Optimal Australia Absolute Trust

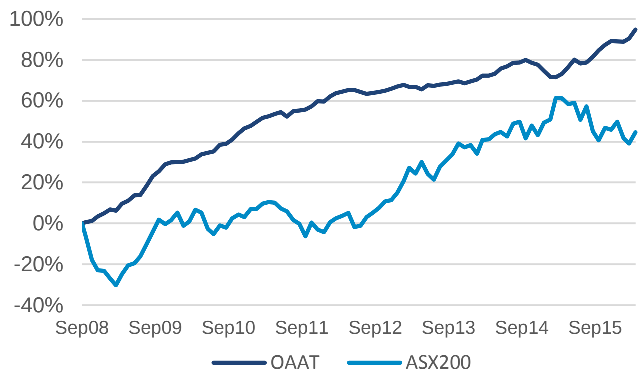
Optimal FUND MANAGEMENT AUSTRALIA

Monthly Report | March 2016

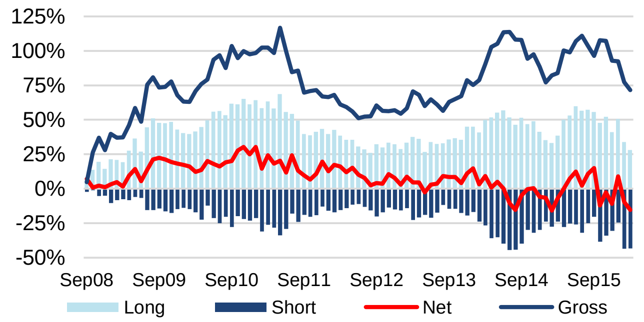
	Month	Qtr	Year	Life (p.a.)
Fund returns	2.3%	3.1%	12.5%	9.2%
Series 1 NAV				$10.955
Positive months			83%	84%
Worst month			(1.1%)	(1.9%)
Volatility				3.6%
Sharpe ratio				1.35

Monthly key contributors - by sector	
Longs	
Positive	Resources, media, utilities, retail, staples
Negative	Transport
Shorts	
Positive	Healthcare, banks
Negative	Builders, index futures

Cumulative performance



Fund investment profile (% NAV)



Risk settings

% of NAV	Long	Short
Equities	28.0%	(26.4%)
Debt / Hybrids	0.0%	0.0%
Derivatives		(17.0%)
Gross exposure		**72%**
Net exposure		**(15%)**

Concentration by position	Long	Short
Top 5	19.5%	-13.6%
Top 10	26.8%	-22.1%
Top 15	282%	-26.4%

Performance Review

The Trust recorded a net return of +2.3% in March.

March's equity market was another case study of the nexus between a weak real economy and (supposedly) market-friendly monetary policy signals. This symbiosis (or unhealthy co-dependency) has characterised markets for some time, leading investors to bid-up risk asset prices, despite faltering growth and higher valuations, confident that central banks will engineer verbal or actual policy reassurance at every stumble. Credit markets now seem much less willing to play this game, driving 'bad volatility' and a general increase in investment risk. Timing is everything, but a step-change in the psychology underlying this relationship is long overdue, and will likely prove very ugly for passive (unhedged) equity market returns when it arrives.

The data that took our market down intra-month (March 24th) revolved around bank credit quality and profitability. This issue is key, and may act to strengthen concerns that Australia's amazing run in dodging the bad debt bullet has run its course. The market was digesting this news at a potentially dangerous juncture, as confidence in the ability of central banks to continue to underwrite asset prices has waned, if only slightly. Right on cue, Janet Yellen played very much to the market's script, with dovish remarks on the path for the Fed funds rate, given 'developments abroad'.

At a Fund level, our stock selection worked extremely well during March, and just as well – the Fund was solidly net short through the month, which detracted from returns. The Fund enjoyed solid gains from our high-conviction longs in the retail, media and utility sectors. Our hedging through short exposure was not too expensive, with loss attribution of around 0.70% arising almost solely from index futures – our stock shorts broke even for the month. This is certainly no time to run high long market exposure, for reasons touched on above.

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Fund Strategy

In Australia, the real economy data in March was mixed. The signal that unwound a fair bit of March's market rally related to bank credit quality and profitability. ANZ reported that its credit loss charges had increased by a further $100m (since its update a month earlier) due to a 'small number of Australian and multi-national resources-related exposures'. Westpac followed with an update showing that two rounds of mortgage rate repricing had not been sufficient to lift its net interest margin. Investors are highly sensitive to these issues, given the very heavy concentration of financials in the index, the deterioration in international credit market conditions over recent months, and a spate of high profile corporate bankruptcies in Australia.

Bank credit quality – and the appropriately intractable desire by regulators to further increase bank capital – are key issues for the direction of the Australian equity market, absent a miracle economic acceleration in China spreading to the wider commodity complex. Australia still strikes us a low-growth economy in the grip of a major structural adjustment. The national disposition towards leverage in general, and property in particular, have disguised that reality from many consumers. Bank credit standards in property lending are tightening by the day, impacting credit availability.

It would be very concerning, but hardly surprising, if that driver of the 'wealth effect' turns negative.

At a wider level, it's exactly that dependency on a 'wealth effect', with economic effects that are broadly unconvincing (except in the eyes of central banks), and the associated reliance on monetary policy signals that most worries us about markets. Relentless yield curve compression engineered by central banks has caused many distortions in markets, including unusual risk-seeking investor activity clustered in equity and debt securities, which represent an important precondition for market instability.

M. El-Erian put it very well this week: "*market participants have a choice: either break away from a co-dependency that has served them well but, almost inevitably, exposes them to volatility in the short term and the possibility of major losses over the longer term if economic and corporate fundamentals fail to improve significantly; or continue to ride the rollercoaster powered by signals from a data-dependent Fed*…"

Our guess is that investors will be dragged screaming from this trade, and that as a result, recent market volatility is here to stay. We'll continue to focus on stock opportunities, with limited exposure to market risk.

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%				9.36%
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	$10.955	**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
Strategy AuM	$100m	**Bloomberg**	OPAUSAB AU Equity
Last distribution	$0.444 per unit (Jan 2016)	**Fund inception**	15/9/08 at $10.000 per unit