WATERMARK ABSOLUTE RETURN FUND

Monthly update – April 2022

APIR ETL8732AU
APIR ETL5025AU

WATERMARK FUNDS MANAGEMENT

FUND AT A GLANCE

Fund Strategy	Variable Beta
Benchmark	RBA Cash rate
WARF Ord.Unit NAV	$1.106
WARF Ord.Unit Applic/Redeem	$1.110/$1.103
WARF B Class NAV (Ex ALF)	$1.058
WARF B Class Redeem	$1.055

PORTFOLIO CONSTRUCTION

No. Long Positions	87
No. Short Positions	97
Gross Exposure	203%
Net Exposure	-3%
Funds in Strategy	119M

GROSS PORTFOLIO STRUCTURE

Investment Type	%
Listed Securities – Long	100
Listed Securities – Short	-103
Cash	103

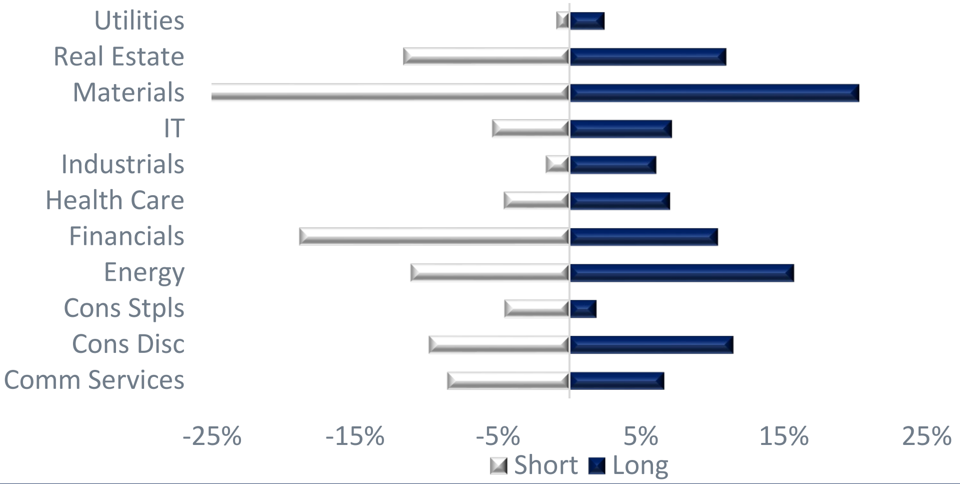
CONTRIBUTION

Top	Bottom
Stanmore Resources	EML Payment
Green Technology Metals	Carnarvon Energy
Pilbara Minerals	Life360

TOP 10 LONG HOLDINGS

- Santos
- Telstra
- Stanmore Resources
- CSL Ltd
- Vicinity Centres
- Ampol
- Goodman Group
- Insurance Australia Group
- Origin Energy
- Macquarie Group

SECTOR EXPOSURES



KEY RISK INDICATORS

Beta	Volatility	Information Ratio
0.00	4.68%	0.87

MONTHLY NET PERFORMANCE (%)

	1 Month	3 Months	FYTD	**Inception (pa)
WARF Ord Unit (Established May 2019)	-0.1	0.5	5.9	9.6
RBA Cash Rate	0.0	0	0.1	3.3
Outperformance	**-0.1**	**0.5**	**5.8**	**6.3**
	1 Month	**3 Months**	**FYTD**	****Inception (pa)**
WARF B Unit (Established 26 March 2021)	-0.1	0.5	6.7	9.7
RBA Cash Rate	0.0	0.0	0.1	3.3
Outperformance	**-0.1**	**0.5**	**6.6**	**6.4**

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

MONTH IN REVIEW

The Australian share market saw a small contraction in April with the All-Ordinaries Index down 0.83%, much less than the 8.7% contraction seen in the S&P 500. The modest move in the index disguised material moves in underlying sectors. Sell-offs were concentrated in Technology and Consumer Discretionary, down 10.4% and 3.2% respectively, while Utilities was the strongest sector, up 9.3%, and continuing its strong run as a safe haven against inflation. For the first time in 2022 the Materials sector fell, down 4.3%, which is an important development for the Australian market. We discuss further below.

In terms of factor leadership, growth surprisingly outperformed value in April. While the Technology sector was week, 'growth' stocks in Consumer and Healthcare sectors traded better. The 'value' factor was also dragged down by the Materials sector which has now started to fall, as mentioned above.

The Watermark portfolio delivered a return of -0.1% in April. After the first 10 months of the FY22 financial year the fund has delivered a return of 5.9%.

While May has started poorly for share markets globally, the hedges in our portfolio have so far protected the fund from any drawdown. The strategy is very well suited for the environment we find ourselves in.

MARKET OUTLOOK

In April capital markets pivoted from reflation to deflationary bust as investors started to factor in a recession next year. We saw this play out clearly as commodities and commodity currencies fell sharply, including the Australian dollar.

With this, late-cyclical sectors such as resources, which had held up relatively well, joining the route in growth shares. The catalyst for this shift was a further tightening in financial conditions and lockdowns in China weighing on growth in the world's second largest economy.

China historically has acted as a counterweight to growth trends in the west, this was particularly event coming out of the financial crisis. With low vaccination rates amongst seniors in their community they have resolutely stuck to COVID zero policies. Rolling lockdowns are weighing on growth and further disrupting supply chains into western markets. This is unlikely to change in the medium term given the virulence of Omicron. With China already in a recession, it is unable to play its typical role of balancing weakness in the west.

The other major development last month was the breakdown in US mega-cap technology shares. This group of companies has led the share market higher in recent years. Together they account for one quarter of the value of the S&P 500. Until April they managed to escape the broader weakness in the NASDAQ.

The 'Generals' as they are often called, reported disappointing results for Q1'2022, with Apple, Amazon, Netflix, and Facebook either missing expectations or providing weak guidance. The NASDAQ and Russell 2000 having fallen more than 20% now, joining emerging market equities and growth sectors in a new bear market.

The Australian share market had been resilient through this earlier weakness in shares offshore only to fall sharply as commodities and mining shares broke down with the news out of China and broader concerns of a pending global recession. China almost certainly is already in a recession with growth in business activity and household spending in full retreat.

If you break down the Financial Conditions Index (FCI) into asset values (falling); interest rates across the term structure (rising); and the US dollar (rising), FCI is tightening quickly, and we are only just embarking on a tightening cycle.

The incidence of central banks tightening to combat inflation is the highest in many decades. This will likely end in recession in advanced economies. As these economies slow, profit expectations for public companies will fall along with valuation multiples as real interest rates continue to move higher. This is what a bear market looks like and we are almost certainly in one.

Bear markets don't end until policy reverses course and financial conditions start to ease. We are still early in this tightening cycle, there is a long way to go. Liquidity will tighten further as central banks become sellers of the assets; they have accumulated through COVID emergency measures. Bear markets typically last 18 months to 2 years and don't end until the liquidity spigot is turned back on again.

Central banks are fully committed to combatting inflation and will not reverse course until inflation comes back into their target range of 2%. There is no central bank 'put option' this time around - falling asset values only helps Central Banks in their crusade to kill excess demand.

While we are probably at peak inflation now and Consumer Price Index (CPI) and Personal Consumption Expenditures Price Index (PCE) will moderate in the months ahead as we cycle inflated data from last year, any moderation will happen slowly. Key components of the inflation basket- energy, food and shelter will remain under upward pressure for years to come. Labour markets remain acutely tight, employment needs to fall (recession) to reduce pressure on wages.

We are in a 'secular' bull market for commodities, resource security and de-carbonisation will ensure ongoing investment in the sector for decades to come. Australia should benefit from this. While activity will slow in Australia, particularly if our major trading partner China is in recession, our economy should prove resilient even if advanced economies move into recession. There is a good chance Australia avoids the recession bullet once again.

Having said that, commodities and mining shares are in a 'cyclical' bear along with other risk assets and will fall through the balance of this year.

Share markets globally are over sold short term, sentiment is extremely bearish, and positioning is light. Shares should recover in the weeks ahead, an improvement in COVID cases in China would be particularly helpful.

Any rally though should be used as an opportunity to reposition into defensive, quality names that will outperform in a slowing economy.

Volatility will remain high into the second half of the year as financial conditions tighten further. We are still to see an exodus of retail investors who invested $1.3 trillion globally in equities through COVID.

As markets fall in the second half of the year and investors come to realise, there is no central bank bailout this time around, a weaker tape could easily turn into a route as we close the year. The bear is just getting started.

SECTORS IN REVIEW

The ***Consumer*** sector made a positive contribution for the month, with gains in Fuel marketing longs partially offset by losses on Agriculture shorts.

Our long position in the ***Fuel Marketers*** has been gaining momentum as fuel security becomes an increasing issue for Western Governments. *Ampol (ALD)* and *Viva Energy (VEA)* refining assets, which are generally loathed by the market, are now generating super returns and driving upgrades for both companies. This sector is under-owned and offers defensive exposure at a cheap multiple.

While coming at a cost to near-term performance in April, the ***Agriculture*** sector is building as fertile ground for short ideas. Share prices have risen aggressively given the confluence of a strong domestic grain harvest, and sky-high soft commodity prices driven by supply-chain dislocation. We know however, as with all highly cyclical industries, that conditions are ever changing, and we should be careful extrapolating at either the top or the bottom of the cycle. To overcome this issue focus should always be given to mid-cycle analysis. Given decades of data on the Australian grain crop, we can predict with some certainty what mid-cycle earnings for companies like *GrainCorp (GNC)* might look like. On these mid-cycle earnings, current valuation multiples look extreme.

Financials had a disappointing month in April. The primary driver was our long position in *EML Payments (EML)*. *EML* delivered a guidance downgrade two months after its result in February. Given the volatility in the market, earnings dependability is currently paramount. As such, unexpected downgrades are seeing stocks punished by investors, with *EML* nearly halving over the month. In March, we saw press coverage that *EML* was being stalked by Private equity player Bain Capital, this saw the price above $3.00. We are cautiously optimistic that *EML* is forced to negotiate a reasonable price, which we view as the best outcome for investors.

The ***TMT*** portfolio was a slight detractor of performance during the month. Our shorts in internet companies delivered as investors focused on deteriorating housing market drivers. They have also been caught up in a broader global technology sell off. Offsetting this was our technology portfolio, where losses were largely driven by our position in *Life360 (360)*. *360* gave a quarterly update, where it reinstated guidance. We viewed the update as overall positive and were surprised to see the share price negatively impacted. We continue to see absolute and relative value in the name.

The ***Mining*** sector was hit hard in April on lockdowns in China. The best performers recently were impacted the hardest with lithium names in particular retracing recent gains. Commodity prices were also weaker with lithium chemical and rare earths prices falling off peak levels.
Coal continued to perform with our investment in *Stanmore Resources (SMR)* making a strong contribution.

Healthcare: The medical device names are struggling with supply chain issues. Notably, *ResMed (RMD)* has had trouble locating components out of Asia.

Industrials: Defensive industrial shares outperformed with *Amcor (AMC)* and *Brambles (BXB)* leading. Elsewhere housing names continued to struggle as investors adopted a more bearish view of housing activity and the property market- the building material names in particular were weak.

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	-0.2	0.1	0.4	-0.1			5.9

**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@boardroomlimited.com.au.

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