



# WATERMARK

MARKET NEUTRAL FUND

## NTA and Monthly Update – October 2017

### Company at a Glance

ASX Code	WMK
Fund Size	AU\$80.0m
Fund Strategy	Equity Market Neutral
Share Price	\$0.91
Shares on Issue	87.6m
Dividend (FY17 Annual)	2.5 cents
Dividend Yield (annualised)	6.0%

### Net Tangible Asset (NTA) Backing

	Sep 17	Oct 17
NTA Before Tax	\$0.99	\$0.94
NTA After Tax	\$1.00	\$0.95
Dividend Declared (2.5¢)	(\$0.025)	\$0.00
NTA After Tax \$ Dividend (2.5¢)	\$0.97	\$0.95

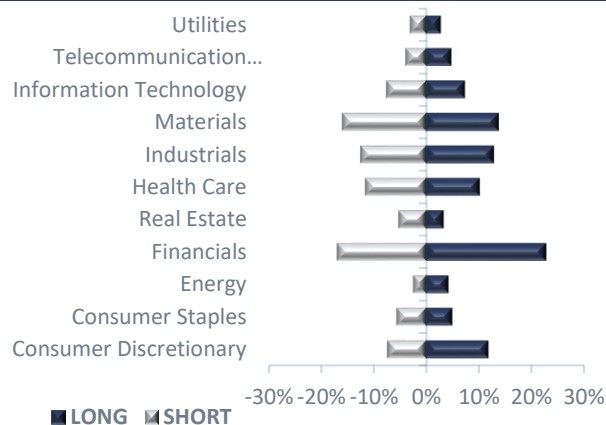
### Gross Portfolio Structure

Long Exposure	122.4%	99.5%
Short Exposure	-116.5%	-94.0%
Gross Exposure	238.9%	193.5%
Cash	94.1%	94.5%

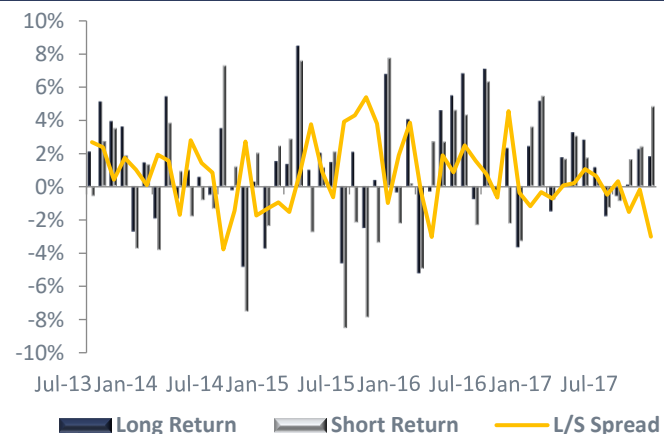
### WMK Performance

	1 Mth	3 Mths	1 Yr	2 Yrs (pa)	3 Yrs (pa)	S.I. (pa)
Portfolio Return (net)	-3.0%	-4.9%	-5.4%	1.5%	5.1%	5.0%
RBA Cash Rate	0.1%	0.4%	1.5%	1.7%	1.9%	2.1%
<b>Outperformance (net)</b>	<b>-3.1%</b>	<b>-5.3%</b>	<b>-6.9%</b>	<b>-0.2%</b>	<b>3.2%</b>	<b>2.9%</b>

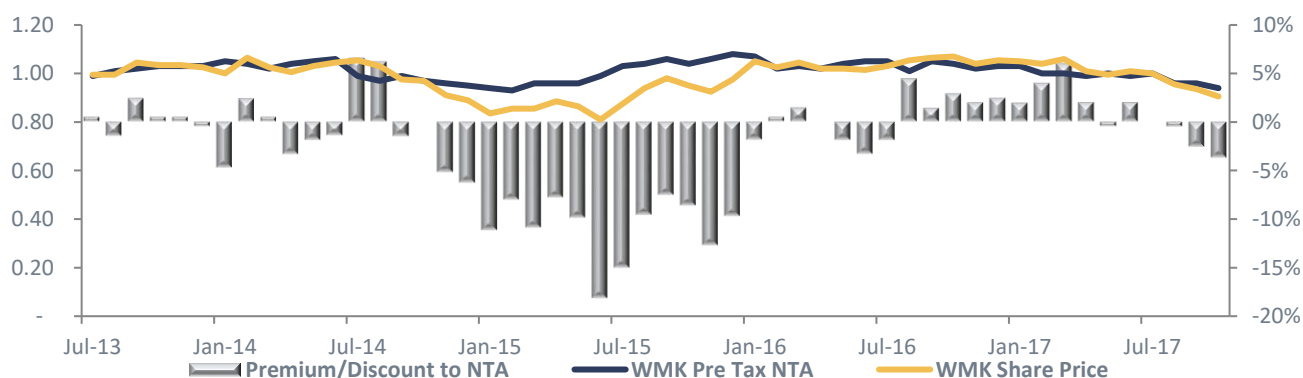
### Sector Exposures



### Long Short Spread



### Premium/Discount to NTA History





## Month in Review

October was another strong month for global share markets, as investors responded positively to further signs that the global economy is growing, and that central banks are likely to remain dovish. The US reporting season also provided some upside surprise, with the tech giants surging again, buoyed by prospects that tax reform in the US is on the agenda for early 2018.

Local shares also rallied in the month, with most sectors posting solid gains. A weaker local currency versus the USD provided a boost for producers of base metals, while commodities in general continue to benefit from strengthening industrial production data from China and across the global economy. While labour market indicators would suggest modest growth in the economy, there are continued signs that the property market is cooling which, will be a headwind for much of the economy.

It was a difficult month for the fund, which posted a fall of 3% after fees. This was the worst draw-down in a single month for many years driven by a confluence of several surprise results from international positions through the busy US reporting season. As this cycle completes, we are witnessing moves across asset markets that are highly unusual and not supported by fundamentals. Shorts again proved the most difficult to manage in a 'risk-on' month for share markets. We take some comfort from the fact the sharp falls in fund performance have historically been a precursor to stronger performance, as fundamentals prevail over unwarranted greed or fear.

There was little news flow for global financial shares from politicians or central bankers. Long positions in CBA and Suncorp were the stand out performers in the sector, offset by broad based gains across the short book and weaker performance from a long position in Swedbank, which fell on concerns over falling local house prices.

The Consumer Discretionary sector was amongst the strongest performing sectors in October, and positions in Tabcorp, Aristocrat and Star Entertainment were key contributors for the Fund. Woolworths continues to be the stronger of the two local supermarket operators, winning market share and benefitting from sales growth across its Big W stores. Globally, performance of consumer shares was more mixed, with discretionary names posting gains while staples were flat. Investments in Heineken and Pernod Ricard continue to perform well, along with shorts in companies supplying packaged goods to a highly competitive North American grocery market.

The Fund suffered modest losses in the industrial portfolio, again concentrated around short positions that moved higher with a buoyant market. A speculative takeover bid for Rockwell Automation was also a key detractor. Domestic positions fared better, with investments in Downer EDI and Brambles continuing to perform well.

TMT was another challenging sector in the month. In the domestic portfolio, solid contributions from investments in Fairfax and outdoor advertisers were offset by broad based losses from the short book. Strength in the Global technology sector was the lead story again in the month. While valuations across the sector look stretched, investors continue to be enthralled by the potential for new applications from AI, and new product launches such as the iPhone X. With a modest net short exposure to semiconductor manufacturers, the Fund suffered heavy losses as this sector rallied strongly, recovering recent underperformance relative to other parts of the tech sector. An investment in IT security vendor - Fortinet made a positive contribution in the month.

Poor performance in the healthcare sector was the largest contributor to negative returns. Again, it was global exposures that caused the greatest problems, with investments in Celgene and Merck suffering precipitous falls as jittery investors reacted to negative news flow and earnings downgrades. As we have seen through recent Australian reporting seasons, investors have been quick to de-rate companies that are priced for perfection if there is any hint of risk to earnings or should they fail to meet lofty expectations for future growth.

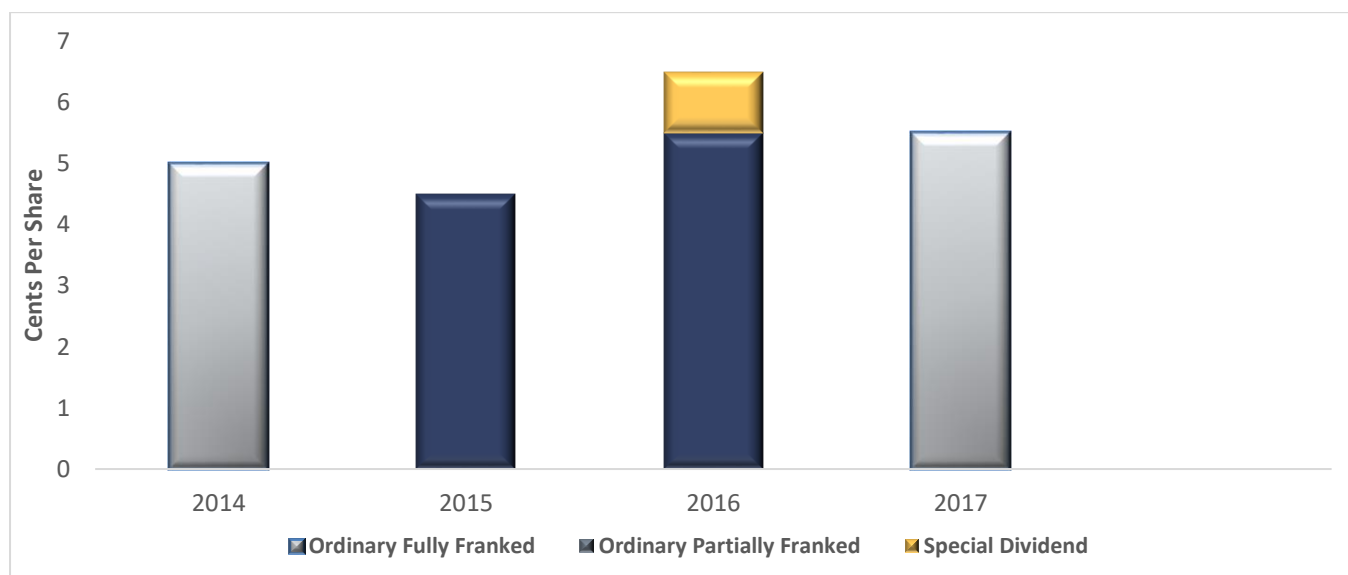


While these short-term price movements have been a significant detractor from returns, detailed re-examination of the investment thesis supporting each position suggests substantial embedded value going forward.

Basic Industries shares provided benign results in the month. A stronger oil price saw energy names rally strongly while mining shares were mixed, as commodity markets digested news from the nineteenth National Party Congress in China. We retain our neutral position across the commodity complex. An investment in Fletcher Building fell on news of losses in its construction division while a core position in Independence Group performed well.

## 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](mailto:callcentre@boardroomlimited.com.au)



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