



Tuesday, 27 February 2018

PERFORMANCE REVIEW AND DIVIDEND POLICY

Dear Fellow Shareholders,

Last year was a difficult year for the Australian Leaders Fund (**ALF or the Company**). Challenges in the period were felt most strongly in the 6 months to December 31, where the gross value of the Company's portfolio fell by 3.1% before fees. This setback looks even more unsatisfactory in the context of a share market that has surged higher.

ALF is an Absolute Return Fund with two key objectives, to outperform the All Ordinaries Accumulation Index through a market cycle while protecting the Company's capital when risks in the share market are elevated. Risk in asset markets is primarily reflected in the price, and in our view on most measures, risk assets such as shares are historically very expensive, posing a significant risk to investors. Many investors forget that the Australian share market is still yet to fully recover from the losses experienced through the financial crisis, with the market still below its previous peak reached in 2007, over 10 years ago.

Given these inherent risks we have retained a fully-hedged position, relying exclusively on security selection to deliver returns for shareholders. As a result, the Company has not participated in the strong performance of the share market in recent months.

In 2017, security selection detracted from performance, and the Company has reported a small loss. This is unusual for Watermark given its long track record of adding value for investors. As a result, unfortunately the Company was unable to pay a dividend.

Whilst the value in this strategy may not currently appear obvious (given the small loss experienced last year), the Company expects that it will become apparent when this bull market eventually ends. The Company believes we had a foretaste of this earlier in the month when the MSCI Global Index fell by 6% from its peak, leading the local market lower along with it. Pleasingly, the value of ALF's portfolio increased marginally over this same period.

ALF broadened its investment mandates in 2014 to allow investments in offshore markets. Development of this international capability has necessitated additional resources and the Manager has been busy over the last 12 months building out its investment team with four senior appointments, including Harvey Migotti as Head of International Equities. Harvey joins Watermark from Balyasny Asset Management in London, one of the leaders globally in market neutral strategies.

CAPITAL MANAGEMENT

The Board remains committed to actively managing the Company's capital. As at market close on the 26th of February 2018, 871,597 ALF shares have been purchased on-market at a discount to NTA through the buy-back, which is immediately accretive to shareholder value.

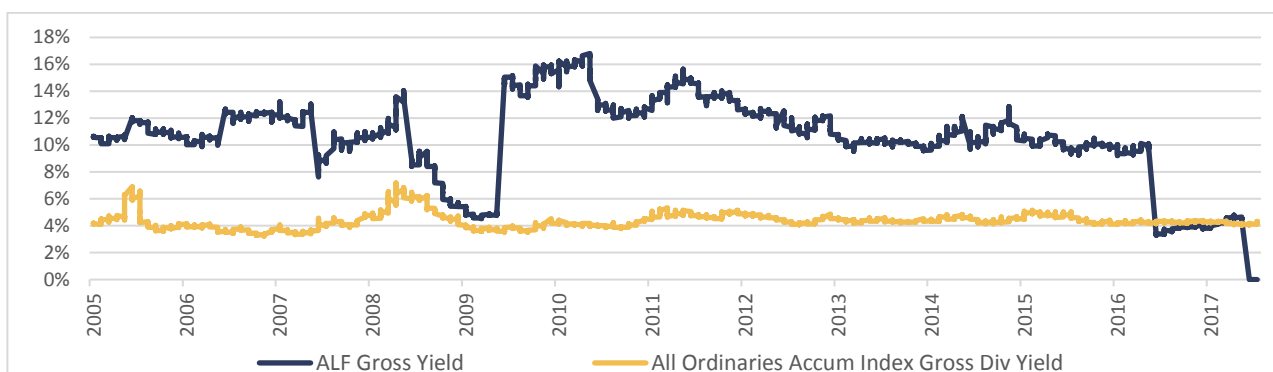


DIVIDEND POLICY

At the Company's AGM in October 2017, that the Board indicated it intended to provide Shareholders with clarity in respect of future dividends by releasing an updated Dividend Policy with the half-year financial results.

ALF has traditionally paid a high dividend, allowed by the Company's historical returns. Shareholders have received dividends with a gross value of \$1.68 per share since the Company listed in 2004. The historic yield paid on ALF shares has been well above the yield of the broader Australian share market as can be seen in the chart below.

Figure 1: Dividend Yield – ALF shares vs All Ords Accumulation Index



The Company applies the All Ordinaries Accumulation Index as its benchmark. Provided the Company has sufficient profits and franking, and that it accords with prudent business practices, the Board believe that the Company can sustain a dividend that is commensurate with the market yield.

A period of lower returns necessarily means less profits and lower dividends. Having distributed all the Company's retained profits, the Board had to reduce the dividend in 2017. If the Company is successful in meeting its return objectives next year, the Board currently expects the Company to return to paying a full dividend. The outcome depends on the Company's performance.

I thank Shareholders for their ongoing support of the Company and look forward to meeting you in person at our investor updates in May. In the interim, the most recent issue of Watermark's quarterly newsletter - The Leading Edge, provides a more comprehensive review of current portfolio settings and outlines the Company's views on markets for the months ahead.

Yours sincerely,

Justin Braitling
CIO – Watermark Funds Management