

Optimal Australia Absolute Trust

Optimal
FUND MANAGEMENT
AUSTRALIA

Monthly Report | June 2016

	Month	Qtr	Year	Life (p.a.)
Fund returns	0.1%	1.7%	11.2%	9.2%
Series 1 NAV				\$11.140
Positive months			83%	86%
Worst month			(0.7%)	(1.9%)
Volatility				3.7%
Sharpe ratio				1.39

Monthly key contributors - by sector

Longs

Positive Industrials, resources, staples

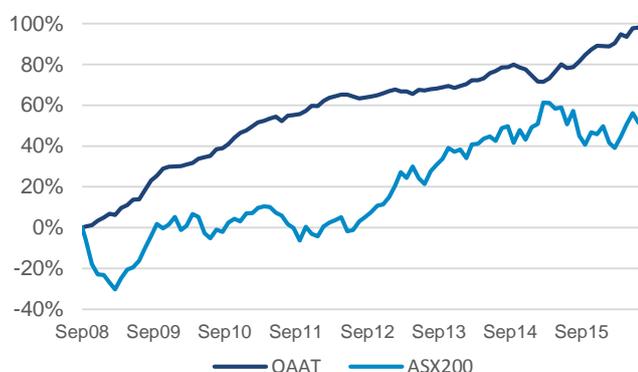
Negative Insurance, banks, chemicals

Shorts

Positive Banks, builders, index futures

Negative REITs, media

Cumulative performance

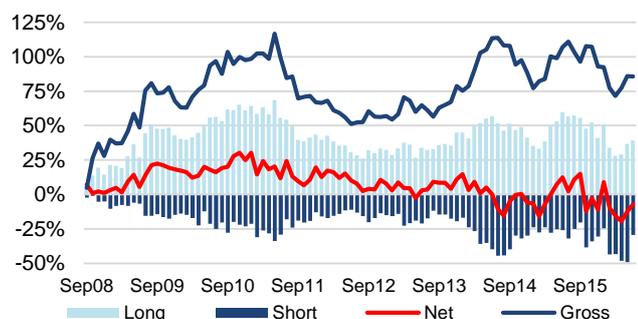


Performance Review

The Trust's NAV is quoted cum-distribution, with net returns of +0.11% in June and +11.2% for the 2016 financial year. The Trust was true to label this last year, with returns broadly uncorrelated to a weak Australian equity market, where the ASX S&P 200 Index fell 4.1% in price terms, with elevated volatility a feature.

The investment environment locally and globally remained dominated by downward pressure on the yield curve. It's certainly possible to value an equity security at almost anything using near-zero interest rates, but FY2016's markets remind that it's not quite that easy.

Fund investment profile (% NAV)



This backdrop is very difficult for investors, precisely because it requires suppression of risk-aversion. "There is no alternative" (to equity dividend yields), or so we are told, for coupon-hungry investors, and so markets pay ever-higher multiples of essentially weaker corporate earnings. This mind-set also increases vulnerability to event shocks. So it was in June, with the outcome of the 'Brexit' vote taking stocks down sharply, with the ASX 200 down over 6% at its low, then recovering around half that loss to finish down 2.7%.

Risk settings

% of NAV	Long	Short
Equities	39.2%	(29.5%)
Debt / Hybrids	0.0%	0.0%
Derivatives		(17.1%)
Gross exposure		86%
Net exposure		(7%)

Concentration by position	Long	Short
Top 5	16.4%	-13.6%
Top 10	29.4%	-24.3%
Top 15	37.2%	-29.5%

We certainly can't claim any special insight into the 'Brexit' vote, but the Fund maintained net short exposure throughout the month, and profited nicely from the resulting risk liquidation. Most of our gains evaporated in the immediate post-Brexit rally, however. We were a little too cautious and did not materially reduce portfolio hedging, despite plenty of evidence that such an event always brings the Central Bank liquidity put into play, with a consequent further rally in bonds, and the inevitable follow-through to stocks.

Our short positions made a net contribution to the Fund return of 1.30% (on average exposure of 48% of NAV), slightly exceeding losses on our longs. June was a month in which the value of portfolio hedging was made very clear. It was very easy to incur large losses, as the vast bulk of investor money was completely blindsided by Brexit.

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Fund Strategy

The Fund maintained an essentially defensive focus for much of the last year, as we became increasingly concerned over the growing discrepancy between higher equity valuations and weaker corporate earnings.

Economic fundamentals appeared to us to be deteriorating in most Western economies, while China appears to prioritise reform and quality of growth over growth at any cost, and its regulators recognise that leverage has reached frightening levels. With 35% of global sovereign debt now priced at negative yields, we continue to see aggressive monetary policy and financial repression causing a lot of unnatural clustering by investors in equity securities in an attempt to produce coupon income. This process remains vulnerable to broader political and economic shocks.

System leverage continues to rise, so any sharp repricing of credit spreads is a further left-field event likely to impact equity market volatility. We'd be surprised if Brexit does not result in some pretty material losses once the dust settles, and we find it hard to see the economic growth positive in this outcome –

although it does seem to bring the unholy prospect of outright sovereign debt monetisation a step closer.

In Australia, the Federal election 'result' perpetuates a woeful state of politics, in which no substantive progress on structural reforms, archaic industrial relations, or any sensible plan to arrest a steadily-deteriorating fiscal position can be made. Concerns around housing excesses potentially deflating sharply persist, and in our view are real. At best, the economy looks set to grind along, producing an unspectacular earnings backdrop, such that market gains remain largely a function of multiple expansion, and are thus vulnerable to any reversal of the "bad news is good" paradigm. After all, negative yield only exists through an alliance between monetary intervention and the fear of deflation. The latter is not usually a good recipe for equity returns, and the combination of these features with investor crowding in equity securities represent potent preconditions for capital loss.

We intend to remain wary, and to ensure that the Fund's equity market exposure is well hedged.

Optimal Australia Absolute Trust – monthly returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
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	\$0.444

Fund facts

Initial series NAV	\$11.140 (cum Jul-16 distribution)	Distribution frequency	Yearly or bi-yearly
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	OP AUSAB AU Equity
Last distribution	\$0.444 per unit (Jan 2016)	Fund inception	15/9/08 at \$10.000 per unit

This report is prepared for investors in the Optimal Australia Absolute Trust. Returns and prices are quoted net of all expenses, management fees, and accrued performance fees. This is neither an offer to sell nor a solicitation of any offer to buy Units in the Trust. Any such offering can only be made to qualifying 'wholesale investors' pursuant to the Fund's Information Memorandum, and the relevant Subscription Application.