



WATERMARK

MARKET NEUTRAL FUND

NTA and Monthly Update – April 2017

Company at a Glance

ASX Code	WMK
Fund Size	AU\$87.5m
Fund Strategy	Equity Market Neutral
Share Price	\$1.01
Shares on Issue	87.4m
Dividend (HY17 Interim)	3 cents
Dividend Yield (annualised)	5.7%

Net Tangible Asset (NTA) Backing

	Mar 17	Apr 17
NTA Before Tax	\$1.03	\$0.99
NTA After Tax	\$1.03	\$1.01
Dividend Declared (3¢)	(\$0.03)	-
NTA After Tax \$ Dividend (3¢)	\$1.00	\$1.01

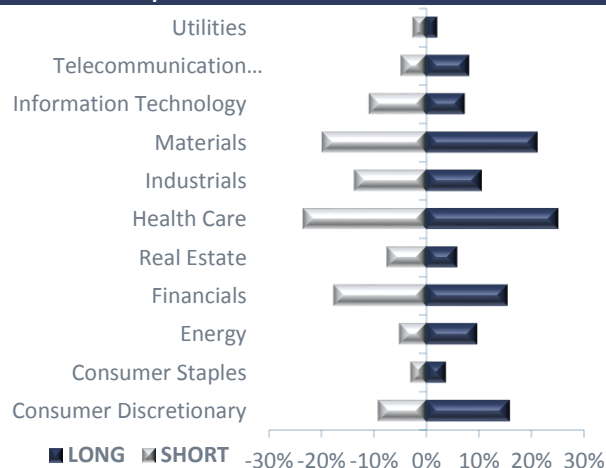
Gross Portfolio Structure

Long Exposure	108.1%	125.3%
Short Exposure	-107.9%	-118.4%
Gross Exposure	216.0%	243.7%
Cash	99.8%	93.1%

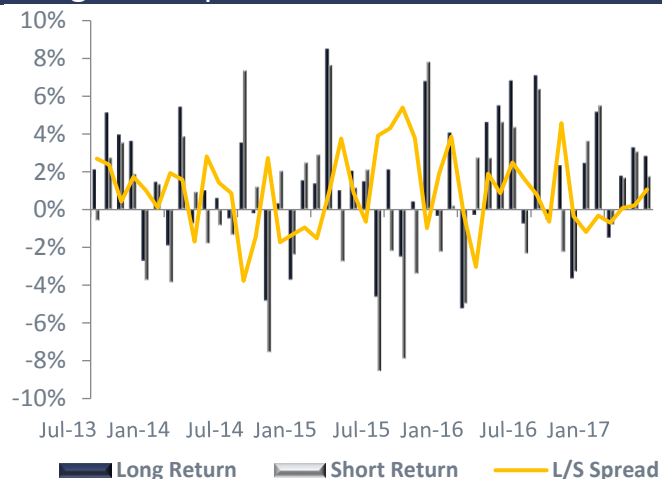
WMK Performance

	1 Mth	6 Mths	FYTD	1 Yr	S.I. (pa)
Portfolio Return (net)	0.9%	-0.9%	1.1%	4.3%	6.9%
RBA Cash Rate	0.1%	0.7%	1.3%	1.6%	2.1%
Outperformance (net)	0.8%	-1.6%	-0.2%	2.7%	4.8%

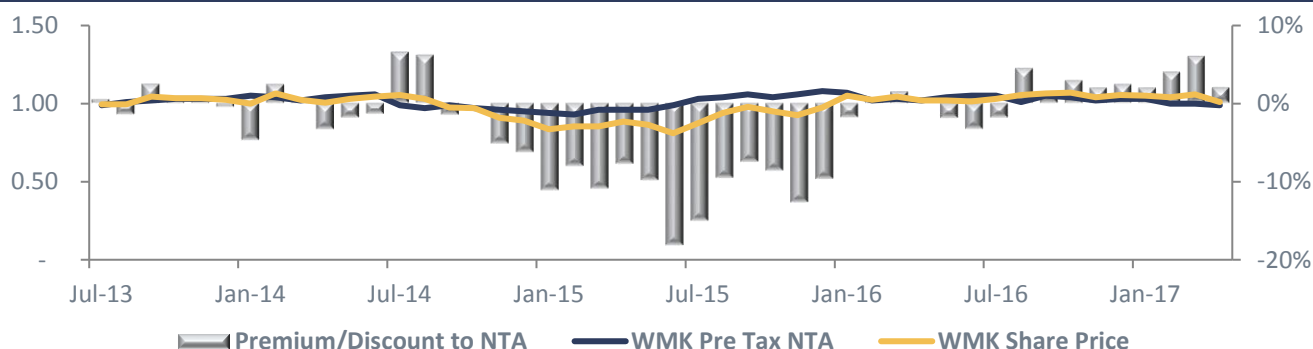
Sector Exposures



Long Short Spread*



Premium/Discount to NTA History





Month in Review

April saw a continuation of recent themes, with shares across the cyclical/industrial sectors pushing the market higher, while resources and telcos weighed on market performance overall. The Australian share market underperformed its global peers, particularly in Europe where markets rallied strongly as the prospects of a French departure from the EU faded along with the political aspirations of Marine Le Pen. Volatility remains unnervingly low, smothered by the continued availability of cheap liquidity, as provided by central banks.

The Fund delivered a net return of 0.9% for the month, with attribution coming predominantly from the long portfolio. The strongest returns came from within basic industries and consumer sectors, while exposures in the real estate sector weighed on performance.

Domestic healthcare shares outperformed the broader market in April, led by CSL which posted a strong 1H result and upgraded FY17 guidance. With valuations across the sector looking full, we are net short in the sector. Short exposures continue to be focused around companies most vulnerable to drug pricing pressures and adverse outcomes from US healthcare and taxation reforms. Despite these structural headwinds, medical device companies are trading near peak valuation levels, providing additional shorting opportunities. In the near-term, we will be monitoring the outcome of the federal budget for potential winners and losers amongst domestic healthcare providers. The Healthcare segment of the portfolio delivered modest positive returns in April with key contributions from our short in Sirtex Medical and a new Long position in GenMab.

The global technology sector continued its strong performance in April, as quarterly results from leading companies met or exceeded expectations. Software and Internet shares drove the outperformance, benefitting from continued strength in enterprise spending and a pick-up in global advertising respectively. Semiconductor shares were flat despite reporting robust earnings - suggesting some exhaustion. Telcos globally continue to struggle in the face of price deflation and declining revenues for legacy voice and enterprise services. The sector has capitulated in Australia, as TPG Telecom confirmed their entry as the fourth mobile operator with an expensive spectrum purchase. The portfolio was positioned well around company results released during the month, with notable contributions from our core holding in Alphabet (Google) and a key short in IBM. The broad-based rally in European shares caused some of our European short positions to drag on performance.

Consumer positions made a positive contribution to portfolio returns in April with holdings in defensive staples outperforming our discretionary names. The Fund benefitted from the strong performance of an investment in Melco Resorts, with VIP play continuing to surprise positively in Macau. An investment in Heineken also performed well, with that company having fully recovered from its sell-down following the change in the US government. This was offset in part by losses in domestic discretionary retailers Super Retail Group and JB Hi-Fi, where modest valuations did not provide sufficient incentive for investors to hold their nerve in the face of a barrage of negative news concerning Amazon's entry to the Australian market.

The Fund is hedged in industrials, reflecting full valuations across the sector, with long and short positions that align with structural and stock specific themes. One key theme is the industrial internet or 'internet of things', which is forcing companies to upgrade their products for wireless connectivity and to allow for remote monitoring (eg. wind farms, jet engines). This will provide significant benefits to customers, such as up-time optimisation and predictive maintenance. Another key theme in the sector is the ongoing impact of e-commerce on logistics businesses.

In Australia, the funds have benefitted from longs in higher quality industrials such as Amcor (an underappreciated global leader in packaging), and stocks trading at a discount to the broader industrial sector such as Qantas (which was trading at a significant discount to foreign competitors). Internationally, core longs include Deutsche Post DHL (a beneficiary of growing e-commerce parcel delivery globally), BMW (a stand-out in the auto sector given its strong brand and management), Siemens (an industrial powerhouse, benefitting from restructuring and a strong position in industrial automation/industrial internet), and Airbus (strong backlog, should benefit from ramp up of the A350 and the roll-off of hedges). On the short side, companies facing structural pressures, such as Kone (pressure on Chinese margins from competition), and Fastenal (facing pressure in industrial distribution from online competition) are core holdings.

The break down in mining shares accelerated in April as tightening measures in China impacted commodity prices.



The mining portfolio was well positioned for this and made a solid contribution to Fund returns in the month. Importantly, a core investment in Iluka Resources bucked this negative trend, following an improved quarterly report. The Energy sector felt further pressure with crude oil prices falling to recent lows. We remain hedged in this sector, however individual stock positions dragged performance. Investment opportunities are emerging in the sector following the recent washout.

Volatility in financial shares has heightened as global interest rates shift higher. Financial firms which typically borrow short and lend long, benefit from higher Interest rates which are lifting across the yield structure as policy tightens and inflation expectations rise. We have targeted banks that can benefit from higher rates without suffering from adverse credit quality such as UniCredit SpA and ING Groep. Both companies have just reported excellent Q1' 2017 results. In the US, we are seeing the emergence of some troubling credit quality issues in auto lending and credit cards, typical of a maturing cycle. In Japan and Europe where the economic recovery continues to be less vigorous, very low rates are weighing on margins while credit quality is more benign.

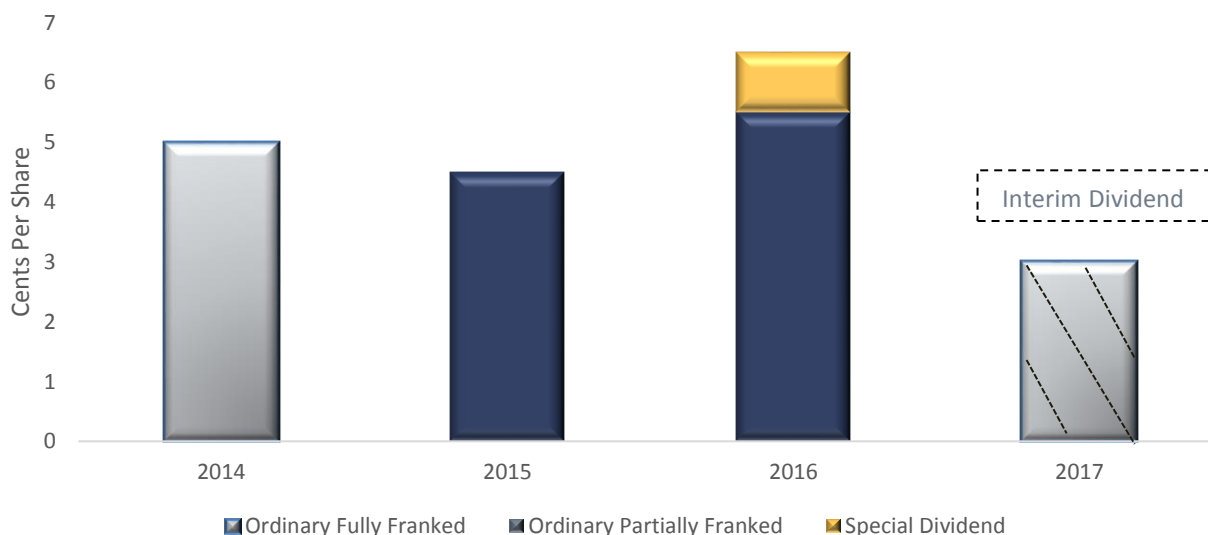
In Australia – the first half bank results were disappointing. Soft revenue trends are set to continue as the property sector slows. Meanwhile, net interest margins are falling as the regulator APRA looks to strengthen the banks' funding structure. On the positive side, diminutive loan loss charges continue given low interest rates and strong employment conditions. Looking forward, revenue growth expectations appear too high given the limited capacity for Australian households to accumulate more debt. The tax on deposits announced with the Federal Budget was a complete surprise. A reminder that banks are a lightning rod for public discord and a soft target given challenges with an inflated property sector.

In insurance, we have added to our positions in the general insurers Suncorp and IAG, we are seeing premiums firm in home and motor policies as challenger brands have pulled back or reached maturity. In commercial lines, we are also seeing premiums pick up having fallen for many years.

In the listed Real Estate sector, we are long the super regionals and short the lower quality sub regional centres which are under pressure as specialty retailers in B and C grade locations close.

Dividend History

The Board is committed to paying an consistent stream of franked dividends to shareholders, provided the Company has sufficient profit reserves and franking credits and that it is within prudent business practices. Dividends are paid on a six-monthly basis. A Dividend Reinvestment Plan is available to shareholders. Please contact Boardroom Limited for details on how to participate – 02 9290 9600; callcentre@boardroomlimited.com.au



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