



# WATERMARK

FUNDS MANAGEMENT



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# Agenda

Performance Update

Market Outlook

Portfolio Review

Questions

# Watermark's Objectives

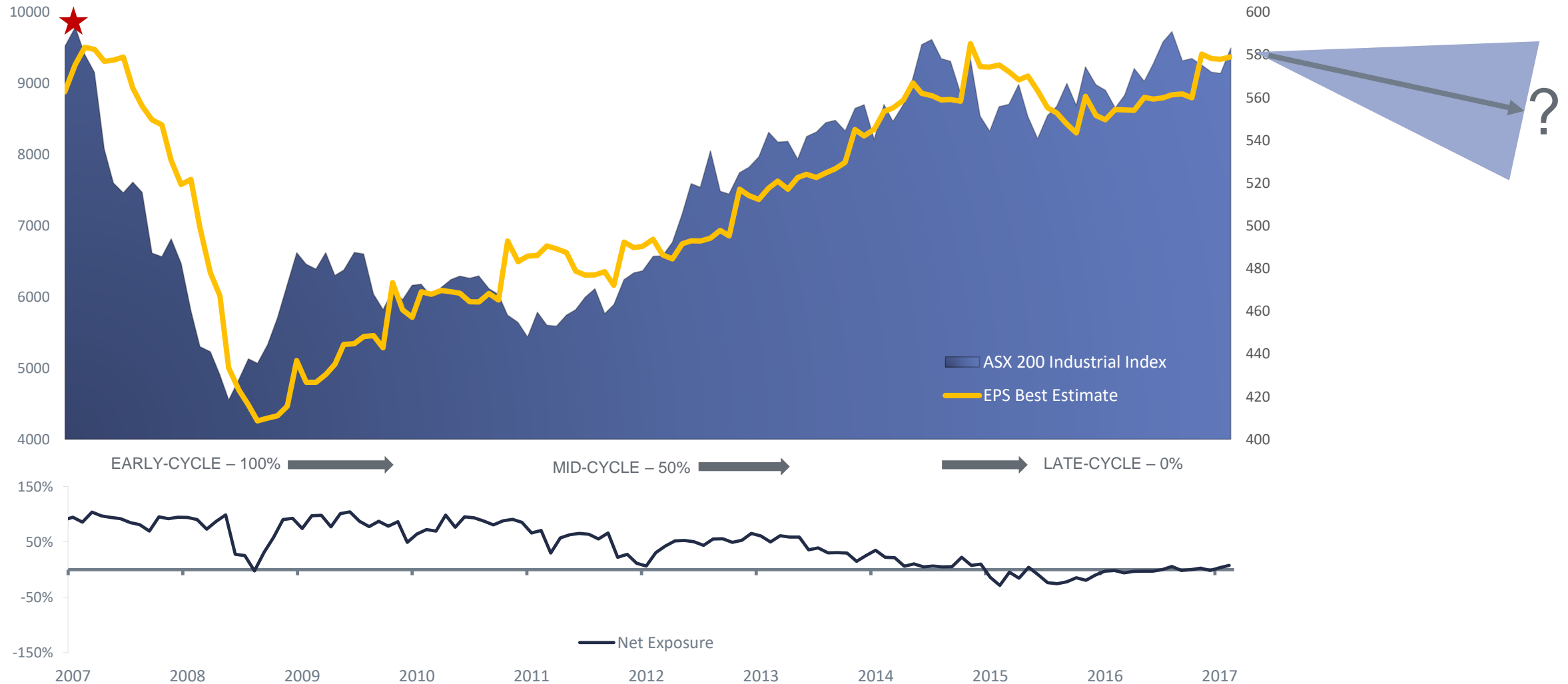
- As an absolute return manager, we have two key objectives:
  - Attractive returns (6-8% after fees) through an investment cycle
  - Capital preservation when market risks are elevated
- We achieve these objectives through the use of hedging strategies:
  - ALF employs a directional strategy, adjusting the amount of hedging through the cycle
  - WMK and WGF are fully hedged at all times
- Returns in these strategies depend exclusively on the manager's success in selecting the right securities and are uncorrelated with the share market
- We continue to strengthen our investment team

# Performance Review

- The Funds have fallen short of targeted returns in 2017
  - Our listed funds have seen modest falls in NTA so far in 2017 (Ex Dividends)
  - Strong returns from the long portfolio undermined by weaker performance of shorts
  - Substantial embedded value in all portfolios
- Comparisons with the share market are unhelpful the funds are fully hedged
  - Insurance has a considerable cost - we don't participate in a rising market
- Watermark strategies will protect shareholders when this bull market ends
- Lower returns have left less retained profits to payout dividends

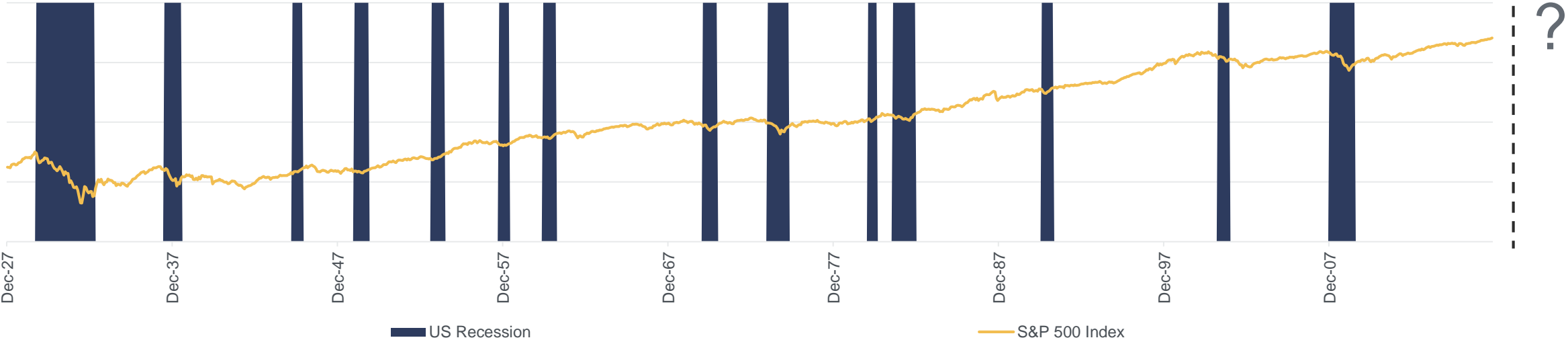
# Performance Summary

Objective : Capital preservation when risks are elevated

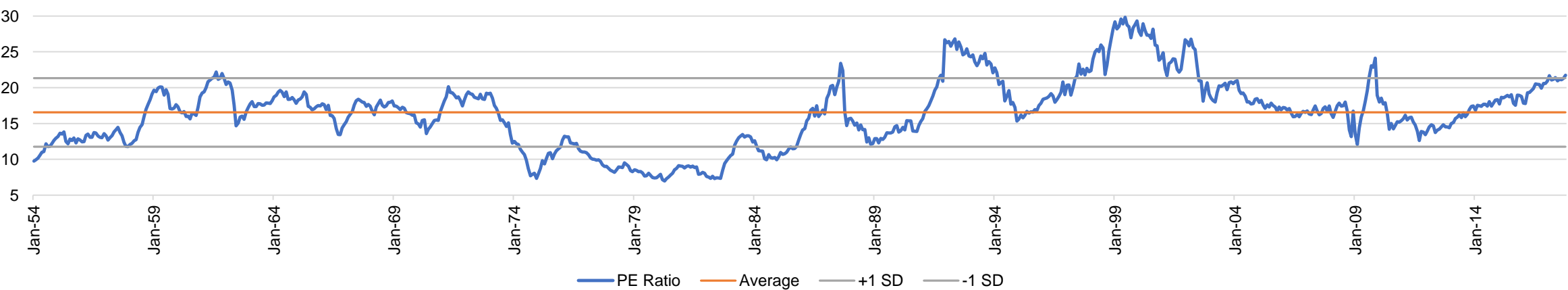


# Time to Hedge?

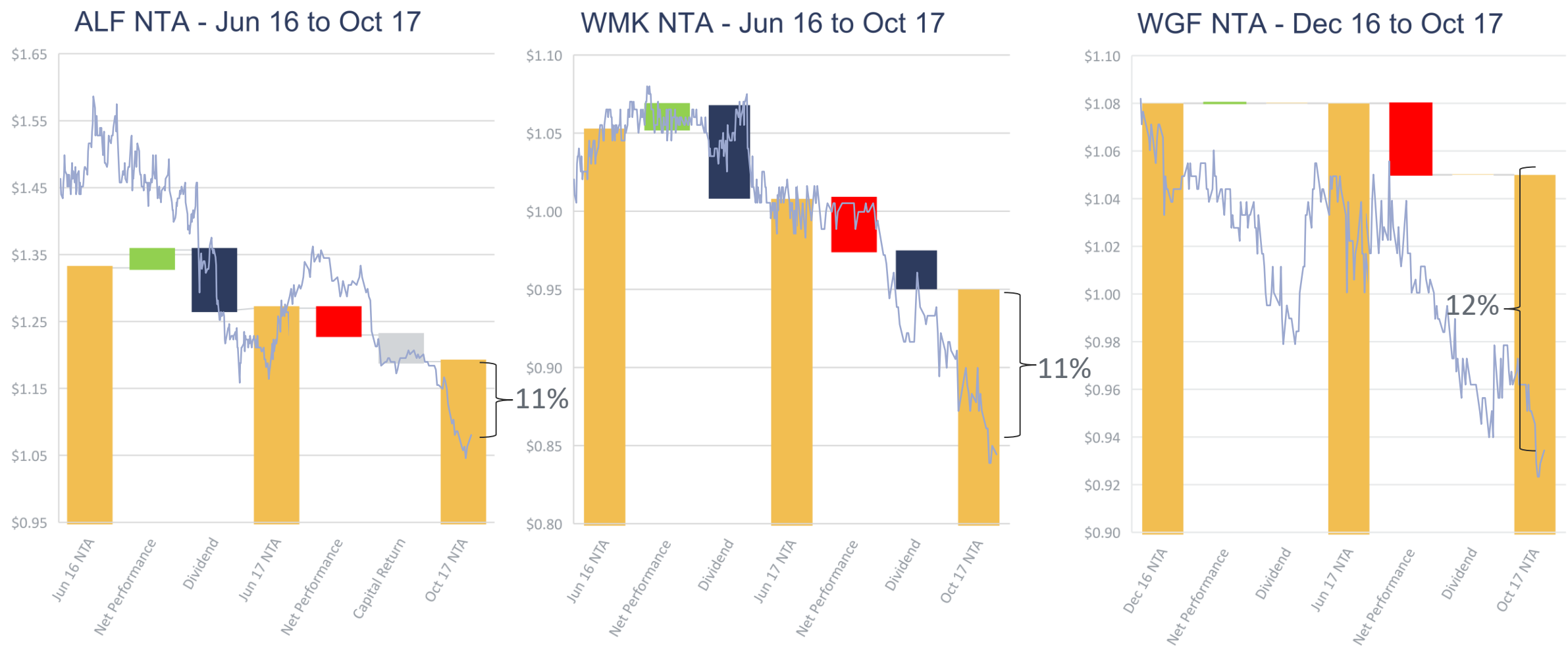
Price vs. US Recession



S&P 500 Index - PE Ratio



# Fund Performance





# ALF Performance Summary

Objective: Absolute Returns in excess of the All Ordinaries Accumulation Index

	1 Year	3 Years (pa)	5 Years (pa)	Since Inception (pa)
Long Portfolio	12.4%	15.6%	16.3%	-
Short Portfolio	14.5%	6.4%	4.3%	-
ALF	-2.9%	4.0%	10.2%	12.6%
All Ords Accum	8.5%	7.3%	10.1%	8.7%
Excess	-11.4%	-3.3%	0.1%	3.9%
Avg Net Exposure	-0.6%	-2.0%	17%	-
Fund Beta	-0.04	-0.07	0.04	0.69
Volatility	3	6	7	13
Correlation	-0.11	-0.14	0.06	0.68

ALF Portfolio Performance as at 30 September 2017

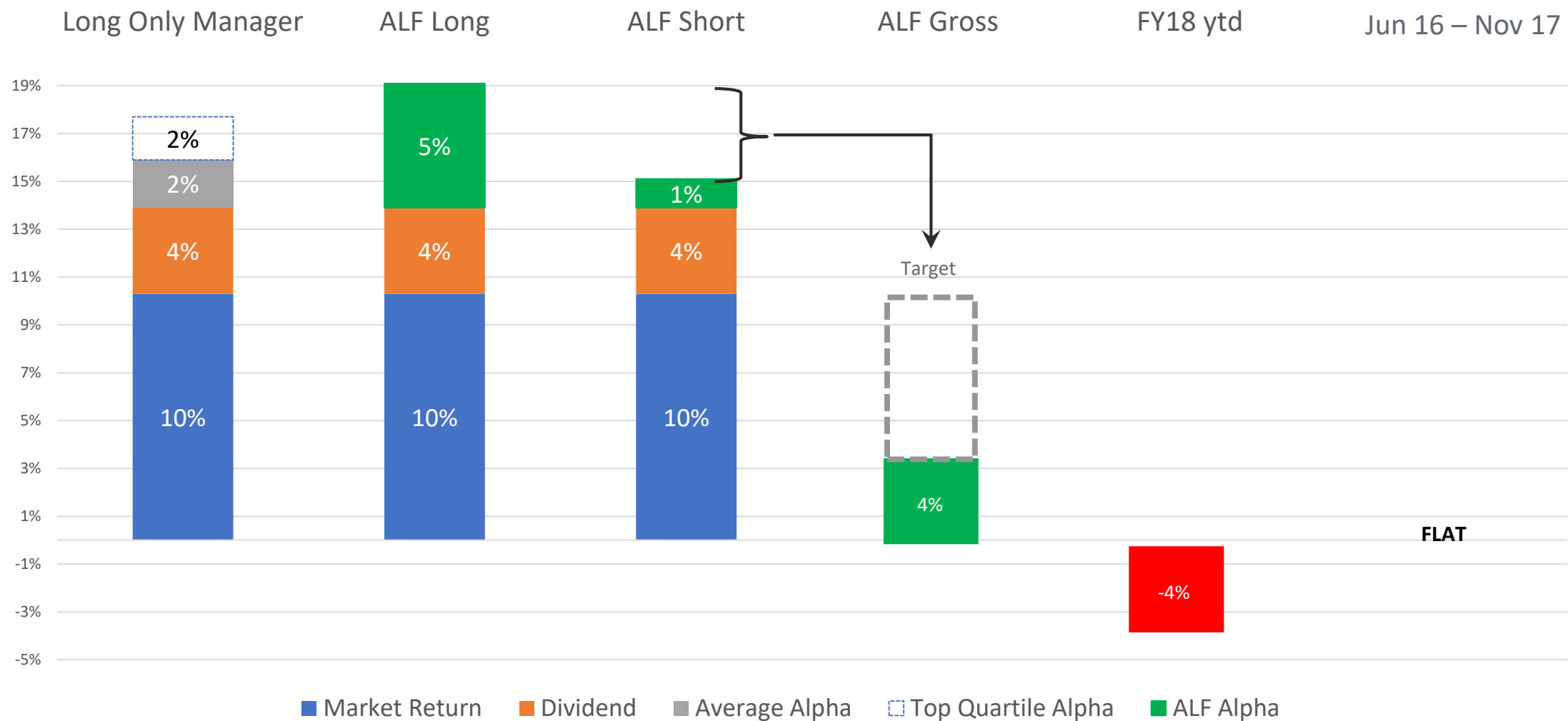
# WMK Performance Summary

Objective: Absolute Returns in excess of the RBA Cash Rate

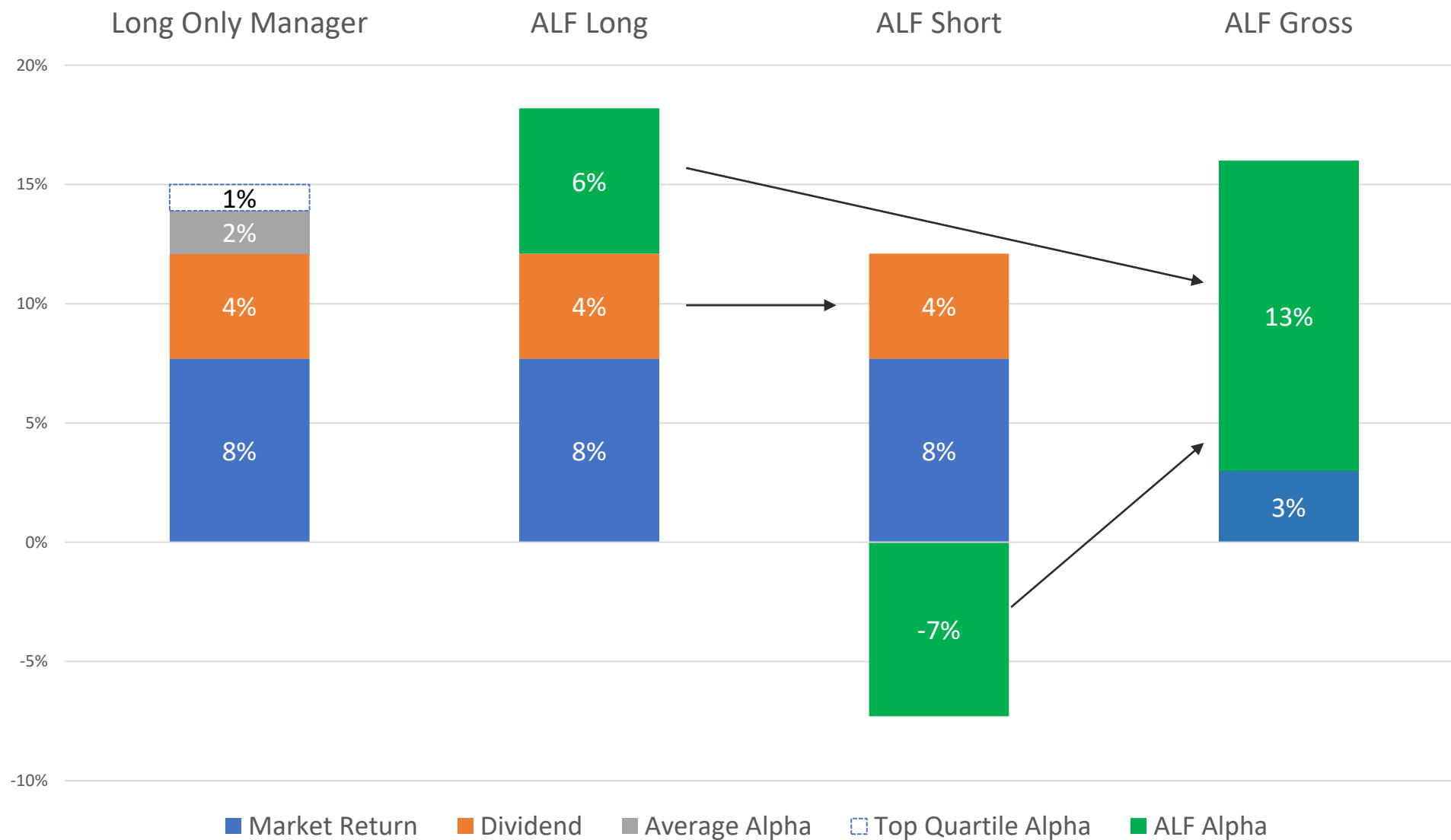
	1 Year	2 Years (pa)	3 Years (pa)	Since Inception (pa)
Long Portfolio	11.7%	22.0%	17.0%	15.8%
Short Portfolio	14.4%	15.8%	6.6%	5.1%
WMK	-3.0%	2.1%	5.5%	5.8%
RBA Accum	1.5%	1.7%	1.9%	2.1%
Excess	-4.5%	0.4%	3.6%	3.7%
Avg Net Exposure	1.2%	-1.0%	-0.1%	0.8%
Fund Beta	-0.03	0.03	-0.11	-0.13
Volatility	2	5	6	6
Correlation	-0.09	0.07	-0.21	-0.23

WMK Portfolio Performance as at 30 September 2017

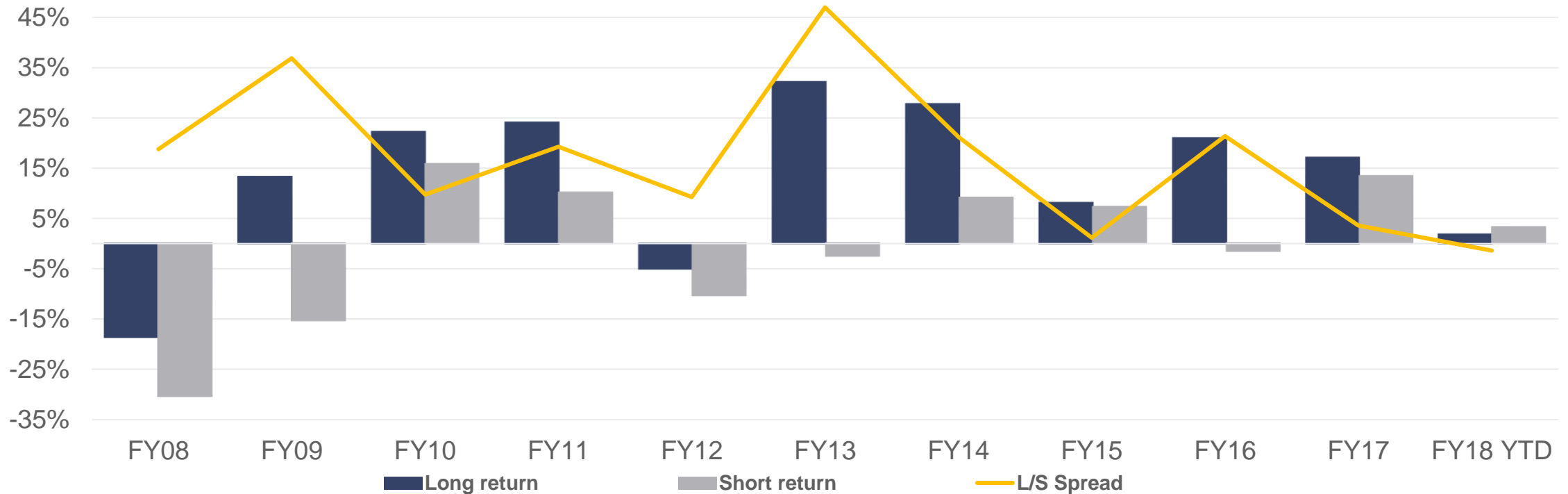
# Seeking Alpha – Waterfall of a difficult 16months



# Seeking Alpha – We have hit our targets over 5 Years



# Alpha created every year



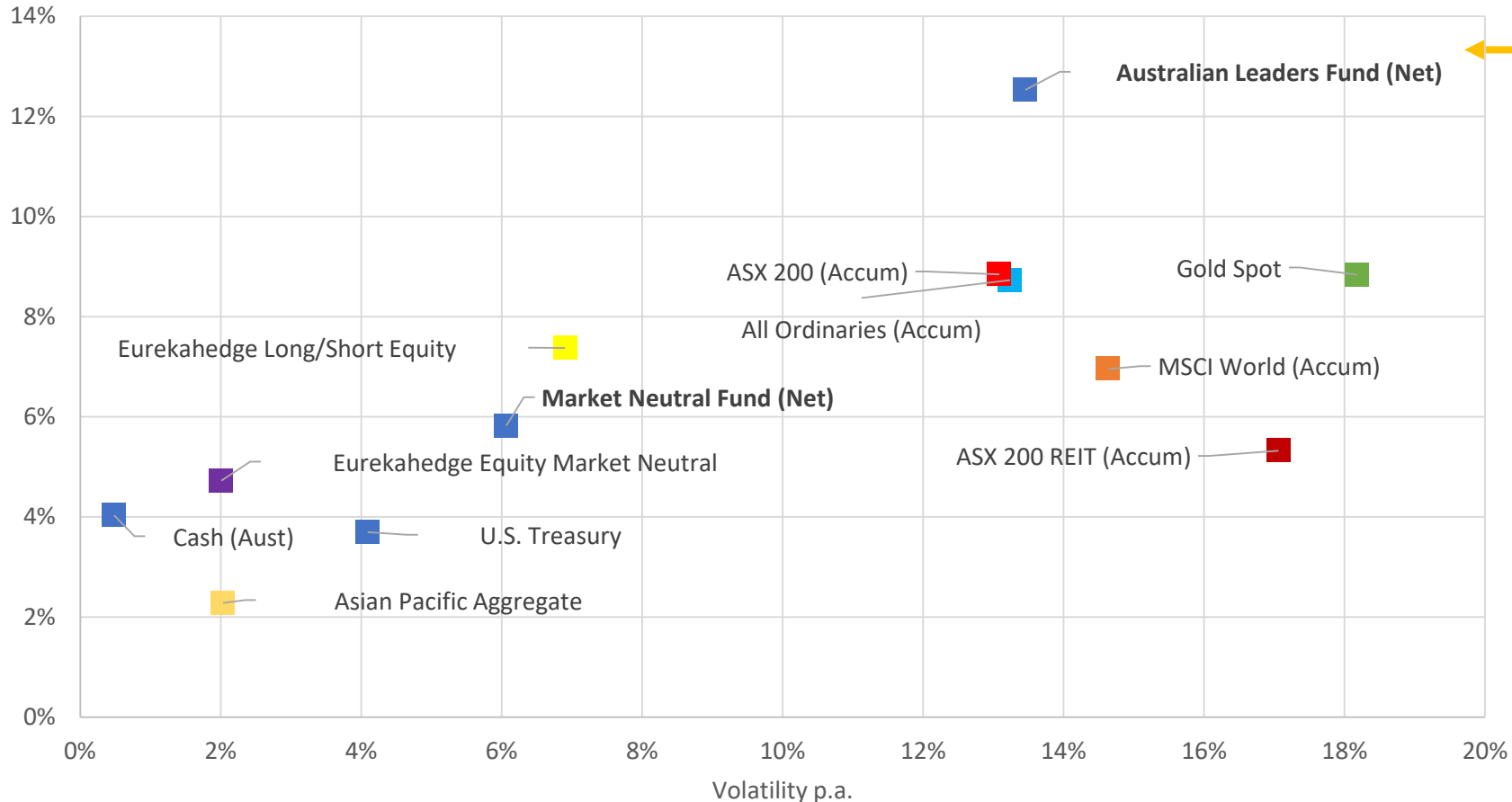
- A positive spread every year. Outperformance of Longs Vs Shorts
- When fully hedged, the value of the fund should only fall if the manager is unable to create a positive spread. (before costs)



# ALF Performance

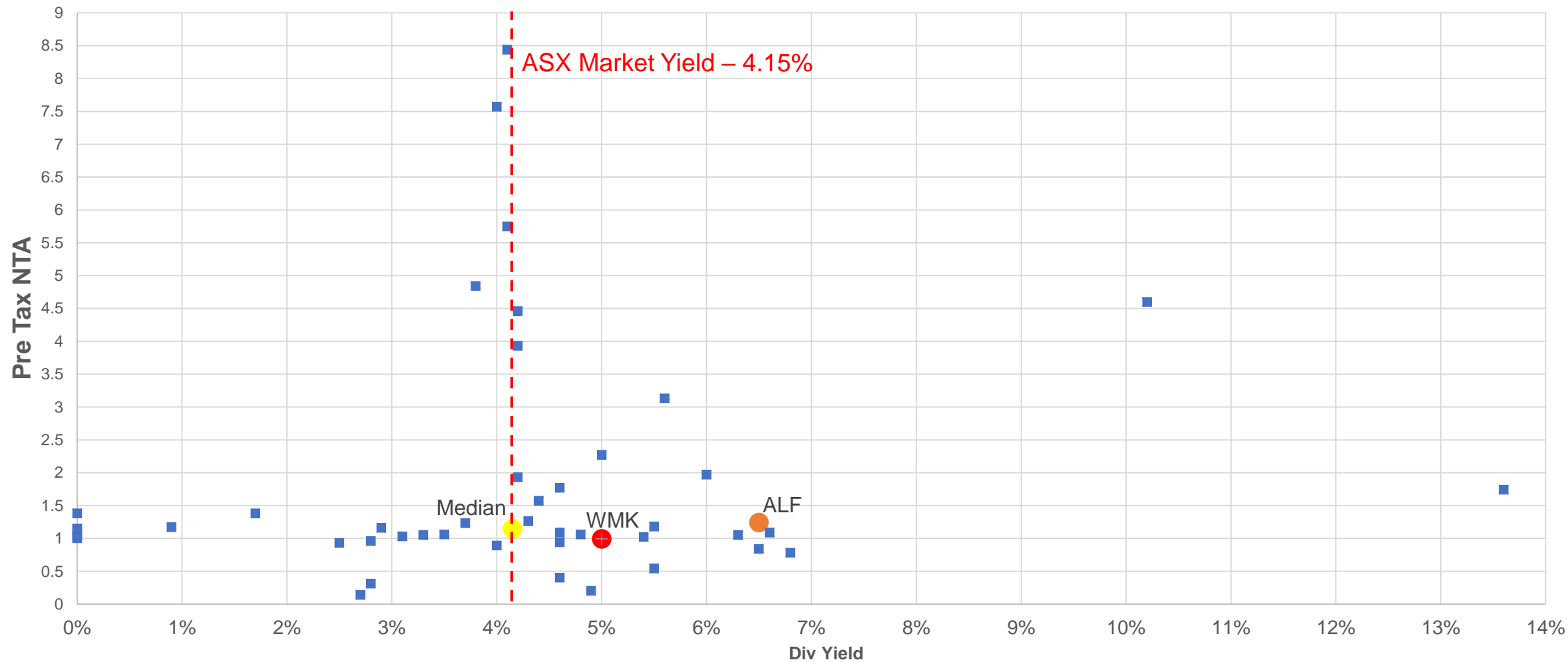
Objective : Absolute Returns in excess of the All Ordinaries Accumulation Index

Return p.a.



- ALF's performance has rarely been a straight line
- Periods of strong performance generally followed by periods of consolidation
- Returns have a low correlation with the share market
- ALF underperformed in FY17 after outperforming by 9% in FY16
- The Fund has beaten its benchmark by 4% pa. since inception.

# Dividend yields / NTA in the Australian LIC peer group



# Outlook for the Funds

- Periods of underperformance have historically been followed by stronger returns
  - More embedded value in the portfolios
  - Old ideas are re-validated, and new ideas incorporated
- Team changes and reallocated responsibilities now complete
  - More analysts, with greater experience are fully focused on their sectors
  - Appointment of Harvey Migotti as Head of International Equities
- Alternative investments such as Watermark's Funds will become more valuable for investors looking to hedge risks from expensive share markets

# Watermark's Expanded Investment Team



## **Justin Braitling – CIO**

Justin has over 26 years' experience investing in Australian and international securities. Prior to establishing Watermark in 2003, Justin spent 10 years as an investment analyst and portfolio manager with the successful equities team at Bankers Trust. Justin is the Chairman of ALF and a director of WMK and WGF.



## **Tom Richardson – Sector Head**

Tom is responsible for coverage of Basic Industries. He joined Watermark in December 2009. Prior to this, Tom began his career as an Investment Analyst with Renaissance Asset Management in 2006. Tom holds a Bachelor of Aerospace Engineering from the University of Sydney and is a CFA Charterholder.



## **Harvey Migotti – Head of International Equities**

Harvey is portfolio manager for Watermark's international funds and is responsible for coverage of the Industrials sector. He will join Watermark in December 2017. Harvey was previously an investment analyst covering Industrials & Aerospace/Defence at Balyasny Asset Management in London. He has also held equity analyst roles with Amiya Capital and Apax Partners. Harvey holds a Bachelor of Business from Lancaster University Management School and attended Cambridge University Judge Business School.



## **Nick Cameron – Sector Head**

Nick is responsible for coverage of the Healthcare sector. He joined Watermark in March 2015. He began his career in finance with KPMG in 2008, before moving into research roles with Credit Suisse and Deutsche Bank. Prior to joining the Watermark Nick was an investment analyst at GenesisCare. Nick has completed bachelor degrees in Science and Biotechnology and holds a PhD from Griffith University in the fields of Molecular Biology and Neuroscience.



## **Ian Carmichael – Sector Head**

Ian is responsible for coverage of the Consumer sector. He joined Watermark in March 2017. Prior to this he spent four years with Platinum Asset Management where he was the Consumer Team Leader and before that was a Portfolio Manager at MLC Investment Management where he worked for five years. Ian began his career as a Chemical Engineer with roles at Montgomery Watson Harza and Cochlear. He holds a Bachelor's degree in Chemical Engineering, a Master's degree in Biomedical Engineering and is a CFA Charterholder.



## **Hamish Chalmers – Sector Head**

Hamish is responsible for coverage of Financials. Hamish joined Watermark in May 2017. Prior to this he has been a Financial sector specialist with Och-Ziff Capital for the last 7 years. Between 2007 to 2010 he was a senior equity analyst (Insurance) for Fox-Pitt Kelton. Hamish holds a Bachelor of Civil Engineering and is a CFA Charterholder.



## **Delian Entchev – Sector Head**

Delian is responsible for coverage of the Technology, Media and Telecommunications sectors. He joined Watermark in August 2014. Prior to this, he was undertaking a cadetship with UBS as an Equity Research Analyst. Delian holds a Bachelor of Commerce (High Distinction) from the University of New South Wales.



## **Matthew Blumberg – Investment Associate**

Matthew is an Investment Associate concentrating on Oil & Gas and Utilities. Matthew recently received his Master of Business Administration (MBA) from Yale University, and joined Watermark in June 2017. Prior to this, Matthew spent approximately 5 years working as an engineer in the Oil & Gas space at 2H Offshore Engineering. Matthew holds a first-class honors degree in Engineering and a Bachelor of Commerce from UWA.

# Financials

*Global interest rates will continue to rise, with positive and negative effects for asset prices*

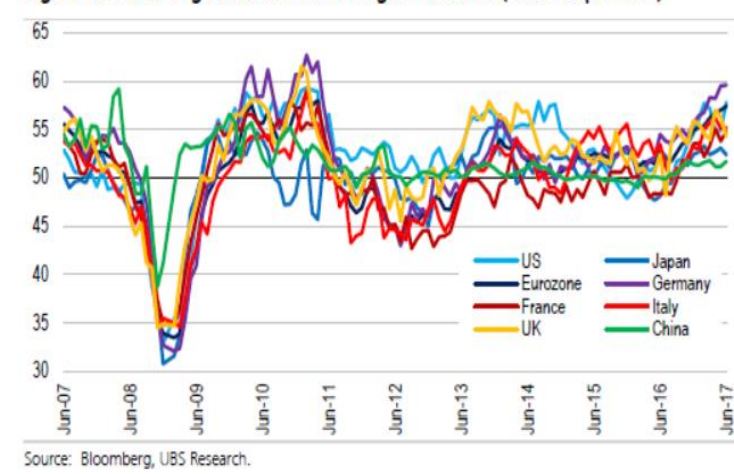
- 1 The “global synchronised recovery” continues. All OECD countries (except Australia and Switzerland) have seen GDP upgrades in the last 12 months
- 2 Inflation remains subdued in most countries, but there is evidence of tightening labour markets which is likely to lead to wage inflation
- 3 Generally, those economies that did worse in the GFC are enjoying the most sustainable current economic momentum. The Australian economy appears to be losing momentum relative to other developed, highly levered economies with high house prices (e.g. Canada, Sweden, New Zealand, Norway)

*How are we positioned?*

- 1 **Synchrony Financial.** Differentiated business model in US consumer credit, high ROE, good growth, cheap valuation
- 2 **Provident Financial.** Opportunity to buy a high quality business following two profit warnings
- 3 Short **Bankia.** Company will find it very hard to grow revenues as a half of pre-tax profit is Sovereign bond carry trade, which is falling as European peripheral government spreads tighten.

## MOST LARGE ECONOMIES ARE EXPANDING

Figure 1: Selected global manufacturing PMI indices (>50 = expansion)



### LONG



PFG | Provident  
Financial Group

Henderson  
GLOBAL INVESTORS

synchrony  
FINANCIAL

### SHORT

Bankia



TRAVELERS



# Consumer

## *Sector is expensive with limited pockets of growth*

- 1 High-quality consumer companies are fully priced, while challenged retailers represent crowded short opportunities
- 2 Online is structurally changing the retail landscape, half of online sales growth is being captured by Amazon. Online comes at a high cost to traditional bricks & mortar retailers
- 3 Consumer packaged goods companies are on the wrong side of health and wellness trends and are challenged by new local competitors that are able to bootstrap their businesses by exploiting online reviews and new distribution channels

## *How we are positioned*

- 1 **Woolworths** Winning significant market share in grocery, best in class liquor business, and optionality around Big W turnaround or disposal.
- 2 **H&M** (Short) Aggressive store rollout, deteriorating store economics, unclear economics of online sales
- 3 **The Star** Sydney and Gold Coast casinos outperforming their local markets, VIP players are returning to Australia, capital efficient expansion plan to deliver further growth



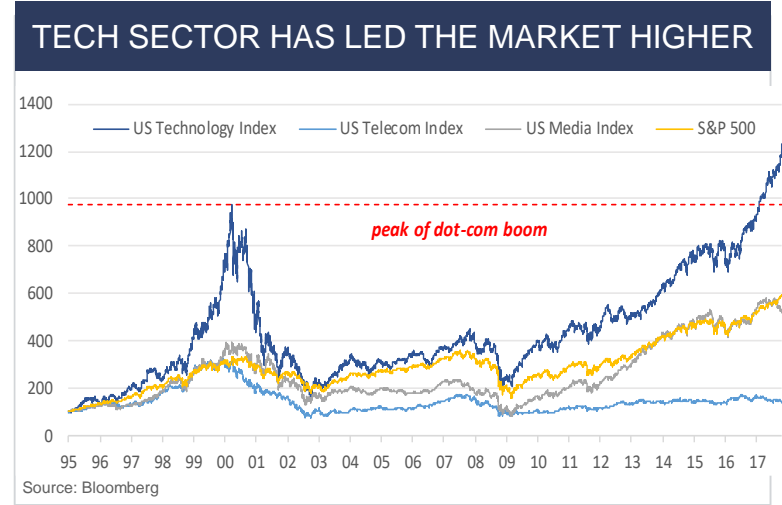
# Technology-Media & Internet-Telecom (TMT)

*Tech is leading the market; media/telco struggling*

- 1 Structural growth across key industrial, auto and consumer end markets is buoying semiconductor demand. Software and Internet shares move from strength to strength.
- 2 Structural pressures remain in media as digital share of ad spend rises. Content remains king, but competition is heating up as distribution companies move upstream to protect margins.
- 3 Telcos are struggling as broadband and mobile penetration matures, deflationary trends continue in shift from voice to data. Convergence across mobile/broadband/content is accelerating.

*How we are positioned*

- 1 Long analog semis exposed to content growth. Short logic as shift to cloud drives down returns.
- 2 Long undervalued content – video games and music. Short vulnerable media agencies and broadcast networks.
- 3 Long telcos in ‘recovering’ markets and short telcos which are overearning or under competitive threat.



# Healthcare

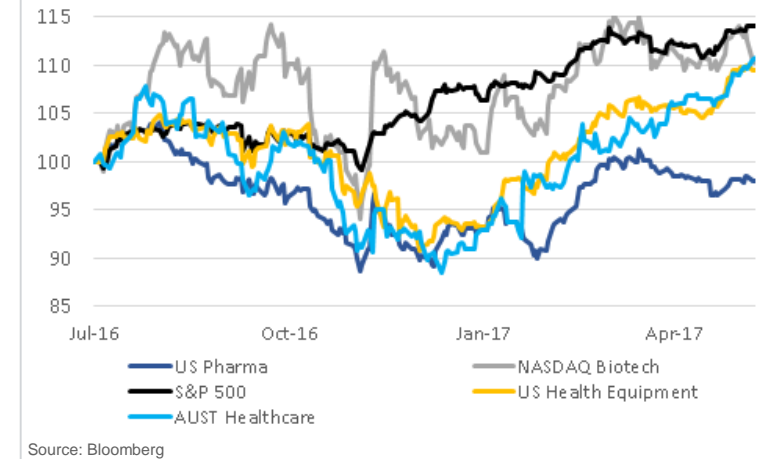
*Drug pricing remains the key risk, competition is fierce*

- 1 Global healthcare is a broad investment universe with defensive and cyclical subsectors. Volatility and subsector divergences more pronounced recently
- 2 Biopharma becoming more competitive, advances in biotechnology allows 'fast followers' to accelerate development of 'me too' drugs. Drug price headwinds (consolidation of US payers/PBMs) remains a key risk
- 3 Medical Devices, Managed Care and Life Sciences are 'safe havens' with stable growth and capital management upside

*How we are positioned*

- 1 **Longs:** Merck, leader in immuno-oncology, recent concerns overdone. Ramsay, a quality operator unloved right now.
- 2 **Shorts:** Lilly, diabetes exposure (pricing pressure), pipeline skew to highly competitive indications. Grifols peak multiples, 4.3x levered, disadvantaged portfolio, no room for error
- 3 Long businesses with large competitive moats (Ramsay) and emerging biotech. Short large pharma, levered service providers

## PHARMA LAGS, DEVICES & BIOTECH AHEAD



LONG	SHORT
	
	
	

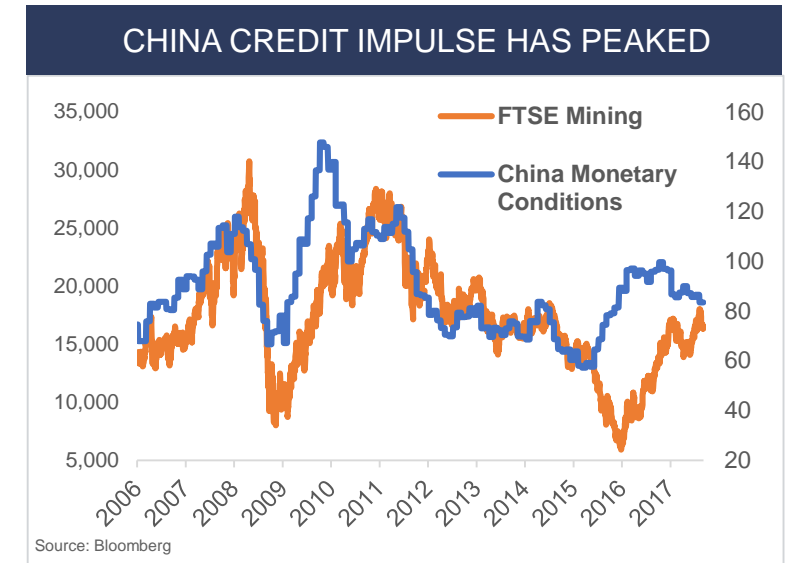
# Basic Industries

## Basic Industries benefitting from global demand

- 1 Tighter credit conditions in China will impact demand in 2018 – however supply side reforms are assisting some commodities.
- 2 Global crude inventory draws suggest a rebalancing in the oil markets pushing Brent above \$60/barrel for the first time in two years.
- 3 High electricity prices have led to regulatory uncertainty in wholesale and retail energy markets.

## *How we are positioned*

- 1 We are neutral the mining sector as China continues to cool. We are long BHP due to Oil optionality and continual pressure for improved performance.
- 2 We are neutral the Energy sector, having been net long before reducing our position in Anadarko as the company announced a buyback.
- 3 We are balanced in utilities preferring turnaround stories such as E.On, and having a preference for transmission over distribution.



# Industrials

## *Industrial recovery accompanied by winners & losers*

- 1 Industrial conglomerates' performance differentiated by cost cutting and efficiency of capital allocation.
- 2 Aerospace industry seeing solid growth from continued increase in global air traffic.
- 3 Some leading franchises available in Australia (eg. Brambles), opportunities from significant valuation dispersion in sector.

## *How we are positioned*

- 1 **Honeywell** – industrial powerhouse benefitting from restructuring and growth in aerospace industry, capital allocation has added value. **Emerson** – leader in process automation, however capital allocation has destroyed value.
- 2 **Safran** – leader in aerospace components, LEAP engine gaining share (jv with GE). **Rolls Royce** – strong technology, but inefficient manufacturer, valuation optimistic.
- 3 **Brambles** – global leader in growing market of supply chain outsourcing (pallet pooling). **Sandvik** – machine tool bit demand undermined by new materials, optimistic valuation.

## INDUSTRIAL RECOVERY, RISKS REMAIN



### LONG

**Honeywell**

**SAFRAN**

**Brambles**

### SHORT

**EMERSON**

**Rolls-Royce**

**SANDVIK**



# Summary

- Challenges in FY17 arising from a growing business have been addressed
- The investment team is well-equipped to deliver stronger returns in FY18
- While markets have proven resilient, valuations are stretched and risks for shares remain elevated
- The Australian economy faces a further challenge if the property market falls
- Hedging strategies are more relevant than ever as this market cycle completes

# Thank You QUESTIONS?

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