

ARCO Investment Management

ARCO Benchmark Independent Fund

Monthly report: October 2018

The global equity market registered its worst monthly return since May 2010. 'Risk-off' sentiment impacted all equity market sectors and high growth stocks in particular. As much as it was an important pressure-release, the retracement also offered a number of buying opportunities.

Tough month for all equity sectors

Valuation risk more relevant?

Stock opportunities emerge

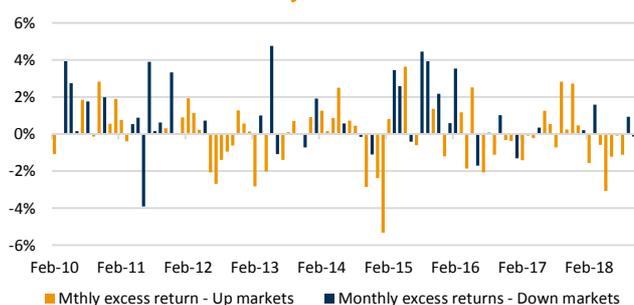
	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	0.9906				
Fund (a)	-6.29%	-6.27%	1.0%	8.9%	11.8%
ASX300 Accum	-6.16%	-5.92%	2.9%	8.1%	6.6%

(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	Resources, banks, healthcare
Negative	Media, materials, building, transport
Top Active	
	O/w – TAH, MIN, FXJ, LYC U/w – CBA, WBC, CSL, NAB

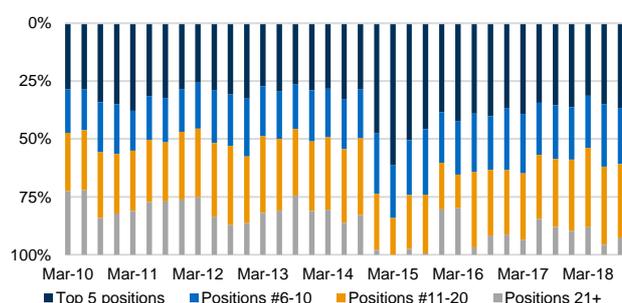
Performance: monthly excess returns



Sector weightings

	ASX300	ABIF	Active
Consumer discretionary	4.3%	8.0%	3.7%
Consumer staples	7.8%	4.5%	-3.3%
Energy	6.0%	6.1%	0.1%
Financials	31.9%	9.9%	-22.0%
Healthcare	8.6%	0.0%	-8.6%
Industrials	7.7%	14.1%	6.4%
IT	2.3%	9.8%	7.5%
Materials	17.9%	40.8%	22.9%
Real Estate	7.7%	0.0%	-7.7%
Telecommunications	3.8%	6.7%	2.9%
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 -6.29% for the month, (ASX300A gross return of -6.16%).

Global equity markets staged a significant retreat in October, led by growth stocks, and fuelled by a rising US yield curve (10yr bond rate through 3.20% for the first time since 2011), some poor earnings reports by some leading tech/growth stocks, and worsening geo-politics. Locally, the ASX300 Accumulation index fell by 6.2%, with every sector in the red, led by energy and IT with double-digit losses.

With the Fund's strong bias towards defensive longs and sustained aversion to high PE stocks for some months now, recognising that equity valuations had become extended we were disappointed with October's result. Much of our good work in terms of appropriate stock exposures (and cash settings) was undone by the impact of one or two stock-specific reversals, as detailed over-page.

Such a significant market pullback has, however, resulted in a number of stocks being rebased back to more attractive levels relative to our 'fair value range' assessment. We have deployed more cash as a result, further diversifying the Fund's holdings.

Our view on markets remains broadly cautious. We view the earnings growth outlook for local companies to remain challenged, most notably in the consumer, housing and credit sectors (a broad band of the local economy). Interest rates globally have seen their lows, as has liquidity creation, absent a much more substantial market correction. Having said that, a few pockets of opportunity are opening up, where risk seems much more appropriately discounted in the valuation.

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Performance review

As for last month, the further retracement of a number of bank, healthcare and high-PE industrial stocks were notable drivers of the market's result in October. Maintaining our aversion to stocks in these sectors has been a positive for the Fund.

Select positions in the Materials sector were also positive contributors to the Fund's result. Most notably, Lynas Corp recovered significant ground as the Malaysian Government's review of its refining and waste disposal operations took on a less hostile guise. We increased our holding in Lynas, at prices at which we felt very adequately

discounted this risk, difficult as this assessment continues to be.

Regis Resources was also a positive contributor for the month, benefitting in part from the markets risk-off shift to the gold sector and also from confirmation in the 1Q production report that management's initial guidance on pre-strip ratios and costs at Duketon had been overly conservative.

Performance took a hit from a number of our higher-conviction holdings within the Fund, including, QUB, Boral, Mineral Resources and Nufarm. Most notably, Fairfax retreated 22% due to an earnings downgrade, mainly from Domain, a risk

factor we had been well aware of. We nevertheless retain a fundamentally positive view of the economics behind the Fairfax-NEC merger.

Portfolio additions during October included Amcor and Worley Parsons. Price retracements for both stocks were, in our view, exaggerated by technical factors, being arbitrage pressure from the Bemis offer, and the size of the equity offering to fund the Jacobs ECR purchase (and uncertainty relating to DAR Group's participation), respectively. As a result, we were able to buy at prices that were well within our fair value ranges: an unusual opportunity for both these high-quality companies.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	-6.3%	1.0%	8.9%	9.9%
Market (ASX300)	-5.9%	2.9%	8.1%	6.0%
- Excess return	-0.4%	-1.9%	0.8%	3.9%
- Correlation		-0.26	-0.24	-0.29
Analytics				
Information ratio – ABIF		-0.37	0.15	0.62
Tracking error		5.3%	5.2%	6.3%
Sharpe ratio – ABIF		-0.3	1.2	1.1
Sharpe ratio – market		0.1	0.6	0.3

Key portfolio changes

Additions/up-weights

Additions

AMC, OSH, ORA, WOR, GXY

Up-weights

BXB, LNK, DOW, TCL, LYC

Deletions/down weights

Deletions

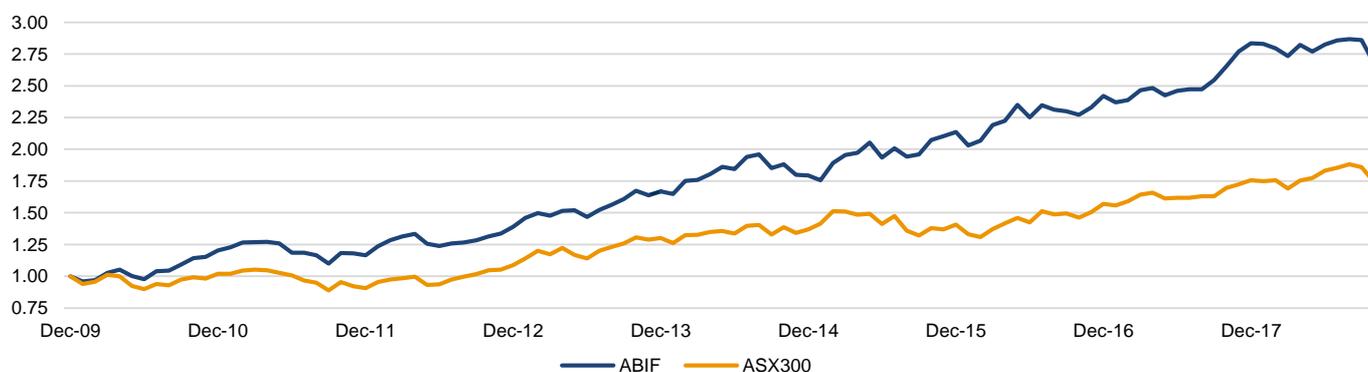
Nil

Down-weights

CTX, ORE

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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