WATERMARK ABSOLUTE RETURN FUND

Monthly update – July 2021

APIR ETL8732AU
APIR ETL5025AU

WATERMARK FUNDS MANAGEMENT

FUND AT A GLANCE

Fund Strategy	Variable Beta
Benchmark	RBA Cash Rate
WARF Ord.Unit NAV	$1.062
WARF Ord.Unit Applic/Redeem	$1.065/1.059
WARF B Class NAV (Ex ALF)	$1.011
WARF B Class Redeem	$0.991

PORTFOLIO CONSTRUCTION

No. Long Positions	100
No. Short Positions	85
Gross Exposure	170.8%
Net Exposure	3.4%
Funds in Strategy	138M

GROSS PORTFOLIO STRUCTURE

Investment Type	%
Listed Securities – Long	87.1
Listed Securities – Short	-83.7
Cash	96.6

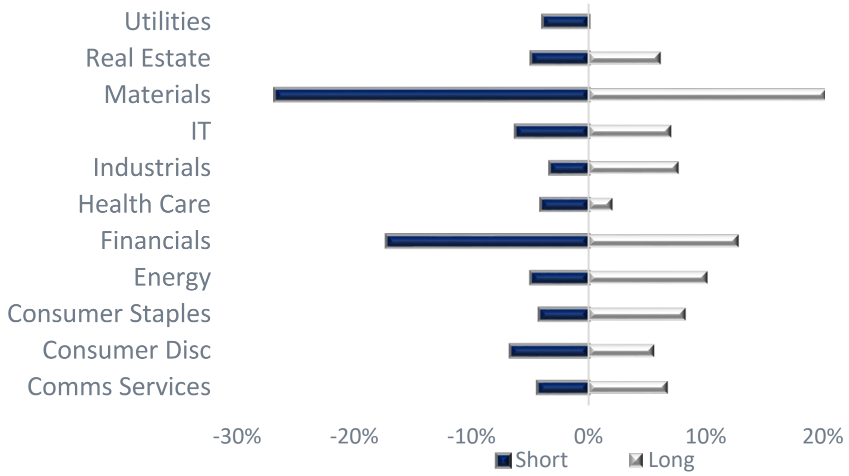
CONTRIBUTION

Top	Bottom
Incitec Pivot	Western Areas
Platinum	Capricorn Metals
AGL Energy	Syrah Resources

TOP 10 LONG HOLDINGS

- Coles
- Incitec Pivot
- James Hardie
- Northern Star
- Telstra
- Viva Energy
- Pendal
- Suncorp
- Perseus
- A2 Milk

SECTOR EXPOSURES



KEY RISK INDICATORS

Beta	Volatility	Information Ratio
0.00	5.47%	0.44

MONTHLY NET PERFORMANCE (%)

	1 Month	3 Months	FYTD	*Inception (pa)
WARF Ord Unit (Established May 2019)	0.7	-2.3	0.7	9.7
RBA Cash Rate	0.0	0.0	0.0	3.4
Outperformance	**0.7**	**-2.3**	**0.7**	**6.3**
	1 Month	**3 Months**	**FYTD**	***Inception (pa)**
WARF B Unit (Established 26 March 2021)	1.0	-2.3	1.0	9.8
RBA Cash Rate	0.0	0.0	0.0	3.4
Outperformance	**1.0**	**-2.3**	**1.0**	**6.4**

**Historic returns from ALF:ASX- same variable beta strategy established in 2004*

Difference in monthly returns based on fee structure (B class –no management fee charged in first 12months of issue) and high watermarks for calculation of performance fees. Past performance is not an indicator of future performance.

DISTRIBUTION POLICY

The Watermark Absolute Return Fund (the "Fund") will look to distribute income semi-annually at the end of June and December each year. As an unlisted unit trust, the Fund is required to distribute all taxable income at the end of each financial year.

The manager has set a return objective of between 8-10% p.a. This is a return target, not a forecast. Please refer to the return history at the end of this report as a guide. The target return comprises both realised and unrealised gains. The Fund would typically turnover each year, most of the income generated throughout the reporting period should be realised, and therefore available for distribution to unitholders.

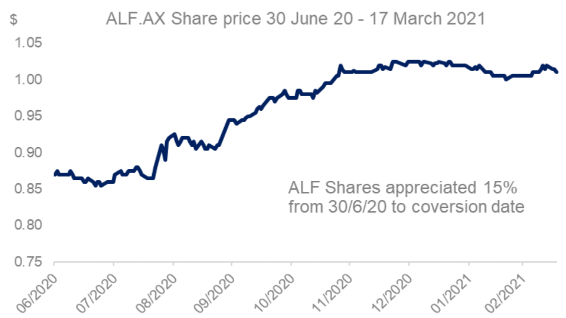
As the Fund does not pay tax on these gains, franking attached to distributions is limited to the franking received on its dividends income. There was no realised income in the final quarter of the 2021 financial year, the Fund did not declare a final distribution for the June period.

The Fund will aim to pay a distribution as soon as there is sufficient realised income to distribute and so far, has generated positive returns in July and August of the new financial year. The Manager will look to distribute the realised portion of these profits once they have accumulated to an appropriate amount.

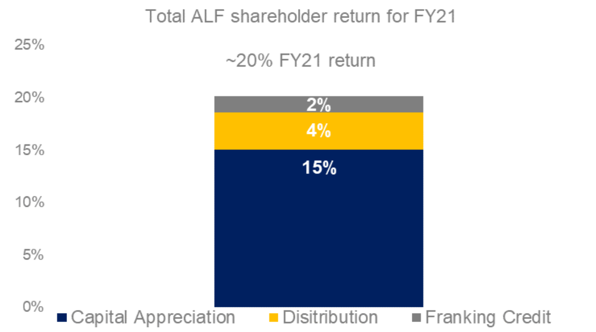
WARF B Class units (ALF:ASX shareholders)

Reviewing the 2021 financial year performance we highlight the Total Shareholder Return (TSR) that ALF investors realised in 2021. ALF shareholders started the year with shares trading at 87.5c and closed the year with B Class units with a Net Asset Value (NAV) of $1.001. Alongside this they received a 3.1c dividend with a franking credit of 1.3c. Putting the capital appreciation and grossed up distribution together ALF/Class B holders achieved a 20.1% TSR for FY21.

ALF shareholders benefited from the discount to NAV closing



Total shareholder return based on ALF share price 30 June 2020



MONTH IN REVIEW

The Australian Share market rose for the tenth consecutive month in July with the All Ords up 1.1%. Leadership switched back to the ***Materials*** sector as commodity prices rose and companies reported strong 4Q results. The ***Technology*** sector was the worst performer, again impacted by a return of inflation concerns.

The Watermark portfolio started FY22 with a solid month, up 0.7% (net of fees). Our annual return target is 8-10% alpha, irrespective of market volatility. The portfolio was aided by leverage to the strength in ***Resources*** stocks and our short positions in ***Financials***, specifically the fund managers. From a stock perspective, the fund benefited from its long position in *Incitec Pivot (IPL)* as the company released a positive trading update. The fund also benefited from its short position in *AGL* as further issues with its demerger emerged.

MARKET OUTLOOK

Broader share indexes continue to consolidate as macroeconomic indicators normalise. Growth is decelerating faster than expected as the health crisis flairs up again with the Delta Variant of COVID. Bond and currency markets have rallied on the back of this, while equities have shown remarkable resilience in the face of these headwinds.

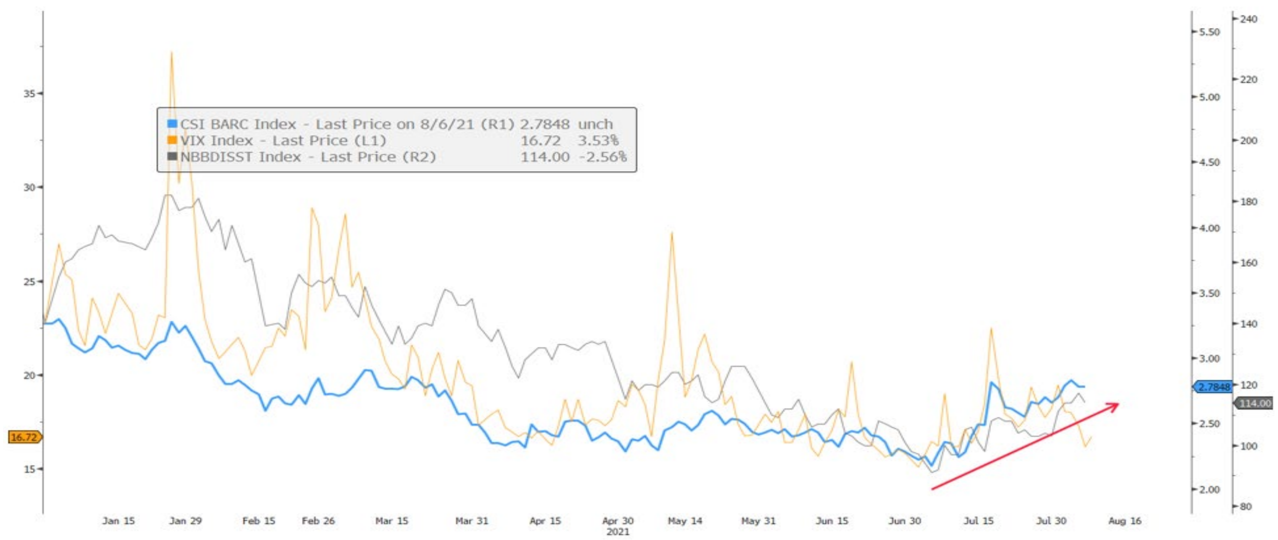
Fig 1: Russell 2000 Index- broader equity indexes have consolidated last years gains

Source: Bloomberg

The S&P 500 with its heavy weighting to technology, has managed to squeeze higher on strong results from the tech leaders. The Australian share market has also surprised us, particularly given the heavy exposure to reflation sectors, banks, and resources. While 'small caps', domestic cyclicals and banks have struggled, the market has pushed higher in recent weeks led by resources.

Risk indicators in credit markets have also turned up, as default rates have ticked higher and risk margins have widened as stimulus has been withdrawn ***(Fig 2)***. Even the VIX- a volatility indicator for equities, is lifting again. A correction in equities is well overdue, traders, retail investors and hedge funds are all fully committed - now would be a timely reminder that shares can fall.

Fig 2: Credit spreads and risk indicators are starting to move higher again



Source: Bloomberg

While the financial results for US companies that have recently reported were strong with 80% of securities meeting or beating market forecasts, the companies that beats estimates on average fell by 1% the day of the result, indicating these strong results have been factored into elevated prices. June quarter profits are backward looking of course, forward guidance was on the softer side reflecting the deceleration taking place as Delta rages.

With the good news in the results delivered and economies slowing with Delta, a much overdue set back in shares into late August/early September is still considered likely. The window for a set-back is closing, bond yields already look to have successfully re-tested recent lows and the rally in bonds is now behind us as fixed interest investors look to economies to re-opening again in Q4.

Mining shares - the leading edge of the reflation trade, also appear to have bottomed in June. The only missing piece is one last rally in the US dollar and a correction in broader equities before all the reflation/value sectors start trading higher again into Q4 leading share markets higher.

As we enter the Australian profit reporting season, most of the capital cities are in lock down so again the results will be backward looking. In the main we are expecting strong results across the board. Given the strong market performance leading into results we may end up following the offshore lead with shares consolidating recent gains as reported.

The Australia's COVID elimination strategy now looks to have backfired given low vaccination rates. Health officials in economies more advanced with vaccinations are suggesting we need 90% of the population vaccinated for herd immunity to be attained, a long way from where we currently are, suggesting rolling lock downs maybe here to stay for another 6 months at least.

SECTORS IN REVIEW

The Australian ***Consumer*** sector has benefited through COVID from excessive government stimulus and a redirection of spending from services in favour of durable goods. While lockdowns have remerged in Australia in recent months, the medium-term trend toward reopening will remain a headwind for the listed retail sector in the year ahead. As the vaccine program accelerates and international boarders ultimately open, household spending will pivot back to the services sector away from consumer durable categories. As such, we see significant opportunity for our short book as this transitionary spending rolls off and weaker businesses once again, show their true colour. The challenge is getting the timing right.

Our ***Consumer Discretionary*** short position is yet to deliver a meaningful return for the portfolio. Delays in the vaccine rollout have pushed out a return to international travel and therefore increases the likelihood of a stronger Christmas trading period as consumers spend more domestically. We remain nimble in our positioning in this sector given the continually shifting environment.

In ***Consumer Staples,*** we have held a long position in supermarkets reflecting the lockdowns and the increasing likelihood of a strong domestic Christmas. We are long *Coles (COL)*, which appears to be demonstrating improved trading relative to *Woolworths (WOW)* in recent months. Having said that, Supermarket valuations are getting to excessive levels.

July was a rollercoaster ride for our position in *A2 Milk (A2M)*. The stock performed very strongly on the back of improving pricing data, however, gave most of that back in late July via an indiscriminate sell-off of many China-related stocks. The key concern driving the sell-off was the fear of increased regulatory intervention from Chinese authorities to curb the cost of raising children. While some commentators have suggested a price cap on infant formula might be introduced, this ignores the fact that the category is very competitive and already offers quality brands over a range of price points, including very cheap domestic products. Installing a price cap would be unlikely to lower the cost of child rearing for the middle-class but would certainly reduce choice for the increasing number of Chinese consumers that do seek premium formula for their children. As is the case with most turnarounds, it pays to be patient.

Financials had a sound July; we used a short position in the banks to fund investments across other sectors. Key contributors were *Janus Henderson* (*JHG*), *Goodman Group* (*GMG*) and fintech *8Common* (8CO).

JHG delivered a solid June quarter result, beating ours and consensus expectations, largely driven by performance fees. We expect the improved performance to support better flows in the medium term. We still see value in the stock as it trades on a 10x next years earnings.

GMG continues to push all-time highs. As long-term yields compress, investors rotate into defensive, income and growth. *GMG* fits each of these parameters it's been well supported over the month. We consider Goodman a class act and expect reliable compounding earnings growth over a long-term horizon.

8CO announced that its Expense8 software has been selected as the exclusive expense management module for the Australian Government. We estimate the deal could add up to $7m of incremental recurring revenue to the $2.5m of group SaaS revenue reported in FY21. Winning a contract of this calibre against global expense management players shows *8CO* is in good stead for its large pipeline in core and new products.

Building Materials: *James Hardie (JHX*) had another stellar result as US housing activity continues to strengthen, we retain this core name. *Seven Group (SVW)* have ended up controlling *Boral (BLD)* shares probably struggle from here.

Healthcare: Our preference has been for domestic healthcare- *Integral Diagnostics (IDX)* and *Virtus Health* (*VRT)*, the offshore device names are too expensive.

Utilities: *AGL* continues to struggle as power prices come under further pressure. While a split of the business is in shareholders' best interests it will come at a significant cost.

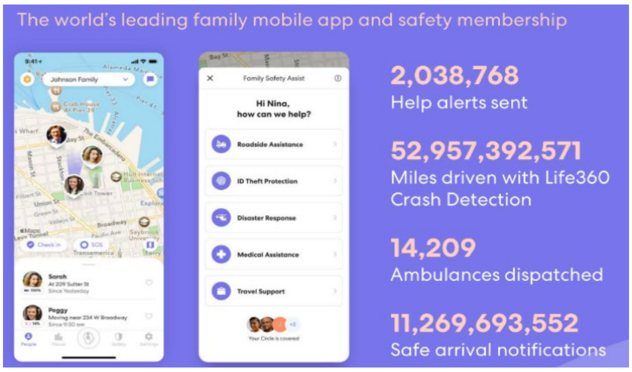
Resources: We have moved to a short position in Iron Ore names as prices peak and Chinese activity slows in the second half of the year. Lithium names continue to advance as Spodumene prices tighten further, we have added *Ioneer (INR)* and *Orocobre (ORE)* to the portfolio. In base metals, copper producers are consolidating ahead of the next major move higher- we have positions in emerging producers *Cyprium Metals (CYM)* and *Peel Mining (PEX)*.

IDEA IN FOCUS Life360 (ASX:360)

At Watermark we love uncovering falling angels. This is typically a market favourite that lands itself in the fund manager sinbin after lofty expectations. Some investors simply label the business as broken and will exit at any opportunity. These situations allow you to keep accumulating stock cheaply, even when the company has turned a corner and is exceeding established milestones. One such opportunity has been *Life360 (360)*, a family location tracking application with more than 32 million active users.

Overview

360 is a family tracking phone application. It allows family members to principally monitor location, driving safety and communicate amongst their family circle. Beyond this *360* is integrating whole-of-life cycle family products, such as insurance, and debit cards for children. Its premium subscription already includes roadside assistance similar to that offered by NRMA or RACV in Australia. It is the market leader in its field with more than 32 million active users.



History

360 listed at $4.79 and after some short-lived fanfare it would continue to trade under its IPO price for nearly two years, only passing it back in March. It's now nearly doubled this hurdle in the past 3 months. We think the key misunderstanding from Australian investors was that phone-based Apps have high churn rates. We are normally accustomed to sticky Software-As-A-Service (SAAS) companies such as *Xero (XRO)* and *Wisetech (WTC)*. Whereas in phone application-based software such as *360*, high churn is just a factor of life, this has been seen on other listed phone apps such as the dating app *Bumble*.

Growth Momentum pre and post covid

Covid has been a significant headwind for 360, with families in stay-at-home mode seeing little value in a tracking each other. This led to a lower than normal 20% revenue growth in calendar year 2020. Even with covid and high churn rates, 360 has grown Annualised Recurring Revenue (ARR) from $45m when it listed in 2018 to its $120m+ that it has guided to this calendar year. This is a 3-year compounded rate of 38%. It is the clear category leader. These kinds of growth rates from a market leader and give us confidence that *360* will assert dominance the family location market.

All-star investment series

We maintain that high calibre strategic partnerships only happen to high calibre companies, as such it further supports our conviction in *360*. Recently a number of high-profile investors joined the register, names included Vanessa Bryant (wife of the late Kobe Bryant), Tony Hawk (professional skateboarder), Nicole and Michael Phelps (Olympic swimmer). They have agreed to also establish an advisory council to execute on the product and marketing strategy

Conclusion

With US reopening and increasing mobility Life360 has tailwinds abound. It still trades on a relatively cheap 6x Price to sales multiple. This is compared to Bumble, its closest peer in the US which trades on 11x price to sales. With better growth forecasted than Bumble, we think *360* is only beginning its rerate. *360* has stated intention to list on the NASDAQ which we see as another catalyst for this disparity to narrow

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MONTHLY NET PERFORMANCE (%) *

YEAR	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY04								0.3	1.1	0.2	0.0	1.8	3.4
FY05	1.0	-0.3	3.7	2.3	3.6	2.0	0.3	1.0	-0.7	-4.9	-0.4	3.9	11.7
FY06	2.0	2.2	3.9	-2.3	3.1	3.1	1.3	1.6	5.3	2.7	-1.0	0.9	25.0
FY07	-3.1	4.4	1.8	6.3	2.5	2.0	2.8	-1.7	2.8	1.1	2.2	1.8	25.0
FY08	-1.0	4.1	2.5	0.8	-0.1	-1.4	-11.7	-8.3	1.4	4.4	1.5	-7.1	-15.1
FY09	-1.1	5.3	-5.2	-16.0	-6.3	3.2	2.5	3.1	16.2	7.3	10.1	7.1	24.5
FY10	9.3	11.2	6.0	0.1	0.5	-0.5	-2.3	1.9	3.5	-1.7	-5.7	-1.9	20.8
FY11	2.9	-3.8	2.4	0.1	2.7	10.8	2.2	1.7	3.6	2.0	-1.2	-1.3	23.6
FY12	-4.0	-6.7	-8.3	6.5	-1.3	1.0	5.0	4.8	3.8	0.9	-2.3	0.8	-1.0
FY13	3.8	4.2	0.0	-1.2	6.7	3.0	2.7	1.2	3.0	2.2	1.6	2.9	34.2
FY14	3.9	3.6	2.9	3.7	-0.2	-0.1	0.4	3.1	-1.3	2.4	1.1	0.6	21.8
FY15	-3.6	-2.4	1.4	-1.2	-2.5	-1.1	-1.2	1.0	3.0	0.8	-0.5	3.1	-3.5
FY16	3.8	4.6	1.9	-2.1	0.6	2.6	0.4	-2.6	1.8	-1.0	1.7	1.8	13.9
FY17	-0.3	-0.6	3.9	-0.5	-0.9	-0.2	-0.7	-0.1	0.2	1.2	0.8	-0.5	2.3
FY18	0.2	-1.9	-0.4	-3.1	1.3	0.1	-0.6	0.7	0.9	0.9	0.0	-0.6	-2.4
FY19	3.0	-2.0	0.2	-2.0	-2.9	-1.4	0.5	0.7	-0.9	-2.3	-0.6%	**1.1**	**-6.6**
FY20	**2.1**	**1.5**	**-0.5**	**1.6**	**-0.4**	**-0.1**	**0.7**	**-1.1**	**-2.4**	**0.9**	**-0.7**	**-1.2**	**0.3**
FY21	**1.2**	**1.1**	**0.1**	**1.4**	**2.8**	**-1.1**	**0.8**	**3.9**	**-1.1**	**1.0**	**-0.5**	**-2.4**	**7.0**
FY22	**0.7**												**0.7**

**Historic returns from ALF:ASX- same variable beta strategy established in 2004. Past performance is not an indicator of future performance.*

MANAGING YOUR INVESTMENT

To view details of your investment such as your transaction history and distribution payments, please register via the secure portal (investorserve.com.au) operated by Boardroom Pty Limited.

The Fund is priced monthly, on or around the 6th business day of each month. Boardroom Limited, who manage the unit registry for the Fund, will accept applications and redemptions up until 2pm on the last day of the month.

In the first 12 months of B Class units issued, there will be no base management fee however a withdrawal fee will apply to those who redeem up until 26/03/2022, please refer to PDS for more information.

WARF Application and Redemption forms can be found on our website wfunds.com.au, once completed please return to watermark@boardroomlimited.com.au.
Product Disclosure Statement Watermark Absolute Return Fund ETL8732AU PDS & ETL5025AU PDS

For further information about the InvestorServe portal or queries regarding your holding, please contact Boardroom Limited 1300 005 027 (in Australia) +61 2 8023 5474 (international) or email watermark@boardroomlimted.com.au.

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