

# ARCO Investment Management

## ARCO Benchmark Independent Fund

Monthly report: March 2019

Take two: carrying on from February, the Australian market completed its best quarterly advance in a decade despite the continued softening of economic data. With fundamental risks rising both at home and abroad, our market hovers at all-time highs. Something has to give!

Strongest qtrly return in a decade

Selling mis-placed optimism

Buying only defensible valuations

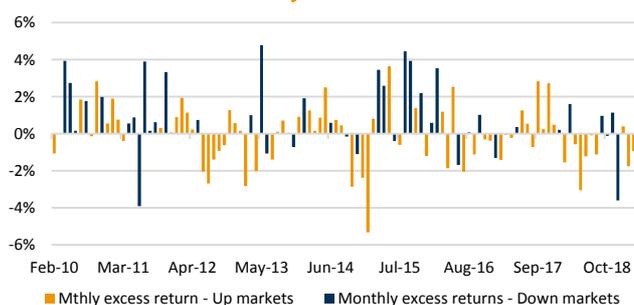
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.0222				
Fund (a)	-0.23%	8.4%	1.1%	8.1%	11.6%
ASX300 Accum	0.73%	10.9%	12.1%	11.4%	7.3%

(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	29 holdings
Positive	Resources, media, industrials
Negative	Gaming, chems/fertiliser
Top Active	O/w – NEC, TAH, ALL, LNK U/w – BHP, WBC, CBA, CSL

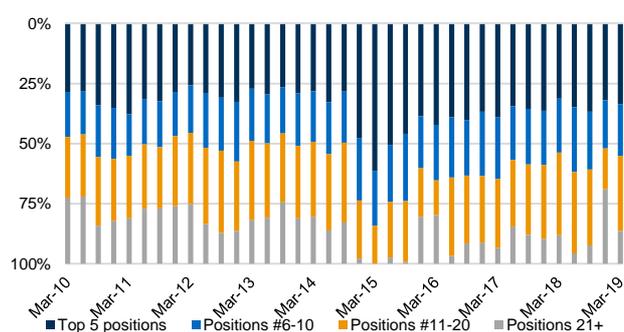
### Performance: monthly excess returns



### Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	6.3%	19.0%	12.7%
Consumer staples	5.3%	8.4%	3.1%
Energy	5.9%	6.4%	0.5%
Financials	31.8%	12.2%	-19.6%
Healthcare	8.5%	0.0%	-8.5%
Industrials	8.1%	13.7%	5.6%
IT	2.7%	8.6%	5.9%
Materials	18.6%	20.5%	1.9%
Real Estate	7.5%	2.3%	-5.2%
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 -0.23% for the month.

As in February, the broad strength of the equity market in March remains a key focus, flying as it does in the face of worsening economic data. GDP barely grew in the December quarter, and was in fact negative on a per capita basis. Subsequent NAB surveys of business confidence, trading conditions and profitability have all softened. Of most concern to us is that growth in credit aggregates again slowed, to levels not seen since the early 1990's recession. It's not clear that a supply-induced iron ore price spike can be relied upon for economic performance or budgetary settings, although our Government seems to think so. Despite all this, our market had its best quarterly return in a decade, and like most world markets, has shrugged off any and all risks that caused the December quarter sell-off.

Our strategy aims to insulate downside risk to the portfolio. As such, our macroeconomic view is an important input in our bottom up stock selection process. Perhaps this allows us to be a bit more sober when viewing the data and adjusting our forecasts and valuation ranges. The fact is we can clearly see empirical evidence of deteriorating economic statistics flowing through to declining earnings and, consequently, valuations. Yet the market still rallies.

The questions all investors are asking remain: "is the worst over, and will the policy response turn it around?" Markets always look forward, but we believe the margin for error is low for two main reasons. First, many markets are already trading at all-time highs. Secondly, with interest rates at record lows, policymakers just don't have many bullets left. In an economy with downside risks, we seek companies insulated from the domestic consumer at defensible stock valuations. We will increase such investment in correcting markets, while always seeking to sell domestically exposed shares that rise on what we deem misplaced optimism.

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### Performance review

The Fund didn't participate in the broader market rally as much as we would have liked during March, with a number of our holdings (including Nufarm, Galaxy, Worley and Star) underperforming solid gainers (especially Lynas, NEC, Mineral Resources, Amcor, and Downer) in the portfolio.

Our patience continued to be rewarded in Nine Entertainment, as February's very credible profit result was further digested. We remain believers that the shares represent compelling value in an expensive market.

Our view of the underlying value of rare earths producer Lynas Corp was endorsed by Wesfarmers non-binding, takeover proposal, at a c45% premium. This is a second recent example of a corporate buyer with a vastly different view on valuation and time-frame for the battery materials sector than that held by the public market. We share Lynas' view on the Wesfarmers proposal as to both value and its highly conditional nature ("more a thought bubble than an offer"), and we remain invested – although on a much smaller scale, as we have found the uncertainties in the regulatory and

political process in Malaysia difficult to quantify for some time.

Our active share was little changed from recent months – at 80% during March. Whilst we didn't initiate, nor close-out any positions during the month, we took advantage of price action to increase our holdings in Nufarm, Star Entertainment and Mineral Resources, whilst trimming our Coles holding as its value pushed toward the upper-end of our fair value range for it.

### Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
<b>Returns</b>				
Fund (1)	8.4%	1.1%	8.1%	9.5%
Market (ASX300)	10.9%	12.1%	11.4%	7.3%
– Excess return	-2.5%	-11.0%	-3.3%	2.2%
– Correlation		-0.26	-0.21	-0.31
<b>Analytics</b>				
Information ratio – ABIF		-2.18	-0.65	0.32
Tracking error		5.1%	5.1%	6.6%
Sharpe ratio – ABIF		-0.3	1.1	1.0
Sharpe ratio – market		1.4	1.0	0.5

### Key portfolio changes

#### Additions/up-weights

##### Additions

Nil

##### Up-weights

NUF, SGR, MIN

#### Deletions/down weights

##### Deletions

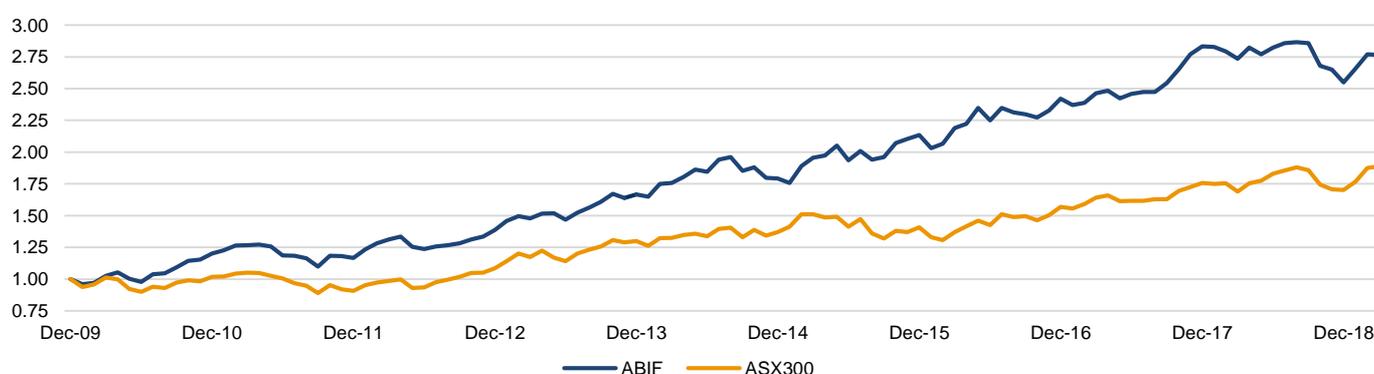
Nil

##### Down-weights

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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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