



The Leading Edge

QUARTERLY REPORT • June 2019

Level 23, Governor Phillip Tower, Sydney NSW 2000

TEL (02) 9252 0225 • info@wfunds.com.au • www.wfunds.com.au

This report has been prepared by Watermark Funds Management Pty Limited.

This report is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. The report should not be regarded by recipients as a substitute for the exercise of their own judgement. Any opinions expressed in this report are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. Watermark Funds Management Pty Limited is under no obligation to update or keep current the information contained herein. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.



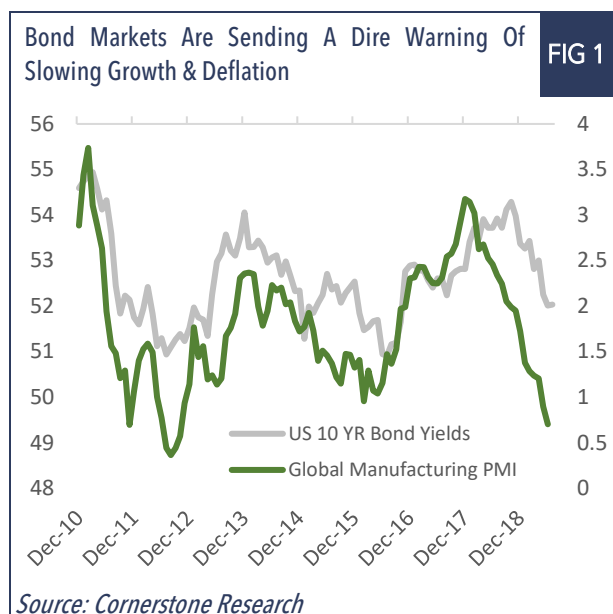
Justin Braitling
Portfolio Manager

Message from the CIO

It is fitting that the All Ordinaries Index is testing its all-time high, as I suspect a significant peak in risk assets is imminent. The internal health of this bull market in shares has deteriorated significantly in recent weeks as the leadership has narrowed to just a few sectors. Many offshore indices already look to have peaked, particularly those that track industrial and smaller companies.

This distributive pattern of sector returns is typical of a market top, suggesting this bull is very tied and that there is insufficient fuel in the tank to propel the market higher. Given a backdrop of decelerating global growth and a market desperately trying to hold onto large gains, we see a repeat of last year unfolding in the months ahead, where shares fall in the second half of the year.

Only time will tell whether this ends up being another mid-cycle pause, or a curtain call for this business cycle. I suspect the next global recession is still beyond the immediate horizon, so we are likely to see a replay of what happened in 2018 in the second half of this year, before shares stage one last rally next year to close out this cycle.



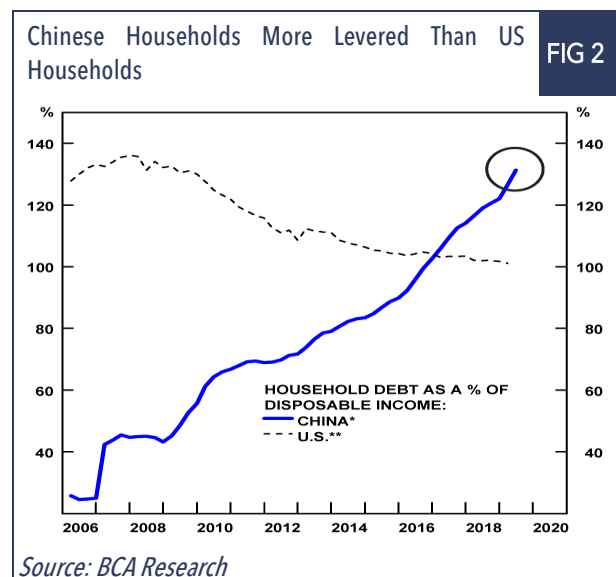
Bond and Commodity markets are signalling trouble ahead for the global economy. Fig 1 above shows the

clear relationship between economic conditions (Global PMI) and 10-year US treasuries. Narrowing our focus to forward orders, activity should continue to slow through the balance of this year. By year-end, US manufacturing is likely to be in outright contraction, as is Germany today.

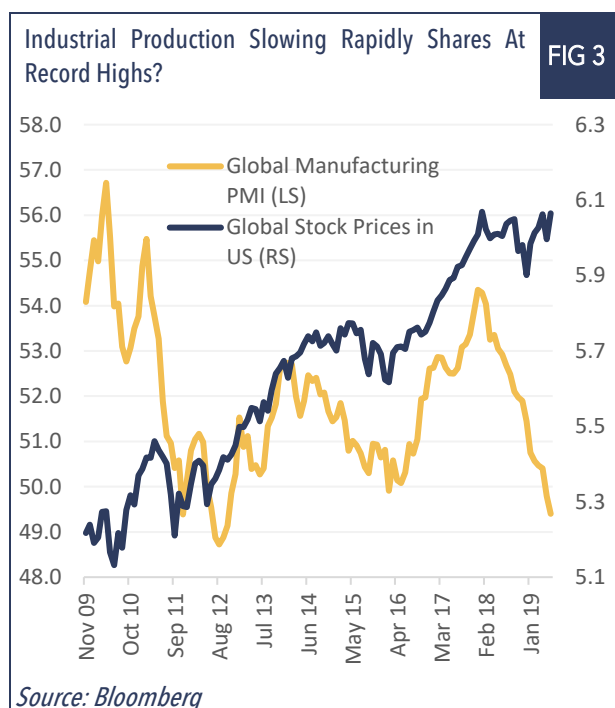
The global economy is expected to expand by \$3 trillion this year; China alone accounts for fully 1/3rd of this. Its overall influence on growth is even greater, given its pivotal role in global trade and the impact it has on major exporting nations. Asian export volumes to China are currently falling at 10% YoY. Germany, the export powerhouse of Europe, has just reported a dismal PMI of 43 (the lowest in years), principally because of weakness in China; its largest customer. Of all the major economies, the US is least exposed to China, a key reason why growth has been so resilient.

This slowing in global activity is, of course, having a meaningful impact on corporate profitability, with profits for US companies contracting in the second quarter. Expectations for the second half are still far too high, and profit forecasts will need to be lowered as we progress through the year.

Investors have looked through all this and instead, have followed the money, with Central Banks everywhere lowering rates once again. They live in the hope that growth will pick up again later in the year. China, as already stated, is a big piece of this puzzle. So far, the Chinese economy has failed to respond to the numerous policy measures taken to stabilise growth. As with western economies, the efficacy of incremental doses of stimulus may be waning, potentially due to the excessive levels of embedded debt in the economy. Chinese households are now more levered than those in the US (Fig 2).



Meanwhile, investors in shares seem to be reading from a different hymn sheet with major indices reaching all-time highs. Rarely do you see such diametrically opposed views on the outlook for risk assets between bond and equity investors. Historically, the price signal from the bond market has been the right one to back.



Turning to the domestic outlook, the federal election result was clearly a Black Swan event that caught everyone offside, including institutional investors. Leading up to the election, the domestic economy was losing momentum rather quickly in expectation of a raft of less-than-friendly Labor policies. While confidence has clearly improved post the election, supported by two interest rate cuts and the prospect of tax rebates in the fourth quarter, this has yet to translate into stronger trading conditions. Retailers generally, are reporting weak trading conditions. In housing, auction clearance rates have picked up, but the litmus test will be the spring selling season, when new listings come back on the market. Credit continues to be tight in spite of macroprudential easing. While the RBA has indicated it is ready to cut rates further if required, it becomes harder for banks to pass these on as rates move lower.

The saving grace for the domestic economy is the resurgence in terms of trade, filling the government coffers and providing a much-needed boost to the economy. As we move back to a trade surplus, the government is once again contemplating a fiscal surplus, as early as next year.

Investors should consider the implications of the sharp fall in Australian Commonwealth Government bond yields, which have collapsed in recent months. As interest rates fall across the curve, capital markets are suggesting there are very real and powerful deflationary forces at play, not just globally but in the Australian economy as well. The RBA has certainly stood up and listened, moving decisively to lower rates, having held them steady for 7 years.

Portfolio Review

As with markets offshore, the local share market has responded positively to lower interest rates. Cyclical shares in housing and retail have rallied in recent months as investors look through the valley to stronger trading conditions next year. Time will tell whether this comes to pass. We are more circumspect, with the fund tilted toward more defensive parts of the market such as utilities, infrastructure and staples.

While we are more cautious on cyclical sectors, James Hardie Industries has de-rated significantly and US housing starts should recover now that mortgage rates have fallen. Local suppliers of building products GWA, Adelaide Brighton and CSR will find it tougher in the months ahead with detached housing starts down 10% YoY. Digital real estate sites REA Group and Domain Holdings are also likely to report disappointing results, given the collapse in property listings.

In retail, homeware suppliers Harvey Norman, Breville and Nick Scali will also find it tough in the months ahead. We like Baby Bunting as it is benefiting from industry consolidation and has an exciting roll out ahead of it. In other discretionary spending segments - GUD Holdings, EVENTS and Corporate Travel will struggle. Of course, we have to have some cyclical exposures and we feel Flight Centre and Nine Entertainment are both attractively priced and are creating value for shareholders.

In Technology, we like Xero Ltd, Bravura Solutions and soon to list Fineos - a leading provider of software solutions to Life, Accident & Health insurers globally. Next DC, a leading data centre provider with strong connectivity in key data gateways is benefitting from the rapid roll-out of hyperscale computing. As valuations in Technology are over-extended, we have hedged these

exposures by shorting tech companies that we believe will disappoint lofty expectations.

In the Industrial heartland, we think Downer and Caltex both offer excellent value. Turning to the defensive parts of the share market where we are overweight, we retain our preference for infrastructure and staples. While valuations are also looking stretched, we feel bonds yields can fall further and that these bond proxies can still perform. Sydney Airport, APA Group and Qube are unregulated monopoly-like assets. In a deflationary environment, the ability to take price is invaluable. We have hedged these with AGL Energy - the company faces a raft of challenges as pool prices in the NEM fall, as renewable projects are commissioned and fuel costs increase on renewal. While the political scrutiny around power prices has eased, it won't disappear any time soon.

The drought has depressed profits in the bush, but with recent rains, the prospect of a prolonged drought has eased. Elders, Select Harvest, and Australian Agriculture are cheap and well-positioned to participate in a recovery. Costa Group and Tassal Group are challenged by excess supply and poor yields, respectively.

In packaging, Orora and Amcor are both challenged by rising manufacturing costs and shifting consumer preferences away from plastics. Brambles Limited on the other hand, should benefit from an improvement in margins for its CHEP pallets business in the US. As it continues to drive strong growth in Europe, the capital recycling from the sale of IFCO should also further support earnings.

In Healthcare, an acute global shortage of plasma-derived IG (immunoglobulin) puts CSL Ltd in the box seat. The Seqirus flu business it bought from Novartis is also hitting its straps and is looking at strong growth in the next few years at least. Cochlear has lost significant share in cochlear implants, having trailed in the launch of an MRI ready device. In our view, investors are too confident in the company's ability to recover this lost share. I suspect Ansell Ltd will also be under pressure given the deceleration in manufacturing activity we see globally. Automotive is one of its largest segments and the trade dispute has disrupted the supply chain.

In staples, Woolworths continues to execute well while newly listed Coles has a long way to go, having underinvested in recent years. Wesfarmers may also find

trading conditions tougher as softer home improvement volumes impact Bunnings. Elsewhere in Consumer, we like PointsBet an Australian based sports betting platform that is launching into multiple US states as sports betting is legalised.

We remain cautious on the major trading banks. Like their peers offshore, they will struggle in a deflationary environment. Fees and margins continue to come under pressure and credit growth is unlikely to reaccelerate given the scale of household indebtedness. We are very excited by the management changes taking place at National Australia Bank (the largest position across our portfolios) and believe the market will underestimate the improvement here, as a seasoned banker takes the reins at a perennial underperformer. In Insurance, we are long QBE Limited. As the insurance cycle hardens, the domestic general insurers are expensive and are likely to disappoint at forthcoming results. The Private Health Insurers are ridiculously valued and offer little growth. Steadfast Group continues to benefit from strong premium growth and ongoing consolidation within its agent network.

In Diversified Financials, we are cautious on Computershare - as interest rates fall, the margin it achieves on the cash float comes under pressure. It also has some serious headwinds in the UK while the best years of growth in mortgage servicing are behind us (margins also come under pressure as mortgage refinancing increases). Every investor is looking for exposure to undervalued infrastructure and the best way to play this is through the global leader in infrastructure finance - Macquarie Bank. The embedded profits in the asset management business only improve as bond yields fall, ensuring ongoing performance fees in the years ahead.

Elsewhere in the payments space, we continue to like Afterpay; the Buy Now Pay Later platform is scaling well-ahead of expectations in multiple countries. EML Payments will offer payment solutions to corporate bookmakers who launch in the US, as sports betting is legalised. It already has existing relationships with these key players in Australia and the UK, so it will follow its clients' success as the market opens.

In Resources, the major diversified miners have rocketed higher along with iron ore prices. These companies have

returned much of this windfall to investors as dividends, which has been well received. This may have run its course though, and recent events suggest the majors may have underinvested in recent years, with some struggling to sustain production. Gold is a good example of a sector that has been underinvested in. We can see the gold price moving higher in the medium term. As the yield on bonds fall (they are negative in many countries) the case for holding gold as a hedge against deflating fiat currencies improves. There has also been chronic underinvestment in reserve replacement, which sets us up for much higher prices in the longer term.

The Oil and Gas sector is struggling in spite of a firming oil price as spot LNG has fallen in an oversupplied market. The larger LNG producers will struggle as they look to recontract on less favourable terms. Woodside is challenged here, while Santos is less exposed and benefits from high East Coast gas prices. Origin should also do better with the strong cash flows coming out of APLNG.

The share market continues to look grossly overvalued. On our valuation metrics, industrial shares are three standard deviations above historical valuation metrics - this is bubble territory. We retain a fully hedged position on this basis. In our directional funds will look to get short at the appropriate time to benefit from a falling market.

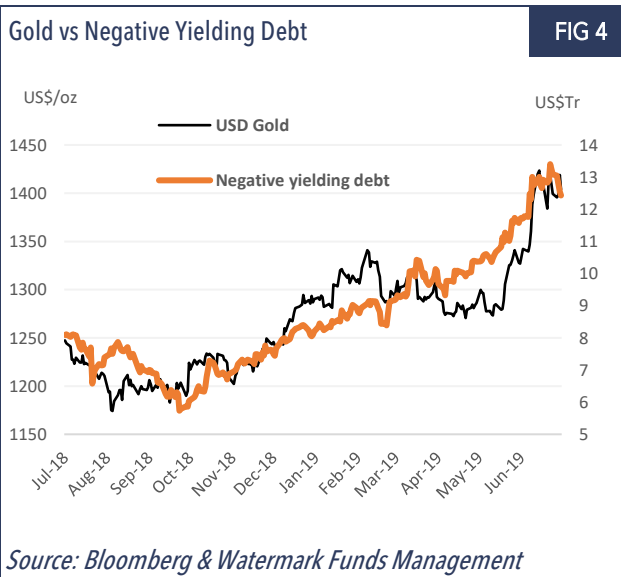
PORTFOLIO REVIEW

Basic Industries

Trade tensions, supply disruptions and interest rates were the key drivers of the mining sector during the second quarter. The base metals (copper, aluminium, nickel, zinc) traded lower on softening demand and the ongoing US-Sino trade dispute. Iron ore climbed higher on elevated demand from the Chinese steel sector and tight supplies following mine disruptions in Brazil. However, until ship arrivals pick up or demand softens, it is unlikely that we will see sustained price falls.

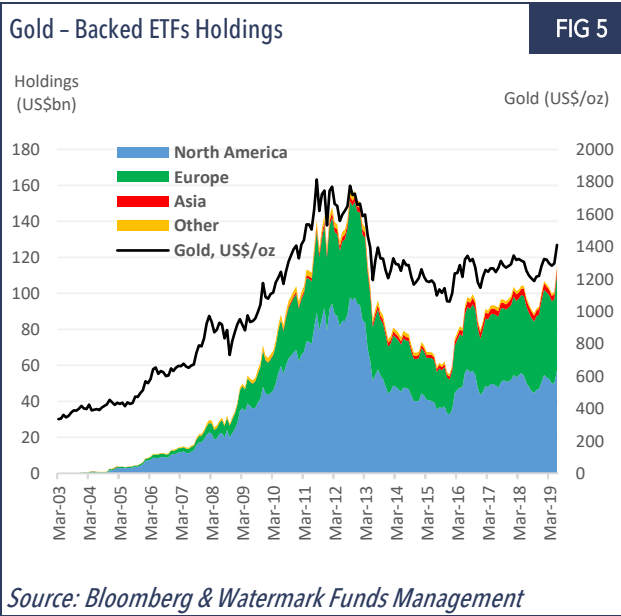
We have maintained a balanced position in the mining space and are aligned to underlying commodity themes. We remain constructive on iron ore, coking coal, copper and gold. We continue to be cautious on commodities with a poor supply/demand balance such as thermal coal, aluminium, alumina, and speciality minerals.

The gold price has been tracking higher since October last year and reacted strongly at the end of June to the marked shift in positioning from the US Federal Reserve. Markets were quick to price in the changed outlook for US interest rates, lifting gold to over US\$1,400/oz (A\$2,000/oz). In a reflection of the current rate-easing cycle globally, levels of negative-yielding debt have been building consistently and now sit above.



This trend has been a major driver of interest in gold as an asset class and will continue to support the buying of the yellow metal. Holdings of gold by ETF's remain strong

and central banks, particularly Russia and China, have been buying aggressively in the last 6 months.

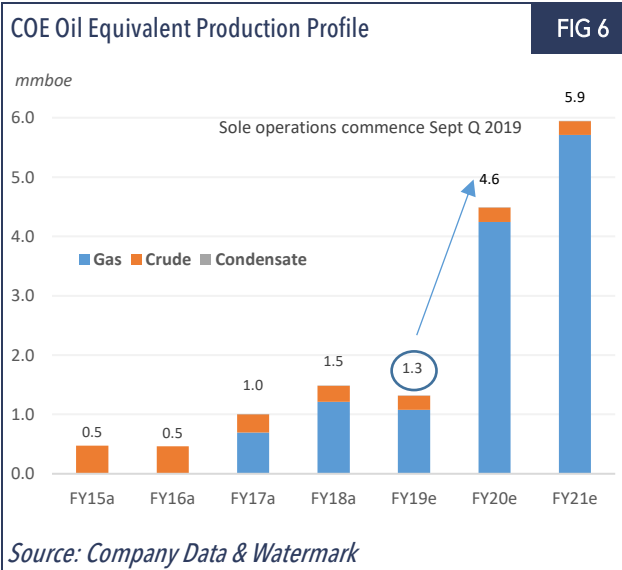


Prices may consolidate around current levels in the near term; however, as expectations of rate cuts come through, the price may move higher. We hold a long bias to both gold mining shares and those in the supply chain while shorting names that are susceptible to changes in outlook or performance.

Oil was mostly range-bound throughout the quarter. Inventory builds early in the period weighed on prices, before tensions in the middle east; positive G20 discussions; and OPEC restraint led to a recovery towards the end of June. We have positioned the portfolio to take advantage of the East Coast gas thematic, which we believe will deliver stable and robust cash flows, over companies with LNG and oil exposure. Currently, there is an LNG glut as new facilities ramp up, putting pressure on pricing. While demand is constructive, many LNG companies are now repricing existing contracts or signing new ones on weaker terms.

We added to our Cooper Energy (COE) position, which has a strong focus on Victorian gas opportunities. Commissioning of the Orbest gas project in Victoria will be undertaken in the coming months and will deliver a four-times uplift in gas sales. The plant is fed from the Sole gas field which has a 10-year life, and there are several expansion and extension opportunities nearby. COE also has exposure to the Otway Basin and has agreed to purchase 40% of the Minerva gas plant from BHP (taking ownership to 50%). Two exploration wells are due to be drilled in the second half of 2019 with exploration success a strong catalyst for the stock. The Cooper Basin assets

are cash-generating; however, production has been declining as the assets age. Recent developments and application of new technology in the Basin have yielded positive results, and we expect an expanded drill program could lift production.



East Coast Gas – Politics Ignoring Reality a Costly Reality

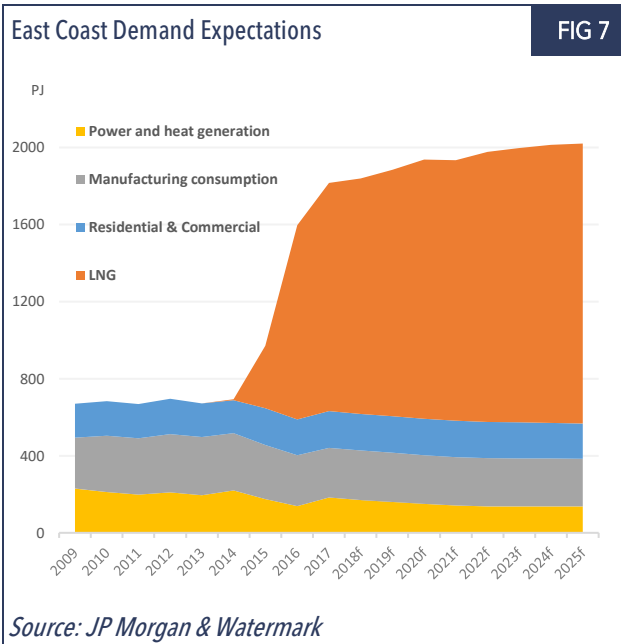
In commodity markets, the issue of high prices is often its own solution, with incentivised supply eventually bringing the market to balance. However, the current high pricing on the East Coast of Australia may be more firmly entrenched due to a lack of investment in the ageing gas fields; surging demand; and the shifting economics of gas in Australia due to increased red/green tape.

This issue has recently garnered more publicity, with politicians now reviewing domestic reservation policies and even arguing for price controls. Reservation policies without concessions are likely to reduce the optionality (and value) of a project and may delay investment. Price controls (<A\$7/GJ) may provide short term relief, however this will likely lead to gas shortages over the long term.

Demand

LNG (Liquified Natural Gas) developments in Gladstone are large consumers of gas and have rapidly changed market demand since 2015. Issues such as adequate gas supply, soft LNG markets and construction schedules have held these plants back from achieving nameplate capacity. As these plants ramp up they will consume more gas and be the major demand driver for the East Coast.

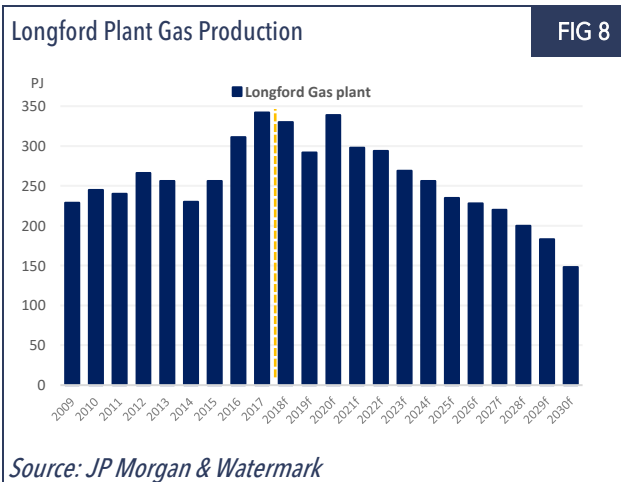
Manufacturing and mining demand should broadly soften along with power and heat generation, which have been declining with increased renewable power generation. Residential and commercial consumption will likely be flat and high prices may dampen consumption as consumers are faced with higher bills.



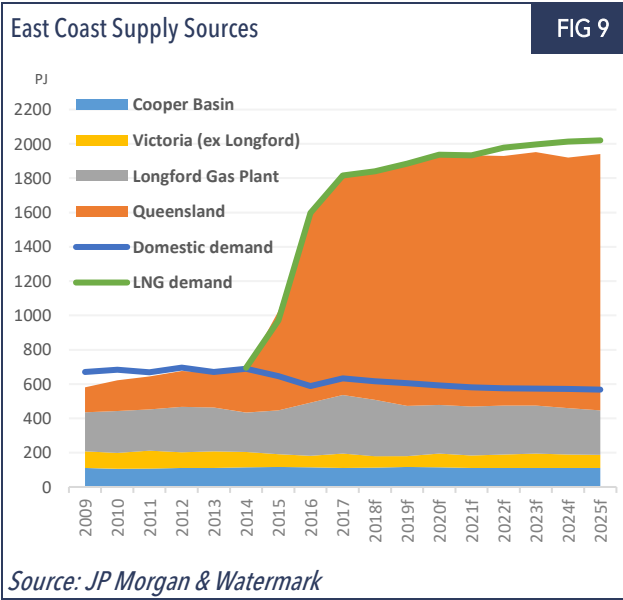
Supply

Key issues with the supply of gas on the East Coast include field decline, high-cost QLD gas, a lack of exploration success in the southern states and red tape/green tape holding up development.

For over 40 years the market was underpinned by gas from the Exxon/BHP Longford gas plant in Victoria, providing c.70% of East Coast supply. This had been a cheap source of gas (A\$3-5/GJ), but as production declines, supply will be matched with higher cost gas (A\$7/GJ) from QLD.

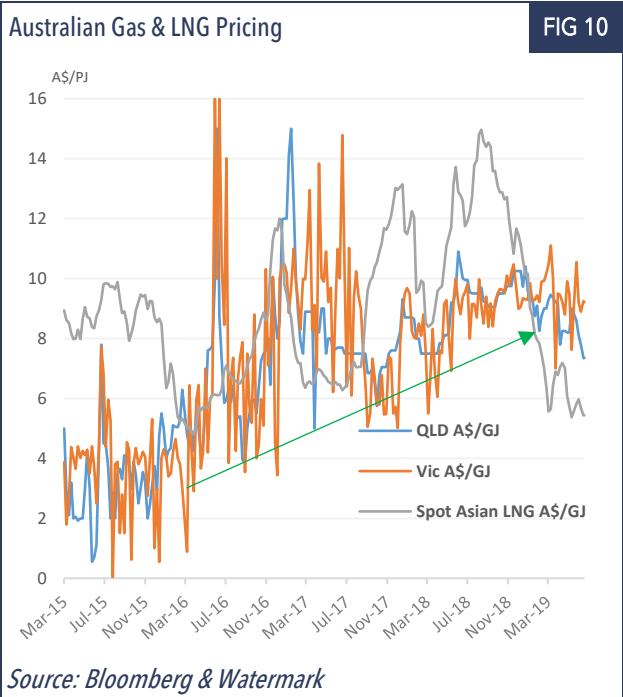


QLD Coal Seam Gas (CSG) has been developed to satisfy LNG demand, however these fields are providing one-third of domestic gas. CSG generally requires higher levels of Capex and has suffered from delayed ramp up and faster production decline vs conventional wells. Current QLD gas prices are around A\$7-9/GJ however to transport and distribute it to southern states would cost an additional A\$2.5-3.0/GJ, leading to an indicative price of ~A\$10/GJ.



In 2015 Victoria put in place a moratorium preventing onshore gas exploration over concerns around fracking. This has reduced investment in assets which are generally low cost and quicker to bring to the market. Gas development in NSW has been all but suspended over the last three years as projects are delayed due to red tape. Removing red/green tape barriers would be the most effective mechanism to bring these markets back to balance. This would take time and need federal and state alignment, while exploration and development occur.

Another proposal that has been put forward by industry and politicians is for an LNG import terminal to be built. Such a facility would cost between A\$150-250m to supply c.15% of market requirements. The cost to import this gas would vary depending on the source, with the current Asian spot price at c.A\$8/GJ and US LNG costing A\$11.50/GJ. This ignores any return for the import terminal and would likely equate to prices around A\$10-14/GJ. This may add to the stability of the domestic market, however it underpins it with high-cost gas, which is subject to volatile international LNG trading prices.



TMT/Healthcare

Australian technology stocks: Wisetech, Afterpay, Appen, Altium and Xero (WAAAX) found new highs during the period, sustaining the momentum seen in Q1. While gains in the first quarter were driven by earnings upgrades across the group, share price performance in Q2 signified a re-rating of these names, with nothing to note in terms of earnings growth. Valuations for this group of market darlings now exceed valuations for US cloud/FAANG shares by some margin, while offering similar opportunities for revenue growth. This might explain why US-based companies like Life360 have chosen to list on the ASX – Australian investors' voracious appetite for growth.

The performance of telecommunications shares has been idiosyncratic. Telstra shares have enjoyed a re-rating driven by lower bond yields and the prospect of stabilising earnings along with a solid dividend yield. Vocus has been bid for twice (EQT at \$5.25 and AGL at \$4.85) where both bids were pulled quickly, sending the share price plummeting by 35%, to a point where we now see value. TPG remains caught up in its litigation with the ACCC due to its proposed merger with Vodafone. In New Zealand, Chorus was impacted by the recent publication of an opinion paper by the local regulator, which inferred that revenues that are reflected in the cost of capital for the company might need to be lower going forward. In the meantime, the debate around Spark has intensified, with supporters highlighting yield support for the name at 6%pa, while detractors are focused on balance sheet strength and concerns over slowing revenues.

Among media shares, Nine and News Corp stood out in the quarter. Nine continues to trade well, reflecting solid audience ratings, good execution at Stan and the recovery in Domain's share price post-election. News Corp shares pushed higher after announcing the results of an evaluation of strategic alternatives for its North America marketing business, highlighting a significant discount to the sum of the parts valuation.

In Healthcare, defensive stocks Ramsay and Sonic continue to push higher, reflecting a combination of solid execution by company management and investors' preference for defensive exposures late in this cycle. On the flipside, growth-driven names like Resmed and

Cochlear continue to be lifted by the global re-rating of Med Tech stocks.

CSL had a strong quarter (shares were up 11%) driven by evidence of a solid flu season for Seqirus and continued tightness in Immunoglobulin (IG) markets. Tight IG markets will inevitably lead to price increases for IG, which drop straight through to CSL's margins. The company admitted that revenue recognition for Albumin would suffer in FY20 as a result of moving to its own GSP (Good Supply Practice) distributor in China. However, the market quickly comprehended that this is simply an accounting change, and underlying demand for Albumin remains solid. By gaining greater control of the supply chain, the company is in a stronger position in the long term.

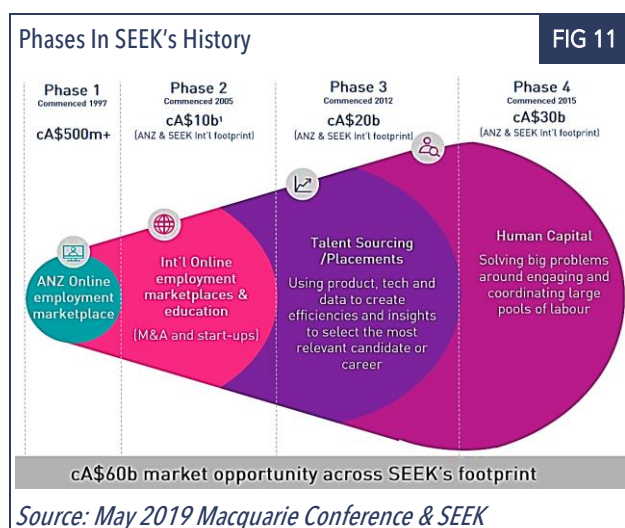
SEEK

SEEK is the leading online jobs classifieds marketplace in Australia and owns majority stakes in other online jobs marketplaces in China, Southeast Asia, Brazil and Mexico. Over the past five years, SEEK has grown revenue at a rate of 15% per annum. Profits are diversified across numerous geographies, with Australia representing 60%, SE Asia 20% and China 20%. The business has successfully sourced high-growth opportunities in adjacent markets where it can apply scale and know-how, resulting in a string of equity stakes in smaller, high-growth businesses, that could become successful in their own right.

The market often focuses on the high penetration of the jobs marketplace in Australia as a sign of slowing growth ahead for SEEK. That perspective misses the significant opportunity that SEEK has ahead, to better monetise its role in the hiring process. At a recent investment conference in May, SEEK's management communicated to investors a renewed focus on pricing in the context of the Australian market, citing the example of REA Group, which has had great success in recent years growing its 'depth' (mix) revenues by a factor of 8x. In SEEK's case, management has compared the blended price for an ad on their marketplace at \$150 vs. US / European comparable at 3x to 6x that figure. According to SEEK's estimates, its blended price point of \$150 represents a mere 0.6% of overall hiring costs, which amount to

\$25,000 on average. This is despite SEEK having a 35% placement share in Australia, leaving significant opportunity for the company to leverage its strong position to increase its share of total spend.

The second leg of the opportunity for SEEK is in exploiting higher value-add adjacencies beyond their core marketplace and talent solutions, wading into Human Capital management. According to the company, their penetration of the marketplace and talent solutions verticals in Australia (a c.\$5bn market) is around 10% today compared to less than 1% for Human Capital (a c.\$3bn market). SEEK is pursuing these opportunities through investments in high growth early-stage ventures in HR Software-as-a-Service (e.g. Go1 and employment hero) and contingent labour properties (e.g. Sidekicker, Workana).



competitor, Jobs51, has pursued a paid search model. Considering the vast numbers of private companies in China that do not currently advertise jobs online, there remains a significant opportunity to increase the penetration of online marketplaces. In our view, Zhaopin has adopted the right approach here, with a view to increasing pricing and share of total spend once the land grab is over. Our investment thesis in SEEK revolves around a high-quality business which is asset-light, highly scalable and well managed. Watermark currently estimates SEEK's existing business opportunities should be able to deliver a revenue and EBITDA CAGR of between 12% and 14% over the next five years. Our numbers do not include any meaningful upside from tapping into adjacent opportunities in Human Capital management. If we were to factor in the full \$5bn in FY25 revenue opportunity that was highlighted by management at their investment briefing, we could comfortably see the target share price double. However, we do think that capturing some of those opportunities will require more time and further investment in acquisitions.

The strategy for SEEK's subsidiaries in Asia and China is similar to Australia, although the operations in these geographies are less mature than Australia. Naturally, the most obvious opportunities are to bring the penetration of SEEK's online marketplaces in Asia into line with its Australian offerings. If a franchise such as Jobstreet (SE Asia) could increase penetration in line with local ratios (measured as a % of GDP), it would increase revenues by a factor of 5. Using the same logic, Zhaopin (China) could increase revenues by a factor of 7 if it was to achieve the same penetration as SEEK enjoys in Australia. It is worth noting that the situation in China is a slightly unusual one. Since the third quarter of 2017, Zhaopin has adopted a 'freemium' model, whereby the company has sought to win support from job applicants and employers, while its

Financials

The Financials portfolio had a weaker quarter, with our short position in the banks detracting from performance. Bank shares rebounded sharply following the federal election result, coinciding with firming (subsequently confirmed) expectations of one or more cuts to the cash rate and an incremental relaxation of credit standards from APRA. In our view, this took the material long-tail risk scenarios relating to the housing market off the table, which was enough to prompt substantial buying of bank shares and other housing-related investments. We still see near term earnings risks for the banks and only have to look to Europe and Japan to see the impact of rates approaching zero, and the impact on bank ROEs.

Notwithstanding the net short positioning across the major banks, we have maintained a core position in NAB. NAB recently announced Ross McEwan as its next CEO following the controversial departures of its CEO and Chairman. We met with Mr McEwan recently and are confident that he has the skillset to turn NAB into a sector-leading franchise. Paired with NAB's new chairman Phil Chronican, we see this as the strongest CEO/Chairman combination at any of the major Australian banks. Mr McEwan comes from the UK where the banking environment is a few years ahead in terms of remediation, disruption from new competitors, open banking and ultra-low rates. This gives NAB a particular advantage in navigating the roadmap for the Australian banking landscape over the next five years.

Investments in a number of fintech companies fared better, most notably Afterpay and EML Payments. Afterpay continues to be volatile as near-term price action responds to press coverage of regulatory inquiries and potential competition. These are not new issues for Afterpay, and the shares are regaining losses from recent weeks, as operating data flowing through from external sources continues to be positive.

EML Payments

EML is a global payments company that, in its simplest form, produces cards for businesses to facilitate payments from customers. It has two main segments: non-reloadable - i.e. gift cards for malls/shopping centres

and reloadable, which will operate similar to a transaction account with a bank. These reloadable cards are used across many different industries, from wagering websites (to facilitate payments to and from customers) and more bespoke industries such as salary packaging companies.

EML's customers vary from well-known listed companies such as Smartgroup to household names Bet365. They are also diverse by geography - there are 1,300 programs across 23 different countries with more than half of FY18 revenue coming from North America.

The growth in the company has been supported by its superior/leading technology offering. EML has benefitted from Rfid technology (Paypass and PayWave technology). This has allowed the business to move from plastic to digital wallets, which not only lowers the cost to facilitate it but also drives the value proposition and ease of use for customers. EML was the first payments company in Australia with the ability to place a card in a digital wallet without the customer having received a physical card. This enables instantaneous signup to its reloadable card programs. With structural tailwinds in most segments, the company is currently in a sweet-spot.

We see the four key drivers for EML as follows, with each to be delivered concurrently, as incremental earnings growth increases over the next five years:

1. European payments directive requires malls to take cards off balance-sheet - near term opportunity.

- At 1H19 EML operated card programs with ~600 of the estimated 10,000 malls in Europe and is the largest player in outsourced programs. They recently acquired the second biggest player (Flex-e-Card) in the space and now have 800 malls in Europe. We expect EML will continue to roll out its technology and grow above 20% market share in Europe.

2. US legalisation of sports wagering - blue sky transformational opportunity.

- Following the Supreme Court decision in the US to allow states to legalise sports wagering, activity is being undertaken across many states to establish newly regulated wagering industries.

- As a provider of 'best in class' payments solutions, EML has a significant opportunity to win contracts as

international play penetrates the US, and new players emerge.

- Research suggests that the potential size of this market is \$17b, assuming online wagering was legalised in all 50 states at once. This is ~10x the size of the online wagering market in Australia.

- EML has already signed with early entrants Pointsbet and now bet365.

- Little of this upside is captured in consensus numbers.

- At this stage, analysts attribute negligible incremental growth from this opportunity, but we expect forecast growth will crystallize as EML clients enter the market.

3. Salary packaging penetration.

- Launched in June 2017 with 112,000 accounts, this has grown to 156,000 accounts in FY19 – at a rate of ~18% p.a. This industry is still developing and further growth is expected in the channel. With its recent contract win with Smart Group, EML is expected to reach 260,000 accounts by April 2022.

4. Bolt on acquisitions.

EML has the capacity to make a further bolt-on acquisition which will support incremental margin expansion. The company has form in this area, having acquired Perfect Card in July 2018. This scaling-up of the business will continue to drive EBITDA at a group level.

With a diversified earnings base that is seeing synchronised growth across all divisions, not only do we see earnings growth, but we also expect investors will pay a higher multiple for those earnings. EML has faced some issues in the past and has been guilty of getting investors over-excited by new contracts. We think the company has learnt from its mistakes. These missteps have created attractive entry points to purchase shares since the beginning of the year and we expect the company will beat its prudently set earnings guidance during the August reporting seas.

Consumer/Industrial

The Consumer/Industrials portfolio delivered a flat return in the June quarter. The largest contributors to performance came from core holdings within the grocery and gaming segment. Woolworths currently holds the upper hand in the domestic supermarket duopoly, with stronger trading momentum and strategic superiority. These should see it maintain operational outperformance over Coles. Aristocrat is another key investment that produced positive returns in the quarter, delivering a strong earnings result in May. Within the gaming space, a recent addition, PointsBet, had a successful IPO and continues to perform well.

Our short portfolio detracted from performance, specifically a basket of shares linked to the housing cycle. The surprise federal election result and subsequent efforts by regulators to slow the rate of decline in housing prices have resulted in an accelerated recovery in housing-related shares. While key economic data points continue to concern us, buyer sentiment has swung and this is likely to drive the market in the near-term. Ultimately affordability and credit availability will determine where the property market heads, and both these factors remain headwinds. However, we have to be realists and for the time being Australians are prepared to follow the advice of real estate agents and mortgage brokers that it's a good time to buy.

Overall, the portfolio remains positioned for a tougher consumer outlook. Consequently, we have built positions within the portfolio that can perform irrespective of those headwinds. For example, counter to the economic cycle, the Australian agriculture cycle appears near its lows, and we have therefore started building exposure to the sector. While picking agriculture cycles can be difficult, we take comfort that many stocks were priced for drought into perpetuity. Importantly, the Bureau of Meteorology removed its El Nino warning in June. In our experience, the BOM aims to avoid 'flip-flops' wherever possible, so typically waits for strong signals before adjusting its outlook. We see this as an important signpost for the sector. New positions were established through the quarter in Elders, Graincorp, and Select Harvests.

PointsBet Holdings

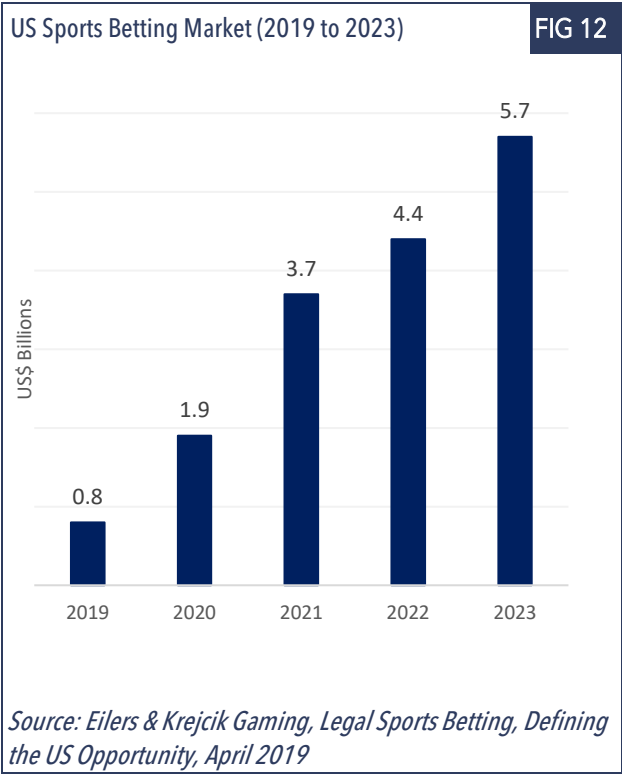
One of the most exciting investment opportunities within the Gaming sector globally is the emergence of a new corporate bookmaking industry in the US. This new industry is currently in the early formation stage following a decision by the US Supreme Court in May 2018 to overturn a standing Prohibition Act. Given the passion for US sports runs high (NFL, NBA MLB, NHL, NCAA), we believe a significant market opportunity exists. Our research suggests that early uptake of sports betting has been well ahead of expectations, given the excitement factor of participating in what was once a black market. With the industry being created from scratch, an opportunity exists for entrepreneurial operators to get in early and carve out a share.

One such operator is PointsBet Holdings (PBH), which IPO'd on the ASX in June 2019. The business was founded by former executives of Tom Waterhouse, a successful Australian bookmaking start-up that was ultimately acquired by William Hill. Tom Waterhouse was an early player in the formation of the Australian corporate bookmaking market; this team understands what is needed to obtain customers rapidly in an early mover land-grab situation.

PointsBet's competitive advantage is its innovative and nimble culture. An example of this was its decision to quickly sign-up high-profile sporting ambassadors such as Alan Iverson and Darrelle Revis before the player's agents realised the value of the bookmaker's association. Also, PointsBet has attracted valuable press coverage promoting its 'Karma Kommittee', where credits are offered to punters who lose due to a controversial refereeing decision. These initiatives have seen PBH achieve 5% market share since February 2019.

The regulatory environment is particularly complex as legislation is being drafted on a state-by-state basis, not on a national level. Consequently, the rules of operation, tax rates, licencing etc., will be different across each state, creating different operating models for bookmakers from state-to-state. While this adds complexity, we believe it plays into the hands of more nimble operators who are flexible and not encumbered by rigid corporate decision-making structures.

While PBH is unlikely to generate profit within the foreseeable future, the value of the business will grow as the company builds a network of licences and recruits new customers. History has shown that these businesses are often acquired before they become profitable. Given the licencing complexity and the scale of the US market opportunity, we expect transaction multiples to be above historical transactions of this type.



Performance Review

Having consolidated our smaller funds in April, Watermark has narrowed its focus to two core investment strategies for the Australian share market. Australian Leaders Fund and the Watermark Absolute Return Fund employ a Long/Short equity or ‘variable beta’ strategy while the Watermark Market Neutral Trust is an equity market neutral strategy.

Both strategies delivered negative returns for the quarter, driven primarily by weak performance in the month of April. As has been widely publicised in the financial press and in our correspondence to Watermark investors, it has been a difficult period for active fund managers and an especially challenging environment for hedge fund strategies with a mandate to maintain a hedged exposure to rising share markets. The surprise election result in May also led to losses, felt most acutely in the financials portfolio.

Half of the negative performance in April was attributed to short positions in two companies that were the subject of takeover offers. This is an ongoing risk for our Funds, with M&A activity likely to remain elevated while the cost of capital is so low. The balance of losses in April arose from defensive (net short) exposures in cyclical sectors such as retail, which rallied on expectations of a cut in interest rates. This typifies the current climate for share markets, where investors interpret remedial action taken by central banks as a panacea for flagging economic growth, overlooking the risks that remain for expensive assets such as shares.

Unfortunately, these isolated issues overshadowed a range of positive developments for the Watermark Funds. We have identified several exciting opportunities in the mid and small cap parts of the market, some of which have been discussed in this report. This has traditionally been a rich vein of opportunity for Watermark Funds and we have renewed our efforts looking for investments in this space, since bringing our focus exclusively back to the local share market. Furthermore, we have called the broader market themes reasonably well, and look forward to seeing this reflected more clearly in the performance of the funds during the second half of 2019.

Quarterly Performance by Sector

Sector	Portfolio
TMT	0.02
Healthcare	-0.34
Consumer	-0.04
Industrials	-0.22
Basic Industries	-0.43
Financials	-0.88

*Portfolio data is for Australian positions in Watermark Market Neutral Trust.



WATERMARK
FUNDS MANAGEMENT



**AUSTRALIAN
LEADERS
FUND**

Fund at a Glance - June 2019

ASX Code	ALF
Fund Size	AU\$257.8
Fund Strategy	Variable Beta
Share Price	\$0.91
Shares on Issue	241.7m
Net Exposure	1.3%

Net Tangible Asset (NTA) Backing

	May 19	Jun 19
NTA Before Tax	\$1.14	\$1.15
NTA After Tax	\$1.14	\$1.14

Gross Portfolio Structure

Long Exposure	74.5%	70.2%
Short Exposure	-71.0%	-68.9%
Gross Exposure	145.5%	139.1%
Cash	96.5%	98.7%

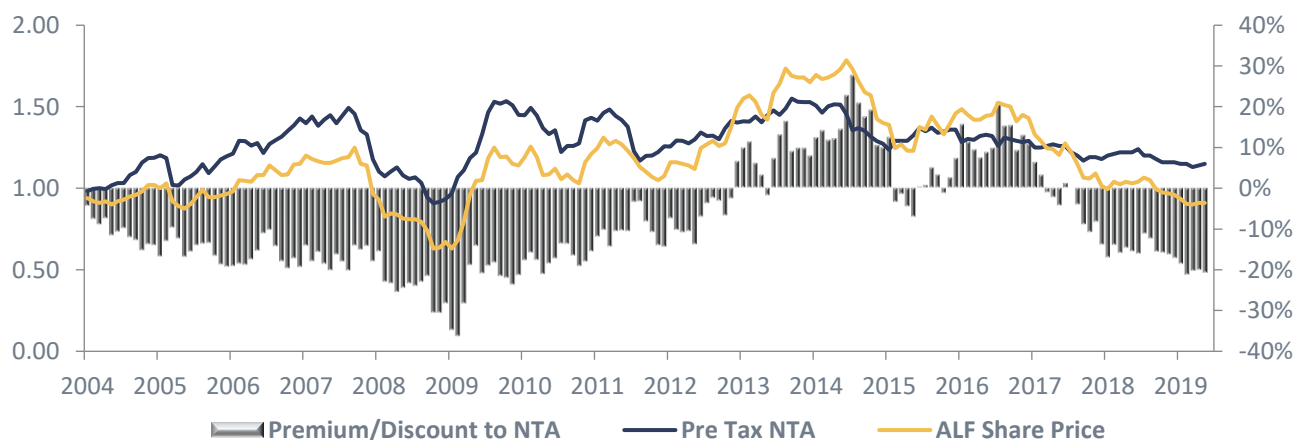
ALF Performance

	1 Mth	3 Mths	1 Yr	3 Yrs (pa)	5 Yrs (pa)	7 Yrs (pa)	S.I. (pa)
Portfolio Return (net)	0.7%	-2.5%	-7.2%	-2.5%	-0.1%	7.1%	10.5%
All Ords Accum Index	3.4%	7.8%	11.0%	12.6%	9.0%	11.8%	9.3%
Outperformance (net)	-2.7%	-10.3%	-18.2%	-15.1%	-9.1%	-4.7%	1.2%

Net Equity Exposure



Historical Premium/Discount to NTA History





Fund at a Glance - June 2019

Fund Size	AU\$181m
Strategy FUM	AU\$149m
Fund Inception Date	August 2012
Fund Strategy	Equity Market Neutral
Application/Redemption	Daily
Management Fee	1.5%
Performance Fee	20%
Benchmark	RBA Cash Rate

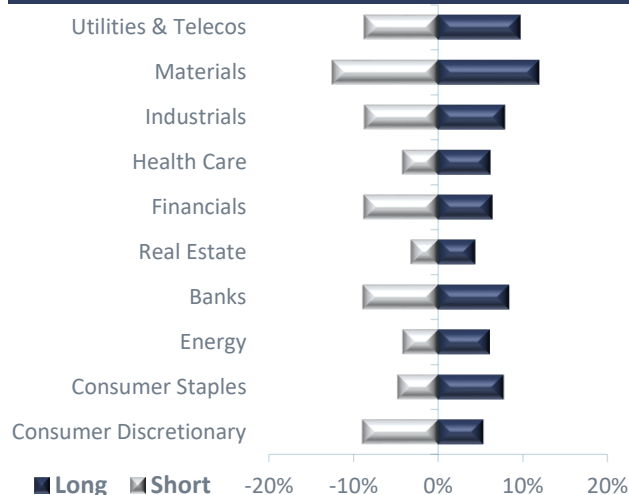
Return Characteristics

Positive Months	66%
Portfolio Beta	-0.1%
Sharpe Ratio	0.8
Sortino Ratio	2.5
Standard Deviation	6.6%
No. Long Positions	63
No. Short Positions	66
Gross Exposure	148%

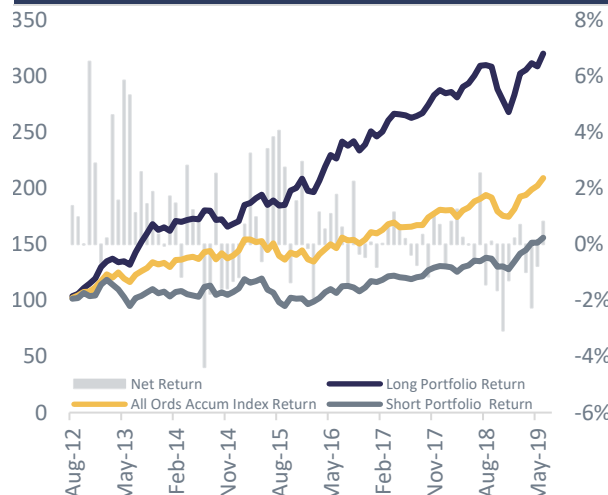
Performance

	1 Mth	1 Yr	2 Yrs (pa)	3 Yrs (pa)	4 Yrs (pa)	5 Yrs (pa)	SI (pa)
WMNT (net return)	0.8%	-7.1%	-3.4%	-1.4%	2.9%	1.9%	7.6%
RBA Cash Rate	0.1%	1.5%	1.5%	1.5%	1.6%	1.8%	2.1%
Outperformance	0.7%	-8.6%	-4.9%	-3.0%	1.3%	0.1%	5.5%

Sector Exposures



Long/Short Spread



Monthly Net Performance (%)

Cal. Yr	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2012	-	-	-	-	-	-	-	1.36	0.97	0.00	6.51	2.88	12.14
2013	-0.71	0.21	4.60	1.55	5.83	5.31	1.11	2.57	1.43	1.86	0.35	-0.06	26.57
2014	1.71	1.45	-1.17	2.80	1.21	0.84	-4.38	-1.77	2.52	-1.57	-1.58	-1.32	-1.51
2015	-1.18	0.70	3.23	0.96	-0.61	3.39	3.82	4.04	2.73	-1.36	1.53	2.93	21.92
2016	-0.14	-1.93	1.13	0.53	1.08	1.76	0.60	-1.46	2.23	-0.34	-0.46	0.07	3.03
2017	-0.81	0.02	0.76	1.13	0.61	0.19	-0.39	-0.75	0.34	-1.14	1.00	0.69	1.62
2018	-0.86	0.80	1.23	0.23	-0.01	-0.61	2.52	-1.44	0.10	-1.65	-3.08	-1.30	-4.11
2019	0.22	0.69	-1.00	-2.27	-0.78	0.80							-2.35

Fund at a Glance - June 2019

Fund Size	AU\$46m
Strategy FUM	AU\$304m
Fund Inception Date	May 2019
Fund Strategy	Variable Beta
Application/Redemption	Monthly
Benchmark	RBA Cash Rate

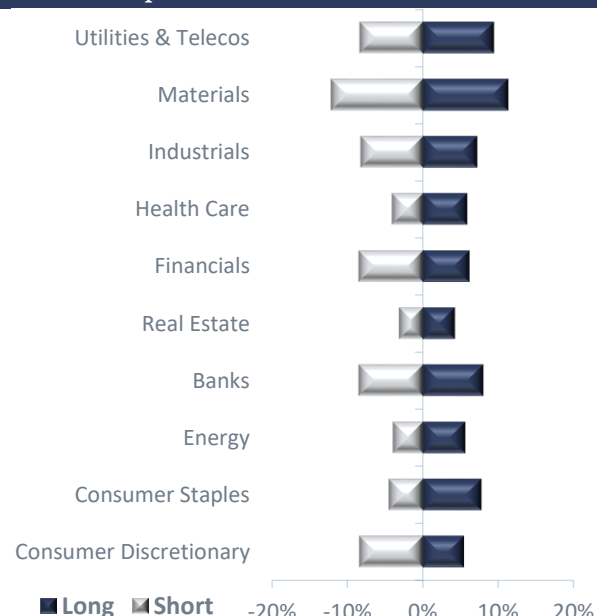
Return Characteristics

No. Long Positions	63
No. Short Positions	66
Gross Exposure	142%
Net Exposure	1.1%
Unit Price	\$1.0023

Performance

	1 Mth	1 Yr	2 Yrs (pa)	3 Yrs (pa)	4 Yrs (pa)	5 Yrs (pa)	SI (pa)
WARF (net return)	0.9%						
RBA Cash Rate	0.1%						
Outperformance	0.8%						

Sector Exposures



Gross Portfolio Structure

Investment Type	\$m	%
Listed Securities - Long	32.8	71.4
Listed Securities - Short	32.3	-70.3
Net Exposure	0.5	1.1
Cash	45.5	98.9
Capital	46	100

Managing your Investment

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 redemption requests up until 2pm on the 10th business day of each month, giving investors the opportunity to review the latest unit price before deciding to apply for, or redeem units. Redemption proceeds will ordinarily be paid within 5 days of the cut off. Investors should refer to the Product Disclosure Statement for the Watermark Absolute Return Fund for details on applying for and redeeming units in the Fund.

For any queries regarding your unit holding, please contact the unit registry managed by Boardroom Limited at watermark@boardroomlited.com.au; or 1300 737 760.

Notes

Level 23, Governor Phillip Tower, Sydney NSW 2000

TEL (02) 9252 0225 • info@wffunds.com.au • www.wffunds.com.au