WATERMARK ABSOLUTE RETURN FUND
Monthly update – December 2021

APIR ETL8732AU
APIR ETL5025AU

WATERMARK FUNDS MANAGEMENT

FUND AT A GLANCE

Fund Strategy	Variable Beta
Benchmark	RBA Cash Rate
WARF Ord.Unit NAV	$1.114
WARF Ord.Unit Applic/Redeem	$1.117/1.111
WARF B Class NAV (Ex ALF)	$1.062
WARF B Class Redeem	$1.042

PORTFOLIO CONSTRUCTION

No. Long Positions	115
No. Short Positions	95
Gross Exposure	252%
Net Exposure	0%
Funds in Strategy	126M

GROSS PORTFOLIO STRUCTURE

Investment Type	%
Listed Securities – Long	126
Listed Securities – Short	-126
Cash	100

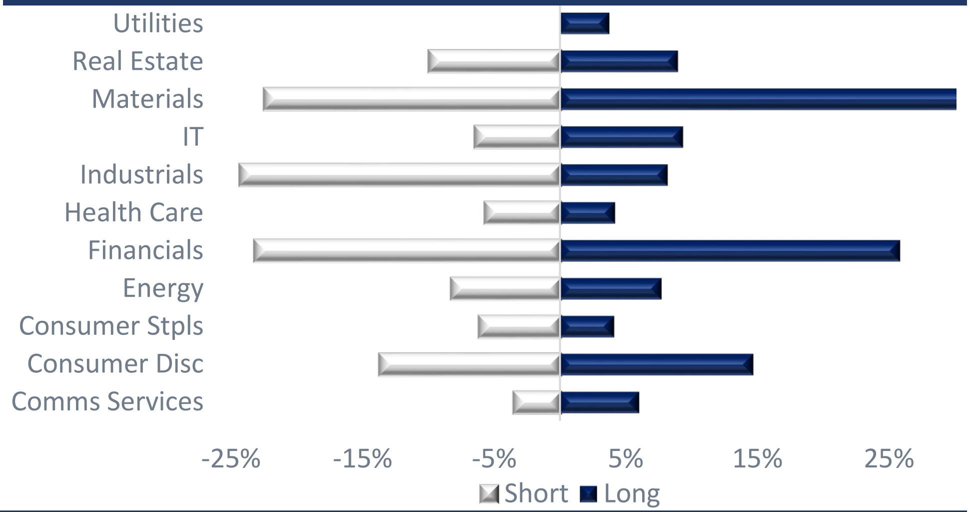
CONTRIBUTION

Top	Bottom
Magellan	Sims
South32	Champion Iron
Virtus Health	Life360

TOP 10 LONG HOLDINGS

National Australia Bank
Origin Energy
Qube Holdings
GPT Group
Telstra Corp
Santos
QBE Insurance
ASX
GWA Group
Northern Star Resources

SECTOR EXPOSURES



KEY RISK INDICATORS

Beta	Volatility	Information Ratio
0.14	5.29%	0.72

MONTHLY NET PERFORMANCE (%)

	1 Month	3 Months	FYTD	*Inception (pa)
WARF Ord Unit (Established May 2019)	0.4	4.4	5.6	9.8
RBA Cash Rate	0.0	0.0	0.0	3.3
Outperformance	**0.4**	**4.4**	**5.6**	**6.5**
	1 Month	**3 Months**	**FYTD**	***Inception (pa)**
WARF B Unit (Established 26 March 2021)	0.3	4.5	6.1	9.8
RBA Cash Rate	0.0	0.0	0.0	3.3
Outperformance	**0.3**	**4.5**	**6.1**	**6.5**

**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.

MONTH IN REVIEW

The Australian Share market bucked its recent down trend with a strong December relief rally, with the All-Ordinaries Index up 2.6%. Volatility returned to markets as the more transmissible Omicron COVID variant emerged. Utilities (+6.9%) and Materials (+6.4%) were the strongest sectors, while IT was again the poorest sector, down 5.4%.

Value outperformed growth by 4% in December, driven by the solid gains in Miners and Banks vs the falls for Technology, Health and Staples. This factor rotation continues to be the dominant driver of returns and has accelerated again in early 2022 (discussed further in the Market Outlook).

The Watermark portfolio delivered a return in December up 0.4%. After the first six months of the FY22 financial year the fund has delivered a return of 5.6%, on track for our 8-10% annual target.

MARKET OUTLOOK

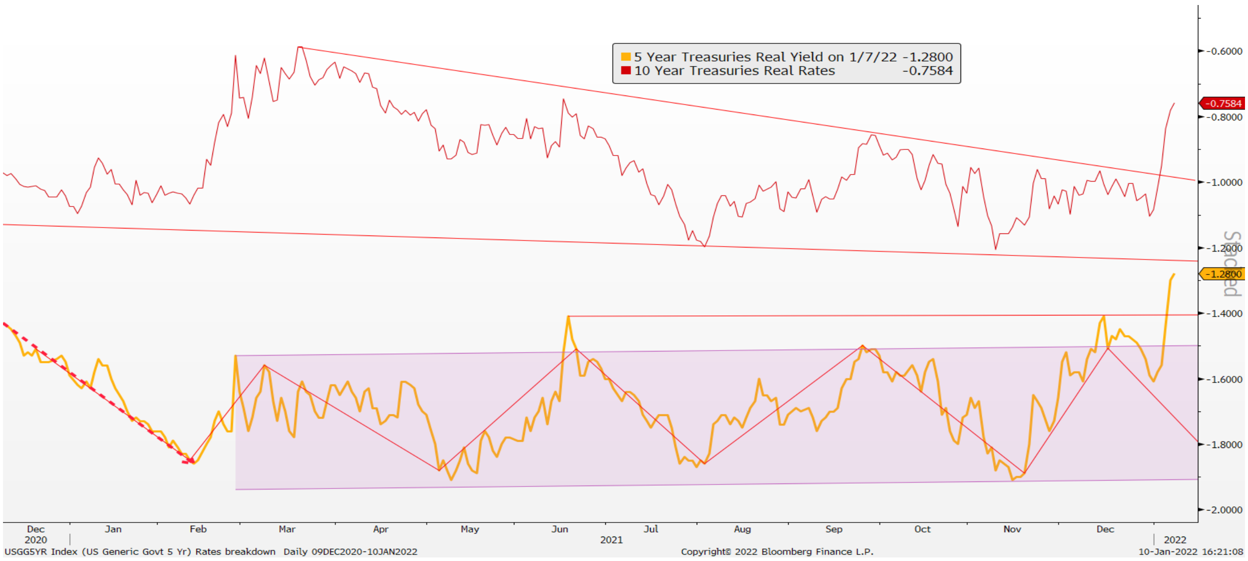
Significant share market moves often occur when everyone is away on Christmas vacation. Shares collapsed on Christmas Eve December 2018 just ahead of the Fed pivot. Once again, we have seen a major shift in capital markets this holiday season with interest rates reacting violently to the release of the December US FOMC meeting minutes which were far more hawkish than expected.

The Committee decided to wind down asset purchases faster than originally planned and are now considering shrinking their asset holdings, becoming sellers of fixed interest securities. Previously they were injecting liquidity into capital markets, they are now considering draining liquidity- a clear headwind. They have also brought forward their target for when the US economy reaches full employment.

At the same time, we have seen some improvement on the supply side of the economy as supply chains have recovered allowing inflation break-evens to improve. With nominal yields moving higher and inflation expectations falling, real interest rates have moved sharply higher (*Fig 1*).

In last month's update we suggested this was the key indicator to follow for equity markets and growth shares in particular.

Figure 1: Rates breakdown



Source: Bloomberg

We flagged the risk to shares of a move higher in real rates. Admittedly, we did not expect the break-out to occur so quickly. Higher real rates are a headwind for valuations and growth shares in particular.

Since the minutes were released, markets have been weaker and growth shares have underperformed value shares by 10%. Growth has now underperformed value in the US by 27% over 12 months. The best performing fund managers in Australia in recent years have all been 'growth' managers - they are having a very tough time of it at the moment I suspect.

You may recall also we highlighted last month how disruptive and unprofitable growth sectors peaked in February of 2021 when real rates bottomed and have underperformed since. With this break out in real rates we are in a confirmed bear market for growth shares. Where previously investors would buy the dips, going forward any rallies will be met by selling for this over owed sector.

We are neutral this factor, we thought the sector was oversold short term and was hoping for an opportunity to get short into any strength, this strategy has not changed but clearly, we are now positioning from lower levels.

As we start the new year, our core thesis has not changed. When you look at where we are in the business cycle, we can get some sense of where markets may peak

1. When the US economy reaches full employment (end of 2022).
2. When policy rates move back to neutral levels (H2'2022).
3. When the yield curve inverts (end of 2022).

We work backwards to land at a timeframe for a market peak sometime in Q2. The market rallies until then, reaching 5000-5500 on the SPX.

SECTORS IN REVIEW

Financials had a sound month. Gains across Fintech, Real Estate and Wealth Managers more than offset losses in our short in the Banks. Within Fintech we saw solid contributions from Buy Now Pay Later (BNPL) shorts. *Afterpay (APT)* and *Zip (Z1P)* were down 17% and 14% respectively in December. Globally, payments companies have come under pressure as investors question lofty valuations applied to emerging business models. We still see risks of competition challenging business models further. This comes alongside capital-intensive marketing strategies. Within the ***Real Estate*** portfolio our defensive industrial real estate exposures outperformed in the month as investors retreated to safety amidst Omicron concerns.

Technology had a weak December. The key detractor was our key position in *Life360 (360)*. The tech sector saw a global decline and Australian names were not immune. Declines were largely valuation led as opposed to questions around business models. The *360* business continues to perform well and we were very supportive of their recent acquisition of Tile.

The ***Consumer*** sector made a solid contribution to monthly performance in December aided by short positions in supermarkets, and long positions in retailers linked to the housing construction cycle.

In terms of our medium-term view on the Australian Consumer, we expect the sector to be impacted by the hangover from excessive government stimulus and a redirection of spending away from durable goods back toward services (travel, restaurants, etc). In addition, the prospect of higher interest rates will likely impact household disposable income and sentiment in the year ahead.

In the near-term, stock performance will be dictated the outcomes of Christmas trading, which on initial review, appears to have been soft. The late and rapid onset of Covid cases has seen consumers self-isolate. Given the rapid acceleration of cases, consumers have not been able to make alternat spending plans and have appear to have ultimately spent less. Given both the near-term and medium-term outlooks for discretionary spending are now negative, we have lifted our net-short positioning on the sector.

In ***Consumer Staples,*** we have pivoted from a net-short position to net-long having added long positions in Fuel Retail. With the Federal and some State Governments transitioning towards open economies the supermarket sector is likely to underperform going forward. We hold a large short position in supermarkets.

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	0.5	0.0	2.9	1.1	0.4							5.6

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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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