WATERMARK
MARKET NEUTRAL FUND

NTA and Monthly Update – July 2017

Company at a Glance

ASX Code	WMK
Fund Size	AU$87.8m
Fund Strategy	Equity Market Neutral
Share Price	$1.00
Shares on Issue	87.4m
Dividend (HY17 Interim)	3 cents
Dividend Yield (annualised)	6.0%

Net Tangible Asset (NTA) Backing

	Jun 17	Jul 17
NTA Before Tax	**$0.99**	**$1.00**
NTA After Tax	$1.01	$1.01

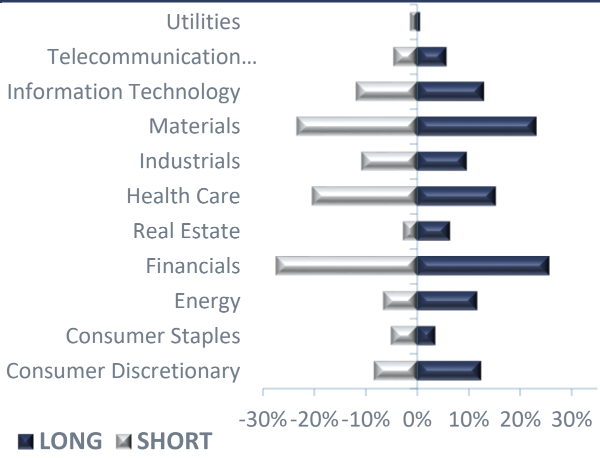
Gross Portfolio Structure

	Jun 17	Jul 17
Long Exposure	131.6%	127.3%
Short Exposure	-129.7%	-123.4%
Gross Exposure	261.3%	250.7%
Cash	98.1%	96.1%

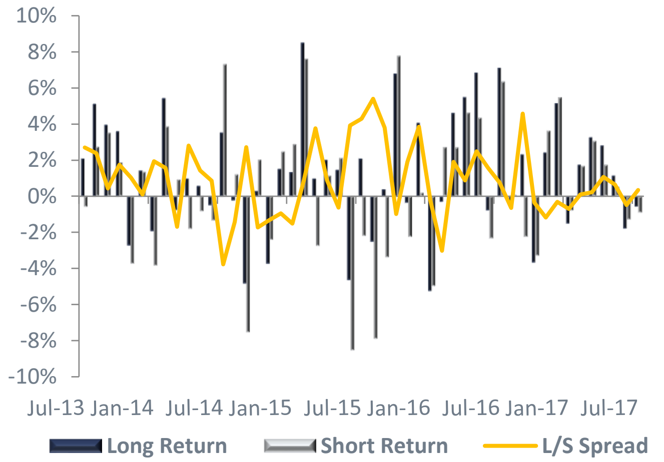
WMK Performance

	1 Mth	3 Mths	6 Mths	FYTD	1 Yr	3 Yrs (pa)	S.I. (pa)
Portfolio Return (net)	0.3%	0.4%	1.1%	0.3%	1.3%	6.5%	6.6%
RBA Cash Rate	0.1%	0.4%	0.7%	0.1%	1.5%	1.9%	2.1%
Outperformance (net)	**0.2%**	**0.0%**	**0.4%**	**0.2%**	**-0.2%**	**4.6%**	**4.5%**

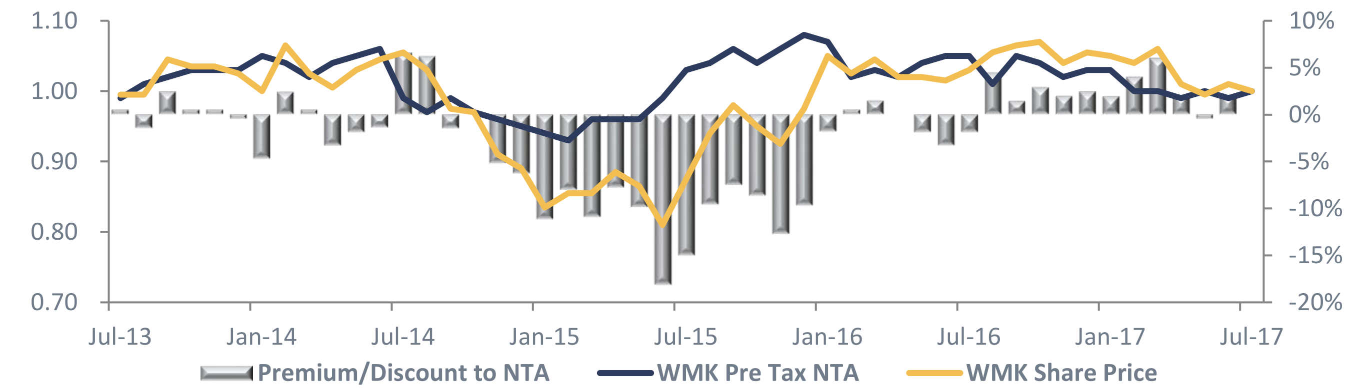
Sector Exposures



Long Short Spread*



Premium/Discount to NTA History



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Month in Review

In a continuation of themes from recent months, currency markets continue to be a key driver of equity market performance. It was a strong month for global shares, with most major indices posting gains, particularly emerging market and commodity based economies, which are beneficiaries of a weaker US dollar. Investors the world over continue to dissect every syllable issued by central bankers for clues as to the timing and quantum of future rate rises, reading dovish tones into comments by the Governor of the US Fed, while finding hawkish inferences in the minutes of the RBA's July monetary policy meeting.

The Fund posted a modest gain in July, rising by 0.3% after fees. The international portfolio delivered the greater share of monthly performance, bucking the trend in global markets in generating solid returns from the short side of the ledger. Strong performance in the healthcare and financial sectors was offset by stock specific issues in consumer discretionary and industrials, while a rallying resource sector led to losses on core short positions in diversified miners.

Global healthcare shares were broadly flat in July, albeit with significant divergences in performance between subsectors and regions. Currency was a driver of regional dispersion with European healthcare shares falling on strength in the EUR and domestic healthcare shares down sharply after a rally in the Australian dollar. Macro themes also played a role in healthcare's underperformance, as investors continue to shift out of defensive shares in favour of more cyclical exposures. March quarter financial reporting saw most major healthcare companies deliver results in line with expectations, however management outlook and full year guidance statements were, on balance, more cautious in consideration of drug pricing pressures in the US.

The Fund's Healthcare positions delivered solid returns, driven from the short portfolio. We highlighted in the March edition of The Leading Edge, potential issues with AstraZeneca's clinical trial of a key oncology treatment for lung cancer. The trial read out in July and failed to show any benefit in respect of progression free survival, sending the shares tumbling 15%. An investment in Nevro performed well after the company pre-announced strong results underpinned by a robust recovery in sales in the June quarter, confirming our thesis that slowing sales in March were an anomaly. New investments in gene therapy company Spark Therapeutics and small molecule pharma company Galapagos were established in the period. We see commercialisation of gene therapies being closer to reality than the market expects and believe Galapagos' pipeline is underappreciated particularly following competitor mishaps (Lilly).

Technology shares recovered from weakness in the prior month, with most of the performance within the sector driven by company-specific earnings releases. On the whole, media shares were laggards, weighed down by emerging concerns around weakness in advertising spend, particularly from consumer companies pressured by anaemic growth and activist investors. Telecom shares finally displayed a glimmer of hope as the major US telcos posted better-than-expected earnings releases, while European telcos also beat expectations through accelerated cost efficiencies.

The Fund's TMT portfolio was a modest detractor. Domestically, an investment in Fairfax Media underperformed as both potential suitors failed to submit bids by the deadline. Globally, short positions in networking companies Juniper and Check Point performed well on the back of lacklustre earnings while a core short in legacy software vendor IBM reaped further rewards, in response to a poor quality financial result featuring some creative accounting. On the long side, investments in Facebook and Ubisoft reported encouraging results.

Leading indicators for the global economy remained strong in July supporting industrial shares. However, with investor expectations remaining high and valuations elevated by historical standards, industrial shares remain at risk of a pullback. This was seen towards month end, when many companies sold off on earnings reports, despite posting strong results. The Fund remains fully hedged, with investments in more resilient, higher quality companies, and companies benefitting from restructuring, balanced by short positions in more cyclical shares on high valuations, carrying risk of disappointment.

The automotive sector is currently out of favour with investors and is trading on depressed earnings multiples as a result. Given the value on offer, we recently initiated an investment in Volkswagen. With vehicle sales largely unaffected by the recent emissions scandal (the financial impact of which has been fully provisioned) and a portfolio of successful brands including Porsche, Audi and Scania, we see significant upside for the company as it rebuilds credibility with investors.

July was a comparatively quiet month for the financials portfolio, with no major surprises from global central banks. An investment in Dutch insurance company NN group performed well, with the company's shares upgraded from hold to buy by London-based analysts at Exane, BNP and Bernstein. A position in Westpac group also contributed positively to returns as details emerged that APRA's volume cap on interest only mortgages excluded refinancing of existing customers and would therefore be less disruptive to the bank's new business volumes.

The broader consumer sector, spanning staples and the more economically sensitive consumer discretionary shares were largely flat in both global and domestic markets in July. We initiated a new investment in the local slot machine manufacturer Aristocrat, following a currency driven sell-off in the its shares. We also established a new short in US household and personal goods company Kimberly-Clark, which is under pressure from price cuts by competitor Proctor and Gamble. Positions in Lululemon (US apparel) and SkyCity Entertainment (NZ casino) were sold following strong recent performance.

Consumer positions were a slight detractor to fund performance over the month of July. The main source of underperformance was our long position in O'Reily Automotive (US autoparts retailer) where concerns around the potential impact of ecommerce on DIY customers was further magnified by a broader slow-down across the entire industry.

Mining shares surged in July as Chinese growth data announced through the month surpassed expectations. A weaker US dollar contributed to strength that saw iron ore up 15% for the month. Concerns around financial tightening have eased and expectations are now that the economy will remain strong through to the Congress meeting later in 2017. Oil also benefitted from the weaker US dollar, however is struggling to break through a key technical level at just over USD$50. Despite the strength in the oil price, energy shares lagged through the month with results from US shale producers disappointing investors. Question marks were raised over the durability of the Permian basin, as Pioneer Resources highlighted an increasing mix of gas from their wells. We initiated an investment in Anadarko Petroleum following recent underperformance, given the company has a privileged suite of assets across conventional/unconventional oil and gas basins.

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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 avaialble to shareholders. Please contact Boardroom Limited for details on how to participate – 02 9290 9600; callcentre@boardroomlimited.com.au