

Watermark Market Neutral Fund announces an interim dividend of 2 cents per share

Company update

The Company today announces a loss after tax of \$4.5 million and declares an interim dividend of 2 cents per share for the 6 months to 31 December 2014. Watermark Market Neutral Fund Limited (ASX: WMK) ('WMK' or the 'Company') is a listed investment company managed by Watermark Funds Management ('Watermark').

WMK Chairman, Matthew Kidman, said: "After a strong 2014 financial year, the performance of the Company's portfolio has been disappointing in the 6 months to the end of December. We are confident that the Company's investment strategy is the right one and that the Manager can deliver on the investment objectives it has set".

Interim Dividend

The Board declared an interim dividend of 2 cents per share, franked at 70%. The dividend will be paid on April 14, 2015 and trade ex on March 26 2015. Mr Kidman said "it remains the board's objective to deliver a growing stream of franked dividends over time. The board has also signalled a preference for payment of fully franked dividends where possible and will endeavour to do so in the future."

Buy-back

The board previously announced a share buy-back and purchased 100,000 WMK shares in August 2014.

The Board intends to be active in buying back the Company's shares where they are trading at a deep discount to NTA. As explained by Mr Kidman, "the directors consider that a purchase of the Company's own shares represents a good investment opportunity where the Company's shares are trading at a discount to NTA".

Investment Strategy

WMK offers a unique investment proposition to shareholders by virtue of its investment strategy. Equity market neutral funds traditionally fall into the 'alternative investment' asset class, due to the uncorrelated nature of their returns as compared with other investments. Notwithstanding the Company makes its profits from investments in shares, the returns from WMK's portfolio will have little or no correlation with traditional share funds or with the underlying share market. Alternative investments such as WMK have an important role diversifying risk in a portfolio and offer investors an opportunity to hedge share market risk, thereby lowering their overall exposure to the share market.

Risk in an equity market neutral strategy will rest entirely with the investment manager's ability to select a long portfolio of shares that can outperform a short portfolio of shares. WMK offers shareholders an opportunity to benefit from the services of a highly experienced investment manager, focused solely on managing hedging strategies.

With sluggish growth trends expected to continue in 2015, returns for shares from current elevated levels are likely to be anaemic at best. Risks remain however, with deflation looming in many economies and any recovery in economic growth looking increasingly brittle. The Manager's Chief Investment Officer, Justin Braitling said: "As imbalances continue to build in asset markets, investment strategies that offer a genuine means of hedging market risk will play an increasingly important role in investors' portfolios. In this regard WMK shareholders can feel comfortable that the value of the Company's portfolio is protected in the event of a major market setback".

Investment performance

Portfolio performance was disappointing for the half year, particularly in respect of key investment objectives; to deliver returns in excess of the RBA Cash Rate while managing market risk. In relative terms, the short portfolio performed in line with the market while the long portfolio significantly underperformed.

Performance at 31 December 2014	1 Mth	3 Mths	Fin. YTD	1 Yr	3 Yrs %pa	5 Yrs %pa	Since Inception %pa
WMK (net return)	-1.1%	-4.4%	-7.5%	-1.8%	N/A	N/A	2.4%
RBA Cash Rate	0.2%	0.6%	1.3%	2.5%	N/A	N/A	2.5%
Outperformance (net)	-1.3%	-5.0%	-8.8%	-4.3%	N/A	N/A	-0.1%

Poor stock selection, particularly in the long portfolio accounted for most of the under-performance, with the financial services and mining sectors posing challenges. Leadership in the Australian share market has narrowed around a handful of high yielding shares, which are being pushed higher as investors look to supplement income in their portfolios. With valuations for these companies having looked stretched for some time, they have not been represented in the WMK and performance has lagged the market as a result.

Analysis of the long term track record of Watermark's unlisted market neutral strategy depicted in the chart below, reveals how in each of the last seven financial years, a positive gross return has been achieved. Past performance is not an indicator of future returns and the data in the chart below does not pertain directly to WMK however, it is meaningful for WMK shareholders given the substantial similarities between the Company's portfolio and others managed by Watermark.

While long/short strategies may at times appear complex, they are actually very simple. As a fully hedged portfolio, shareholders benefit to the extent that the long portfolio of shares the Manager likes, outperforms the short portfolio of shares it doesn't like (blue and orange bars below) irrespective of what the share market does. The gross portfolio return is simply the spread between these two bars as shown by the blue bar in the lower panel. This has been a remarkably stable and reliable strategy until recently.



Returns from the market neutral strategy have been consistently positive through varied market conditions. Every year Watermark has been successful in picking a portfolio of winning shares that has outperformed a short portfolio of losing shares, with the exception of the last six months. As explained by Mr Braitling, "while this year is clearly a disappointing break from the past, a setback at some stage was somewhat inevitable particularly in the highly distorted investment markets we are currently dealing with. This is clearly the Manager's *Annus horribilis*. We look forward to a resumption of prior form, hopefully in the near future."

Company outlook

Shareholders will receive a copy of the latest edition of *The Leading Edge*, the quarterly journal outlining Watermark's current views on economic and investment themes. In this edition, the Manager shares observations on the state of the global economy and the outlook for Australian shares. A detailed analysis can also be found on the much maligned *Resources* sector, with a frank appraisal for the risks and opportunities that the sector presents.

Yours sincerely



Matthew Kidman
Chairman