Optimal Benchmark Independent Fund

Optimal FUND MANAGEMENT AUSTRALIA

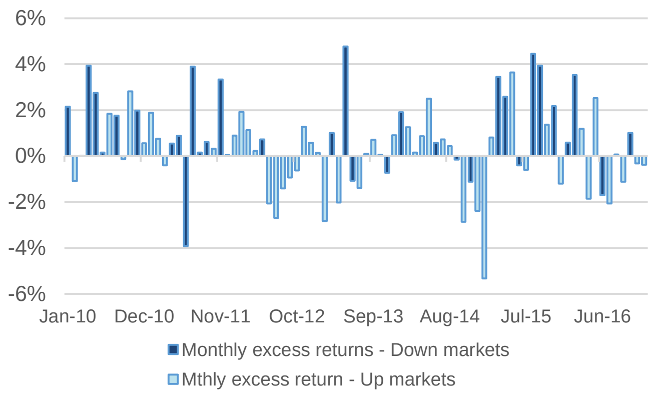
Monthly Report | December 2016

Performance	5yr (p.a.)	1yr	Qtr	Month
Series 1 NAV				$1.0344
Return (a)	15.7%	13.3%	5.3%	4.0%
ASX300	11.8%	11.5%	5.2%	4.4%

(a) Model portfolio gross returns to Jun16; actual net returns thereafter

Monthly attribution and top active investments	
Attribution	
Positive	Media, staples, software, pharma, DivFins
Negative	REITs, banks, utilities, telco, insurance
Top active	LNK, APN, WOW, HGG, CYB

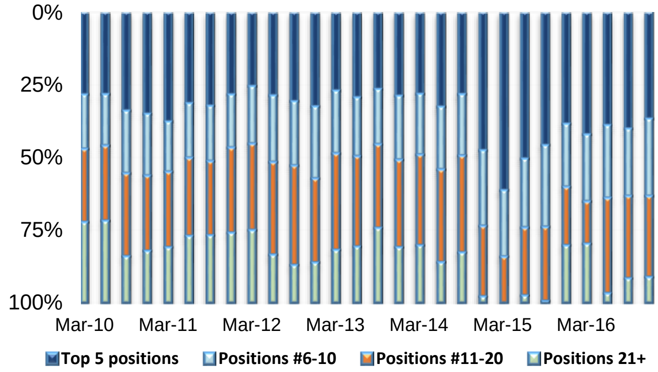
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	4.9%	16.2%	11.3%
Consumer staples	7.0%	8.3%	1.3%
Energy	4.1%	6.4%	2.3%
Financials	37.8%	35.6%	-2.1%
Healthcare	6.4%	5.3%	-1.1%
Industrials	6.9%	7.8%	0.9%
IT	1.2%	8.9%	7.7%
Materials	16.3%	7.9%	-8.4%
Real Estate	8.3%	0.8%	-7.5%
Telecommunications	4.7%	2.8%	-1.9%
Utilities	2.5%	0.0%	-2.5%

Stock concentration - % of equity exposure



Fund Strategy and Outlook

The Fund recorded a +4.0% net return in December, against a +4.4% return for the ASX300 Accum index.

The US-led "buy the election" theme coincided with a useful uptick in global PMI data, leading to very strong advances in most risk markets. In Australia, the Accumulation index is +13.1% from Nov 9th to Jan 9th. This is a big move in short order, ranking as the second largest rolling 7-week gain since the recovery from the crisis lows of early 2009. More recent gains have been indiscriminate: over the 3 weeks from Dec 19th, only three stocks in the ASX 100 were down. Without entering the "great rotation" debate (in which we side with GS: it's probably a mirage), one fact is clear – this market move has absorbed a lot of sideline cash.

Tactically, we'd expect it to get harder from here, and with more volatility. Valuations are elevated at current prices, with earnings still uncertain, as we will likely see in a challenging February earnings season for Australia. The key lesson of 2015 and 2016 was that crowding kills. The Trump-driven "reflation" trade firing markets has become very crowded, very quickly. Impatience on policy delivery looms as a key test for investors.

We continue to fear structurally higher inflation, with energy prices recovering and higher wage growth. Geopolitics seem to represent another risk for bond yields. Higher bond yields require faster earnings growth just for constant equity prices. The recent market narrative is that higher bond yields are a corollary of higher growth. Maybe, but bond yields have been gamed for many years. A reversion to more sensible levels seems well overdue, and this carries many other risks with it. Financial repression as practised by central banks (and the vast "risk-parity" and "structured product" liquidity flows stemming from it), have had a profoundly distortive effect on equity pricing. That game appears very nearly over.

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Performance Review

The Fund's stronger investments included our recent purchase of APN. This company has emerged from a tortuous restructuring process, to end up with two attractive and now wholly-owned media exposures in radio and Adshel. We were able to make an investment at a discounted valuation arising from technical pressure around its recent capital raising.

Woolworths also performed strongly for us, partly in anticipation of capital liberation through the sale of its non-core interests in petrol retailing. This deal was announced just after Christmas, deleveraging the balance sheet and removing another distraction from management's focus on the core supermarket business.

Other solid performers included financials, namely ANZ, Suncorp, Hendersons, and Clydesdale. The Fund has limited long exposure to resources and materials, but our key long holdings in Orocobre and Newcrest did well. The Fund began investing in Vocus Comms into the severe price weakness arising from AGM earnings guidance: this detracted from performance.

We were very surprised at the extent of outperformance (relative to the broader indices and to other markets) by REITs and utilities, despite only a minor retracement in bond yields. We see this as another great tell as to the importance of purely passive and yield-seeking money in our equity market.

Performance summary

	Dec qtr	1 Yr	3 Yrs	5 yrs
Returns				
OBIF (i)	5.3%	13.3%	16.2%	15.7%
Market (ASX300)	5.2%	11.5%	6.5%	11.8%
- Excess return	0.1%	1.9%	6.8%	4.0%
- Correlation		-0.23	-0.33	-0.39
Analytics				
Information ratio - OBIF		0.32	1.44	0.59
Tracking error		5.9%	7.2%	6.7%
Sharp ratio - OBIF		1.86	1.44	1.89
Sharp ratio - market		1.38	0.27	0.68

(i) Note: returns are model portfolio gross of all fees and costs to Jun16, actual portfolio net of all thereafter.

Key portfolio changes

Additions / up-weights
Additions
Santos, Newcrest
Up-weights
Orecobre, Caltex, APN, ANZ, Woolworths

Deletions / down-weights
Deletions
Coca Cola Amatil
Down-weights
AMP, Tatts, Oil Search, Myer, Scentre, CommBank

Cumulative returns since inception