

**COMMENTARY**

**EXPOSURES AND ATTRIBUTION**

We use global indices to position and move the book around quickly as risk and opportunities arise. October was certainly one of those months. Gross exposure began the month at 89% and ended it at 240%. Net exposure also move from flat to longer as opportunities arose later in the month. Most of these shifts were executed in our index positions. That is S&P 500, Nasdaq and ASX 200 (SPI) futures and options as well as BHP, which we treat as a blunt tool to move risk similar to futures. Unsurprisingly, we had large losses in our longs and large profits in our shorts.

**PORTFOLIO OPPORTUNITIES AND RISKS**

There is a terrific interview on [Stanley Druckenmiller](#) (click on link) where Stanley talks about listening to the market for signals on position sizing. We use this technique to assist in understanding, with other indicators, where we are in the investment cycle. After the February fall, we incorrectly thought it was around 12 o'clock and began increasing our shorts during the March rally. That didn't work so well as seen by our poor April and May performance. One of most interesting changes over the last few months is that these shorts are now behaving well. I think the market is telling us that we may be in an environment where you can confidently run more shorts. It has been not been that way for the last few years. Why is this? Well I think the market is now focused on a discount rate that may be going up at the same time as margins are at extreme levels. No longer it seems is the market chasing growth at any price.

Our core shorts are mainly in two themes. Credit risk in Australia and High Valuation names with catalysts. At this early stage of the credit rationing cycle we are more focused on companies with operational leverage and or exposure to the Australian consumer. That is, we are looking to capture decreasing demand and changing spending behaviour by the Australian households. If the cycle develops we will likely move more exposure to those companies with financial leverage. Particularly if we see a rise in defaults. Our high valuation shorts are focused across many sectors but share some or all of the following attributes. They are expensive, their margins are high, their growth forecasts look unachievable and generally there are some issues in the accounts.

**MACRO WATCH**

I believe the trade issues run much deeper than just trade and are unlikely to be resolved anytime soon. For anyone who doubts this I highly recommend listening to [Pence's 4th October speech](#) (click on link). Nevertheless, right now we are listening with great interest to the developments prior to trade talks between China and the US as we run into the G20 leaders summit and the meeting between Donald Trump and Xi Jinping. We see the following possible broad outcomes:

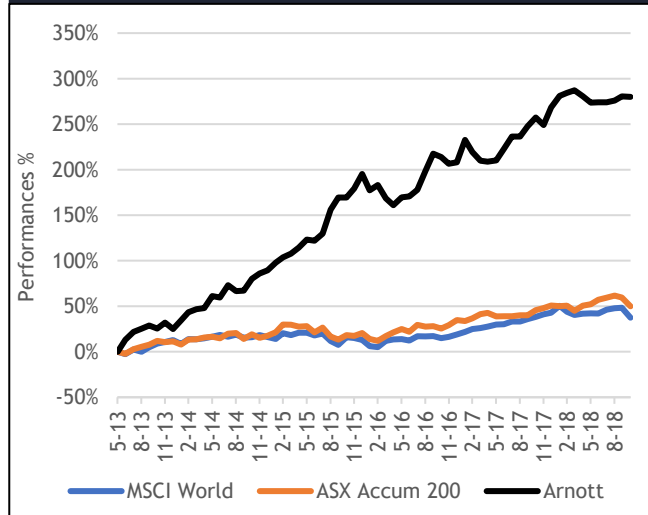
1. Resolve and discussion of backtracking on tariffs - very low probability but big market move higher.
2. Stalemate - markets continue to bumble along - medium to high probability.
3. Negative outcome and expected implementation of further tariffs - low to medium probability with negative market move.

If option pricing provides decent entry we will position accordingly with calls and or puts. If not we will sit on our hands.

**PERFORMANCE METRICS**

	From May 2013
Annualised returns	27.94%
% Positive months	69.23%
Average monthly return	2.15%
Avg +ve monthly return	4.09%
Avg -ve monthly return	-2.20%
Best month	13.07%
Worst month	-6.09%
Largest drawdown	-11.61%
Longest drawdown (mths)	7
Up Capture ratio	42.8%
Down Capture ratio	-231.0%
Sortino	3.94
Sharpe ratio	1.86

**CUMULATIVE FUND PERFORMANCE (2013-current)**



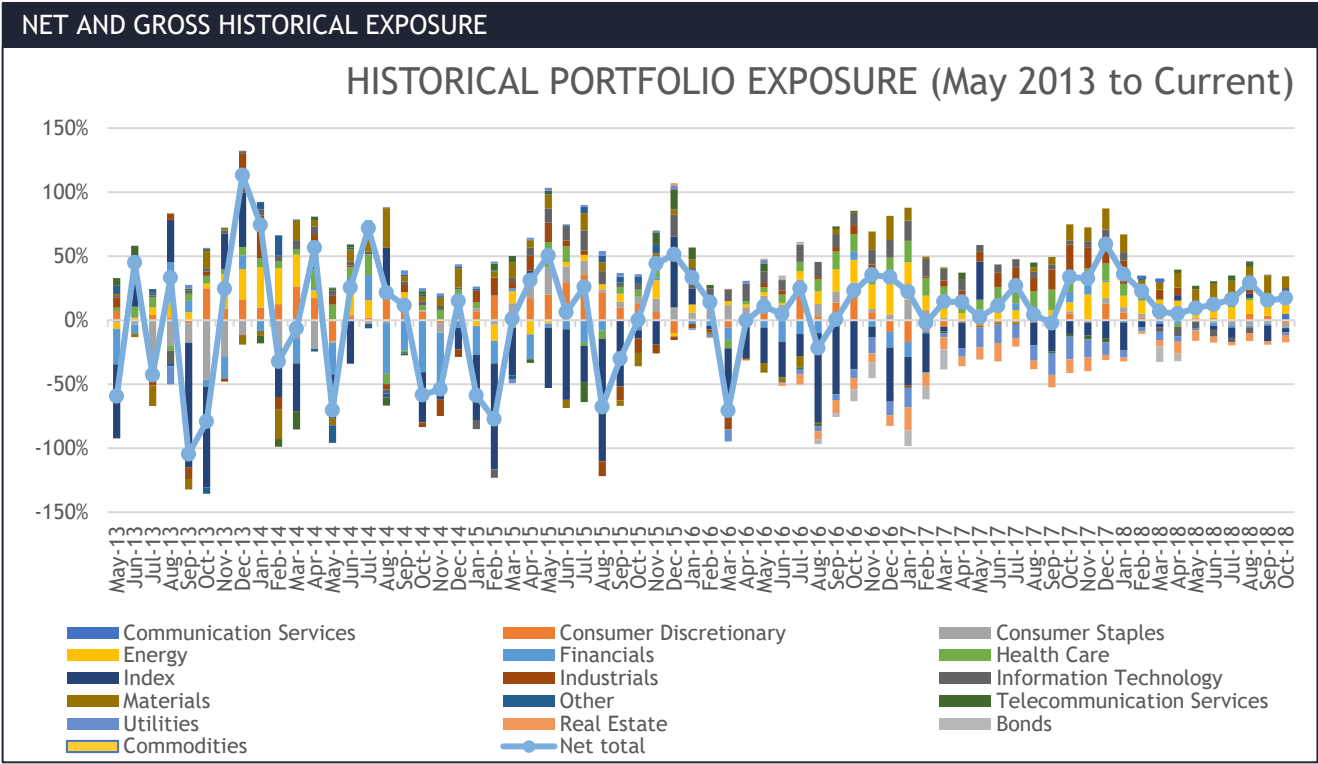
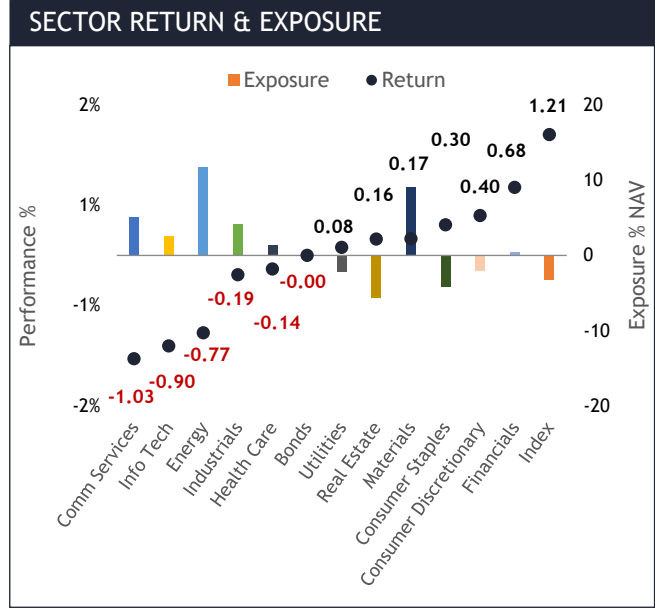
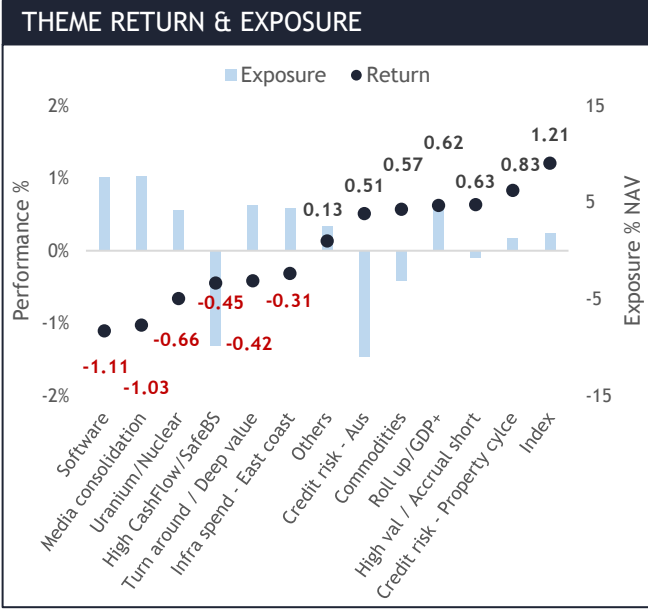
**MONTHLY SUMMARY METRICS**

NET RETURN	AV GROSS EXP	AV NET EXP
-0.18%	159.47%	17.17%

**STRATEGY HISTORICAL PERFORMANCE (%)**

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
2013						13.07	7.63	2.97	2.82	-2.69	5.23	-5.25	25.00
2014	7.61	6.56	2.43	0.77	8.87	-0.93	8.46	-3.78	0.34	7.78	3.24	1.92	51.59
2015	4.46	2.88	1.99	3.19	4.12	-0.52	3.44	11.47	5.23	0.00	3.67	5.72	55.80
2016	-6.09	2.14	-5.17	-2.83	3.30	0.40	2.69	7.49	6.29	-1.15	-2.34	0.48	4.33
2017	7.99	-4.01	-2.94	-0.34	0.43	4.08	4.21	-0.02	3.37	2.79	-2.32	5.51	19.58
2018	3.47	0.88	0.72	-1.68	-1.86	0.09	0.03	0.66	1.24	-0.18			3.31

2013 - 2017 Data. Bondi Capital Investments Pty Ltd (managed account). Performance net of 0 & 25 fees. Currency AUD. Fund administered by Mainstream. Fund was not audited.  
2018 - Current Data. Australian Unit trust. Performance net of 0 & 25 fees. Currency AUD. Fund administered by Mainstream. Fund audited by EY.



### STRATEGY SUMMARY

The investment process involves three stages:

1. Themes are identified as investment opportunities
2. Valuation screens are run to find stock opportunities within the theme
3. Market dynamics are assessed to determine entry timing

The strategy is long / short equity with a variable delta bias. The universe is global equities with a focus on Australia. The portfolio will typically contain 40 to 70 position. Global futures and options are also actively traded from time to time.

The strategy aims to identify trends and opportunities using value investing principles and capture price oscillations around the underlying trend using trading skills.

FUND INFORMATION

BASE CURRENCY	AUD	ARNOTT CAPITAL PTY LTD	AFSL License 233743 ABN 23086081889
STRATEGY INCEPTION	1999	CIO KENNY ARNOTT	kma@arnott.com.au
MINIMUM SUBSCRIPTIONS	AUD \$100,000	CONTACT DETAILS	<a href="mailto:investor@arnott.com.au">investor@arnott.com.au</a>
WITHDRAWALS	Monthly	PRIME BROKER	Morgan Stanley
PERFORMANCE FEE	25%	FUND ADMINISTRATOR	Mainstream
MANAGEMENT FEE	0%	FUND AUDITOR	Ernst and Young
SUBSCRIPTIONS	Monthly	LEGAL ADVISORS	Norton Rose Fulbright

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