

Our broadly cautious view of the local equity market was somewhat rewarded in January, outperforming the ASX300 by 20bps. Cheap stock prices for quality companies though have been (and remain) difficult to find.

We trimmed a number of our holdings on the back of strong recent price rises. In some cases, these price movements have had the effect of significantly narrowing the discount at which many of our positions were trading relative to our assessment of ‘fair value’.

Positive performance contributors for the month were relatively broad-based across our materials (BLD, ORE), software and services (Link), telecoms (Telstra) and financial (Macquarie) holdings.

Long-held positions in CYB, AHG and WOW took a breather though we retain our confidence in the growth path of these stocks.

The Fund continues to reflect our negative view of interest rate sensitive stocks, our favourable view of companies with clear earnings/margin growth paths and a selective interest in cyclical/material stocks as their prices drift away from our fair value range for them.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	6.6%	19.4%	17.2%	14.2%
Market (ASX300)	3.0%	12.2%	7.2%	9.0%
– Excess return	3.6%	7.2%	10.0%	5.2%
– Correlation		-0.18	-0.34	-0.38
Analytics				
Information ratio – OBIF		1.66	1.64	0.78
Tracking error		4.3%	6.1%	6.6%
Sharpe ratio – OBIF		3.9	2.4	1.7
Sharpe ratio – market		1.3	0.5	0.5

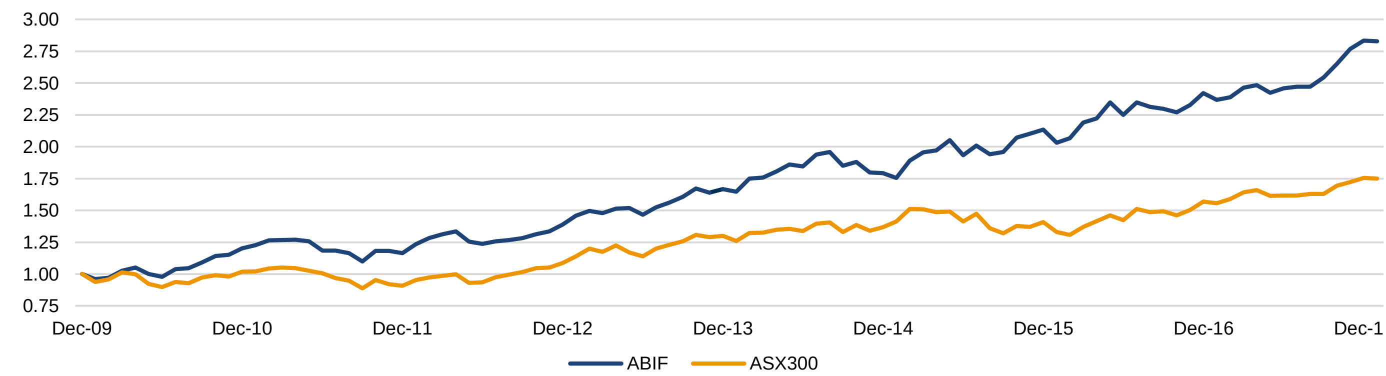
Note (1): Returns from the long portfolio of the ARCO Absolute Trust to Jun16, actual Fund returns thereafter.

Key portfolio changes

Additions/up-weights
Additions
Nil
Up-weights
BHP, AWC, LYC, ORE, HT1, BXB

Deletions/down weights
Deletions
Nil
Down-weights
TLS, MQA, RRL, AMP, CYB

Cumulative returns since inception



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