

# ARCO Investment Management

## ARCO Benchmark Independent Fund

Monthly report: May 2019

Defying the lead from its global peers, the ASX rallied further in May, fuelled by an unexpected election result, still-lower rates for longer and the 'rise and rise' of the price for earnings – any earnings. Time for caution as share price exuberance must give way to market logic.

ASX defies global equities pull-back

NEC and LYC rally further

We retain a cautious posture

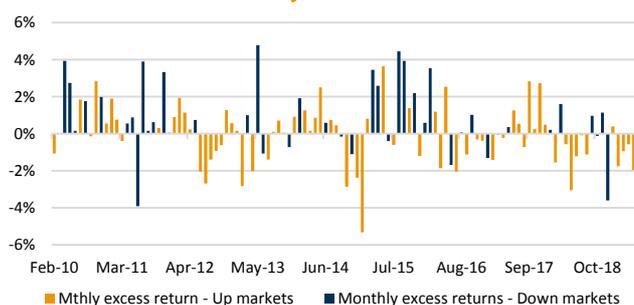
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.0395				
Fund (a)	-0.19%	1.4%	1.5%	6.2%	11.6%
ASX300 Accum	1.75%	5.0%	10.9%	10.5%	7.4%

(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	26 holdings
Positive	Media, materials, gaming
Negative	IT, agric.&chemicals
Top Active	O/w – ALL, TAH, NEC, SGR U/w – BHP, WBC, CSL, CBA

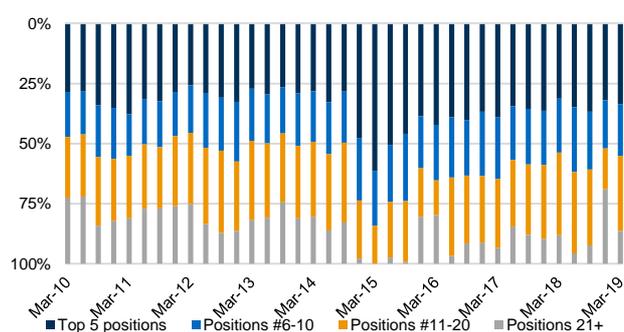
### Performance: monthly excess returns



### Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	6.6%	21.6%	15.0%
Consumer staples	5.8%	5.1%	-0.7%
Energy	5.6%	6.1%	0.5%
Financials	31.5%	15.9%	-15.6%
Healthcare	8.5%	0.0%	-8.5%
Industrials	8.3%	13.6%	5.3%
IT	2.5%	6.9%	4.4%
Materials	18.1%	20.4%	2.3%
Real Estate	7.6%	3.5%	-4.1%
Telecommunications	3.7%	7.0%	3.3%
Utilities	1.9%	0.0%	-1.9%

### 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 -0.22% for the month.

The tide flowed-out again in global equity markets during May with the MSCI down almost 6% for the month as trade wars escalated, the Brexit fiasco continued to plague markets, and as Central Banks grew more cautious about softening economic data.

Our market, by stark contrast, rose 1.7%. The snap-rally on the back of the Coalition victory at the polls was a sugar-hit that drove an already expensive market higher. We too believed that the RBA would reduce interest rates though out of growing concerns for our economy, not share market sponsorship.

We fail to see strong upside in the local banking and finance sector with private credit growth now at six year lows, business confidence waning, credit loss provisions still close to cycle lows, and NIM and real earnings growth capacity shrinking – even if there is an imminent levelling-out of house price declines. We were on the wrong side of the significant rally in bank stocks during the month but won't put investor capital at risk when we can't see a rational reason to do so.

Reflecting our continued cautiousness about the broader economy, plus our scepticism that stock price rises on the back of multiple expansion rather than proven earnings growth are additional reasons for conservatism, the Fund maintained an elevated level of cash during May.

The year to date has been a tough period. Our focus remains deploying capital into investments that we believe will deliver stronger (and predictable) returns over time, to not trade short term momentum and to continue our longer-term track record of delivering strong risk adjusted returns, with significantly less downside exposure than the broader equity market.

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### Performance review

The Australian market's march upwards in complete contradiction to the rest of the world weighed on returns given the defensive tilt to the Funds' portfolio.

We were heartened by strong returns from our two largest contributors, in **Nine Entertainment** and **Lynas**, both of which were held (and added to) through periods of share price stress which we believed were due to non-fundamental facts. It was only a few short months ago that Nine, for example, traded at \$1.30 before rebounding to close out May at \$2.08 as the market began to realise, as we have long argued, the company isn't simply captive to the Australian advertising cycle.

The privileged nature of Lynas rare earths asset and status as the largest non-Chinese supplier continued to be recognised post the conditional bid from Wesfarmers, especially given that China is using rare earths as leverage in the ongoing trade war. Both of these investments highlight the bottom up, long term fundamental nature of our process.

In addition, as we have maintained, the individual stock volatility of the market also throws up opportunities for the patient investor. Our investment in **Aristocrat** (made under substantial price stress in November) again paid off, as its result revealed continued strong momentum in its traditional business,

coupled with evidence of the potential of its burgeoning digital gaming business.

**Nufarm** (retained) and **Link** (reduced) were the two largest negative contributors during the month. Sadly, both have featured before as major detractors, though our view on the two has diverged. The investment thesis for Nufarm was and is the value creation from its European acquisitions, the value of a global distribution footprint to novel chemical producers (hence its biggest shareholder is Sumitomo Chemical) and the promise of its novel Omega 3 canola. Conversely, we have changed our thinking on the quality of, and risks to Link's earnings outlook.

### Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
<b>Returns</b>				
Fund (1)	1.4%	1.5%	6.2%	8.6%
Market (ASX300)	5.0%	10.9%	10.5%	7.7%
- Excess return	-3.6%	-9.4%	-4.3%	0.9%
- Correlation		-0.30	-0.19	-0.32
<b>Analytics</b>				
Information ratio – ABIF		-2.05	-0.89	0.13
Tracking error		4.6%	4.8%	6.6%
Sharpe ratio – ABIF		-0.2	0.8	0.9
Sharpe ratio – market		0.8	0.9	0.5

### Key portfolio changes

#### Additions/up-weights

##### Additions

Nil

##### Up-weights

MQG, TWE, SGR

#### Deletions/down weights

##### Deletions

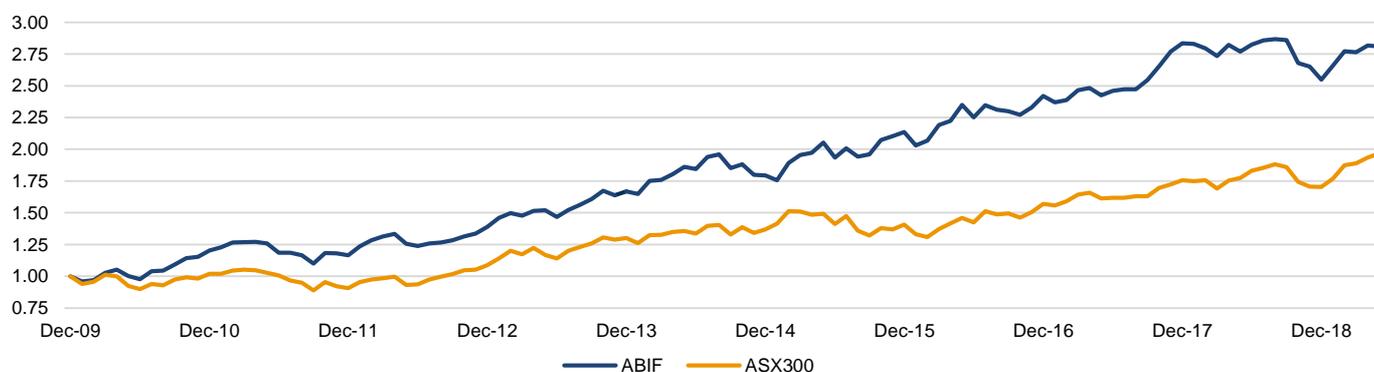
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##### Down-weights

NEC, LNK, QUB, LYC

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

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