



WATERMARK

MARKET NEUTRAL FUND

NTA and Monthly Update – August 2017

Company at a Glance

ASX Code	WMK
Fund Size	AU\$85.0m
Fund Strategy	Equity Market Neutral
Share Price	\$0.96
Shares on Issue	87.4m
Dividend (FY17 Annual)	2.5 cents
Dividend Yield (annualised)	6.3%

Net Tangible Asset (NTA) Backing

	Jul 17	Aug 17
NTA Before Tax	\$1.00	\$0.99
NTA After Tax	\$1.01	\$1.00
Dividend Declared (2.5¢)	-	(\$0.025)
NTA After Tax \$ Dividend (2.5¢)	\$1.01	\$0.97

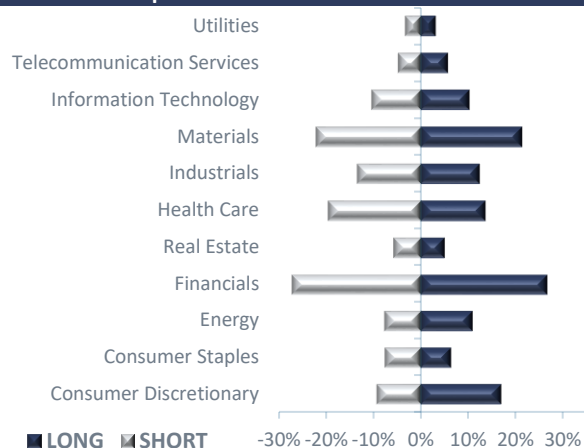
Gross Portfolio Structure

Long Exposure	127.3%	133.0%
Short Exposure	-123.4%	-132.2%
Gross Exposure	250.7%	265.2%
Cash	96.1%	99.2%

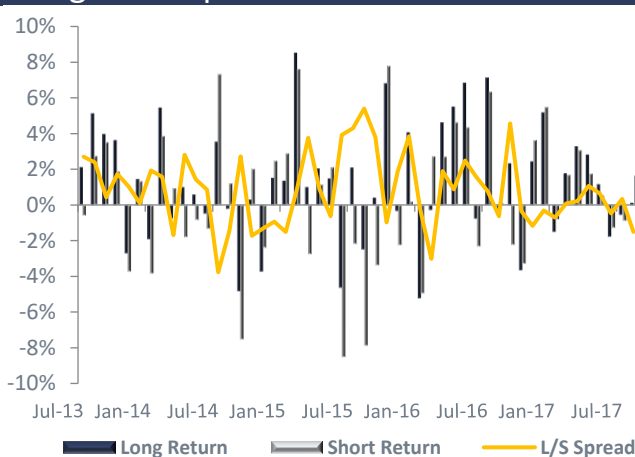
WMK Performance

	1 Mth	3 Mths	6 Mths	FYTD	1 Yr	3 Yrs (pa)	S.I. (pa)
Portfolio Return (net)	-1.7%	-1.8%	-0.4%	-1.4%	0.5%	6.6%	6.0%
RBA Cash Rate	0.1%	0.4%	0.8%	0.3%	1.5%	1.9%	2.1%
Outperformance (net)	-1.8%	-2.2%	-1.2%	-1.7%	-1.0%	4.7%	3.9%

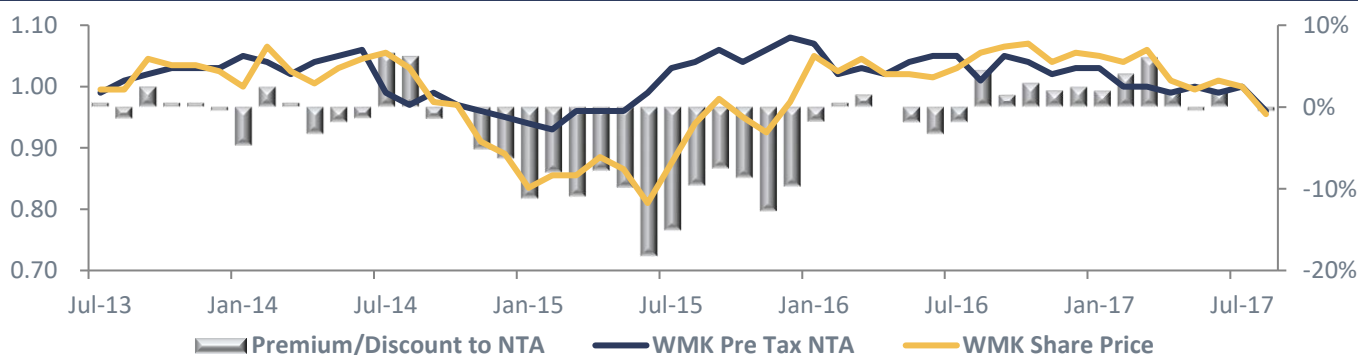
Sector Exposures



Long Short Spread*



Premium/Discount to NTA History





Month in Review

Global share markets posted modest gains in August, with optimism giving way to pessimism as geopolitical tensions in Korea intensified. In Australia, investors were focused on the corporate reporting season, where continued strength in mining shares was a highlight in an otherwise lacklustre month for the broader industrial market.

August was a difficult month for the Fund, which saw the portfolio value fall by 1.7% after fees. Losses were spread across multiple sectors, but were felt most heavily in financials where surprise results in the diversified financials and insurance sectors caught us off guard. Attribution was better in basic industries.

The mining sector continued its rally in August as surprising economic data in China provided a further boost for commodity prices. This was a tailwind for our investment in BHP Billiton, which performed strongly following the company's announcement of its updated strategy, including plans to exit their US Shale business, and for continued focus on capital management.

Results in the utilities sector were in line, with companies continuing to benefit from low interest rates. Spark Infrastructure performed well, as strong revenue numbers and continued improvements in cost efficiency aided their SA Power Networks business. In New Zealand, Contact Energy's announcement that it was successfully reducing debt, and plans for an increase in its dividend payout, was well-received by investors.

We took profits on German electricity provider E.On, which bridged the valuation gap to its peer Innogy, after showing sustained profit growth and allaying concerns around liabilities in respect of its nuclear operations. We initiated a position in National Grid, which we believe has an undervalued US business. On the short side, we are bearish on PPL Corporation, which is facing negative underlying growth in Kentucky. Origin Energy performed well following its profit result. Debt is coming down, and should fall further following a sale/IPO of its Lattice upstream assets. We were also pleased to see a reduction in operating costs at Origin's APLNG project, with read throughs for the whole industry.

Oil again traded lower through the month as questions arose over compliance with OPEC's supply cut. Compounding this was a negative update from leading US Shale company Pioneer Resources on reservoir characteristics, which impacted our position in Anadarko Petroleum.

Financial shares underperformed as yield curves flattened further. While there were no major policy indications from central banks, further signs are evident that inflation is moderating, particularly in the US. Our domestic financial portfolio performed poorly in the period, resulting from a string of mistakes during the Australian reporting season. We initiated a new long position in Commonwealth Bank of Australia soon after AUSTRAC initiated civil penalty proceedings against the bank for serious and systemic non-compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act. We believe that in light of the known infractions, the likely fines will be small relative to the size of CBA's capital base. In retrospect, we were too early in buying, although we believe significant relative value has emerged in one of the world's leading banks.

We increased our exposure to Australian general insurers. They sold-off heavily on poor results during the month, we expect the fundamentals for the industry will improve as rates in commercial and personal lines harden. We sold our position in Italian bank Unicredit, as the share had reached their short-term price target.

Global consumer staples shares were flat in August, while in aggregate, domestic names saw modest gains. The more economically sensitive consumer discretionary shares ended the month down across the board. A new investment in global brewer Anheuser-Busch Inbev was established on evidence of volume growth has returned, and that the integration of SAB Miller is progressing ahead of plan. Positions were re-established in gaming shares Tabcorp and Melco Entertainment, which had both fallen below our valuations.

Domestic consumer positions were a contributor to fund performance over the month while international positions detracted from overall returns. Domestic consumer discretionary shorts also added value. Many



companies in this area are reporting peak profits, just as the housing cycle slows, and with the Australian consumers facing increasing energy and healthcare costs, despite muted income growth, spending will be squeezed further.

Global industrial shares were relatively unchanged in August. The Fund benefitted from short positions in several Australian transport shares, which sold-off following weak results. Given the market has already priced in buoyant data from leading economic indicators, several international names also suffered pull-backs, after failing to meet investors' elevated expectations. The funds remain fully hedged in industrial shares. Themes in the portfolio include the rise of the industrial internet, where some companies are benefitting from better connected equipment (eg. in factory automation), and the impact of e-commerce on traditional industrial distribution models.

Australian TMT shares performed strongly in August, as earnings releases were for the most part better than expected. The exception was of course the telecom sector, which continues to struggle as the NBN transition challenges incumbent players. Global technology shares drifted sideways during a typically quiet month, as investors digested quarterly earnings releases in July. Conversely, it was a month to forget for global media shares, with ad agencies continuing to trim market forecasts, and European broadcaster ProSieben downgraded for the third time this year. Telecom shares were also weak, back to being one of the poorest-performing global sectors so far, this year.

The Fund's TMT portfolio was down slightly for the month. Domestically, MYOB reported a robust result and outlook, and the stock performed strongly despite continued overhang from private equity ownership. Detractors from performance included TradeMe, where we took advantage of oversold conditions post the result to increase our position – this is a highly privileged business that dominates all the key online classified verticals in NZ. Globally, our core investment in China Telecom also contributed strongly to performance.

Global healthcare shares underperformed for most of August before rallying sharply in the final days of the period. After a slow start, Biotechnology shares went on to materially outperform other subsectors, driven by more positive clinical trial data readouts and Gilead's takeover bid for Kite Pharma. M&A activity in the biotechnology sector has been virtually non-existent and the Gilead/Kite deal sparked some much-needed interest in the sector. Signs of ongoing drug pricing pressures in the US for 2018 are emerging, with some payors announcing early formulary changes with notable exclusions of key diabetes drugs. This space will be one to watch in October, as we anticipate further announcements from payors which could surprise pharmaceutical investors on the downside.

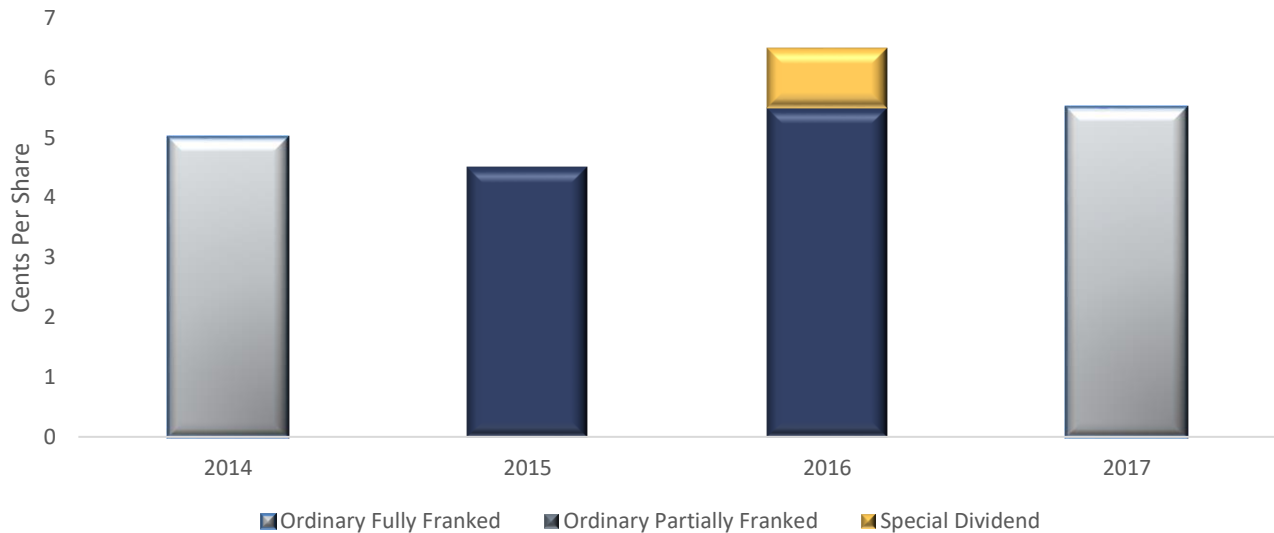
Results for Australian healthcare companies could best be described as disappointing, a trend we have highlighted for the last two years. For the third year in a row, CSL reported material downgrades to earnings forecasts, only to see the shares rally. Valuation multiples for the company are now at extreme levels on an historical basis and versus peers. A string of poor quality results also continued for Ansell, Healthscope, Primary, Sonic and ResMed. Cochlear was the standout, albeit reported results were in line with forecasts. The funds significant holding in Ramsay Healthcare detracted from performance. The business is performing well, we expect to see Australian hospitals reaccelerate in 2018. We see little opportunity in the Australian healthcare market, where non-fundamental factors (crowding, scarcity of defensive earnings growth) have greater impact on valuations. Also, being overlooked by Australian investors is the impact of a stronger \$AUD which will be a major drag in 2018 for many Australian healthcare companies.

The Funds' Healthcare portfolio delivered mixed returns in August. Shorts in European shares detracted while long positions in Biotechnology outperformed. Domestic healthcare positions weighed on performance. Given the significant dislocation between valuations for Australian healthcare shares relative to their international peers, we believe more compelling investment opportunities exist in offshore markets.



Dividend History

The Board is committed to paying an consistent stream of franked dividends to shareholders, provided the Company has sufficient profit reserves and franking credits and that it is within prudent business practices. Dividends are paid on a six-monthly basis. A Dividend Reinvestment Plan is available to shareholders. Please contact Boardroom Limited for details on how to participate – 02 9290 9600; callcentre@boardroomlimited.com.au



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