

ARCO Investment Management Benchmark Independent Fund

Monthly report: September 2017

Despite escalating geo-political tensions and interest rate risks, market volatility nears record lows – is this sustainable? The Benchmark Independent Fund recorded a relatively strong return for September and remains positioned to take advantage of market weakness.

Breakdown in offshore correlation

Geo-political and interest rate risks

Allocating cash into weakness

	Month	Qtr	1 Year	3 Year	Life (p.a.)
Price NAV	1.0744				
Fund (a)	2.88%	3.4%	10.7%	11.2%	12.8%
ASX300 Accum	0.04%	0.7%	9.2%	7.0%	6.6%

(a) Gross returns from the long portfolio of the Optimal Australia Absolute Trust to Jun 16; actual Fund returns thereafter.

Monthly attribution and top active investments

Attribution	
Positive	Resources, REITs, banks, retail
Negative	Pharma, telecoms, media
Top Active	
	WOW, CYB, JHG, FXJ, AHG, TLS, BLD

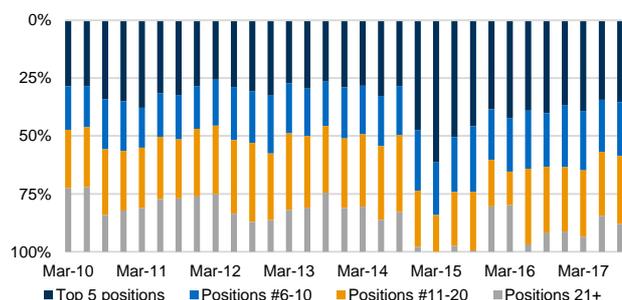
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	5.1%	10.6%	5.6%
Consumer staples	7.4%	7.9%	0.5%
Energy	4.3%	4.0%	-0.3%
Financials	36.3%	33.8%	-2.5%
Healthcare	6.9%	0.0%	-6.9%
Industrials	7.5%	6.0%	-1.5%
IT	1.5%	5.9%	4.4%
Materials	17.3%	15.2%	-2.1%
Real Estate	8.3%	9.5%	1.2%
Telecommunications	3.2%	7.1%	3.8%
Utilities	2.2%	0.0%	-2.2%

Stock concentration - % of equity exposure



Fund strategy and outlook

This fund aims to deliver investors consistent growth over time, with a strong focus on capital preservation and low downside capture.

An interesting feature of recent Australian market performance (or lack of it) has been the breakdown in the usually strong correlation with offshore equity markets. Part of this is likely due to currency – the AUD continues to retrace from recent highs. There is plenty of international capital chasing yield in Australian equity (and debt) securities, typically on an unhedged basis. As a consequence, this money is very FX rate-sensitive. Another factor may be the slide in iron ore prices, which is unlikely to give investors comfort on the prospects for our highly indebted household sector. Government is a further factor. The energy mess is bad enough from a domestic consumer and business perspective, but increasingly erratic policy-making may also impact foreign investor confidence and be additionally unhelpful for markets.

As a manager that focuses constantly on preserving investor capital, there are plenty of risks to take into account. Ultra-low interest rates may continue to underpin expensive equity valuations, but this trade is now very long in the tooth. Absent another growth shock, key offshore central banks seem keen to lift rates and tighten liquidity. In Australia, there seems less immediate upward pressure on rates, but our banks have been tightening credit for some time. We remain wary about the outlook for housing and its broader implications for the economy and the banking sector in particular.

Our focus on preserving investor capital over time means we remain vigilant of the macro drivers of our equity market. Whilst relatively broad-based global economic growth is constructive, we remain alert to escalating geo-political tensions and the prospect of interest rate increases (more particularly its unintended consequences) posing a real risk to investor portfolios at present and need to be taken seriously. The Fund has an 8% cash weighting and is positioned to take advantage of any market weakness.

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Performance review

The Fund posted a strong +2.9% return for September, against a flat performance result by the broader equity market during the month.

Of particular note for September was the strong contribution to investor returns from the Fund's lithium exposure with solid returns from Orecobre, Galaxy Mining and Pilbara Minerals – the lithium sector experienced something of a break-out month as electronic vehicle (EV) manufacturer news-flow captured more market attention.

More broadly in the materials sector, the Fund extended its underweight resources position (ex-lithium stocks) which benefited performance as most

resource stock prices fell during September.

Being underweight major banks was a modest detractor from performance though our long-held position in CYBG again rewarded investors this month as we continue to favour companies with significant self-help strategies. Looking forward, we are likely to further reduce the Fund's domestic bank weightings given our concerns around their exposure to the overheated housing market.

We remain interested in quality companies with significant offshore earnings exposure and began building a position in Brambles this month (in part

replacing the recently divested CSL position which had moved ahead of our fair value range).

We increased our retail REIT exposure during the recent Amazon-inspired sell-off, and this contributed positively to the Fund's return. This was partially offset by our Harvey Norman exposure (divested during the month), where our hopes for greater financial transparency and possible capital management were only partially delivered, with an underwhelming market response.

The Fund's cash weighting reduced to 8% by the end of September, with more to be allocated into market weakness.

Performance summary

	Qtr	1 Yr	3 Yrs	5 Yrs
Returns				
Fund (1)	3.4%	10.7%	11.2%	14.7%
Market (ASX300)	0.7%	9.2%	7.0%	10.0%
– Excess return	2.7%	1.5%	4.2%	4.7%
– Correlation		-0.34	-0.38	-0.39
Analytics				
Information ratio – OBIF		0.35	0.57	0.71
Tracking error		4.1%	7.4%	6.6%
Sharpe ratio – OBIF		1.96	1.16	1.78
Sharpe ratio – market		1.01	0.44	0.60

Key portfolio changes

Additions/up-weights

Additions

BXB, LYC, RRL

Up-weights

FXJ, TLS, SCG, WFD, BLD, AMP

Deletions/down weights

Deletions

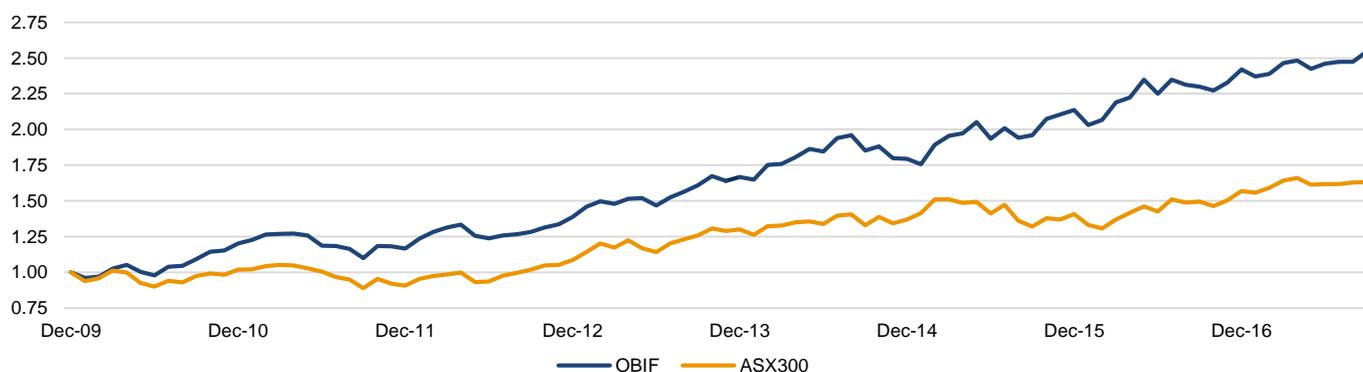
BHP, HVN, STO

Down-weights

ORE, PLS, GXY, ANZ

Note: Gross returns from the long portfolio of the Optimal Australia Absolute Trust to Jun16, actual Fund returns thereafter.

Cumulative returns since inception



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