

# Investment Update and NTA Report

28 February 2015



## Month in Review

Central bank action continued to be a major factor impacting the performance of global share markets in February. European markets were buoyed by the commencement of the ECB's quantitative easing program while speculation as to when the US Federal Reserve may begin raising rates, weighed on US shares.

On the domestic front, the RBA cut the cash rate as expected, signalling their ongoing expectation that growth in the domestic economy will be weak. This weak outlook was evident in softer employment data in January and disappointing investment expectations in business surveys. The rate cut sparked a strong rally, with the All Ordinaries rising by 6.9% for the month.

The portfolio delivered a return of 1% for the month. While this may look uninspiring given the strong market move, the Company has negligible net exposure to the share market, which makes this a credible result. In fact it should be seen as a strong result in the context of the misfortune of having two short positions bid for in February, with Japan Post bidding for Toll Holdings and Novion Property Group merging with Federation Centres. In both cases we are convinced the short case was sound.

While fundamentals will invariably determine the success or failure of a long investment (sometimes luck plays a role), with shorts comes occasional exposure to irrational investment decisions which are not always fundamentally sound. Just consider the track record of corporate transactions - for every successful deal, history is littered with ill-conceived failures.

Every now and then we will be on the wrong side of these transactions. The first time we had one of our shorts bid for was under similar circumstances when the Japanese brewer Kirin bid \$6.5 billion for Lion Nathan in April 2009. That was a terrible transaction with Kirin overpaying and the business has struggled ever since. In our short portfolio, we can be exposed to this irrational behaviour. Sadly, the Toll profit result also announced on the day of the bid was very disappointing and the shares would have otherwise been a lot weaker.

To finish ahead for the month having carried these significant losses without any net market exposure was a solid result and indicates we also had a number of significant successes in the month of February.

## Net Tangible Asset (NTA) Backing

Month	January 2015	February 2015
NTA before tax on unrealised gains	\$1.27	\$1.29
NTA after tax	\$1.30	\$1.31
Dividend Declared*	(\$0.00)	(\$0.05)
NTA after tax and after dividend (5¢)	\$1.30	\$1.26

\*The ex-date for the dividend is 26 March 2015, payable on 14 April 2015

## Performance (Net of all Fees and Expenses)

Period	S&P/ASX All Ordinaries Accum. Index	Net Equity Exposure	Contribution Market <sup>1</sup>	Security Selection <sup>2</sup>	ALF (net returns)
1 Mth	7.0%	7.0%	0.5%	0.5%	+1.0%
6 Mths	7.1%	18.4%	0.1%	-3.8%	-3.7%
Fin. YTD	12.8%	18.9%	1.0%	-10.4%	-9.4%
1 Yr	13.6%	23.9%	1.4%	-8.3%	-6.9%
3 Yrs p.a.	15.2%	39.4%	4.4%	10.5%	+14.9%
5 Yrs p.a.	9.5%	54.5%	2.8%	7.7%	+10.4%
Since Inception p.a	10.0%	-	-	-	+13.9%

<sup>1</sup> The "Market" column displays the contribution to return achieved in the period from the Fund's exposure to the share market weighted on a monthly basis. Due to timing differences and an adjustment for cash holdings, the contribution is not necessarily the same as the average equity exposure for the period multiplied by the market return.

<sup>2</sup> All fees and expenses are netted off against stock selection

### Australian Leaders Fund

ASX Code	ALF
Listed	Feb 2004
Capital	\$325.6m
Market capitalisation	\$354.1m
Share price	\$1.39
NTA before tax	\$1.29
Shares on issue	254.8m
Fully franked dividend (1H15)	5.0¢
Dividend yield (fully franked)	7.1%

### Company Overview

The Australian Leaders Fund (ALF) is a listed investment company, comprising a portfolio of publicly traded Australian shares. As a Long/Short Equity fund the manager looks to take advantage of mispricing opportunities across the full breadth of the share market. As a 'variable beta' fund at any point in the investment cycle the fund may be fully invested, market neutral or short the market depending on the market outlook. Watermark aims to add value through both security selection and the hedging of share market risks. It is the Board's intention to try and deliver to shareholders a consistent and growing stream of fully franked dividends over time.

### Investment Strategy

The primary goal of the investment process is the identification of mispriced securities. The manager looks to buy the shares of good companies on occasions when they are undervalued by the share market. ALF is different to other funds however, in also selling short the shares of businesses that are fundamentally challenged, where these shares can be sold for more than they are worth. Proceeds raised from selling these shares are an additional source of funds for the company's balance sheet. These funds can either be retained in cash as a hedge for the fund's assets, or re-invested in the shares that the manager prefers. By adjusting the relative size of the 'long' and 'short' portfolios and the degree of hedging in place, the manager can set the amount of market risk (beta) retained in the fund.

### Investment & Management Team

**Justin Braitling**  
Chief Investment Officer/Portfolio Manager

**Tom Richardson, CFA**  
Senior Investment Analyst

**Joshua Ross**  
Investment Analyst

**Omkar Joshi, CFA**  
Investment Analyst

**Delian Entchev**  
Investment Analyst

**Tim Bolger**  
COO & Head of Distribution

**Shannon Wells**  
Office Manager

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## Fund Attribution

In February, the Long Portfolio increased by 7.6%, outperforming the FTSE AFSA Index which increased by 6.9%. The portfolio of securities that ALF has borrowed and sold (short) increased by 7%, outperforming the FTSE AFSA Index, and detracting from performance. In aggregate, the total portfolio was up 1.1% on a gross basis in February, underperforming the FTSE AFSA Index by 5.8%. At the end of February, ALF has 5% of net Shareholders Funds invested in equities with the balance retained in cash (95%).

	1 Month Return (%)			6 Month Return (%)			Financial YTD Return (%)		
	Portfolio <sup>1</sup>	Benchmark <sup>2</sup>	Attribution <sup>3</sup>	Portfolio <sup>1</sup>	Benchmark <sup>2</sup>	Attribution <sup>3</sup>	Portfolio <sup>1</sup>	Benchmark <sup>2</sup>	Attribution <sup>3</sup>
Long Portfolio	7.6%	6.9%	0.5%	1.6%	7.3%	-6.6%	4.9%	12.9%	-9.4%
Short Portfolio	7.0%	6.9%	-0.1%	3.5%	7.3%	3.9%	13.1%	12.9%	-0.5%
Cash			-6.2%			-7.6%			-11.6%
<b>Total</b>	<b>1.1%</b>	<b>6.9%</b>	<b>-5.8%</b>	<b>-3.1%</b>	<b>7.2%</b>	<b>-10.3%</b>	<b>-8.6%</b>	<b>12.9%</b>	<b>-21.5%</b>

<sup>1</sup> The "Portfolio" column displays the return achieved in the period from the Investment Portfolio (long) and from the Borrowed Securities portfolio (short) separately. The Total Portfolio performance, representing the underlying return achieved on Shareholder's Funds is a weighted return of the long and short portfolios as well as cash. As such this column will not sum.

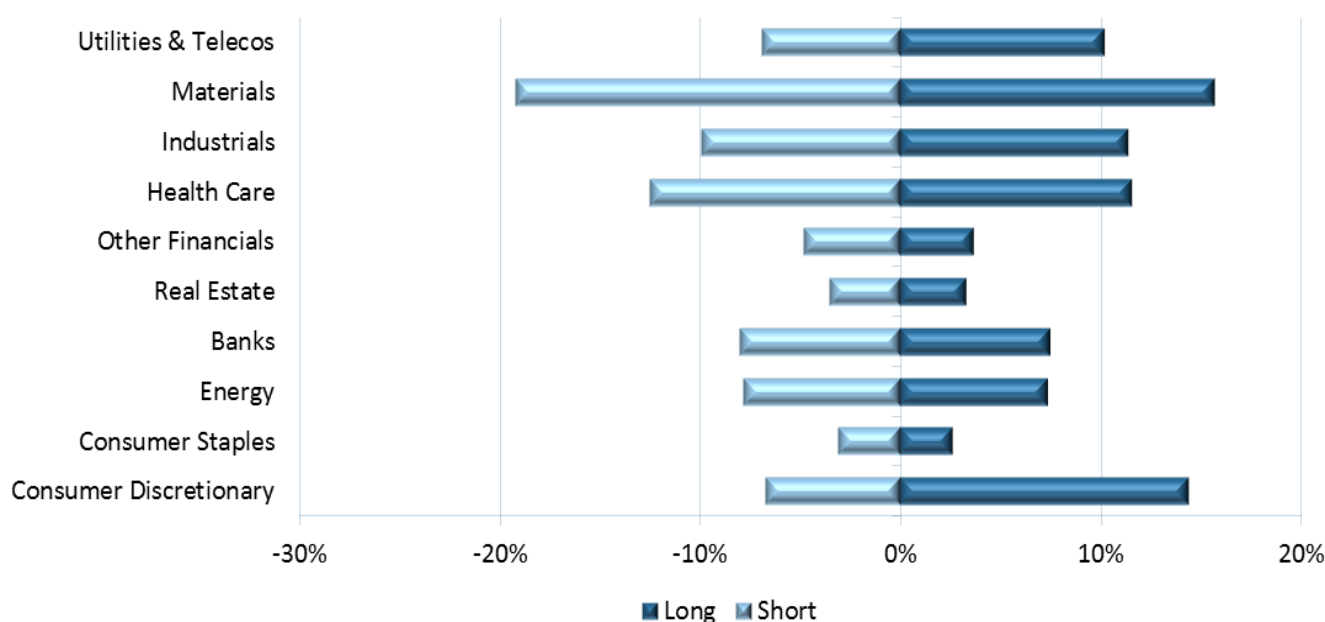
<sup>2</sup> For the purposes of reporting Long/Short attribution we use the FTSE ASFA index - which is a broader index to the All Ordinaries Accumulation with minor differences, the performance numbers reported in Table 2 use the All Ordinaries Accumulation Index series.

<sup>3</sup> Attribution shows the contribution to the outperformance of Shareholder's Funds in the period coming from the Investment Portfolio (long) and the portfolio of Borrowed Securities (short) as well as from the cash retained on the Balance Sheet. Each contribution sums to the overall outperformance of shareholders' funds.

## Gross Portfolio Structure

Investment Type	31 January 2015		28 February 2015	
	\$m	%	\$m	%
Listed Securities - Long	322	100%	286	88%
Listed Securities - Short	-288	-89%	-270	-83%
<b>Net Exposure</b>	<b>34</b>	<b>11%</b>	<b>16</b>	<b>5%</b>
Cash	289	89%	310	95%
<b>Capital</b>	<b>323</b>	<b>100%</b>	<b>326</b>	<b>100%</b>

## Sector Exposures

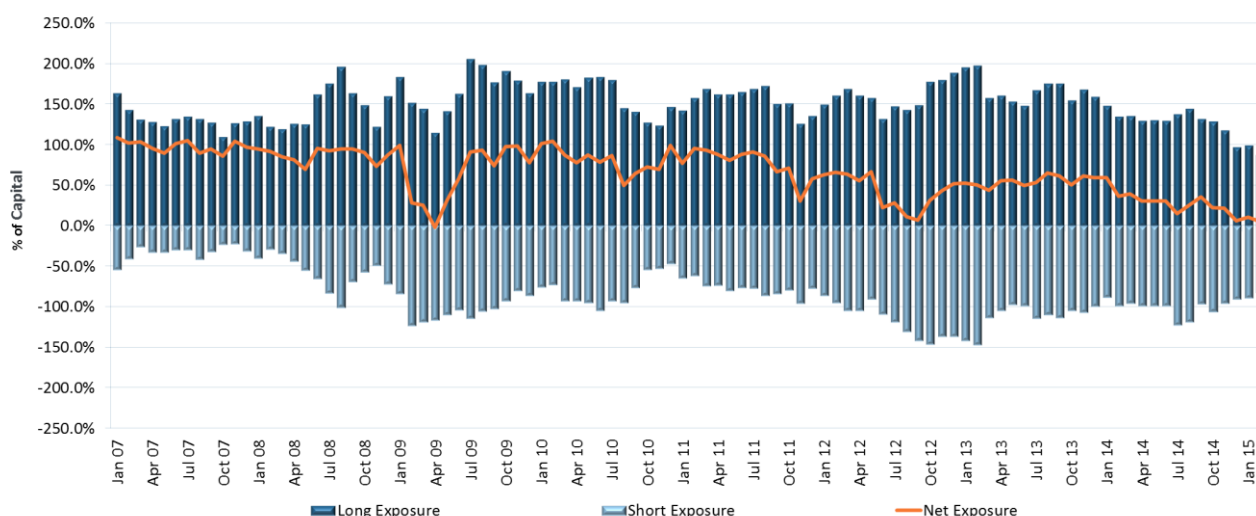


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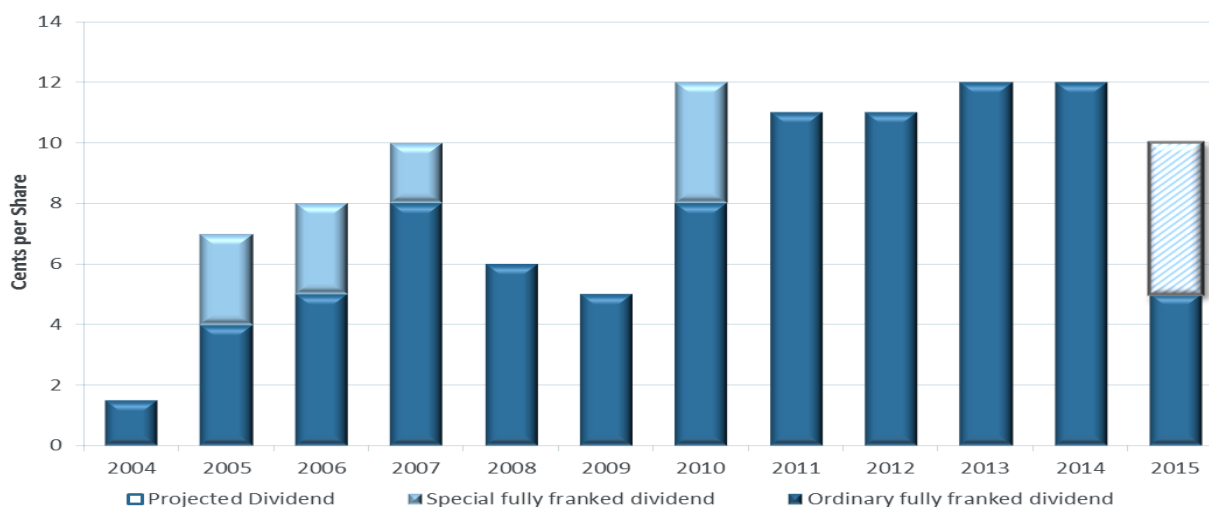


## Net Equity Exposure



## Dividend History

The Board is committed to paying an increasing stream of fully franked dividends to shareholders, provided the Company has sufficient profit reserves and franking credits and it is within prudent business practices. Dividends are paid on a six-monthly basis and the dividend reinvestment plan is available to shareholders for both the interim and final dividend.



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