

## Monthly Update – May 2017

### Fund at a Glance

Fund Size	AU\$198m
Strategy FUM	AU\$243m
Fund Inception Date	August 2012
Fund Strategy	Equity Market Neutral
Application/Redemption	Daily
Management Fee	1.5%
Performance Fee	20%
Benchmark	RBA Cash Rate

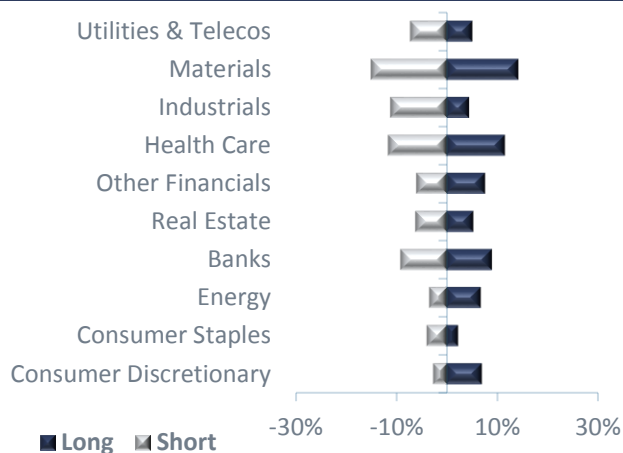
### Return Characteristics<sup>1</sup>

Positive Months	69.6%
Beta	-0.2%
Sharpe Ratio	1.5
Sortino Ratio	4.4
Standard Deviation (annualized)	7.1%
No. Long Positions	61
No. Short Positions	61
Gross Exposure	151%
International Exposure (% of Gross)	20%

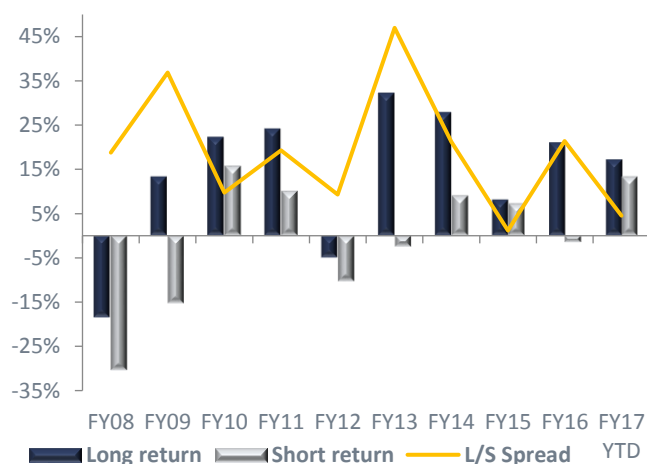
### Performance

	1 Mth	6 Mths	Fin. YTD	1 Yr	2 Yrs (pa)	3 Yrs (pa)	S.I (pa)
WMNT (net return)	0.6%	1.8%	2.3%	4.1%	11.3%	5.8%	12.7%
RBA Cash Rate	0.1%	0.8%	1.4%	1.6%	1.8%	2.0%	2.3%
<b>Outperformance</b>	<b>0.5%</b>	<b>1.0%</b>	<b>0.9%</b>	<b>2.5%</b>	<b>9.5%</b>	<b>3.8%</b>	<b>10.4%</b>

### Sector Exposures



### Long/Short Spread<sup>2</sup>



### Gross Portfolio Structure

	April 2017		May 2017	
Investment Type	\$m	%	\$m	%
Listed Securities - Long	142.5	74.6	146.3	73.9
Listed Securities - Short	143.8	-75.3	153.5	-77.5
<b>Net Exposure</b>	<b>-1.3</b>	<b>-0.7</b>	<b>-7.1</b>	<b>-3.6</b>
Cash	192.3	100.7	205.1	103.6
<b>Capital</b>	<b>191</b>	<b>100</b>	<b>198</b>	<b>100</b>

<sup>1</sup> Return Characteristics are for the period since inception. The Fund's inception date is August 2012.

<sup>2</sup> Long/Short spread shows the gross performance of the long and short portfolios. The Fund makes a profit where the long portfolio outperforms the short portfolio, after the payment of fees. Returns prior to the Fund's inception date are based on the return series from the long and short portfolios of the Australian Leaders Fund Ltd.

## Month in Review

The Australian share market significantly underperformed global peers in May, posting its largest fall since January 2016. Weakness in the domestic market was concentrated in the banking sector which is facing a myriad of challenges. Consumer confidence was also lower, reflecting growing concerns from households over levels of indebtedness and record low wage growth. Heat continues to come out of the housing market, as macroprudential controls and rising interest rates curtail demand from investors.

Global markets continue to show resilience in the face of a range of geopolitical issues creating potential uncertainty for investors. Notwithstanding this resilience, investors remain skittish over concerns that recent momentum in the global economy could be derailed. This was evidenced by the dramatic (but short-lived) spike in volatility during the month as markets digested the looming prospect of a Trump impeachment. While strong results from US and European companies through their respective reporting seasons were encouraging, this will undoubtedly provide cover for central banks to push ahead with tightening measures, providing further tests for markets in the months ahead.

The Fund delivered a 0.6% return for the month after all fees. Domestic and international portfolios contributed to performance roughly in line with their respective weightings, while at a sector level, positive performance was broad-based, led by basic industries and financials. Gains were offset in part by weaker performance in the healthcare and consumer portfolios.

May was another strong month for global consumer staples shares while Australian domiciled staples companies finished the month slightly down. The more economically sensitive consumer discretionary shares were largely flat in both global and domestic markets. Investments in domestic gaming companies Tabcorp and SkyCity were both trimmed following strong performance while our JB Hi-Fi position was sold, as it appears increasingly likely that the Australian housing cycle is slowing.

Consumer positions detracted from performance, particularly an investment in Super Retail Group which is facing concerns around the impending arrival of Amazon in Australia and a weaker domestic consumer environment that is impacting trading across the company's various retail banners. A core investment in Heineken continues to perform well.

Technology shares continued to perform strongly in the month. Internet names recovered sharply after concerns eased around brand safety and measurability (YouTube video ads being displayed among extremist content). Similarly, semiconductor shares struggled for the first few weeks of May as US auto sales (one of the larger end markets) showed signs of weakness and Chinese smartphone shipments continued to slow, before recovering these losses rapidly. The European telco sector, which has struggled with regulatory pressures and anaemic growth for many years now, surged 10% in the month as opportunities for consolidation in some key markets again took centre stage. US media shares had a rocky month as the cable providers' results demonstrated a clear acceleration in cord-cutting, while broadcast networks across the US and Europe guided towards a weaker ad market.

Performance in this sector was solid. A bidding war erupted for a core holding in Fairfax Media, while a core investment in Vivendi also performed well following a strong 1Q17 result. An investment in Vocus Group weighed on performance, with the company downgrading earnings guidance yet again.

A decelerating Chinese economy is weighing on demand for commodities, leading to further softening in the prices of bulk commodities and base metals. We are short the mining sector on the basis that this trend will continue through the second half of 2017. We took profits on an investment in Iluka Resources, which bucked the negative trend in the month, rallying with the price of Zircon.



We re-established an investment in James Hardie Industries, following a difficult 12 months for the company as it grappled with plant execution issues. We believe these issues have been addressed and the de-rating of the shares has provided an attractive entry-point for an investment in a strong growth company. The oil price rallied in anticipation of an extended OPEC agreement, only to fall sharply once the agreement was announced. US shale continues to provide a swing factor for oil supply, with increases in production whenever the oil price rallies. We are neutral in the energy sector as a result.

Shares of global pharma companies found some support in May as rhetoric around drug pricing softened in the US. European pharma companies continued to rally with the broader market and are playing catch-up with US peers, resulting in positive contributions from core investments in Merck and Roche while a core short in Grifols detracted. We remain concerned that drug pricing pressures are a structural headwind for global pharma companies and that the worst is yet to come, particularly as pharmacy benefit managers have come under scrutiny around rebating practices. Specialty and generic pharmaceuticals were notable underperformers, with several large players reporting double digit declines in the prices of generic drugs. Aggregation of distributors and pharmacy chains in the US has exacerbated these pricing pressures, weighing heavily on the shares of Mayne Pharmaceuticals; a detractor from performance in the month. In our view, the sector needs to see increased M&A, accelerated generic drug approvals from the FDA and reduced pricing pressure to justify a re-rating. While some of these factors are beginning to appear, it remains early days.

A sharp pullback in Nevro Corp shares provided an attractive buying opportunity after a softer than expected quarterly result. We believe lower sales volumes was a temporary issue and are confident revenues will bounce back next quarter. Australian healthcare shares in many cases are trading near record-high valuations and are expensive relative to offshore peers. As result, we remain short the domestic sector with better investment opportunities to be found offshore.

The brunt of domestic market falls in May were borne by the banks. Longstanding concerns around deteriorating credit quality and the Banks' prospects for future earnings growth were compounded by the announcement in the Federal Budget of the proposed banks levy. The Fund was well positioned to capitalise on the resulting weakness in the domestic banking sector. Shorts in Australian mortgage lenders and mortgage insurers also performed well. An investment in the newly merged Janus Henderson Group was a standout performer, with the improved size and liquidity of the merged entity making it investible to a broader range of institutional investors.

### Monthly Net Performance (%)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
<b>2012</b>	-	-	-	-	-	-	-	1.36	0.97	0.00	6.51	2.88	<b>11.72</b>
<b>2013</b>	-0.71	0.21	4.60	1.55	5.83	5.31	1.11	2.57	1.43	1.86	0.35	-0.06	<b>24.05</b>
<b>2014</b>	1.71	1.45	-1.17	2.80	1.21	0.84	-4.38	-1.77	2.52	-1.57	-1.58	-1.32	<b>-1.26</b>
<b>2015</b>	-1.18	0.70	3.23	0.96	-0.61	3.39	3.82	4.04	2.73	-1.36	1.53	2.93	<b>20.19</b>
<b>2016</b>	-0.14	-1.93	1.13	0.53	1.08	1.76	0.60	-1.46	2.23	-0.34	-0.46	0.07	<b>3.03</b>
<b>2017</b>	-0.81	0.02	0.76	1.13	0.61								<b>1.71</b>



Macquarie Wrap

BT Wrap

BT Panorama

Asgard

Netwealth

IOOF Pursuit

Mason Stevens

Powerwrap

Hub24

## More Information

Rani Singh – Business Development Manager

02 8047 7744

0422 745 731

[singh@wfunds.com.au](mailto:singh@wfunds.com.au)[www.wfunds.com.au](http://www.wfunds.com.au)

White Outsourcing – Unit Registry

[registry@whiteoutsourcing.com.au](mailto:registry@whiteoutsourcing.com.au)

Disclaimer: This document is issued by Watermark Funds Management Pty Ltd (ABN 98 106 302 505, AFSL 250897) in relation to the Watermark Market Neutral Trust (the Fund). Watermark Funds Management Ltd (Watermark) is a privately owned funds management business. Equity Trustees Limited (ABN 46 004 031 298, AFSL 240975) is the Responsible Entity for the Fund. The information provided is general information only. It does not constitute financial, tax or legal advice or an offer or solicitation to subscribe for units or shares in any fund of which Watermark is the contracted Investment Manager. The information in this document has been prepared without taking account of your objectives, financial situation or needs. Before acting on the information or deciding whether to acquire or hold a product, consider its appropriateness and the relevant Product Disclosure Statement (PDS), which is available on Watermark's website; [wfunds.com.au](http://wfunds.com.au), or by phoning 02 92550225. Watermark receives management and performance fees in respect of the Fund, details of which are also set out in the PDS. Watermark, its affiliates and associates accept no liability for any inaccurate, incomplete or omitted information of any kind or any losses caused by using this information. All investments carry risks. There can be no assurance that any Watermark Fund will achieve its targeted rate of return and no guarantee against loss resulting from an investment in the Fund. Past fund performance is not indicative of future performance.