

Optimal Australia Absolute Trust

Optimal
FUND MANAGEMENT
AUSTRALIA

Monthly Report | August 2016

	Month	Qtr	Year	Life (p.a.)
Fund returns	0.0%	-2.1%	6.8%	8.7%
Series 1 NAV				\$10.627
Positive months			75%	88%
Worst month			(2.3%)	(2.3%)
Volatility				3.8%
Sharpe ratio				1.2

Monthly key contributors - by sector

Longs

Positive Banks, staples, industrial cyclicals

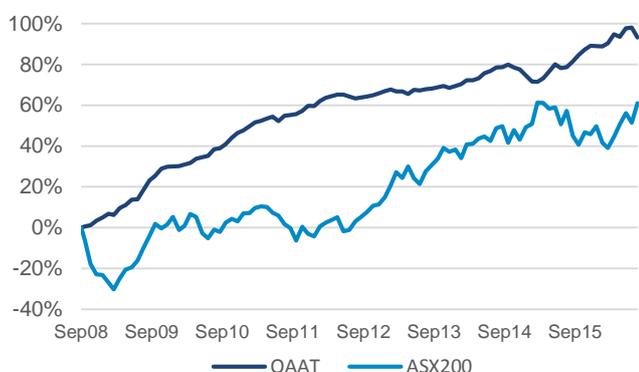
Negative Contractors, media, resources, builders

Shorts

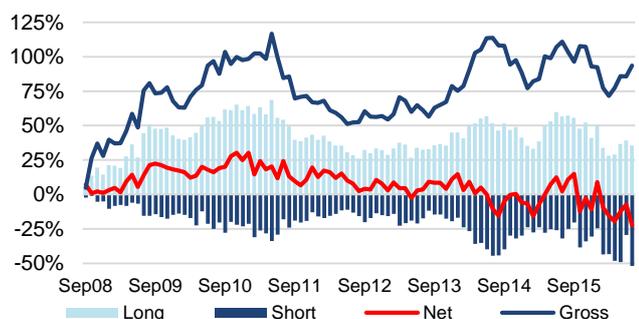
Positive Media, telco, consumer, index futures

Negative Healthcare, non-bank financials, resources

Cumulative performance



Fund investment profile (% NAV)



Risk settings

% of NAV	Long	Short
Equities	33.1%	(29.3%)
Debt / Hybrids	0%	0%
Derivatives		-7.7%
Gross exposure		94%
Net exposure		(22%)

Concentration by position	Long	Short
Top 5	19.2%	-25.8%
Top 10	28.7%	-44.6%
Top 15	34.5%	-55.5%

Performance Review

The Trust recorded a flat net return in August in a weaker market, with the ASX 200 Index down 2.3%.

Our equity market remains dominated by two key factors: an increasingly desperate search for coupon income, and related and growing levels of 'risk-parity' and other 'structured product' liquidity flows. Non-traditional money represents a new element of volatility when equity valuations are high and growth patchy. These are risky days.

August saw a hangover from an exceptionally strong July, in which the ASX 200 Index rose 6.2% in AUD (and 8.5% in USD) terms. These gains were in turn partly influenced by new financial year allocations by "bond refugee" and risk-parity investors, resulting in near-panic buying of yield stocks. This trade began to unwind in August, and with a real vengeance in some sectors – REIT's, for example. This unwind highlights the dangers of a single-factor valuation approach, and of so much money being forced into equities as a result of interest rate repression.

Another key influence on the market and on Fund performance during the month was the earnings reporting season. Our main focus here was to avoid mistakes, as investor positioning so often produces a violent share price reaction to an earnings report. So it was in August, with 20 ASX200 stocks rallying 20%+ and 20 falling 20%+. Our long focus often tends to be on out-of-favour stocks at or close to an earnings inflection point, and with low risk of disappointment. Some of these (Woolworths, for example) worked very well. In hedging portfolio risk, we selectively short-sold some outperforming and high-multiple defensives where we felt the risk of an earnings miss was high. We made good gains on some of these (such as Realestate.com). However, in an economy and stock market devoid of much organic growth, even some lightly-shortened and very highly-rated companies producing completely in-line earnings saw explosive 'relief' rallies, and we fell afoul of one or two of those.

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Fund Strategy

We maintain a defensive focus. The absence of any real volatility since 'Brexit' is frankly disconcerting. The S&P 500 Index, for example, has now clocked up 43 consecutive sessions without a move of over 1% in either direction. This is the longest such stretch for nearly three years, and begs the age-old question: "accumulation or distribution?"

Our thinking remains that markets carried higher by multiple expansion in the face of generally weak growth are higher-risk, especially when key drivers in the great bond rally and experimental monetary stimulus are showing clear signs of fatigue. The proliferation in equity markets of structured yield or 'risk-parity' products (which typically use leverage to juice-up coupon returns), represent an additional source of volatility and risk, and are continuing to distort sectoral valuations.

GPIF of Japan, as but one example of quasi-public 'bond refugee' money, recently disclosed shareholdings in 63 Australian companies, with a heavy yield bias for an essentially index-based investor.

This data, anecdotal as it may be, reinforces our sense of risk in interest-rate sensitive stocks. Our negative bias in this group proved effective as a means of hedging portfolio risk in August, although the extraordinary recent strength of many such stocks vis-a-vis any form of prudent risk control has made it difficult to maintain short positions.

The broad themes from the earnings reporting season themes were mixed. At a sector level, the consumer still seems strong: housing, retail and gaming results were solid. Cost-out situations delivered, in miners, steel and airlines. Earnings remain structurally weak in media and banks. Overall market earnings estimates didn't change very much, which is just as well as EPS growth is very pedestrian, and so PER expansion or contraction remains a key driver of stock returns. Like any scarce commodity, investors are overpaying for decent growth. Active institutional investors on this theme continue to win money, and have to deploy inflows in the same stocks, irrespective of valuation.

Optimal Australia Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
FY17	(2.28%)	0.02%											(2.26%)
FY16	0.31%	1.52%	1.79%	1.42%	1.01%	(0.11%)	0.02%	0.77%	2.34%	(0.69%)	2.29%	0.11%	11.2%
FY15	1.03%	0.06%	0.64%	(0.71%)	(0.53%)	(1.53%)	(1.88%)	(0.08%)	0.98%	1.96%	2.04%	(1.09%)	0.80%
FY14	0.36%	0.14%	0.43%	0.32%	(0.52%)	0.54%	0.57%	1.06%	0.04%	0.57%	1.38%	0.63%	5.64%
FY13	(0.54%)	0.26%	0.29%	0.37%	0.57%	0.66%	0.46%	(0.50%)	(0.06%)	(0.70%)	1.22%	(0.18%)	1.86%
FY12	1.69%	0.29%	0.29%	0.97%	1.63%	(0.09%)	1.51%	1.03%	0.46%	0.46%	0.00%	(0.60%)	7.88%
FY11	2.34%	0.36%	1.45%	2.23%	1.66%	0.86%	1.36%	1.26%	0.50%	0.74%	0.57%	(1.38%)	12.57%
FY10	4.00%	3.88%	2.00%	2.68%	0.78%	0.09%	0.17%	0.52%	0.68%	1.45%	0.59%	0.57%	18.75%
FY09			0.67%	0.59%	2.19%	1.47%	1.81%	(0.56%)	3.10%	1.37%	2.43%	0.09%	13.90%

Note: returns are net of all fees and assume reinvestment of distributions. Fund inception date 15/9/08

Optimal Australia Absolute Trust – distribution history

Y/e June	2009	2010	2011	2012	2013	2014	2015	2016
Series 1 units	\$1.23	\$1.31	\$2.03	\$0.41	\$0.12	\$0.34	\$0.46	\$0.71

Fund facts

Initial series NAV	\$10.627	Distribution frequency	Yearly (bi-yearly in FY 2016)
Strategy	Long-short Australian equities	Minimum investment	Wholesale investors only, \$100k
Objective	Positive returns in all market conditions. Overarching focus on capital protection	APIR Code	OPT0001AU
		ISIN	AU60OPT0014
Firm AUM	\$100m	Bloomberg	OPAUSAB AU Equity
Last distribution	\$0.265 per unit (July 2016)	Fund inception	15/9/08 at \$10.000 per unit

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