

Optimal Benchmark Independent Fund

Optimal
FUND MANAGEMENT
AUSTRALIA

Monthly Report | February 2017

| Performance | 5yr (p.a.) | 1yr | Qtr | Month |
|--------------|------------|-------|------|----------|
| Series 1 NAV | | | | \$1.0611 |
| Return (a) | 13.2% | 15.5% | 2.6% | 0.8% |
| ASX300 | 10.3% | 21.6% | 5.8% | 2.2% |

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

| Monthly attribution and top active investments | |
|--|--|
| Attribution | |
| Positive | Telco, media, consumer services, pharma |
| Negative | Banks, real estate, transport, materials |
| Top active | APN, WOW, CYB, CTX, HGG, LNK, CSL |

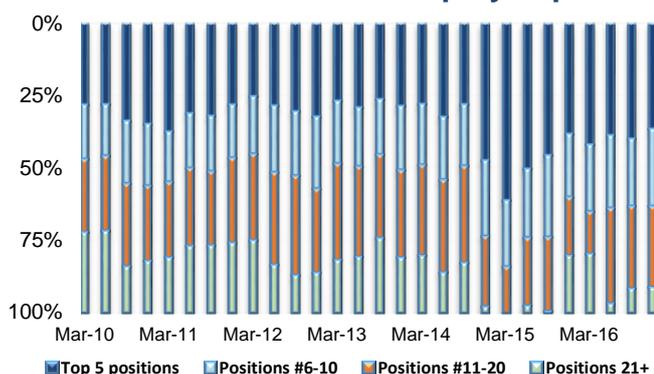
Performance: monthly excess returns



Sector weightings

| | ASX300 | OBIF | Active |
|------------------------|--------|-------|--------|
| Consumer discretionary | 5.0% | 17.8% | 12.8% |
| Consumer staples | 7.0% | 8.9% | 1.9% |
| Energy | 4.2% | 8.5% | 4.3% |
| Financials | 37.8% | 33.2% | -4.6% |
| Healthcare | 6.7% | 7.5% | 0.8% |
| Industrials | 6.6% | 4.8% | -1.8% |
| IT | 1.3% | 6.4% | 5.1% |
| Materials | 16.2% | 6.9% | -9.3% |
| Real Estate | 8.4% | 2.0% | -6.4% |
| Telecommunications | 4.2% | 4.0% | -0.1% |
| Utilities | 2.6% | 0.0% | -2.6% |

Stock concentration - % of equity exposure



Fund Strategy and Outlook

The Fund recorded a 0.8% net return in February, against a 2.2% return for the ASX300 Accum index.

Our strategy often underperforms the broader market when it rallies strongly, as we favour downside investor protection when we see many stock prices move well beyond fundamental fair value. We believe we are at such a juncture at present, and we continue to worry about downside risk. As a result, we have maintained the Fund's cash weighting at the outside end of the target range, and will look for opportunities as stock prices revert to more attractive levels relative to underlying fair values.

Sentiment in US markets remains broadly pro-growth in equities, although bond yields are unable to break out of a well-defined range. The market now expects a rise in short rates at the Fed's upcoming March meeting. Markets continue to give the Trump administration the benefit of the doubt. Policy delivery in the US, and politics more broadly in Europe, will likely remain key sources of market volatility in the near term.

Much of our focus locally has been on recent company earnings reports. JP Morgan's "beat ratio" (earnings 2% > consensus) was 38%, well up from 24% in the August results season. The average earnings surprise was low but the dispersion was substantial, ranging from +9% in Energy to -7% in Telco – resulting from Telstra's huge miss. Materials contributed 85% of market earnings growth, with BHP alone accounting for 51%. Within Materials, 100% of earnings growth was due to higher realised prices, with cost reduction only offsetting weaker volumes. With the very notable exception of iron ore (where producer margins are already at an all-time peak) commodity pricing remains under pressure, with China continuing to signal that economic growth will be less materials-intensive in future.

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Performance Review

Earnings season is always a make-or-break time for stock selection. On the positive side for us, Woolworths reported both slightly better comp-store sales and margin improvement than consensus estimates (or the heavy short interest) allowed for. Woolies is now through the earnings nadir in its core supermarket business, with decent line-of-sight to further improvement in both key metrics before again having to worry too much about negative structural competition.

Results from both APN and Vocus were solid, and the pre-result valuations for both stocks allowed for much worse. APN has a strong growth path through digitisation of its outdoor inventory within Adshel, and continues to generate very substantial free cash flow from its radio business. Vocus' results raised some question marks over earnings quality, but these were largely mitigated by much improved financial disclosure:

an important development as this is very much a management and execution story.

CSL (in which the Fund had invested at around \$100 in October and November) had pre-announced, but the quality of the formal report still drove modest further upgrades.

Much of this good work was undone on the final day of February by Orocobre, which again cut production guidance. Battery storage technology is a key industrial development, in our view. Orocobre's core project has superb low-cost and long-life economics, and is generating 60%+ cash margins even while fumbling the ramp-up towards rated production. As the first greenfield brine-based scale Lithium project in over 20 years, we expected a rocky road, but don't regard this recent setback as a permanent impairment of cash flow capacity.

Performance summary

| | Feb qtr | 1 Yr | 3 Yrs | 5 yrs |
|--------------------------|---------|-------|-------|-------|
| Returns | | | | |
| OBIF (i) | 2.6% | 15.5% | 10.9% | 13.2% |
| Market (ASX300) | 5.9% | 21.8% | 6.4% | 10.6% |
| - Excess return | -3.3% | -6.3% | 9.9% | 2.7% |
| - Correlation | | 0.04 | -0.33 | -0.40 |
| Analytics | | | | |
| Information ratio - OBIF | | -1.30 | 0.62 | 0.40 |
| Tracking error | | 4.8% | 7.3% | 6.7% |
| Sharp ratio - OBIF | | 2.73 | 1.11 | 1.51 |
| Sharp ratio - market | | 2.90 | 0.28 | 0.61 |

(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 | |
| Bapcor, Sky City, Sydney Airport, Westfield | |
| Up-weights | |
| Caltex, Orocobre, ANZ, APN Media, Tattersalls | |
| Deletions / down-weights | |
| Deletions | |
| Brambles, FlightCentre, Newcrest, OilSearch, Reliance | |
| Down-weights | |
| Link, Westpac, Suncorp, Woolworths | |

Cumulative returns since inception



This report is prepared for investors in the Optimal Benchmark-independent Fund (the Fund). 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 Fund. Any such offering can only be made to qualifying 'wholesale investors' pursuant to the Fund's offering materials, and the relevant Subscription Application.