



WATERMARK  
FUNDS MANAGEMENT

# Investor Update

October 2018



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# Agenda

Investment Manager Update

Market Outlook

Portfolio Review

Questions

# Why choose Watermark Funds?

*“Investing in shares is inherently risky. These risks vary considerably depending on where we are in the investment cycle. Today we are late cycle, shares are expensive relative to historic levels, consequently risks are elevated. Conversely, when shares are cheap, the risks of investing in shares is diminished.*

*Irrespective of the near-term outlook for global shares, we can say with confidence that we are closer to the top than the bottom, and that shares are expensive relative to historic valuations. As risks are elevated, investors should think first and foremost of how they can mitigate these risks.*

*Hedging strategies such as those offered by Watermark are one of the few ways to minimise these risks”.*

Justin Braitling – Watermark CIO

# Watermark's Objectives

## 1. Attractive returns

- We target 8-10% annualised returns from our market neutral funds.
  - FY18 proved challenging for many long/short funds, with most falling short of return targets.
- We aim to beat the All Ordinaries Accumulation Index for our directional fund.
  - Dual focus on capital preservation means ALF has been hedged during final phase of this bull market in shares. Returns relative to the market have been poor.
- The LIC's are aiming to pay dividends commensurate with the yield on the Australian share market.
  - All Watermark LIC's paid franked dividends in FY18.

## 2. No draw downs

- In our worst year, portfolio losses were minimal. When funds are fully hedged, so long as Watermark adds value through security selection, NTA's are protected if markets were to fall and should only move higher over time.
- The portfolios tend to perform well when markets fall.

## 3. Uncorrelated returns

- Returns from most asset classes are expected to be low in the medium-term.
- Watermark funds are not dependent on rising asset values.
- Returns are uncorrelated with other asset classes.

# Business update

## 1. Returns from Australian portfolio improving in 2018

- Renewed focus on domestic portfolios.
- Funds fared better during reporting season – a good barometer for performance.
- Exposures are well balanced – solid performance during volatile months.

## 2. International returns also improving gradually

- New portfolio manager has brought new ideas and tighter risk controls.
- WGF holds an array of exciting investments which will bear fruit in the next 12 months.
- Funds have performed well during an extremely difficult period for long short funds (many global peers have seen draw downs in 2018).

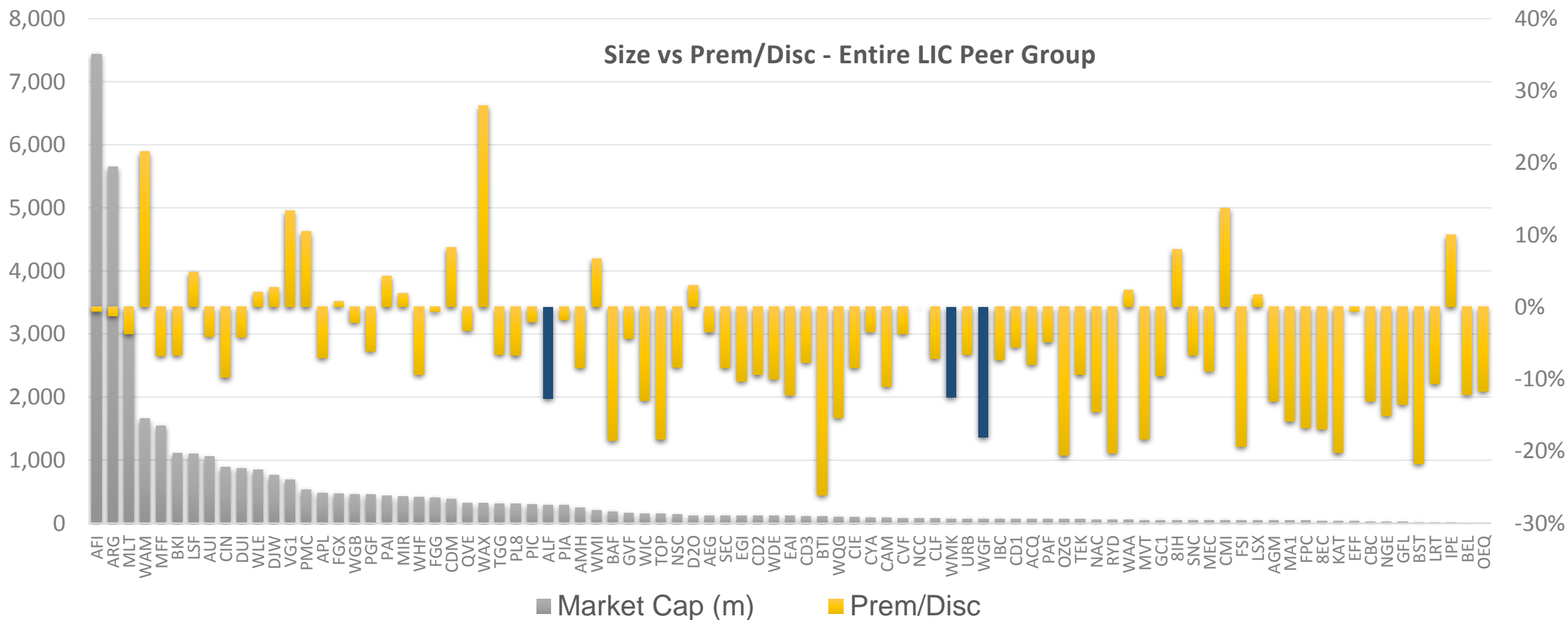
## 3. LIC Boards considering options to address discounts to NTA

- Size and liquidity are clear issues for WMK and WGF.
- All LIC's paid final dividends in respect of FY18.
- Boards are considering all options to address discounts.
- More information will be provided for shareholders at AGM's in November.

## Most LIC's trading at discounts

Size and liquidity have a meaningful impact on premiums/discounts.

The Boards of Watermark LIC's are committed to explore all options available to improve size & liquidity.



# Watermark's 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**

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.



## **Harvey Migotti**

Harvey is portfolio manager for Watermark's international funds and is responsible for coverage of the Industrials sector having joined Watermark in December 2017. Harvey was previously an investment analyst covering Industrials & Aerospace/Defence at Balyasny Asset Management in London. He has also held equity analyst roles with Amiya Capital and Apax Partners. Harvey holds a Bachelor of Business from Lancaster University Management School and attended Cambridge University Judge Business School.



## **Nick Cameron**

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.



## **Gaston Amoros**

Gaston has spent the last 4 years as a Senior Investment Manager with the Abu Dhabi Investment Authority and has over 13 years' experience working across public and private capital markets. He has held investment roles with Benros Capital, TPG and Morgan Stanley. Gaston holds a Bachelor's Degree in Economics from the Universidad Catolica (Argentina) and a Masters in Finance.



## **Hamish Chalmers**

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. Between 2007 to 2010 he was a senior equity analyst (Insurance) for Fox-Pitt Kelton. Hamish holds a Bachelor of Civil Engineering and is a CFA Charterholder.

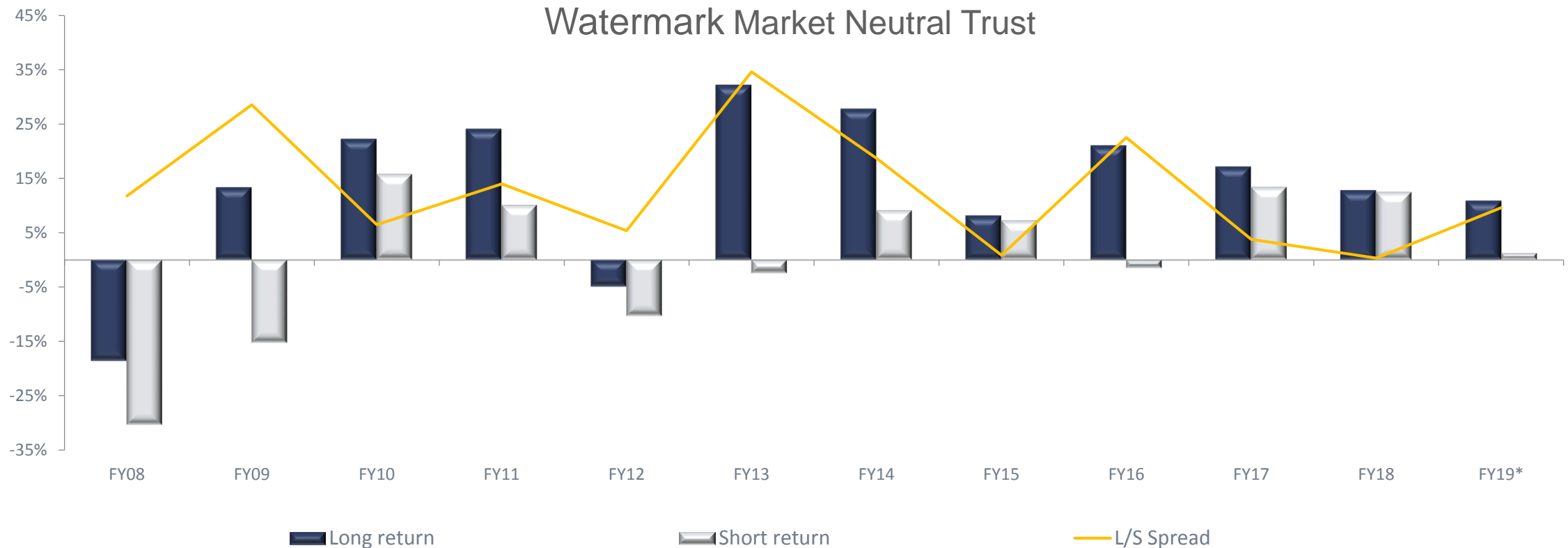


## **Willy Mulyadi**

Willy is a Trader/Quant Analyst, responsible for portfolio trading, quantitative analysis and systems management. Willy joined Watermark in February 2018. Prior to this, he spent two years with Walsh & Co Asset Management as System and Operations Manager and before that he was a Portfolio Trader/Analyst at Metisq Capital (formerly known as MIR Investment Management). Willy holds a Master of Finance and a Bachelor of Accounting.



# Alpha created every year – No losses in 10 years



- A positive spread every year. Outperformance of Longs Vs Shorts.
- When fully hedged, the value of the fund should only fall if the manager is unable to create a positive spread (before costs).

# ALF Performance Summary

Objective: Absolute Returns in excess of the All Ordinaries Accumulation Index

	1 Year	3 Years (pa)	5 Years (pa)	7 Years (pa)	Since Inception (pa)
Long Portfolio	14.2%	18.4%	12.7%	16.8%	-
Short Portfolio	12.7%	14.7%	5.7%	5.3%	-
ALF*	2.1%	2.7%	5.8%	14.2%	15.0%
All Ords Accum	14.7%	12.4%	8.5%	11.2%	9.1%
Avg Net Exposure	7.0%	-2.6%	8.1%	19.4%	-
Fund Beta	-0.25	-0.04	-0.05	0.14	0.64
Volatility	5%	5%	6%	7%	14%

ALF Portfolio Performance as at 30 September 2018

# WMK Performance Summary

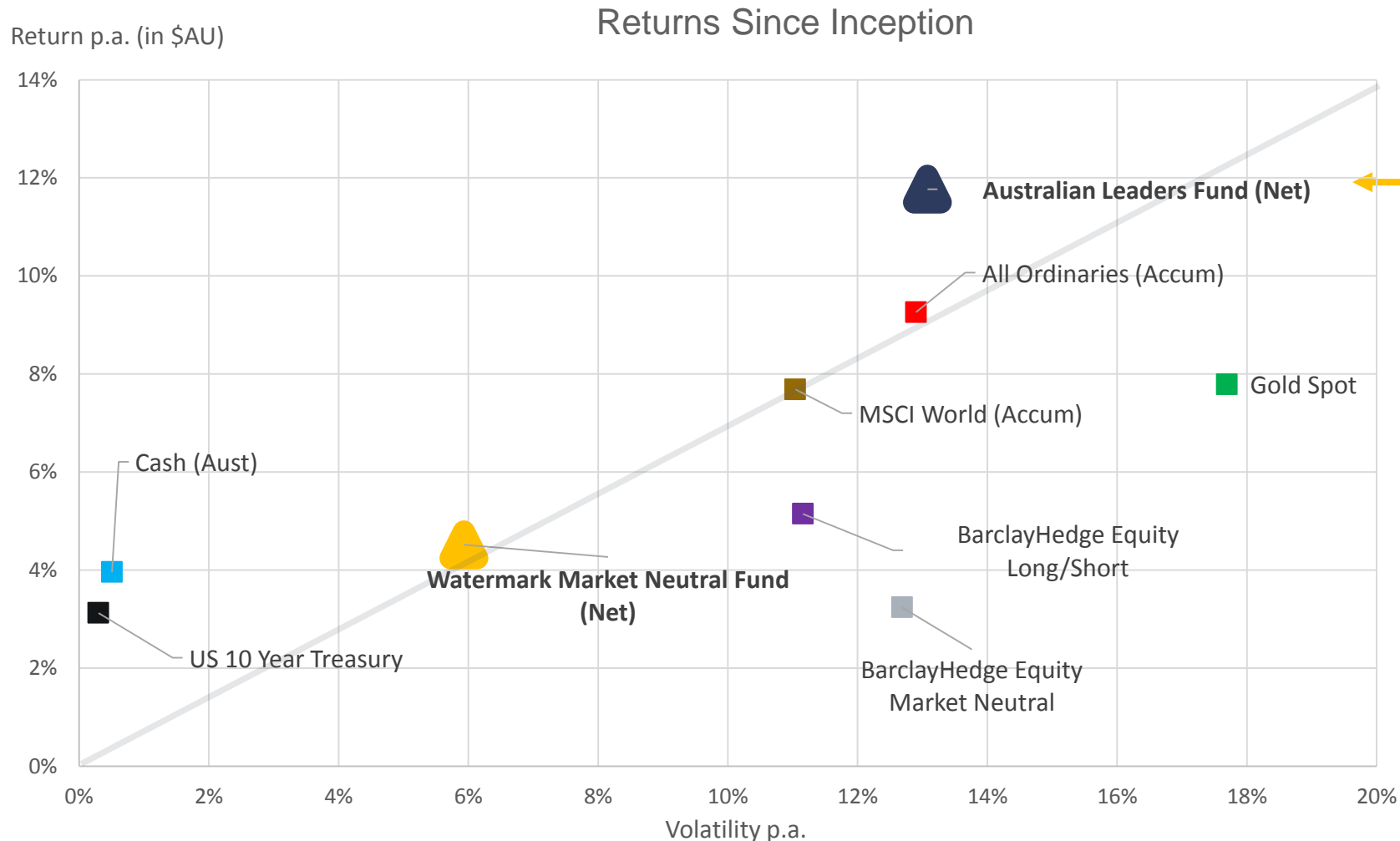
Objective: Absolute Returns in excess of the RBA Cash Rate

	1 Year	3 Years (pa)	5 Years (pa)	Since Inception (pa)
Long Portfolio	13.8%	19.2%	13.7%	15.4%
Short Portfolio	13.1%	14.9%	5.7%	6.6%
WMK*	0.7%	3.4%	7.0%	7.6%
RBA Cash Rate	1.5%	1.6%	1.9%	2.0%
Excess	-0.8%	1.8%	5.1%	5.6%
Avg Net Exposure	4.4%	0.8%	1.5	1.5%
Fund Beta	-0.28	-0.04	-0.17	-0.15
Volatility	5%	5%	6%	6%

WMK Portfolio Performance as at 30 September 2018

# Risk Vs Return- Asset Classes

Objective : Absolute Returns in excess of the All Ordinaries Accumulation Index



- ALF's performance has rarely been a straight line.
- Periods of strong performance generally followed by periods of consolidation.
- When fully hedged, ALF's returns will have no correlation to the share market.
- ALF underperformed in FY17 & FY18 after outperforming by 9% in FY16.
- Relative performance will improve as the cycle for risk assets completes.



# Watermark Global Leaders Fund



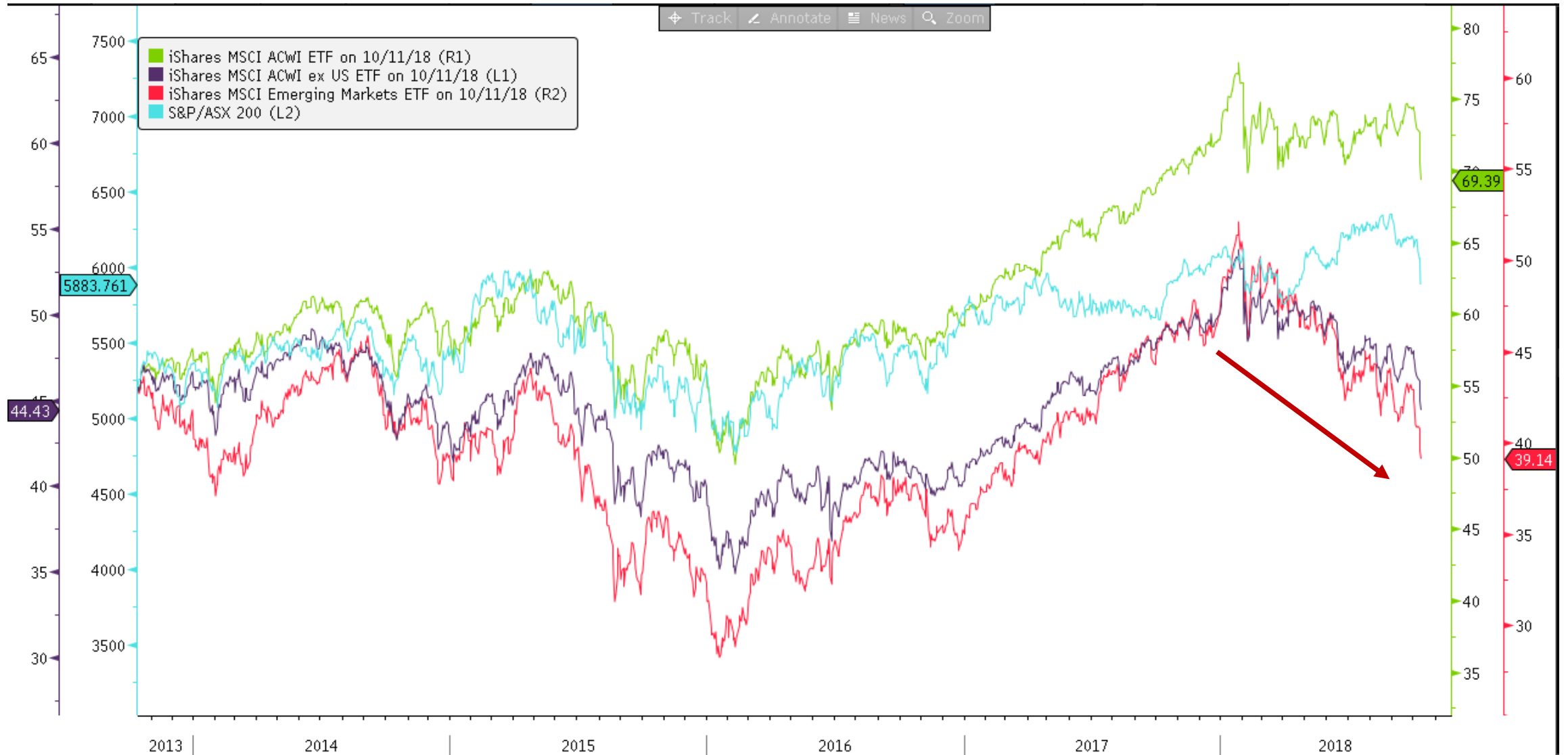
- Returns have been steadily improving over the past year due to actions taken.
  - Separating domestic and international portfolio management responsibilities. Appointment of International PM.
  - Tighten risk management-factor risks such as currency and regional exposures are closely managed.
  - New team members are starting to make a contribution to performance – Gaston Amoros recently joined to spearhead our Consumer & TMT efforts.
- There has been a clear improvement in monthly performance so far in 2018 despite a very tough environment for Long/Short.

# Market Outlook

# Market Outlook

- Emerging markets (EM) and trade have been the mainstay of global growth in recent decades. EM growth is now challenged by tighter monetary policy in the US, as the US dollar and oil prices have pushed higher. Trade has stalled as the US trade war with China has intensified.
- Both these policy initiatives - the trade war and interest rates are likely to ratchet higher in the year ahead presaging further weakness in financial markets.
- An overstimulated US economy has kept the US share market from following other markets lower in 2018. Ex-US shares have moved into bear territory.
- Inevitably as monetary policy becomes restrictive and output gaps close, growth will slow and profit margins will come under pressure dragging US shares low as well.
- While we are not looking for a downturn in the US economy any time soon, the share market is likely to anticipate one later next year marking the end of the longest bull market in history.

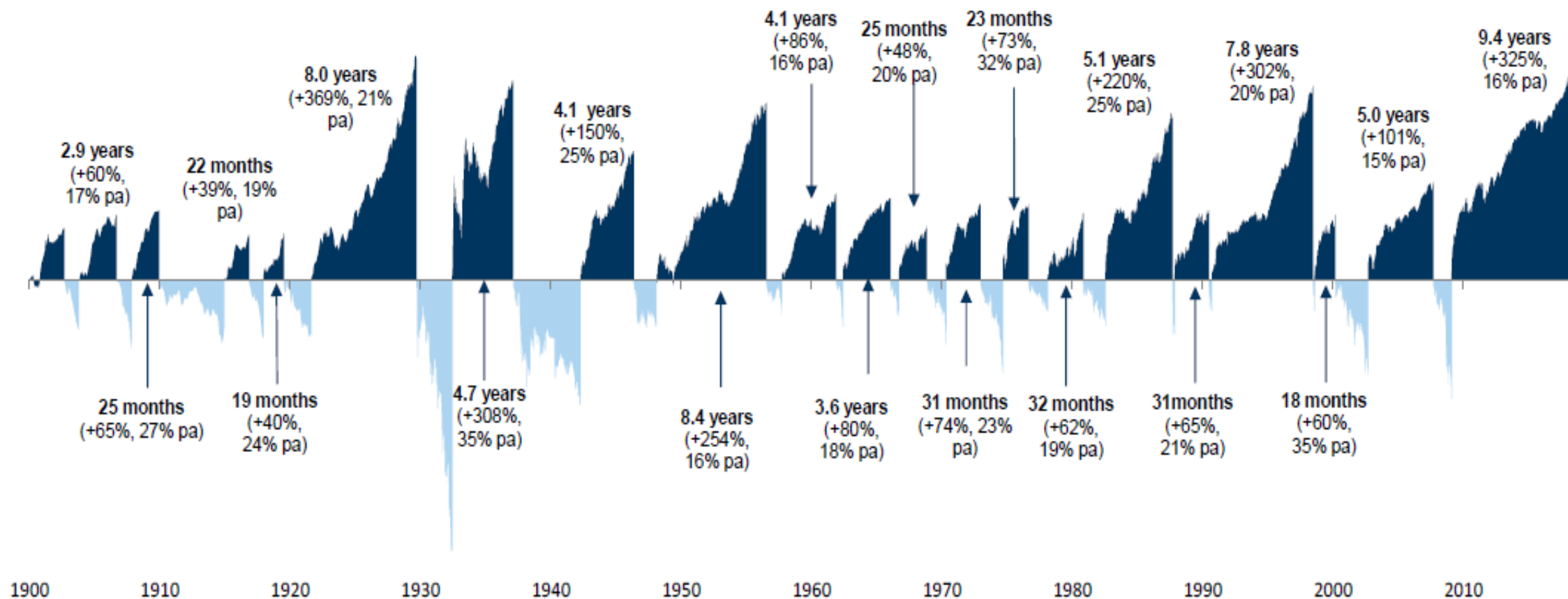
# Share markets outside the US have been falling all year...



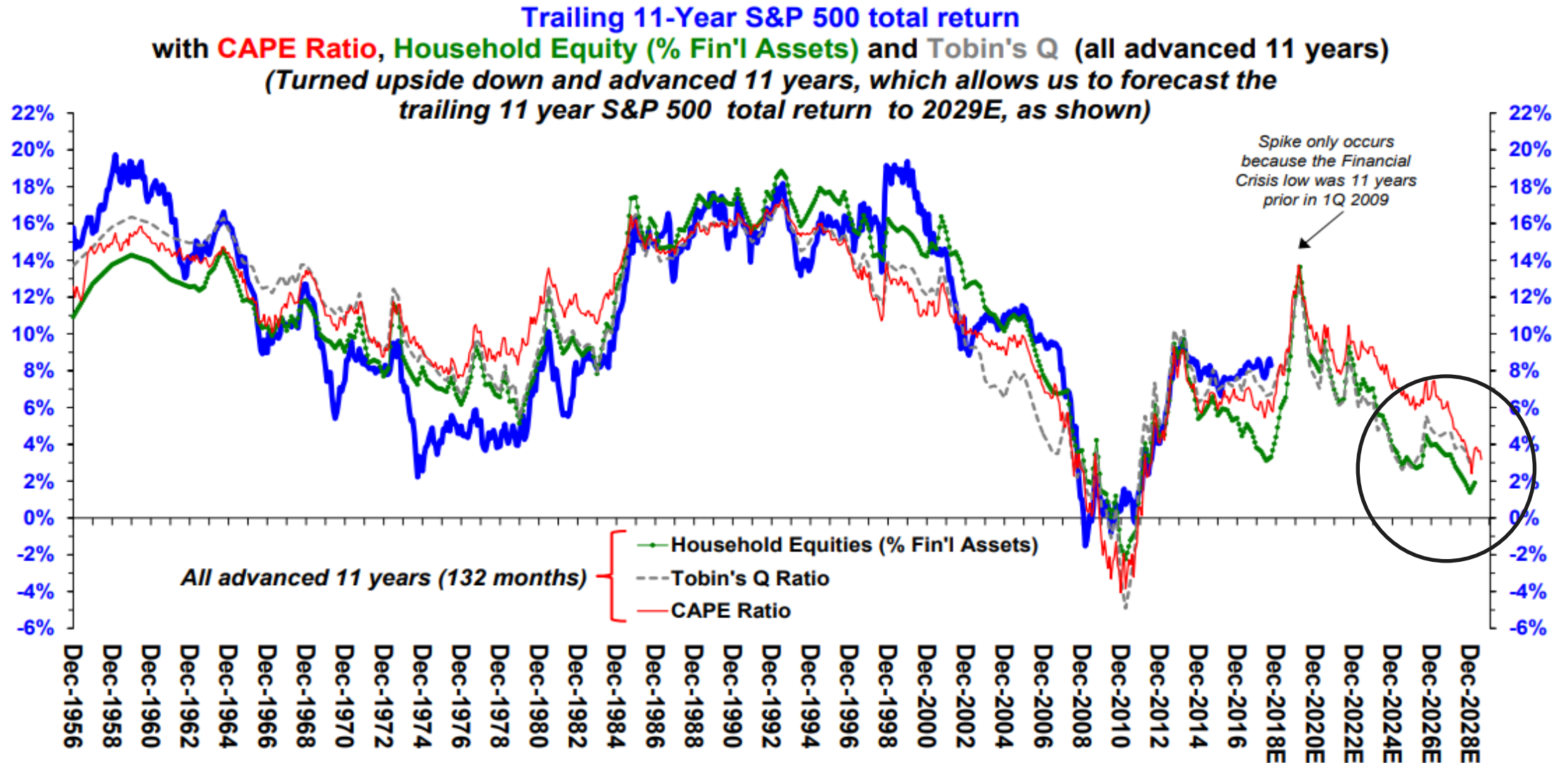


# Late cycle & expensive - time to hedge?

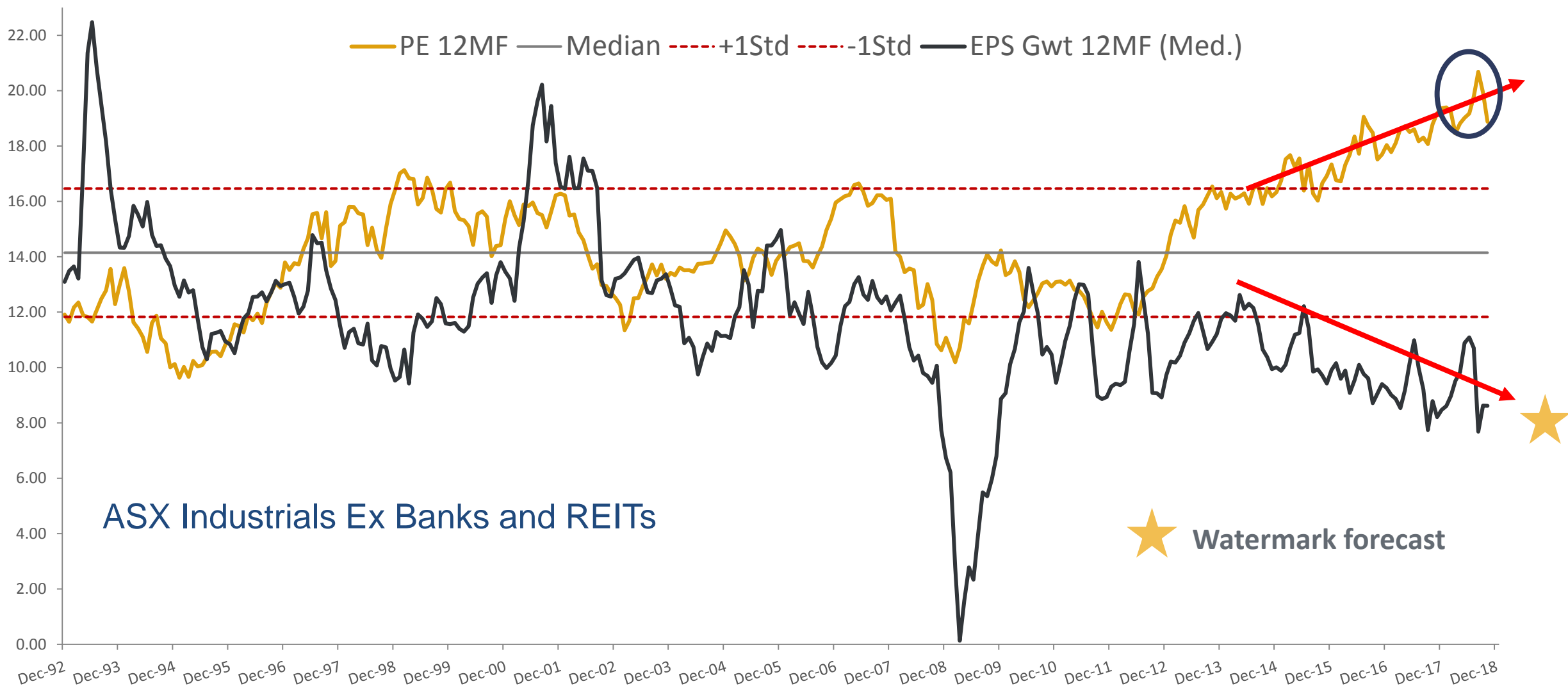
We are in the longest Equities bull market without a 20% drawdown  
S&P 500



# Future returns from shares are likely to be very low

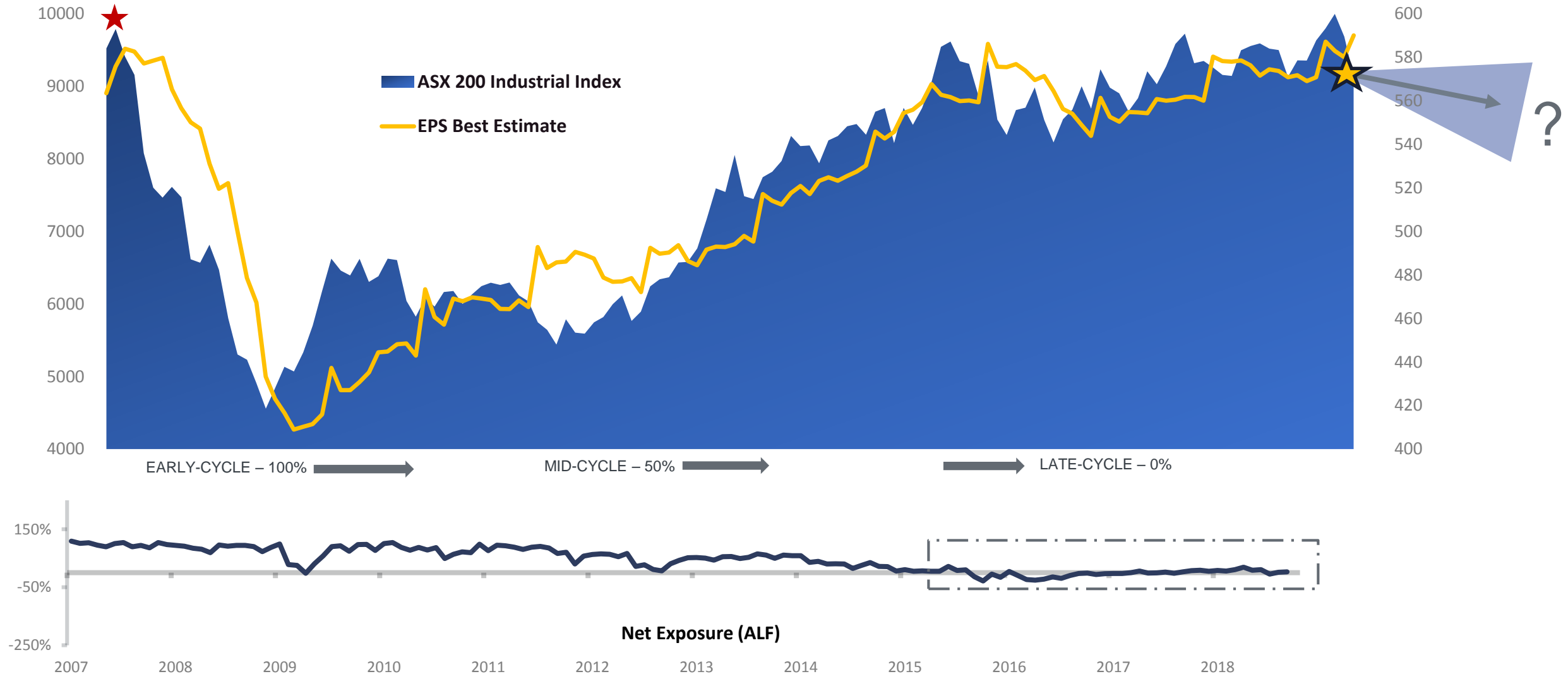


# We are paying a full price for less growth



# Australian Share Market - update

Objective : Capital preservation when risks are elevated





# Portfolio Review

Industrials



ASX: SGM

Healthcare



ASX: CSL

TMT



ASX: OML

Basics



ASX: AMI

Consumer



NYSE: CBS

Financials



ASX: LNK

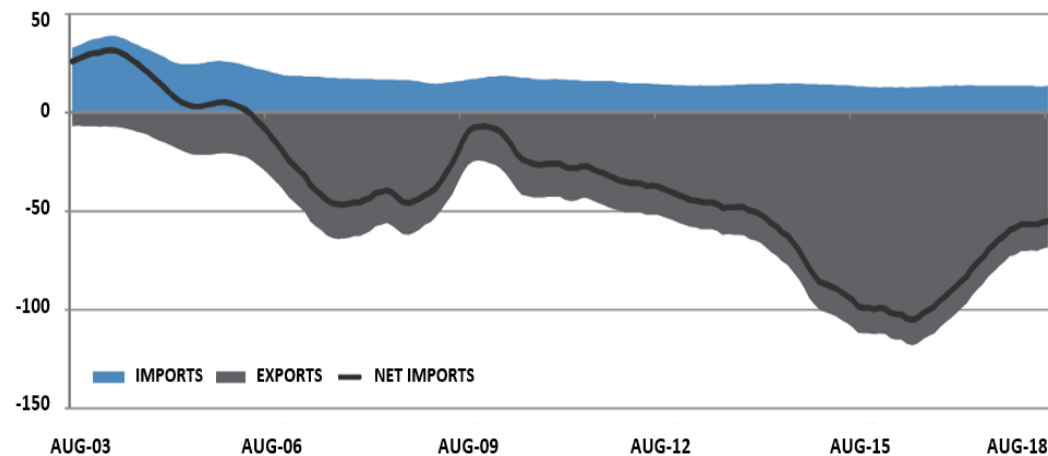


Sims Metal Management is a recycler of ferrous and non-ferrous metals with their primary operations in the US.

### Investment Case: Long

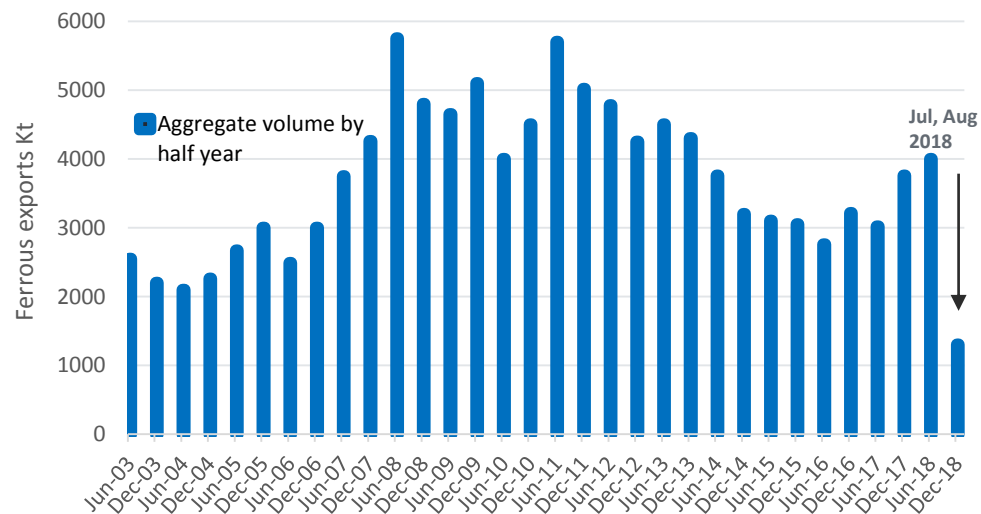
- 1 Continued volume recovery. As a processor and seller of scrap material, Sims is reliant upon scrap availability. The US economy continues to recover with volumes still 30% below the prior peak.
- 2 Structural reduction in Chinese steel exports. China has implemented 'supply-side reform', limiting steel capacity. This has reduced steel exports by over 50 million ton – assisting demand for ferrous scrap.
- 3 China Blue Sky policy an opportunity for Sims. China has banned imports of certain unprocessed scrap material. This has disrupted global recycling flows and creates an opportunity for Sims to invest and process 3rd party material.
- 4 Balance sheet with large net cash position. Sims have nearly \$300m net cash with opportunities to invest in processing plants. The company has recently announced small acquisitions which will also support earnings.

### Reduction in Chinese steel exports



Source: General Administration of Customs, JP Morgan Research

### Sims volumes still well below prior peak



Source: US Customs data, Credit Suisse research



Leading global plasma protein therapeutics company. After a decade of solid growth multiple threats are emerging, time to sell.

## Investment Case: Review

1

Immunoglobulin growth threatened by new technology. CSL's immunoglobulin (IG) products (Privigen & Hizentra) face threats from novel drugs targeting the 'FcRn' pathway. Data thus far is encouraging, suggesting up to 30% of IG use may be at risk. Multiple approvals could arrive in 2 years.

2

Specialty products also at risk. Highly profitable haemophilia and specialty products also face unprecedented competition – risks from gene therapy in haemophilia B (Pfizer, BioMarin); Shire's Lanadelumab launch; and, Roche's growing Hemlibra sales.

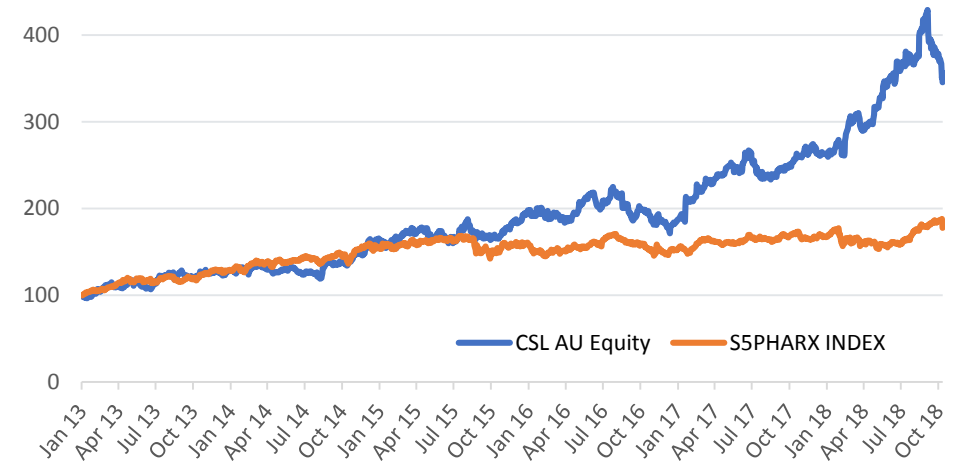
3

'Last litre' economics cuts both ways. The more products CSL sells per litre of plasma fractionated, the more profit it makes. Profitability suffers if all IG and albumin is not sold as no other product has sufficient demand to meet the shortfall. If threats materialise, margins will fall materially and growth will stall.

4

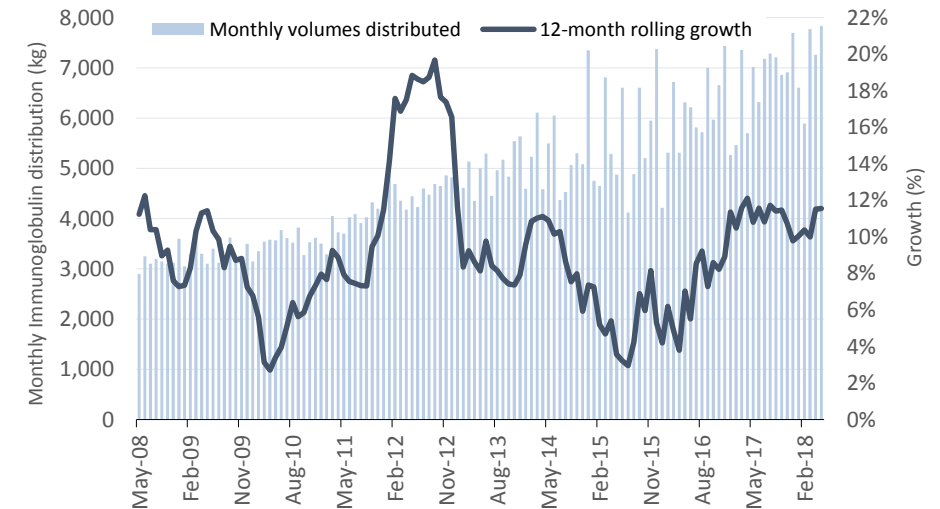
Record valuation suggests risks are being ignored. CSL shares have more than tripled in 5 years and trade at near-record valuation.

## CSL has materially outperformed global peers



Source: Bloomberg

## US immunoglobulin volume distribution



Source: Plasma Protein Therapeutics Association

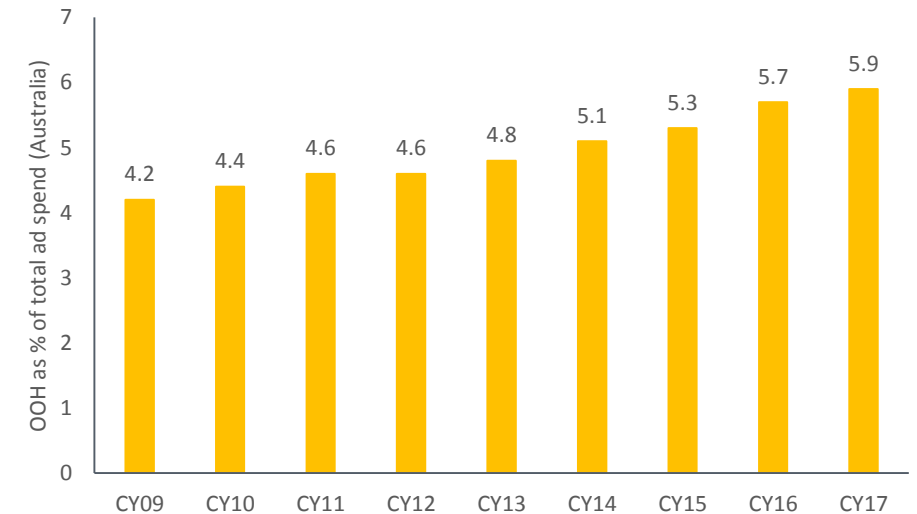


oOh! media will be the largest player in the structurally growing 'Out of Home' sector following its acquisition of Adshel.

### Investment Case: Long

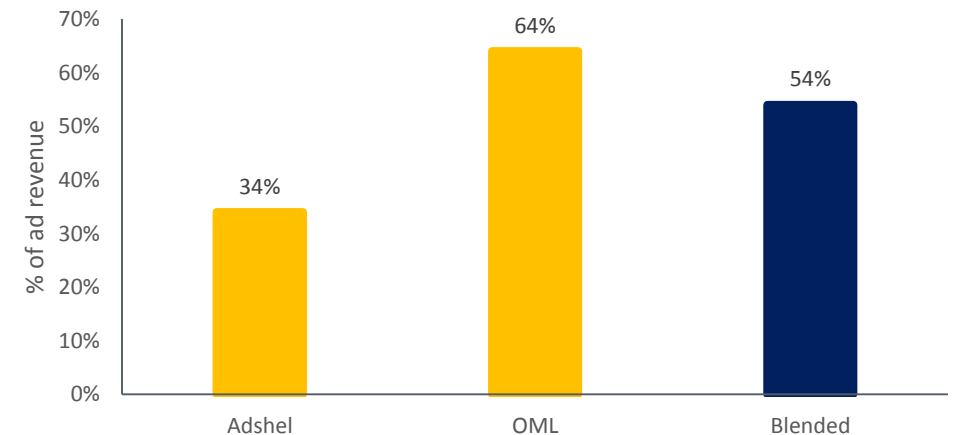
- 1 Outdoor market growth.** In 2017, the Out of Home sector accounted for only 5.9% of total advertising spend. We believe this will move to 10%, as TV, print and even some digital platforms lose share of advertising spend.
- 2 Consolidation has occurred.** At the same time as Ooh acquired Adshel, international competitor JC Decaux acquired APN Outdoor. These two players now command 90% of the Out of Home market.
- 3 Adshel digital.** For many years, Adshel was a JV between Clear Channel Outdoor and APN News. Both companies were financially stretched delaying the shift to digitalise their assets.
- 4 Valuation attractive.** Despite the structural tailwind that we see for Ooh, the company trades on 16x P/E in 2019, well below international peers. Synergies from the acquisition will also benefit beyond this year.

### Continued high growth in Outdoor Ad Spend



Source: Company data, Macquarie Research

### Digital opportunity with Adshel



Source: Company data, Macquarie Research



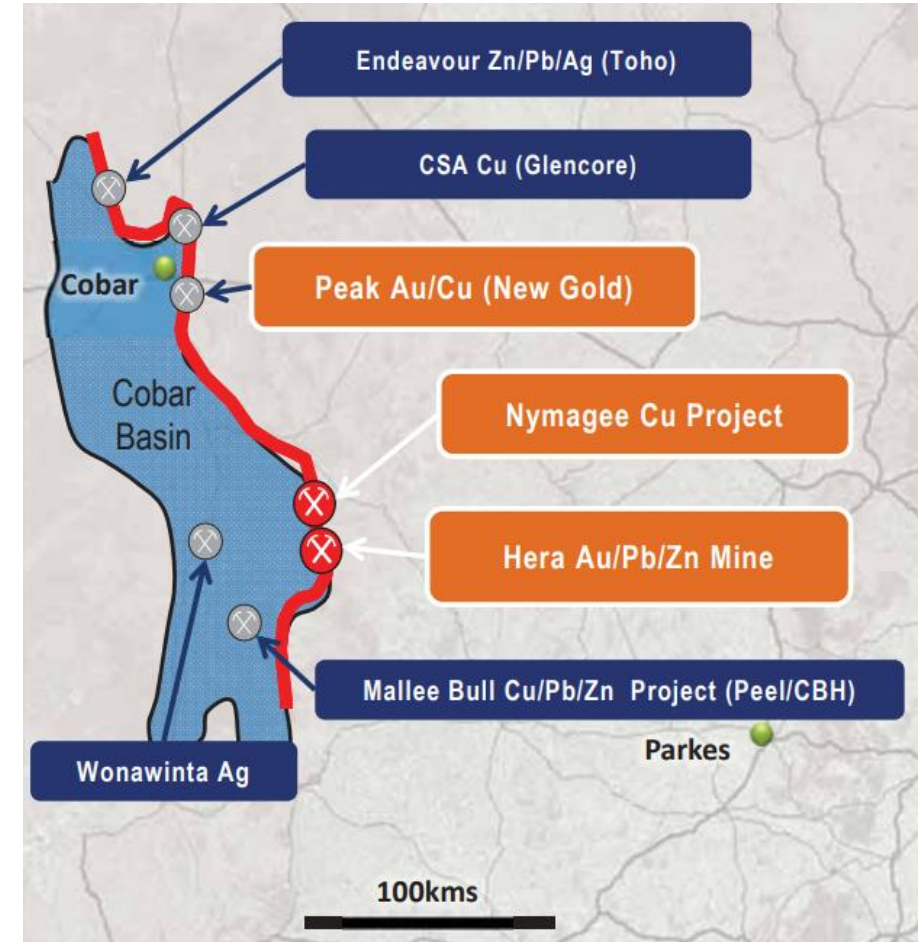


Aurelia Metals acquired The Peak gold mine from a distressed offshore seller, providing a growth path for this mid-cap miner.

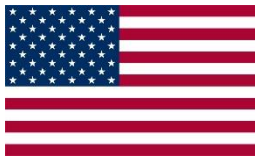
### Investment Case: Long

- 1 **Proven management.** Since joining Aurelia in 2016, Jim Simpson has increased production and reduced costs at their initial mine; Hera, providing a blueprint for the upcoming turnaround of Peak.
- 2 **Transformational acquisition.** The Peak gold mine was acquired from the financially distressed Canadian miner, NewGold. The acquisition price of US\$58m was a fraction of the \$500m replacement cost.
- 3 **Costs and exploration potential.** There is potential to increase production and lower costs at Peak. The acquisition also gave Aurelia a large land holding all the way from Peak down to Hera.
- 4 **Further acquisitions.** The Cobar basin has been underexplored due to the structure of owners. Glencore have previously attempted to sell CSA, and Toho are an unnatural owner of Endeavour. We expect further consolidation of the region in coming years.

*The Peak Mine acquisition has created an enviable land package*



Source: Aurelia Metals



Leading US Broadcast and Cable Network.

## Investment Case: Long

1

**Scarcity of quality content assets in US media / take out target.** The rise of Netflix disrupted the traditional US Pay-TV industry with its TV bundle of 400 channels. Incumbents reacted, triggering a round of consolidation. AT&T acquired Time Warner. Disney is now buying majority of Fox content assets. Discovery acquired Scripps. CBS stands out among the remaining entities for the quality and strategic nature of its assets: Showtime, ABC network and a successful TV studio.

2

**Runway for earnings growth:** CBS is growing revenue at high-single digit pace, driven by continued growth in distribution of Showtime (25 out 96m Pay-TV households), inflation in affiliate fees (4-5%) and 20% growth in retransmission fees. 2019 earnings will be boosted by Superbowl ad revenue.

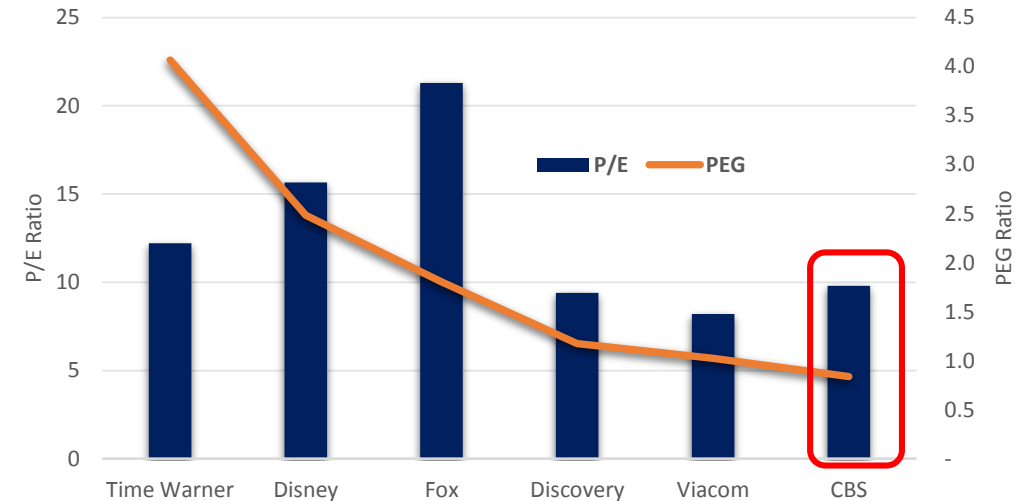
3

**Shareholder conflict resolution.** Shares of CBS had been dragged by the overhang from a potential merger with Viacom, pushed by the Redstone family who is a large shareholder in both companies. On September 9, CBS and Redstone reached a settlement whereby Redstone agreed not to make a merger proposal for at least two years and also to be open to any other strategic approaches. There are rumours of CBS board testing the market for a potential buyer.

4

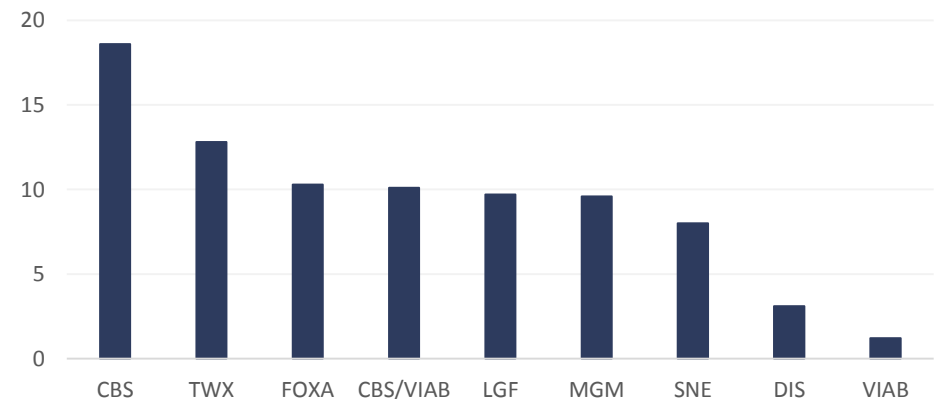
**Cheap valuation:** CBS trades at 9.8x P/E. Fox is in the process of selling the majority of its assets for c.20x PE and AT&T announced its Time Warner deal at 16x PE.

## Cheap for the Earnings Growth (PE vs. PE/G ratio)



Source: Bloomberg & Exane Research

## CBS is levered to attractive trends in content production (TV Studio % of EBITDA)



Source: RBC

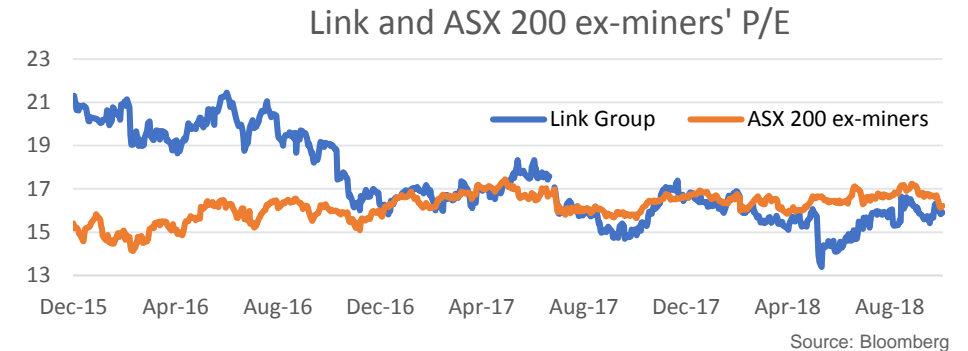


Link Group provides administration services & shareholder management.

## Investment Case: Long

- 1 Shares have de-rated on temporary issues. Link shares have de-rated on concerns around impact of Federal Budget changes, Productivity Commission report on Superannuation and recent small contract losses. These issues are quantifiable, manageable and explainable (respectively).
- 2 Excess capital and M&A to drive earnings growth. 10% of market cap in excess capital following April 2018 capital raise and company has good acquisition track record. Acquisition could cause near-term EPS accretion (Fund Admin or Europe bolt-on's) or long-term growth accretion (e.g. PEXA).
- 3 Cost save opportunity significant. LAS (recent acquisition) synergy guidance looks conservative, only taking out around 6% of the cost base (vs. comps of 10-30%). Every 1pp of LAS cost base is 1% earnings upgrades.
- 4 Above-market earnings growth and cash-flow, below-market P/E. LNK has better revenue, earnings and cash-flow growth than Australian market, but trades at a discount.

## Trades on an unusual P/E discount to the market



## Incremental LAS synergy opportunity

Acquirer	Target	Synergy Target	% cost base	% revenues
Experian	Clear Score	US\$25m	50%	45%
Computershare	Equatex	US\$30m	53%	38%
Computershare	BONY Mellon	US\$78m	30%	27%
Intertrust	Elian	£10m	17%	11%
Equiniti	Wells Fargo SS	US\$10m	12%	10%
SS&C	DST	US\$150m	8%	7%
Link	Capita Asset Services	£15m	6%	5%
Serco Group PLC	ITNET plc	£5m	3%	3%

Source: Morgan Stanley

# Summary

- Returns from the Australian portfolio are improving.
- International portfolio performing well under stewardship of Harvey Migotti.
- All LIC's paid dividends in FY18, pursuant to dividend policy announced in May.
- Plans to close discounts on LIC's, to be addressed at upcoming AGM's.
- Market outlook is uncertain - prices are elevated with limited prospects for further growth.
- Risks remain elevated in the medium-term.
- Hedging strategies are more valuable than ever.

# Thank You QUESTIONS?

For more information, please contact:

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