

# Optimal Benchmark Independent Fund

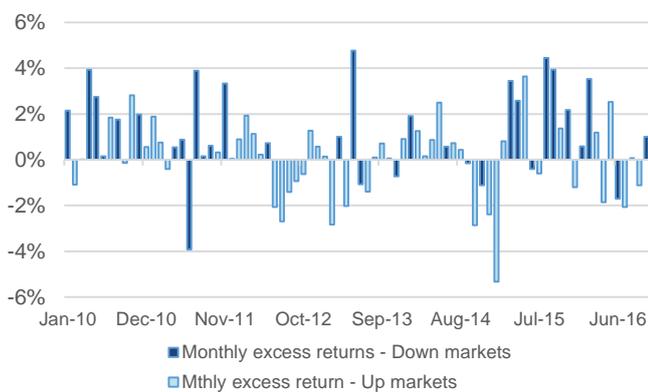
## Monthly Report | October 2016

Performance	5yr (p.a.)	1yr	Qtr	Month
Series 1 NAV				\$1.021
Return (a)	13.9%	9.6%	-3.2%	-1.2%
ASX300	9.1%	5.8%	-3.2%	-2.2%

(a) Derived from returns from long-short strategy to Jun16; actual returns thereafter

Monthly attribution and top active investments	
<b>Attribution</b>	
Positive	REITs, healthcare, transport, cons svcs
Negative	Software, banks, DivFins, capital goods
<b>Top active</b>	LNK, CYB, WOW, HGG, ORE

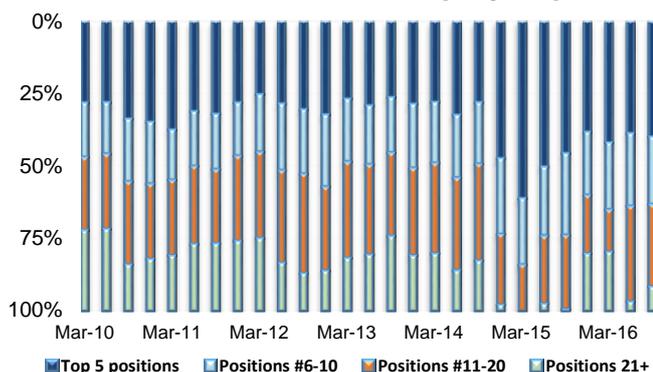
### Performance: monthly excess returns



### Sector weightings

	ASX300	OBIF	Active
Consumer discretionary	5.5%	13.0%	7.5%
Consumer staples	7.2%	11.5%	4.3%
Energy	4.0%	5.1%	1.1%
Financials	35.4%	36.1%	0.8%
Healthcare	7.1%	5.0%	-2.1%
Industrials	7.3%	8.6%	1.4%
IT	1.5%	9.5%	8.1%
Materials	15.6%	6.6%	-9.0%
Real Estate	9.1%	0.5%	-8.5%
Telecommunications	4.9%	0.0%	-4.9%
Utilities	2.5%	4.0%	1.5%

### Stock concentration - % of equity exposure



### Performance review

The Fund recorded a -1.2% net return in October, against a -2.2% return for the ASX300 Accum index.

The Australian equity market fell by 2% in October, caught between growing concerns over the direction of interest rates, the general malaise in the final run-up to the US presidential election, and a series of earnings bombs going off during the AGM season.

US election uncertainty will be resolved pretty soon, but as we have stressed for some time, markets will remain highly sensitised to signals on interest rate reversion. 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. A further back-up in bond yields still seems likely, such that elevated volatility may be with markets for a while, and this process could well turn disorderly.

Higher bond yields weighed heavily on so-called defensive sectors in October, some of which had been treated by investors as 'bond proxies'. REITs and Health Care were the worst performing sectors over the month, with the latter also impacted by a substantial earnings downgrade by Healthscope.

The Fund had no exposure to Health care, and was otherwise largely unaffected by the more notable 'land mines' during the month, including gaming (Crown employees detained in China; Sky City profit warning), and China-facing growth stocks (Bega/Blackmores).

Our returns were negatively affected by continued GBP currency weakness, which impacted two of our high-conviction longs in Hendersons and Clydesdale Bank. We believe the investment case for Hendersons to be stronger again with the nil-premium merger announced with Janus, but the market has entirely discounted the value of ~US\$110m in cost synergies. Our investment and view on Tatts Group was endorsed by Tabcorp's merger proposal, although the market is similarly now discounting the indicated ~\$130m in cost synergies.

# Optimal Benchmark Independent Fund

## Fund Strategy and Market Outlook

Our view remains that the investment landscape is unusually dangerous at present, as central banks come to the end of their experimental policies of financial repression across the entire global yield curve. As a consequence of these policies, any form of coupon income has been revalued up in terms of capital value, and huge amounts of yield-seeking liquidity have clustered in strange places – certainly in many Australian dollar equity and debt securities.

There are now clear signs that these policies have extended well beyond their natural limits, in terms of economics, politics, damage to the credit creation process, and even logistics. A reversion to a somewhat more normalised yield curve appears to be upon us, at least in its early stages, as bond yields have been breaking out for some months.

Markets are rightly sensitised to these early signals, as blind adherence to financial repression has been key to the 'central bank put' so beloved by equity markets in general, and to the extraordinary overweighting of yield in any multi-factor valuation approach.

It's possible that all the market distortions resulting from this vast liquidity creation over recent years can unwind smoothly. However, given the massive investment flows into equity markets of structured yield or 'risk-parity' products (which typically use leverage to juice-up coupon returns), any bond yield-based unwind has the potential to turn disorderly. We'd be more inclined to expect at least some dislocation, and perhaps quite a bit of it. There are good reasons at present to maintain a defensive posture towards market risk.

## Optimal Benchmark Independent Fund – performance summary

	Oct qtr	1 Year	2 Years	3 Years	5 years
<b>Returns</b>					
OBIF (i)	-3.2%	9.6%	9.9%	10.7%	13.9%
Market (ASX300)	-3.2%	5.8%	2.5%	3.8%	9.1%
- Excess return	0.0%	3.8%	7.4%	7.0%	4.8%
- Correlation		-0.25	-0.35	-0.31	-0.40
<b>Analytics</b>					
Information ratio - OBIF		0.60	0.89	0.97	0.71
Tracking error		6.4%	8.3%	7.2%	6.8%
Sharp ratio - OBIF		1.14	0.89	1.08	1.59
Sharp ratio - market		0.60	0.00	0.06	0.48

(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.