Optimal Benchmark Independent Fund

Optimal FUND MANAGEMENT AUSTRALIA

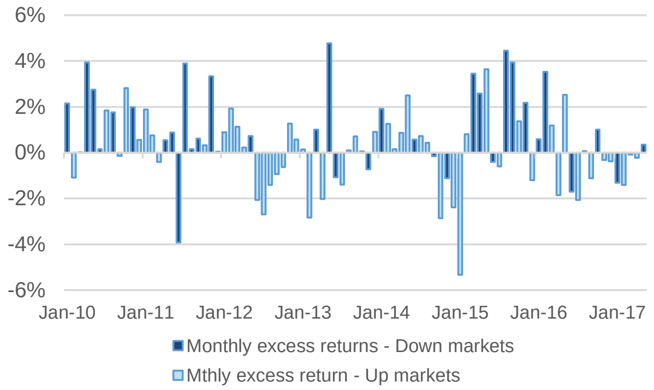
Monthly Report | May 2017

Performance	5yr (p.a.)	1yr	Qtr	Month
Series 1 NAV				1.0770
Return (a)	14.1%	3.2%	1.5%	-2.39%
ASX300 Accum	11.9%	10.8%	1.5%	-2.74%

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

Monthly attribution and top active investments	
Attribution	
Positive	Under-weight banks, under-weight materials
Negative	Over-weight retail, over-weight telecoms
Top active	WOW, CYB, NAB, HGG, BHP, HVN, CTX

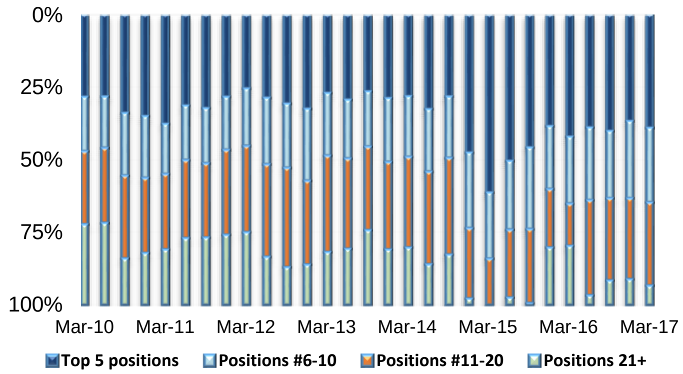
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	5.0%	13.2%	8.3%
Consumer staples	7.0%	9.9%	2.9%
Energy	4.2%	7.2%	3.0%
Financials	38.5%	38.6%	0.1%
Healthcare	7.0%	8.1%	1.1%
Industrials	6.9%	2.3%	-4.6%
IT	1.3%	4.7%	3.5%
Materials	15.4%	9.4%	-6.0%
Real Estate	8.5%	4.5%	-4.0%
Telecommunications	3.6%	2.1%	-1.5%
Utilities	2.7%	0.0%	-2.7%

Stock concentration - % of equity exposure



Fund Strategy and Outlook

The Fund recorded a -2.39% net return in May, +35bps relative to the ASX300 Accumulation index.

Equity markets released the pressure-valve a little during May, with a solid retracement recorded by the index. Notably weak sectors included banks (the Government's jump to the left in the budget was unhelpful), housing-related stocks (with construction activity and home prices peaking) and retailers (with growing evidence of softer consumer activity and fear of the 'Amazon effect'). May's retracement simply took the market back to where it was a couple of months ago. At that point, we believed the markets were already at the expensive end of fair value, and we think there is a little more weakness to come.

Bond markets, both locally and abroad, continue to signal that economic growth data is unconvincing. This is especially the case in the Australian economy which features a continuing absence of real wage growth, sliding commodity prices (especially iron ore), and high (likely unsustainable) levels of household debt – fuelled by record low interest rates and a residential property boom that has enriched a generation of leveraged borrowers. Australian consumers have been living beyond their cash flow means for some years, and recent data shows what can happen if the home equity drawdown slows – but by no means stops or (God help us all) reverses.

Our strategy remains anchored to our core belief that investor returns over time are as much a function of capital preservation during times of market weakness as they are of participating in market rallies.

We continue to actively position the fund to be tactically weighted to stocks which feature little dependence on the domestic economy, strong balance sheets and free cash flows, and defensive valuations.

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Performance Review

Key sources of portfolio attribution in May included some good gains from a number of our high-conviction investments (including Boral, Caltex, and Orocobre), as well as avoiding the worst of some nasty sectoral corrections. In particular, our active underweights in the financial and healthcare sectors made positive contributions to the fund's performance.

Earnings results from the banks in May were somewhat underwhelming, and the Government's liability tax, while still poorly defined at this stage, adds to the sense that the major banks will have to work very hard to stand still, even prior to any consideration of the impact of weaker credit conditions.

At a fundamental research level, May is always a busy period for us, as we seek to engage with as many companies of interest to us as possible prior to management going into the June blackout period. This year has been even busier than usual, with a recent focus on the retail sector, where a number of stock prices have very quickly retraced into consideration under our fair value process. The consumer and structural risk headwinds here are obvious, but in a market largely bereft of value (and in a group so heavily short-sold), we consider one or two of these stocks to be well worth some additional work.

There were no great changes in our conviction holdings. The Henderson/Janus merger has closed on schedule, and the stock was a positive contributor to returns. We maintain a favourable view on the ability of management to deliver cost-out and better leverage the merged distribution footprint. Another of our international-facing financials, CYBG, did less well following its earnings report and pre-UK election uncertainty. We view CYBG's merits as almost the complete inverse of our domestic banks regarding earnings visibility (again from cost-out), trend in ROE, and capital requirements – albeit we could do with a little less political volatility.

Performance summary

	May qtr	1 Yr	3 Yrs	5 yrs
Returns				
OBIF (i)	1.5%	3.2%	9.2%	14.1%
Market (ASX300)	1.5%	10.8%	5.9%	11.9%
- Excess return	0.0%	-7.6%	3.3%	2.2%
- Correlation		-0.34	-0.34	-0.41
Analytics				
Information ratio -OBIF		-2.48	0.45	0.33
Tracking error		3.0%	7.2%	6.7%
Sharp ratio - OBIF		0.27	0.90	1.65
Sharp ratio - market		1.26	0.25	0.70

(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
Alumina Ltd, Macquarie Group, Scentre Group
Up-weights
ANZ, Boral, Henderson Janus, AMP

Deletions / down-weights
Deletions
Aristocrat Leisure, Vocus
Down-weights
Santos, Westpac, Telstra, Caltex, Harvey Norman

Cumulative returns since inception