Optimal Benchmark Independent Fund

Optimal FUND MANAGEMENT AUSTRALIA

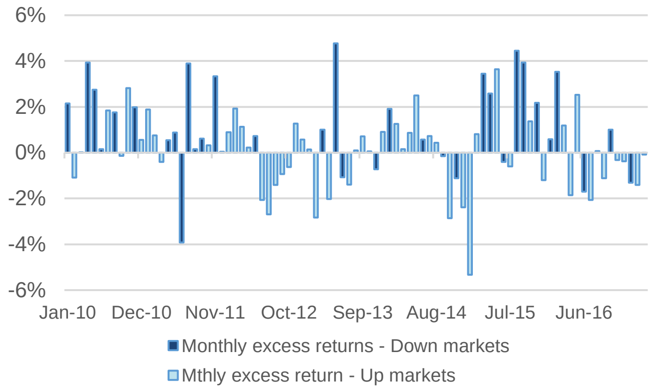
Monthly Report | March 2017

Performance	5yr (p.a.)	1yr	Qtr	Month
Series 1 NAV				$1.0611
Return (a)	13.4%	12.5%	1.8%	3.2%
ASX300	11.0%	20.2%	4.8%	3.2%

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

Monthly attribution and top active investments	
Attribution	
Positive	Retail, software, media, pharma, energy
Negative	Materials, banks, utilities, insurance
Top active	WOW, CYB, APN, CTX, HGG, CSL, HVN

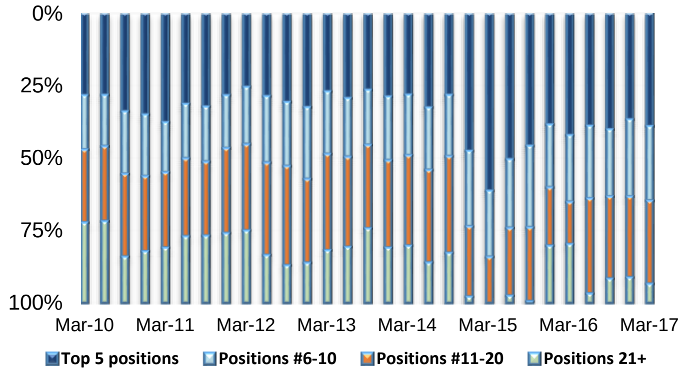
Performance: monthly excess returns



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 3.2% net return in March, in line with the return for the ASX300 Accum index.

Our stock selection worked well in March, but having a cash flex at the upper end of the range in such a strong market clearly detracted from our returns. This begs the question: why maintain any cash flex at all? There are several reasons. First, this strategy is grounded very much in alpha generation, and we view beta as a typically quite volatile source of returns. Key to our process is buying stocks that are priced below our research-based 'fair value' assessment. Strong recent market returns have pushed many mid- and large-cap company valuations further into 'expensive' territory in our view. We are finding fewer stocks to buy, and many more we'd rather sell in order to crystallise profits and/or protect investors' capital.

Secondly, while we expect to be close to fully invested over time, we do focus on investor downside-risk protection. Beta returns have been very, very good for some time now. Equity investors seem convinced that synchronised global growth and 'reflation' is in prospect. Bond investors and commodity buyers see a very different world. Policy execution in the US is not as smooth as investors expect, and geopolitical risk seems elevated. This is far from a risk-free environment.

The Australian market is in any event divorced from the broader growth thematic. The RBA is neatly pinned between its growing sense of panic over the property bubble (where it joins APRA and ASIC in jawing the market) and its inability to raise interest rates due to its concern over the weak state of the wider economy. The earnings story here is much more a company-by-company proposition than any broad market opportunity, in our view. We will look for opportunities as stock prices revert to more attractive levels relative to underlying fair values.

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Performance Review

Key alpha contributors for us during the month included a number of stocks which have been in the portfolio for some time. Clydesdale Bank retains relatively predictable (cost-out and capital release) levers for higher earnings growth and ROE, and remains well-insulated from the concentration, capital, and credit quality issues that we confront with the Australian banks, which are trading at much higher levels relative to our fair value assessment.

Henderson Group captures a similar cost-out theme and trades below our fair value range – we think due to research inertia and index selling ahead of completion of its merger with Janus. We met with management in March, and now have a better appreciation of the growth potential from the merged distribution footprint.

CSL and Woolworths continued to drive strong returns, although we reduced our position in the latter as the stock price approached the upper end of our fair value range. We also moved to realise our investment in Myer during the month, as we no longer see value at prices that reflect speculation around recent strategic shareholding changes.

Performance summary

	Mar qtr	1 Yr	3 Yrs	5 yrs
Returns				
OBIF (i)	1.8%	12.5%	11.9%	13.4%
Market (ASX300)	4.8%	20.2%	7.4%	11.0%
- Excess return	-3.0%	-7.6%	4.5%	2.4%
- Correlation		-0.07	-0.33	-0.40
Analytics				
Information ratio - OBIF		-1.69	0.61	0.36
Tracking error		4.5%	7.3%	6.7%
Sharp ratio - OBIF		2.25	1.25	1.55
Sharp ratio - market		2.51	0.37	0.64

Key portfolio changes

Additions / up-weights
Additions
AMP, Harvey Norman, Vicinity
Up-weights
ANZ, Westpac, Woolworths, Bapcor

Deletions / down-weights
Deletions
Myer, Sydney Airport, Tattersalls
Down-weights
APN, Vocus

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

Cumulative returns since inception