

Optimal Benchmark Independent Fund

Optimal
FUND MANAGEMENT
AUSTRALIA

Monthly Report | November 2016

Performance	5yr (p.a.)	1yr	Qtr	Month
Series 1 NAV				\$1.0344
Return (a)	14.5%	10.7%	0.7%	2.5%
ASX300	10.5%	9.7%	1.3%	2.8%

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

Monthly attribution and top active investments	
Attribution	
Positive	IT, media, cons. services, retail, industrials
Negative	Utilities, telco, banks, energy, DivFins
Top active	LNK, APN, WOW, CYB, HGG

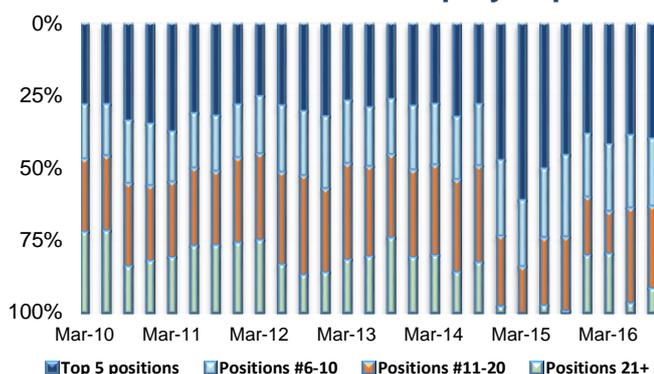
Performance: monthly excess returns



Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	5.5%	17.4%	11.9%
Consumer staples	7.2%	10.2%	3.0%
Energy	4.0%	4.5%	0.4%
Financials	35.4%	35.4%	1.2%
Healthcare	7.1%	5.3%	-1.8%
Industrials	7.3%	7.5%	0.3%
IT	1.5%	8.8%	7.4%
Materials	15.6%	5.4%	-10.2%
Real Estate	9.1%	1.4%	-7.7%
Telecommunications	4.9%	3.0%	-1.9%
Utilities	2.5%	0.0%	-2.5%

Stock concentration - % of equity exposure



Performance review

The Fund recorded a +2.5% net return in November, against a +2.8% return for the ASX300 Accum index.

The Australian equity market enjoyed a decent rebound in November, fuelled in large part by a surprisingly quick embrace of Trump 'reflation' – an essentially bullish view on the impact of fiscal stimulus and corporate tax cuts under the new US administration. This trade was expressed through a sharp rotation out of high-yield and defensive sectors into cyclical, especially resources, which were super-charged by a rampant commodity complex centred on the Dalian futures exchange. Financials also performed strongly in many markets, with a steepening yield curve and perceptions of regulatory roll-back, for example of Basle IV capital requirements locally, and pretty much everything in the US under a laissez-faire Trump Presidency.

This is the easy part. At this point in the political cycle, policy formation (much less execution) runs a distant second to imagination. Driven in part by significant crowding and extreme investor positioning, markets can continue to run with a theme until facts get in the way.

The one fact that could well unsettle markets is the new reality of higher bond yields, and structurally higher inflation. Financial repression as practised by central banks (and the vast 'risk-parity' and 'structured product' liquidity flows associated with it), have had a fundamentally distortive effect on equity pricing in general, and that game appears very nearly over.

The Fund's stronger performers included our holdings in financials (ANZ, Clydesdale, Suncorp, Hendersons), resources (Orocobre) and materials. The Fund initiated a new long position in APN, which has rationalised itself down to two attractive media exposures in radio and outdoor advertising, and at a discounted valuation arising from technical pressure around its recent capital raising.

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Fund Strategy and Market Outlook

The Fund's market exposure at month-end was 90%, at the mid-point of our target range, reflecting some scepticism on our part as to the sustainability of the 'Trump bump'. Our thinking is:

- The market narrative is for a growth breakout, yet the US business cycle is already extended by historical standards. In the words of Jeffrey Gundlach (who now seems equally prescient on US politics as on the bond market): *"The bar was so low on Trump... now this guy is the Wizard of Oz and expectations are very high. But there's no magic here..."*
- It is difficult to understand whether the massive increase in bulk commodity prices over the last quarter reflects a sustainable increase in Chinese steel demand, or (as Barclay's John Clemmow contends) a third attempt to bail-out China's heavily-indebted basic industry SOE's, this time via the commodity markets.
- Either way, beware the bonds. Higher deficit spending in the US and commodity price rises should impact perceptions of future inflation. OPEC's efforts to push oil prices up should add fuel to this fire.

As a result, Bond yields in the US and Australia seem very likely to track higher. To date, we've been surprised by how little sensitivity broad equity indices have shown to higher bond yields – leaving aside the bloodbath in defensives and REIT's. This theme remains a very big deal. Financial repression has been key to the 'central bank put' so beloved by equity markets, and to the vast overweighting of yield.

This view informs our stock selection. We cut our long-held position in Contact Energy (which we remain great fans of at the business and management quality levels), and increased weightings in financials. Much of our other portfolio activity was tactical. We noted (over page) a new position in APN, also in Vocus into the smash-up around the company's earnings warning. We similarly cut our positions in Crown and Orica as these stocks reached the high end of our fair value range.

Market technicals are not universally positive. Liquidity in the high-yield bond market continues to deteriorate. Locally, the IPO market was showing clear indigestion, with even re-priced deals struggling (e.g. Inghams, Bravura). Several market darlings have missed earnings, with horrific price reactions (ISD -27%, BAL -44%) and the mid cap market has fallen sharply.

Performance summary

	Nov qtr	1 Yr	3 Yrs	5 yrs
Returns				
OBIF (i)	0.7%	10.7%	12.4%	14.5%
Market (ASX300)	1.3%	9.7%	5.3%	10.5%
- Excess return	-0.6%	1.0%	7.2%	4.0%
- Correlation		-0.24	-0.32	-0.39

Analytics				
Information ratio - OBIF		0.16	0.99	0.60
Tracking error		6.1%	7.2%	6.7%
Sharp ratio - OBIF		1.38	1.32	1.71
Sharp ratio - market		1.21	0.18	0.59

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

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.

Key portfolio changes

Additions / up-weights	
Additions	
Vocus, Aristocrat, Scentre Group	
Up-weights	
APN Media, CommBank, Boral	
Deletions / down-weights	
Deletions	
Crown, Contact Energy	
Down-weights	
Tatts, Woolworths, Orica, Reliance	