



# WATERMARK

FUNDS MANAGEMENT





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# AGENDA

- Market Outlook
- Performance Update
- Portfolio Review
- Questions



***"Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria."***

Sir John Templeton  
Legendary Value Investor

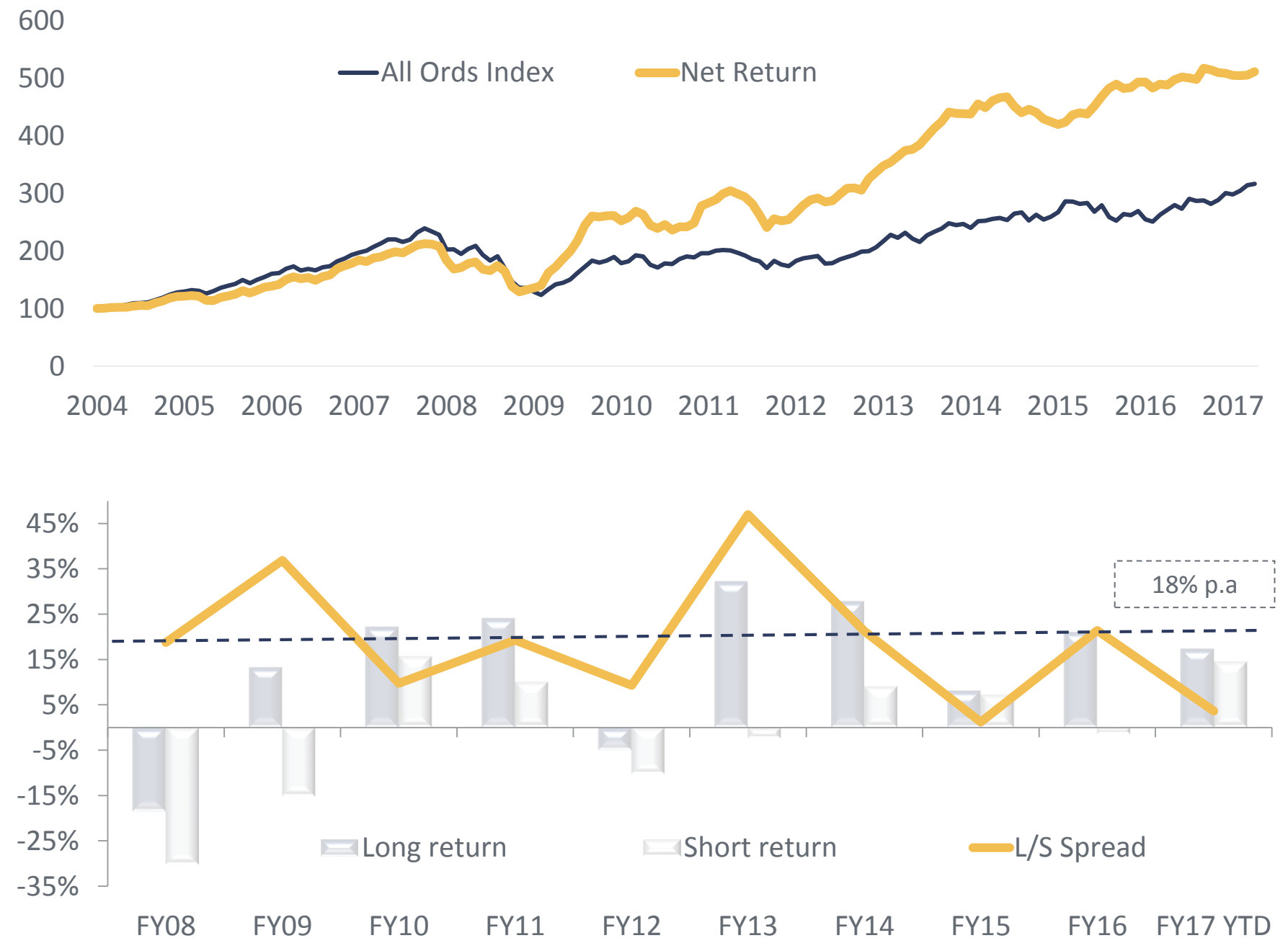
# Performance Summary – Good and Bad News

- Fund performance in 2016 was disappointing by Watermark standards:
  - *Tough conditions for stock pickers*
  - *Value created in Industrial and Healthcare portfolios, offset by losses in Resources and Financials*
  - *Lack of exposure to the rising market (ALF) in the second half of 2016*
- Falling profits resulted in a reduced dividend yield for ALF
- WMK dividend has grown, along with franking after a solid profit in FY16
- Returns from the international portfolios have been strong
- Portfolio returns improving in 2017

# Fund Objectives – Australian Leaders Fund

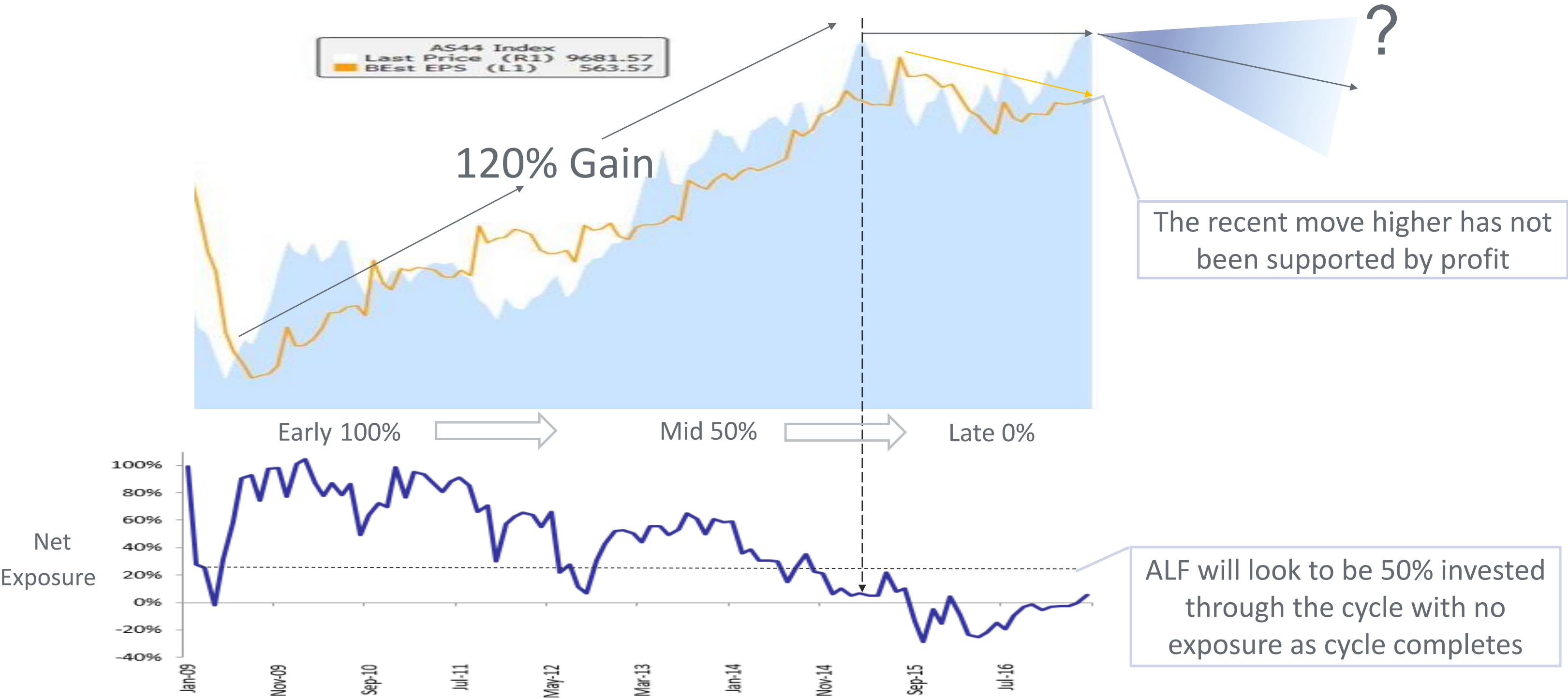
## Positive absolute returns, in excess of benchmark over time

- ALF has delivered a net portfolio return of 13.1% pa since inception which is **amongst the strongest performing LIC's over 10 years**
- Net portfolio returns have outperformed the All Ords by 195%
- ALF's long portfolio has outperformed the market by over 10% in the last year while shorts have detracted
- We have created a 'positive spread' every year since FY08 – alpha generation through security selection



# Fund Objectives – Australian Leaders Fund

Preserve shareholders capital when risks in share markets are elevated



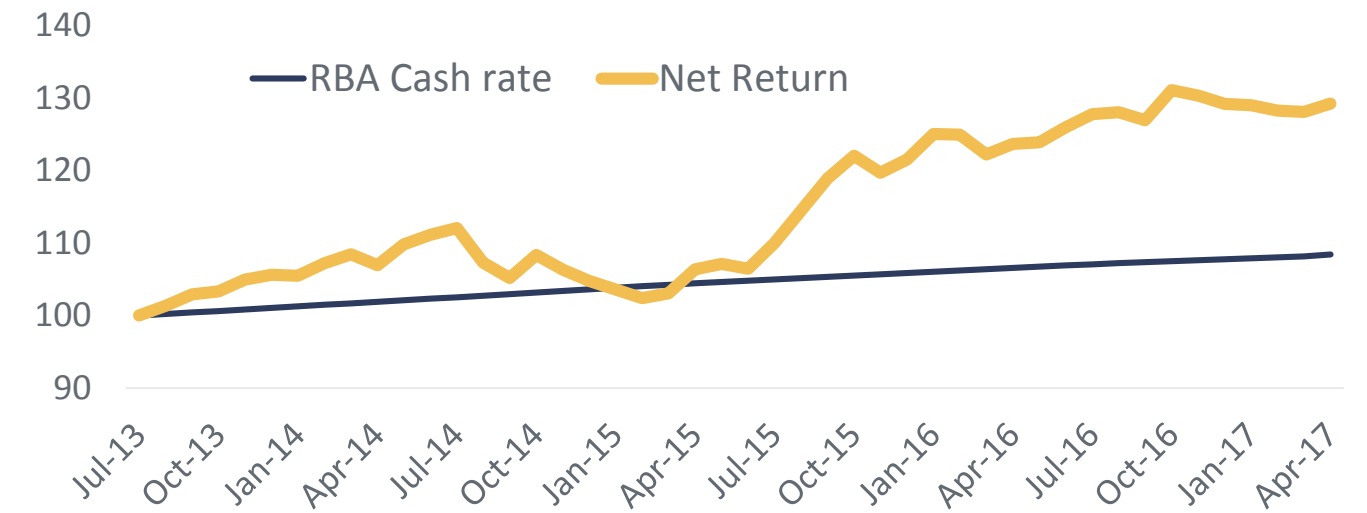
# Shares have been expensive for some time



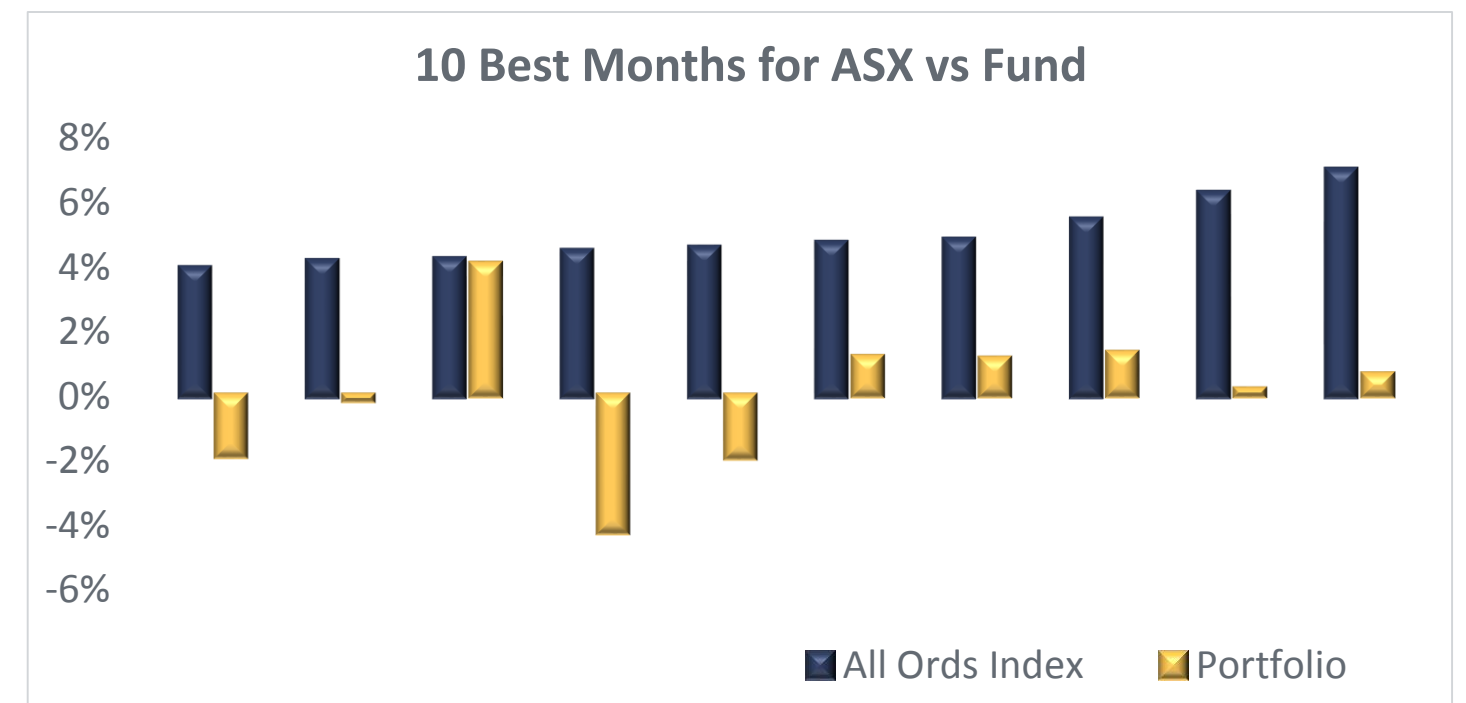
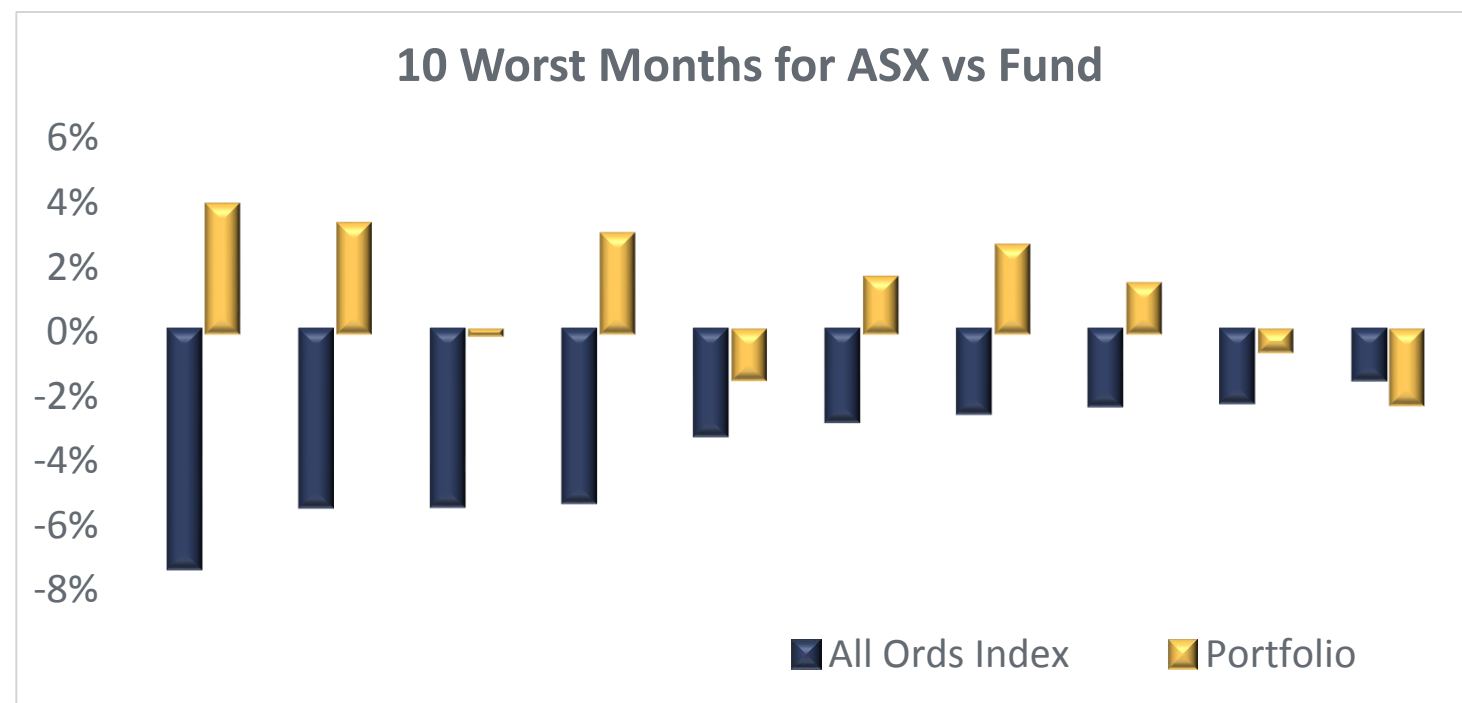
# Fund Objectives – Market Neutral Funds

1. Consistent positive rates of return with relatively low volatility compared with the market

- *Weak period for performance in 2014*
- *Difficult conditions for MN funds in 2016*



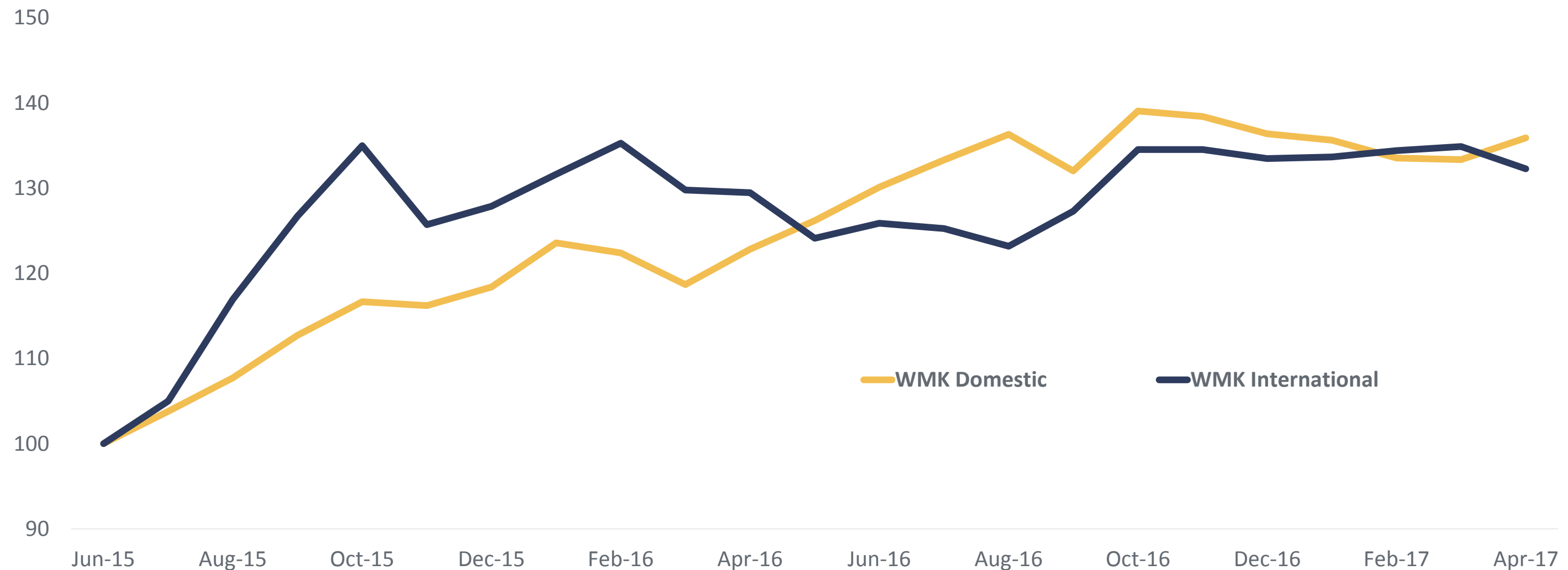
2. Little or no correlation with share market returns – *WMK returns have a correlation with the All Ords of -0.25, amongst the lowest of any market neutral fund*





# Performance of International Portfolio

- International shares now represent half of Watermark's total assets under management
- The inclusion of international shares into Watermark's domestic funds has averaged up returns while averaging down volatility



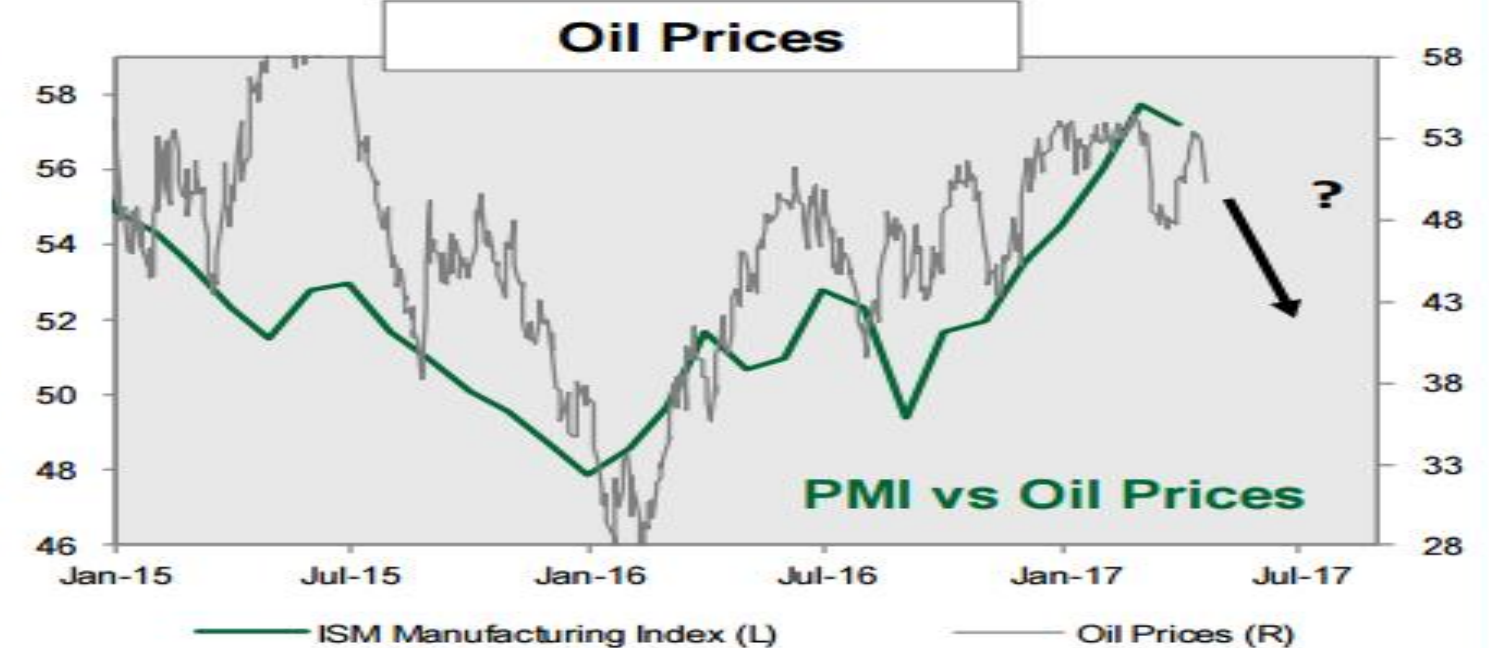
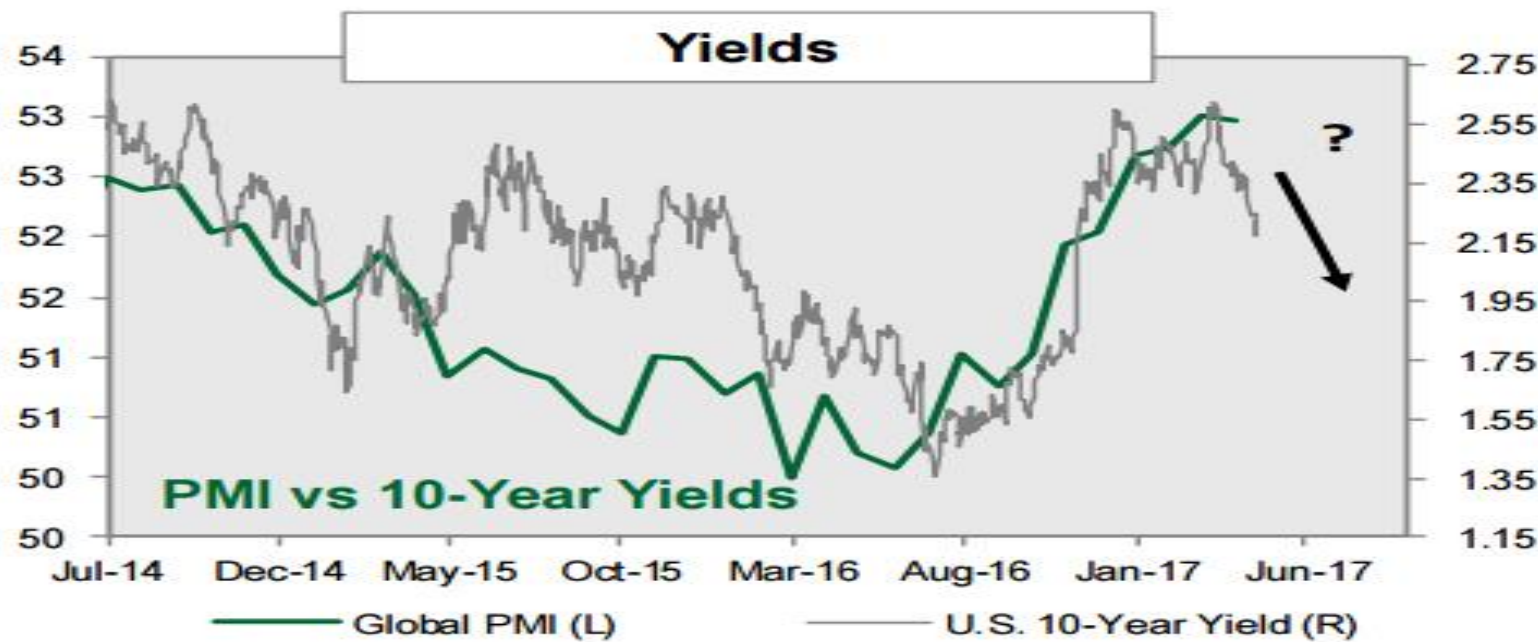
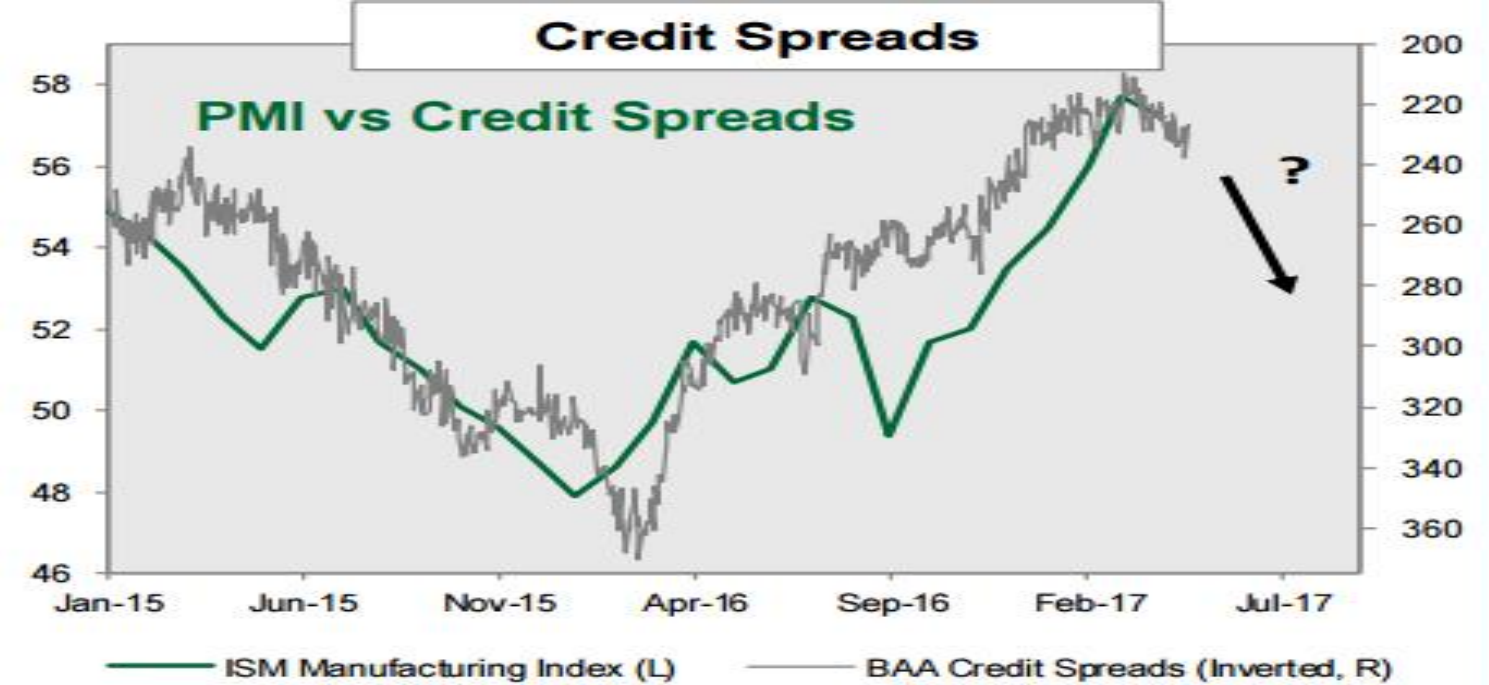
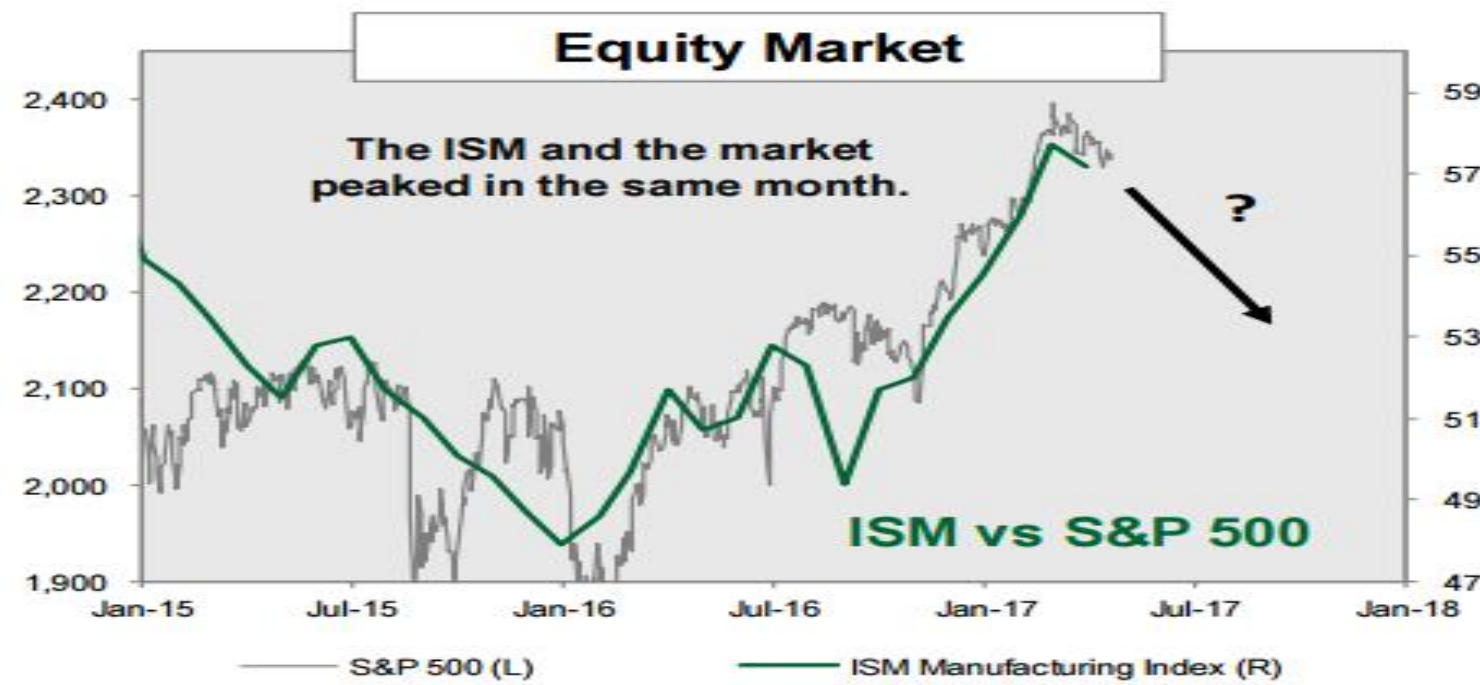
Time period selected to coincide with the earliest date that Watermark managed a representative international portfolio with a gross value in excess of \$40m

# The bell is ringing

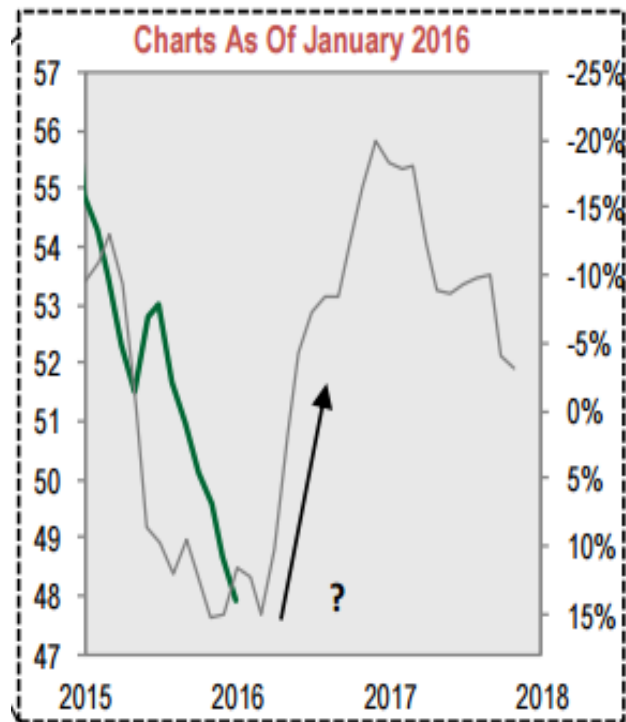
- *This business cycle is very mature*- Eight years into this expansion- potential growth is slowing along with labour participation and productivity
- *Leading indicators are rolling over*- Confidence and optimism is likely to follow
- *Financial conditions are tightening*- Policy support will fade
- *Valuations are back at peak levels*- Shares are expensive which makes them risky



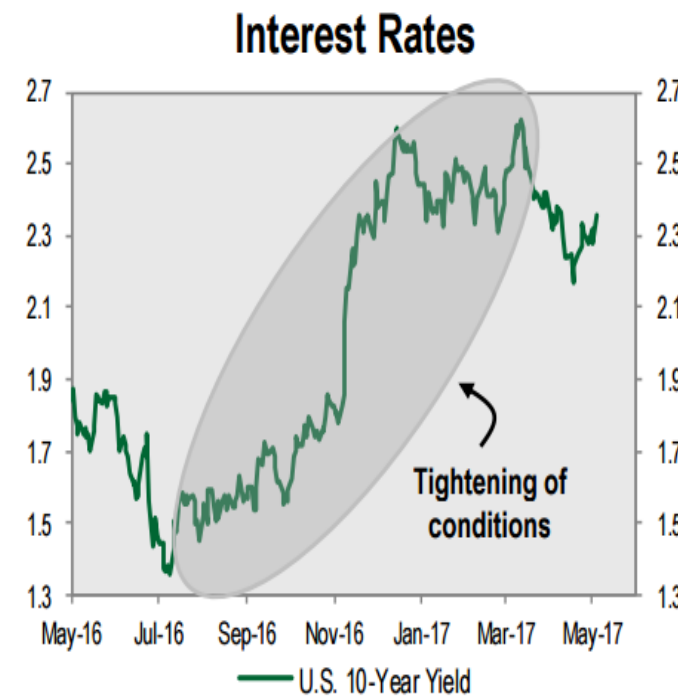
# Leading Indicators Have Peaked



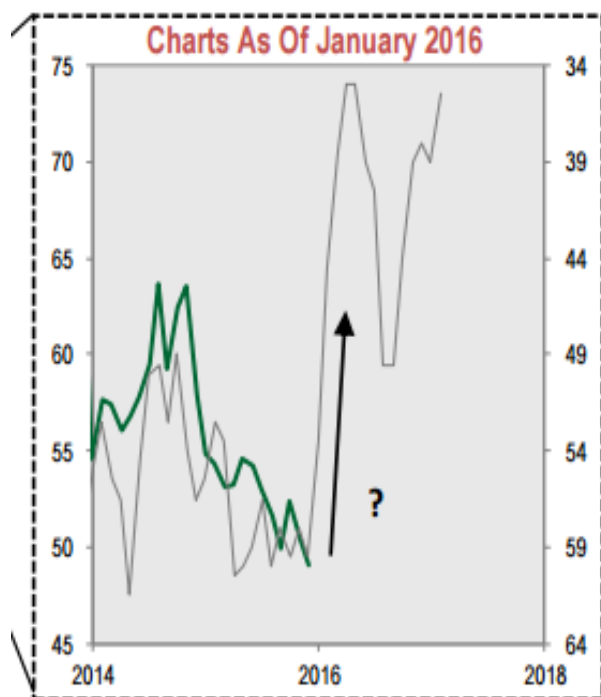
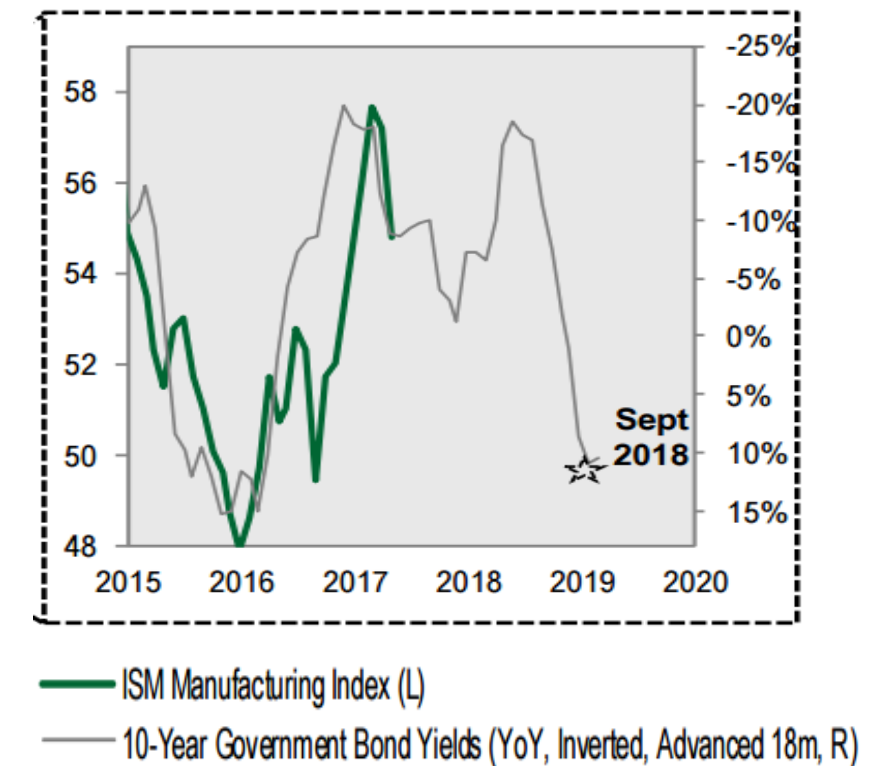
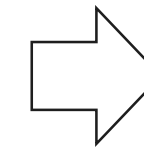
Source: Cornerstone Macro



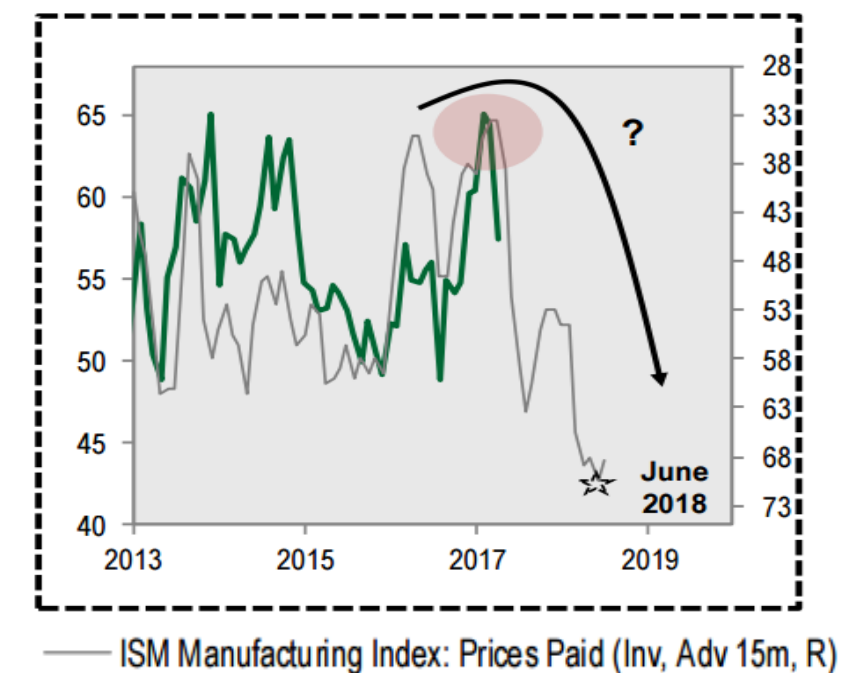
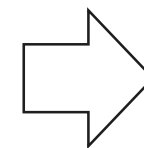
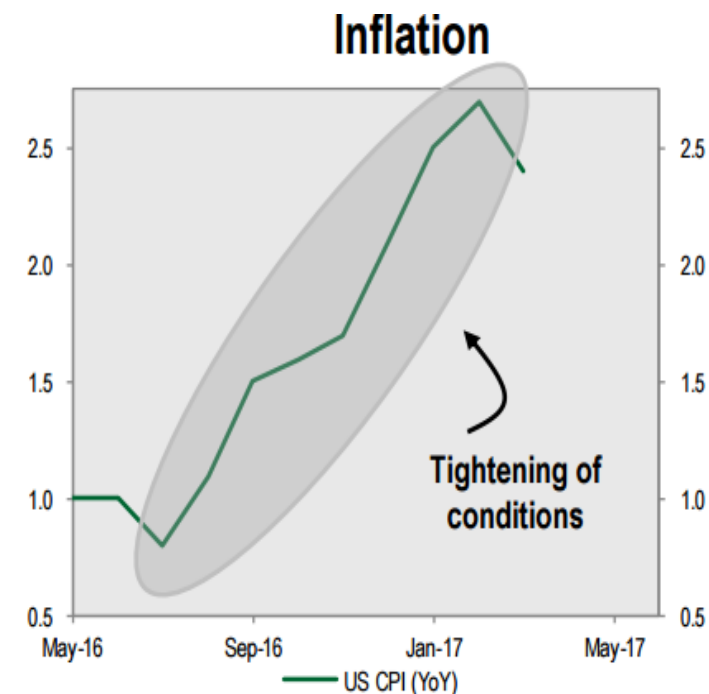
Interest Rates Had Declined Throughout 2015, Setting Up The Cyclical-Recovery Story Of 2016.



Leading Indicators rolling over



Inflationary Pressures Also Declined Sharply, Adding Even More Stimulus To The Pipeline.



Source: Cornerstone Macro



# Watermark's Expanded Investment Team



## **Justin Braitling – CIO**

Justin has over 26 years' experience investing in Australian and international securities. Prior to establishing Watermark in 2003, Justin spent 10 years as an investment analyst and portfolio manager with the successful equities team at Bankers Trust. Justin is the Chairman of ALF and a director of WMK and WGF.



## **Tom Richardson – Portfolio Manager**

Tom is responsible for coverage of Basic Industries. He joined Watermark in December 2009. Prior to this, Tom began his career as an Investment Analyst with Renaissance Asset Management in 2006. Tom holds a Bachelor of Aerospace Engineering from the University of Sydney and is a CFA Charterholder.



## **Simon Felton – Portfolio Manager**

Simon is responsible for coverage of Industrials. He joined Watermark in September 2016. He was previously an investment analyst at Platinum Asset Management for 12 years. Prior to this he was a lawyer at Blake Dawson Waldron specialising in mergers and acquisitions. Simon holds a Bachelor of Commerce and Bachelor of Laws from the University of New South Wales and is a CFA Charterholder.



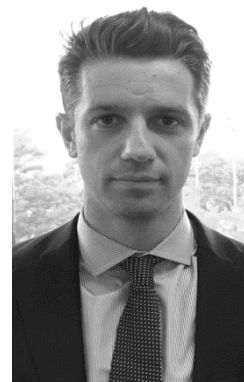
## **Nick Cameron – Investment Analyst**

Nick is responsible for coverage of the Healthcare sector. He joined Watermark in March 2015. He began his career in finance with KPMG in 2008, before moving into research roles with Credit Suisse and Deutsche Bank. Prior to joining the Watermark Nick was an investment analyst at GenesisCare. Nick has completed bachelor degrees in Science and Biotechnology and holds a PhD from Griffith University in the fields of Molecular Biology and Neuroscience.



## **Ian Carmichael – Investment Analyst**

Ian is responsible for coverage of the Consumer sector. He joined Watermark in March 2017. Prior to this he spent four years with Platinum Asset Management where he was the Consumer Team Leader and before that was a Portfolio Manager at MLC Investment Management where he worked for five years. Ian began his career as a Chemical Engineer with roles at Montgomery Watson Harza and Cochlear. He holds a Bachelor's degree in Chemical Engineering, a Master's degree in Biomedical Engineering and is a CFA Charterholder.



## **Hamish Chalmers – Investment Analyst**

Hamish is responsible for coverage of Financials. Hamish joined Watermark in May 2017. Prior to this he has been a Financial sector specialist with Och-Ziff Capital for the last 7 years. Hamish holds a Bachelor of Civil Engineering and is a CFA Charterholder.



## **Delian Entchev – Investment Analyst**

Delian is responsible for coverage of the Technology, Media and Telecommunications sectors. He joined Watermark in August 2014. Prior to this, he was undertaking a cadetship with UBS as an Equity Research Analyst. Delian holds a Bachelor of Commerce (High Distinction) from the University of New South Wales.



## **Leon Lu – Quant Analyst / Trader**

Leon joined Watermark in April 2017. He began his financial career with HSBC in Singapore in 2011, before moving into a research analyst role in COFCO in Beijing. Prior to joining Watermark, Leon was a quantitative analyst at Deloitte in Sydney. Leon is a qualified actuary (AIAA) and holds a double degree in Bachelor of Actuarial Studies and Finance from The Australian National University and a Master of Actuarial Studies from Macquarie University.

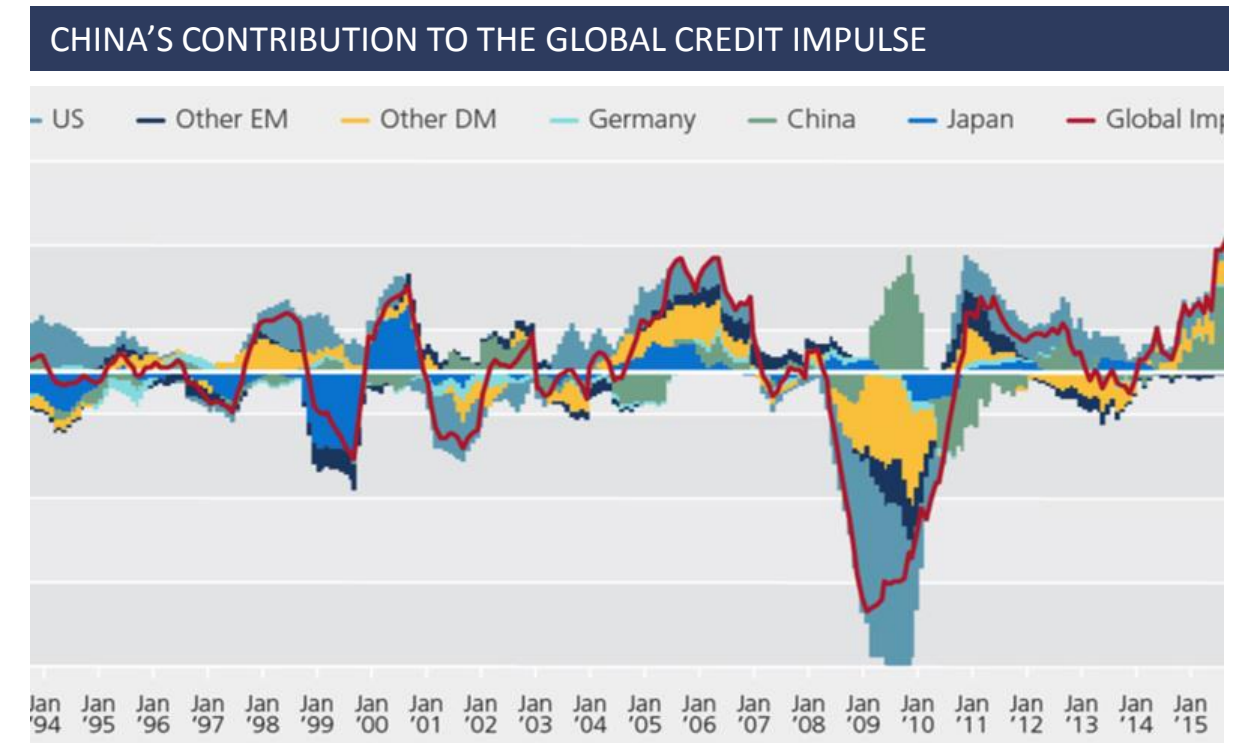
# Financials

## *The global financial system continues to bifurcate*

- 1 Pace of interest rate normalisation is uneven with the US and UK far ahead of Europe and Japan
- 2 The European banks have “cleaned-up” their balance sheets. Credit growth returning to Southern Europe after years of contraction. Conversely, Chinese credit growth is decelerating rapidly
- 3 Regulatory headwinds in most regions are subsiding, as the Trump administration attempts to roll-back Dodd-Frank and Basel IV is diluted by US and European central banks
- 4 Global economic expansion showing signs of fatigue Credit quality to suffer as interest rates rise. First signs of this in US consumer lending.

## *How are we positioned?*

- 1 **Unicredit.** Improved capital position and balance sheet clean-up. On track to meet 2019 ROTE targets
- 2 **Westpac.** Consistently strong across business divisions. Out of favour with institutional investors.
- 3 Short **Credit Suisse.** Euro Investment banks ceding market share to US peers. Private banking margins under pressure.





# Basic Industries

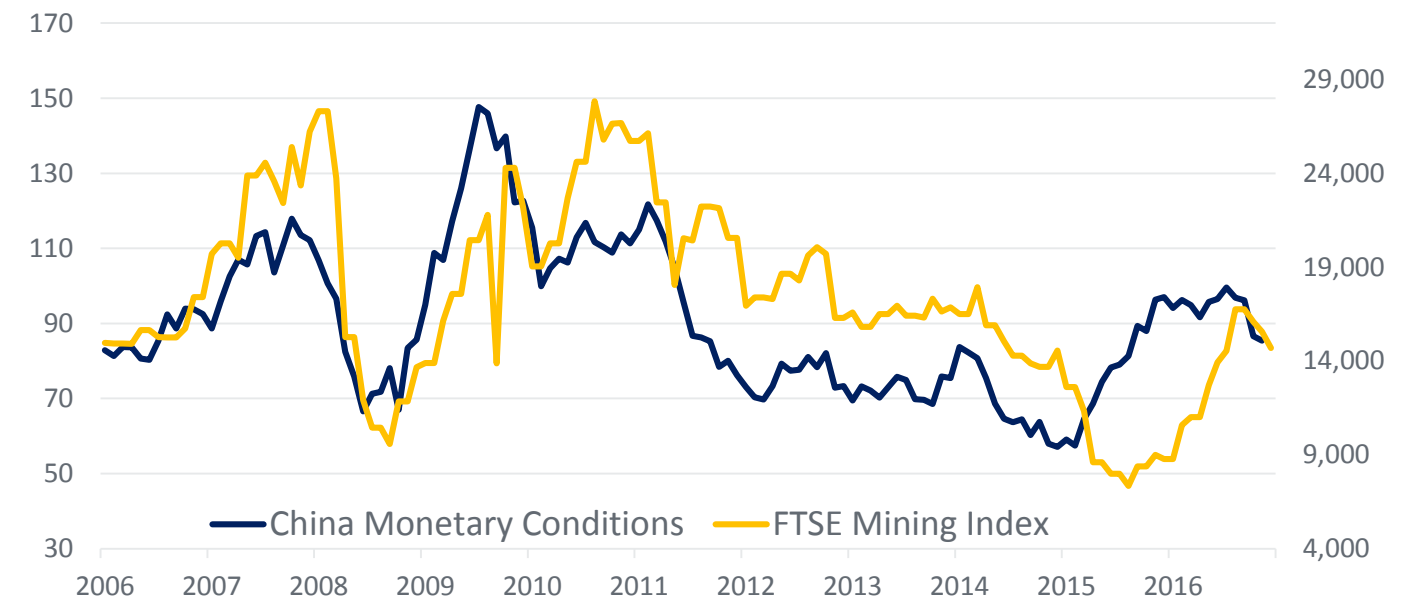
## *Basic Industries retreat after a big 2016*

- 1 The mining sector has broken down as China tightens credit and withdraws stimulus
- 2 OPEC agreement a green light to US shale producers to increase production. Inventories remain high but should fall in 2017
- 3 China exposed industries such as steel, contractors and chemicals are vulnerable from China's shift in policy

## *How we are positioned*

- 1 We are short the mining sector as China continues to cool. We are long BHP due to Oil optionality and continual pressure for improved performance
- 2 We are neutral the Energy sector, while looking to buy the dips. We are long Royal Dutch Shell who continues to optimise their new portfolio, and Hess for their underappreciated Guyana development option

## *Mining sector heavily reliant on Chinese policy*



# Healthcare

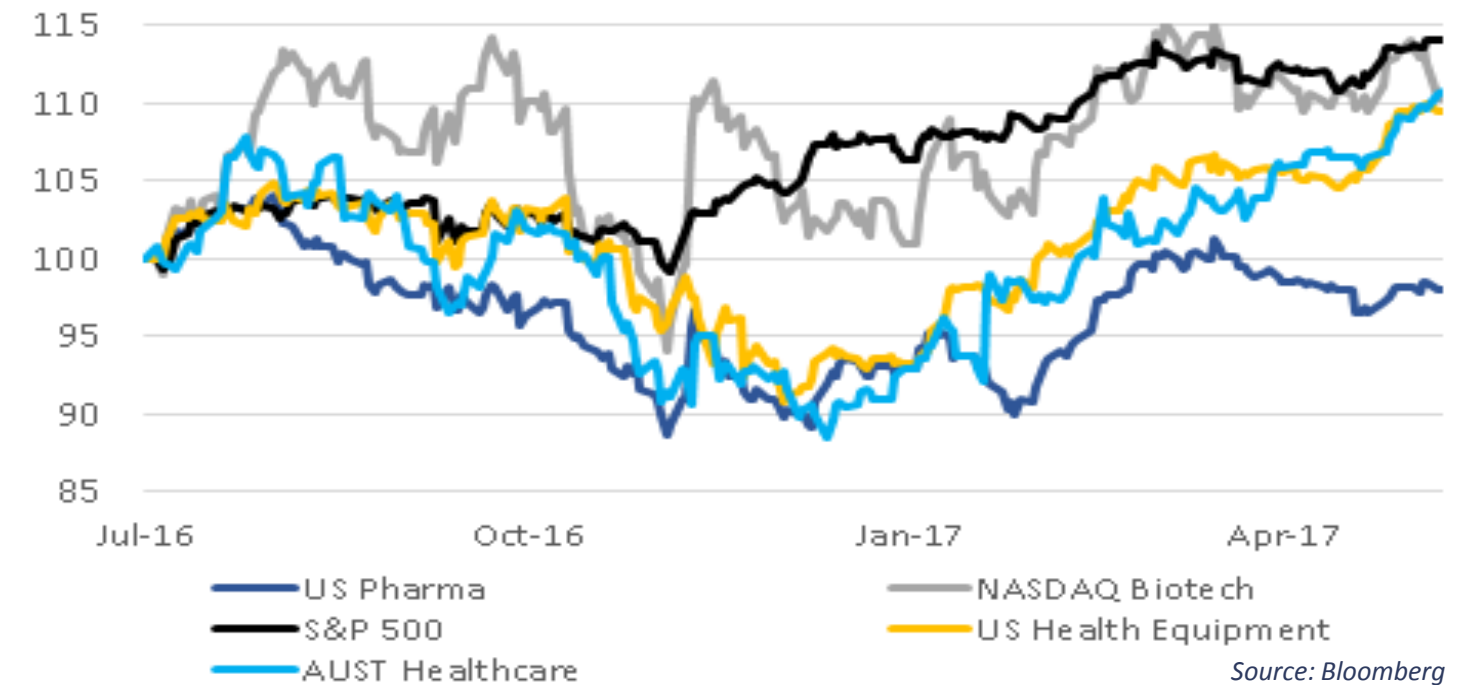
## *Drug pricing remains a key structural and headline risk*

- 1 Price gouging, regulatory probes into anti-competitive behaviour and high leverage makes investing in US generic drug makers too difficult – still too early
- 2 In Biopharma, the pace of innovation needs to lift, especially for biosimilar-exposed companies, to offset structural drug price headwinds due to consolidation of US payers and PBMs
- 3 Medical Devices ‘safehaven’ holds given stable growth and potential capital management activity if US tax reforms ensue

## *How we are positioned*

- 1 **Longs:** Merck & Roche are innovators in immuno-oncology with diversified portfolios. Ramsay is a quality operator, fears overdone
- 2 **Shorts:** Lilly exposed to diabetes pricing pressure and new product launches priced for perfection despite targeting highly competitive indications. Grifols hitting peak multiples, 4.5x levered with a disadvantaged portfolio, no room for error
- 3 Owning innovative companies (MRK, ROG) & selling companies with concentrated/commodity drug portfolios (GRF, LLY)

## *Pharma lags while Devices have recovered*





# Technology-Media & Internet-Telecom (TMT)

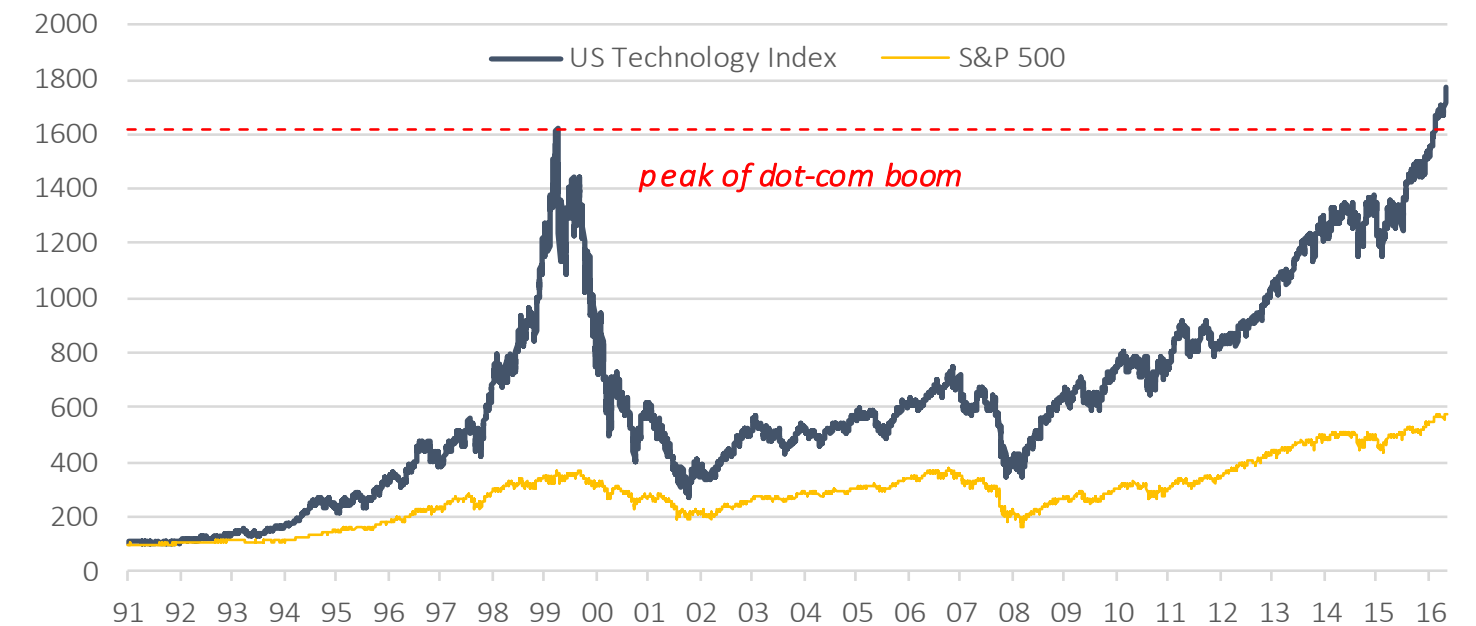
## *Tech is leading the market; media/telco struggling*

- 1 Semiconductor shares are expensive pushed up by M&A. Analog has high barriers to entry and structural growth. Conversely, logic is pressured by enterprise shifting to cloud, and competition
- 2 Structural pressures remain in media as digital share of ad spend rises. Content remains king, but competition is heating up as distribution companies move upstream to protect margins
- 3 Telcos are struggling as broadband and mobile penetration matures, deflationary trends continue in shift from voice to data. Convergence across mobile/broadband/content is accelerating

## *How we are positioned*

- 1 Long analog semis exposed to content growth. Short logic as shift to cloud drives down returns
- 2 Long undervalued content – Video Games and Music. Short vulnerable distribution businesses – TV Networks
- 3 Long telcos in ‘recovering’ markets and short telcos which are overearning or under competitive threat

## *Tech sector has surpassed its dot-com boom peak*



Source: Bloomberg



# Industrials

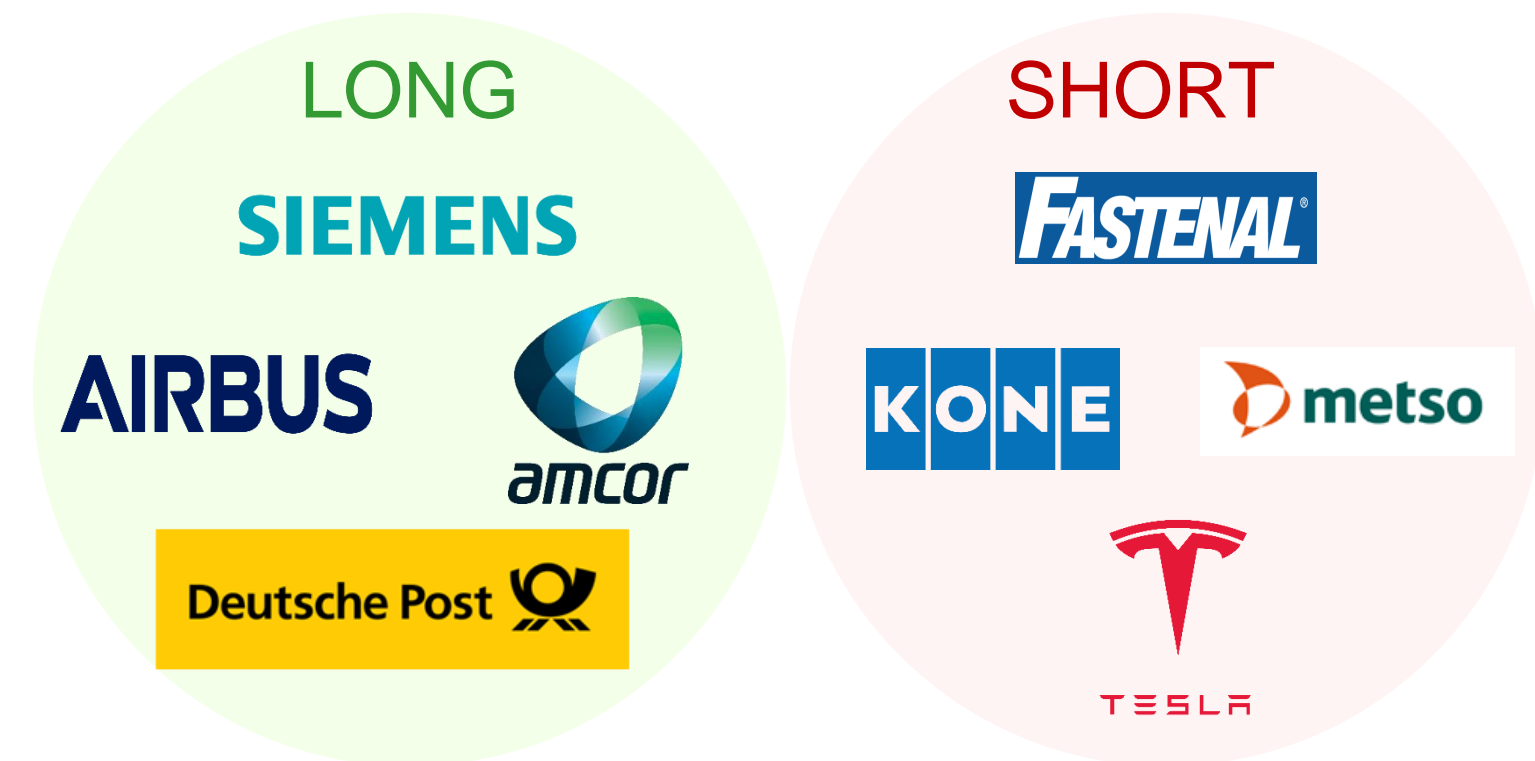
## *Cyclical rally, winners and losers*

- 1 While the 'internet of things' & 'industrial internet' will drive productivity, they will also be highly disruptive
- 2 European industrials restructuring, a catch up to US competitors
- 3 Distribution & logistics is adapting to rapid growth of e-commerce with varied success

## *How we are positioned*

- 1 **Siemens** – industrial powerhouse benefitting from restructuring and industrial internet. **Airbus** – strong order book, A350 ramp. **Amcors** – underappreciated global leader
- 2 **Kone** – pressure on China margins. **Metso** – excessive optimism likely on cyclical prospects. **Tesla** – impressive cars but competitive threat, lossmaking
- 3 **Deutsche Post DHL** (e-commerce beneficiary in parcel delivery) vs. **Fastenal** (industrial distributor, pressure from online competition)

## *Industrials – optimism, risks remain*



# Consumer

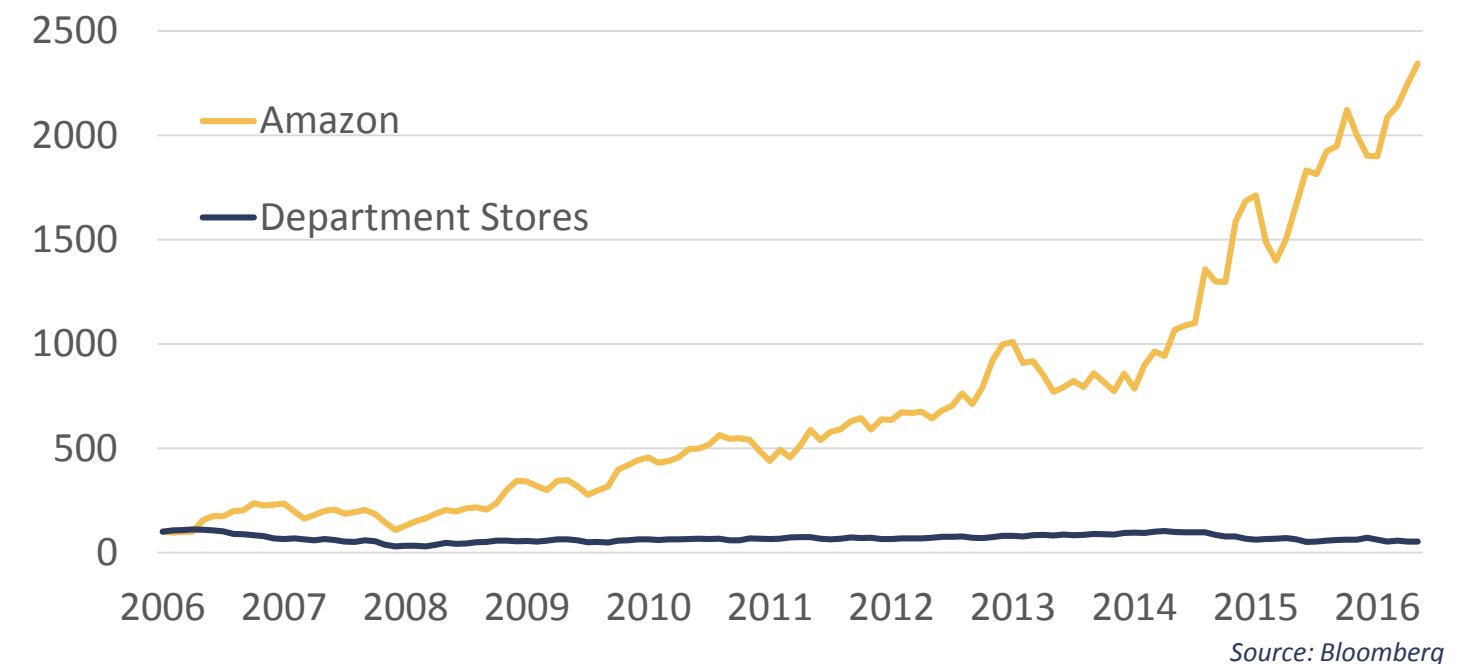
## *Sector is expensive with limited pockets of growth*

- 1 High-quality consumer companies are fully priced, while challenged retailers represent crowded short opportunities
- 2 Online is structurally changing the retail landscape, half of online sales growth is being captured by Amazon. Online comes at a high cost to traditional bricks & mortar retailers
- 3 Consumer packaged goods companies are on the wrong side of health and wellness trends and are challenged by new local competitors that are able to bootstrap their businesses by exploiting online reviews and new distribution channels

## *How we are positioned*

- 1 **Heineken** Best exposure to high growth EM of the major brewers, unique brand portfolio, family ownership ensures a long-term disciplined focus aligned with minorities
- 2 **H&M** (Short) Aggressive store rollout, deteriorating store economics, weak online offering
- 3 **Kroger** Disciplined pricing, best in class analytics, attractive valuation but have been struggling with price deflation

## *Amazon vs US department stores*





# Summary



- Watermark's hedging strategies will demonstrate their value when this bull market completes- we would be surprised if these portfolio's fell in value in any year.
- Our funds are unique in providing truly uncorrelated returns. They tend to do very well when markets fall.
- Performance issues notwithstanding, no capital has been lost in years of underperformance – we haven't create enough value.
- Watermark's expanded investment team is wholly focused on creating value for shareholders.

# Thank You QUESTIONS?

For more information, please contact:

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