



WATERMARK

FUNDS MANAGEMENT



About Watermark

- We are high conviction, active investors in Australian public companies.
- As an 'Absolute Return' manager, we offer investors an alternative to traditional 'long only' funds that are more dependent on a rising share market.
- We look to profit from the mispricing of Australian shares while protecting our investors from loss through the use of hedging strategies that can enhance returns while reducing market risk.
- We have over 10 years experience in long/short equities. Our flagship fund Australian Leaders Fund Limited has delivered a compound net return of 14% p.a. since listing a decade ago.

Our Investment Team



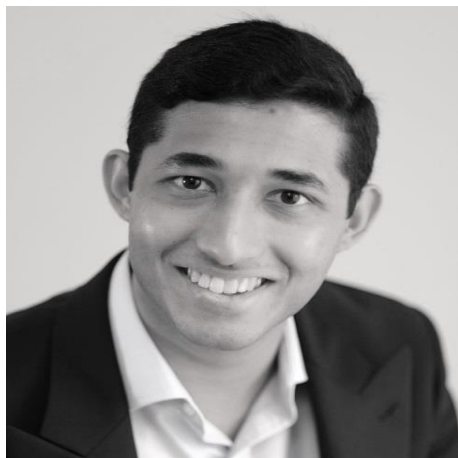
Justin Braitling – Portfolio Manager

Justin has over 22 years experience in investing in Australian and international securities. Justin was an Investment Analyst and Portfolio Manager at Bankers Trust for 12 years from January 1991 to June 2002. Justin was a key member of the investment team at Bankers Trust that was consistently ranked in the top quartile of managers by InTech.



Joshua Ross – Investment Analyst

Joshua joined Watermark Funds Management in April 2010. Joshua is employed as an Investment Analyst responsible for researching a number of sectors within the Australian equities market. Joshua holds a Bachelor of Applied Finance and a Bachelor of Commerce (Accounting) from Macquarie University and has passed Level III of the CFA Program.



Omkar Joshi, CFA – Investment Analyst

Omkar joined Watermark Funds Management in October 2013 as an Investment Analyst. Omkar is responsible for researching a number of sectors within the Australian equities market. Omkar has completed an accounting cadetship with KPMG and has worked as an Equity Research Analyst in Credit Suisse's banks team.



Tom Richardson, CFA – Senior Analyst

Tom joined Watermark Funds Management in December 2009 and is employed as a Senior Analyst. Tom is responsible for researching a number of industry sectors and managing positions within the portfolios. Tom began his career as a Research Analyst with Renaissance Asset Management in 2006.



Nick Cameron – Investment Analyst

Nick joined Watermark in March 2015 and has analytical responsibilities across a number of industry sectors. He previously held Investment and Equities Analyst roles with GenesisCare, Credit Suisse and Deutsche Bank. Nick has a background in science, holding bachelor degrees in Science and Biotechnology and a PhD from Griffith University.



Delian Entchev – Investment Analyst

Delian joined Watermark Funds Management in August 2014 as an Investment Analyst. He is responsible for researching a number of sectors within the Australian equities market. Delian previously worked full-time during a cadetship at UBS as an Equity Research Analyst covering the Utilities and Building Materials sectors.

Managed Funds

Watermark Funds Management

Australian Equities Long/Short Manager



| | | | |
|---------------|--|-------------------------------|-------------------------------|
| Structure | LIC (2004) | LIC (2013) | Retail Trust (2012) |
| Strategy | Variable Long/Short (Variable Beta) | Market Neutral (Zero Beta) | Market Neutral (Zero Beta) |
| FUM | \$332 million | \$85 million | \$35 million |
| Benchmark | All Ordinaries Accum | RBA Cash | RBA Cash |
| Return Target | 15% pre-tax | 12% pre-tax | 12% pre-tax |
| Fees | 1% & 20% on performance | 1% & 20% on performance | 1.5% & 20% on performance |

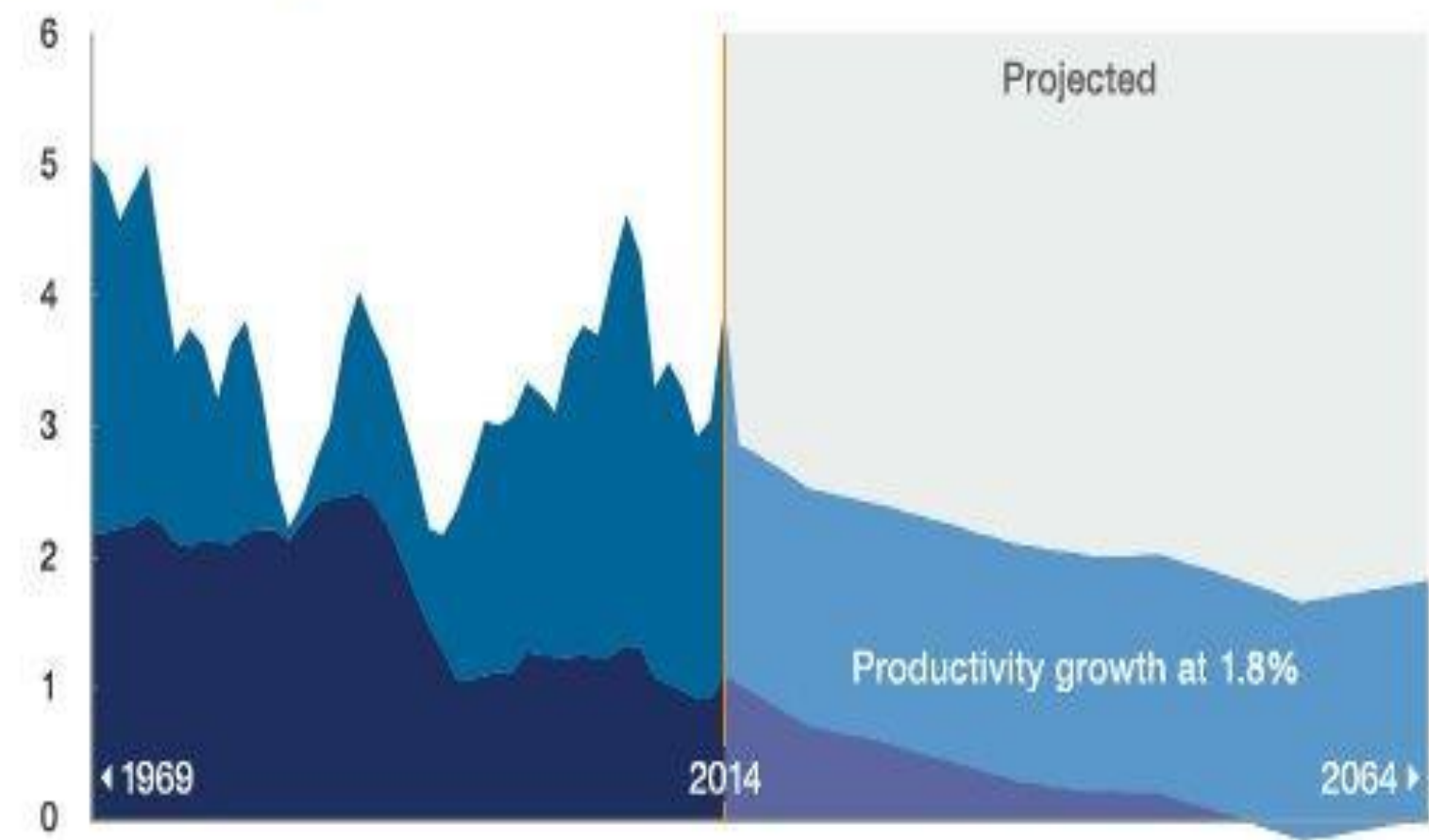
Low returns for investors in shares in the medium term

- We are in a lower growth environment. This means softer profit growth for public companies, a clear drag on returns for shareholders.
- Low interest rates are a corollary of lower growth.
- There is considerable debate around the reasons for weaker growth “Secular Stagnation” or “Excessive debt”?
- Low interest rates and low growth will continue for some considerable time
- Shares are expensive based on historic asset pricing trends. However, interest rates have never been this low and shares still look attractive when compared with cash alternatives.
- To understand where shares are going we must first understand why interest rates are so low.

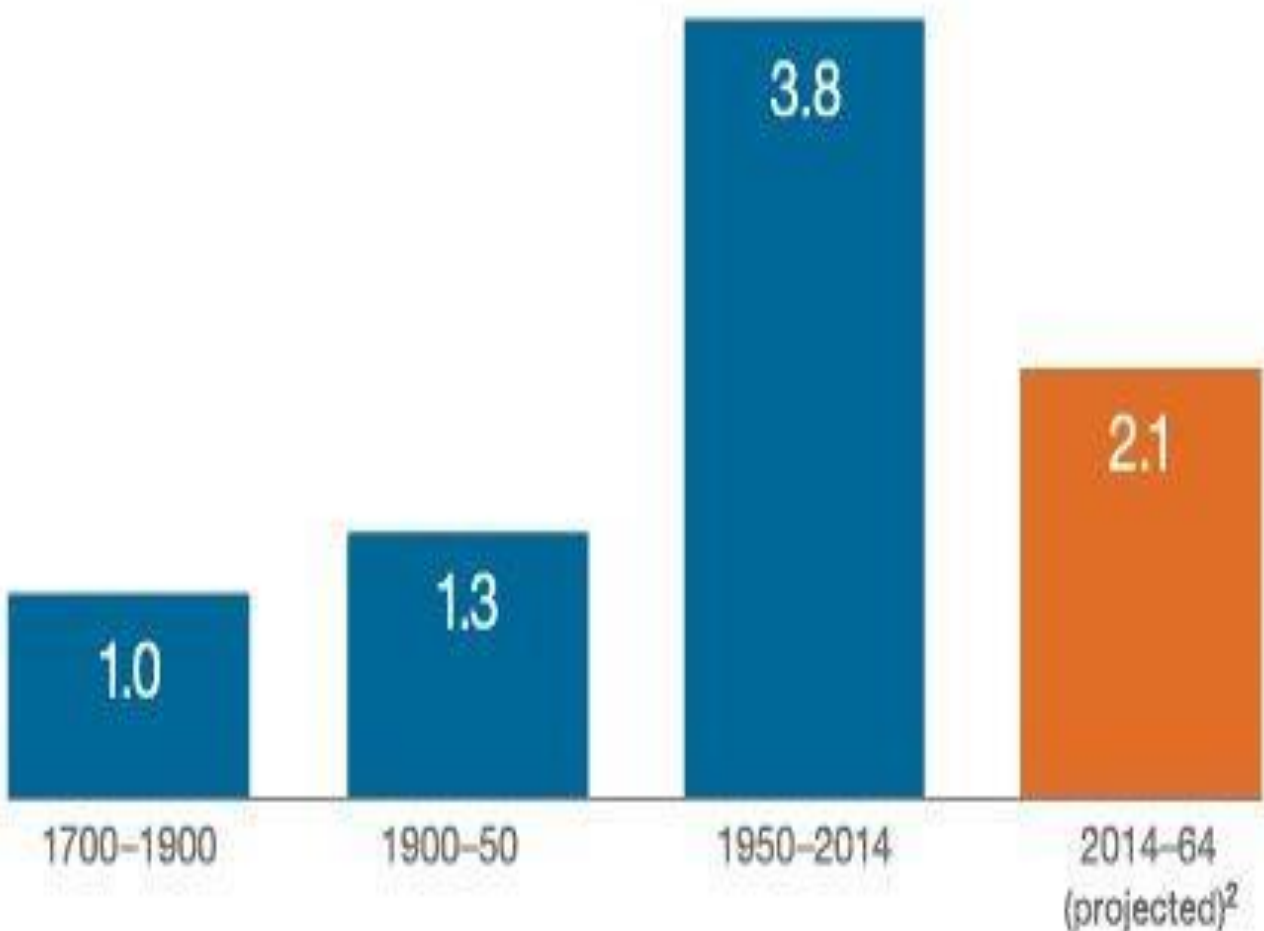
A golden era of growth has passed

GDP growth, rolling 5-year periods, CAGR,¹ %

■ Employment ■ Productivity



GDP growth, CAGR,¹ %



¹Compound annual growth rate.

Source: The Conference Board Total Economy Database; International Labour Organization; United Nations Population Division; McKinsey Global Institute analysis

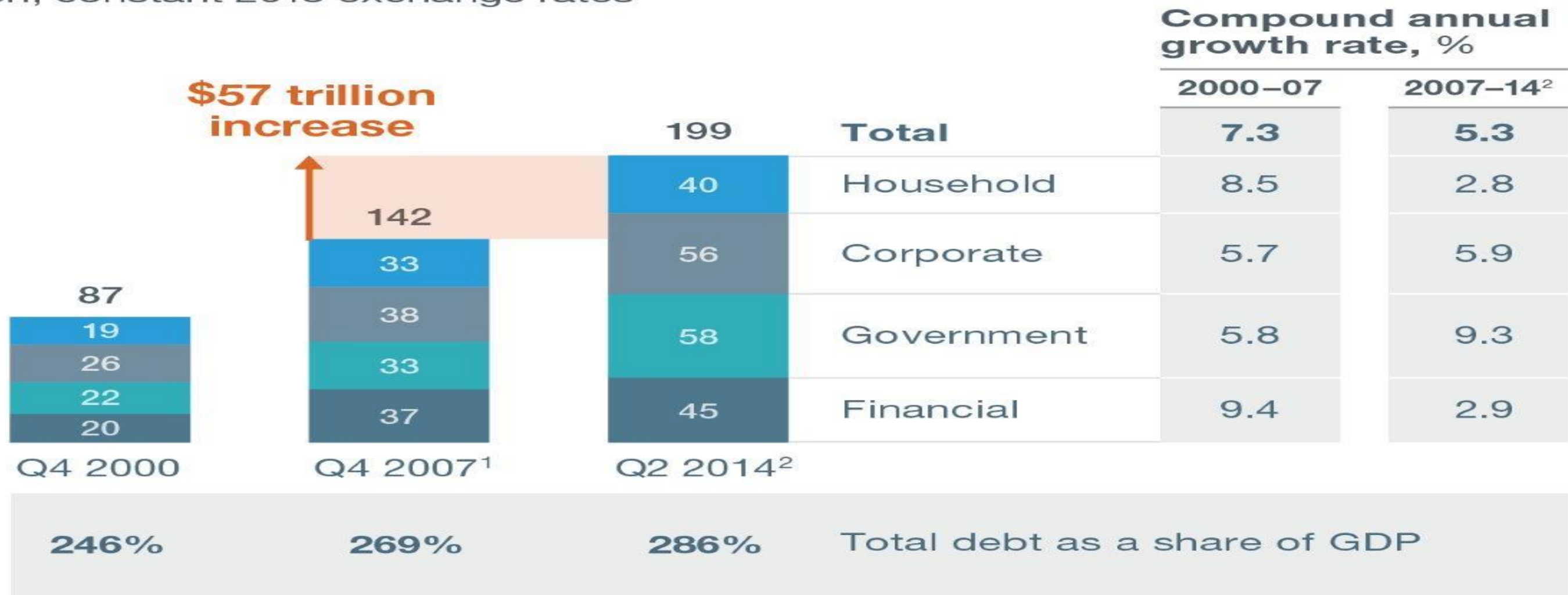
¹Compound annual growth rate.

²Assumes 1.8% productivity growth, equal to average for 1964-2014.

Source: McKinsey Global Institute analysis

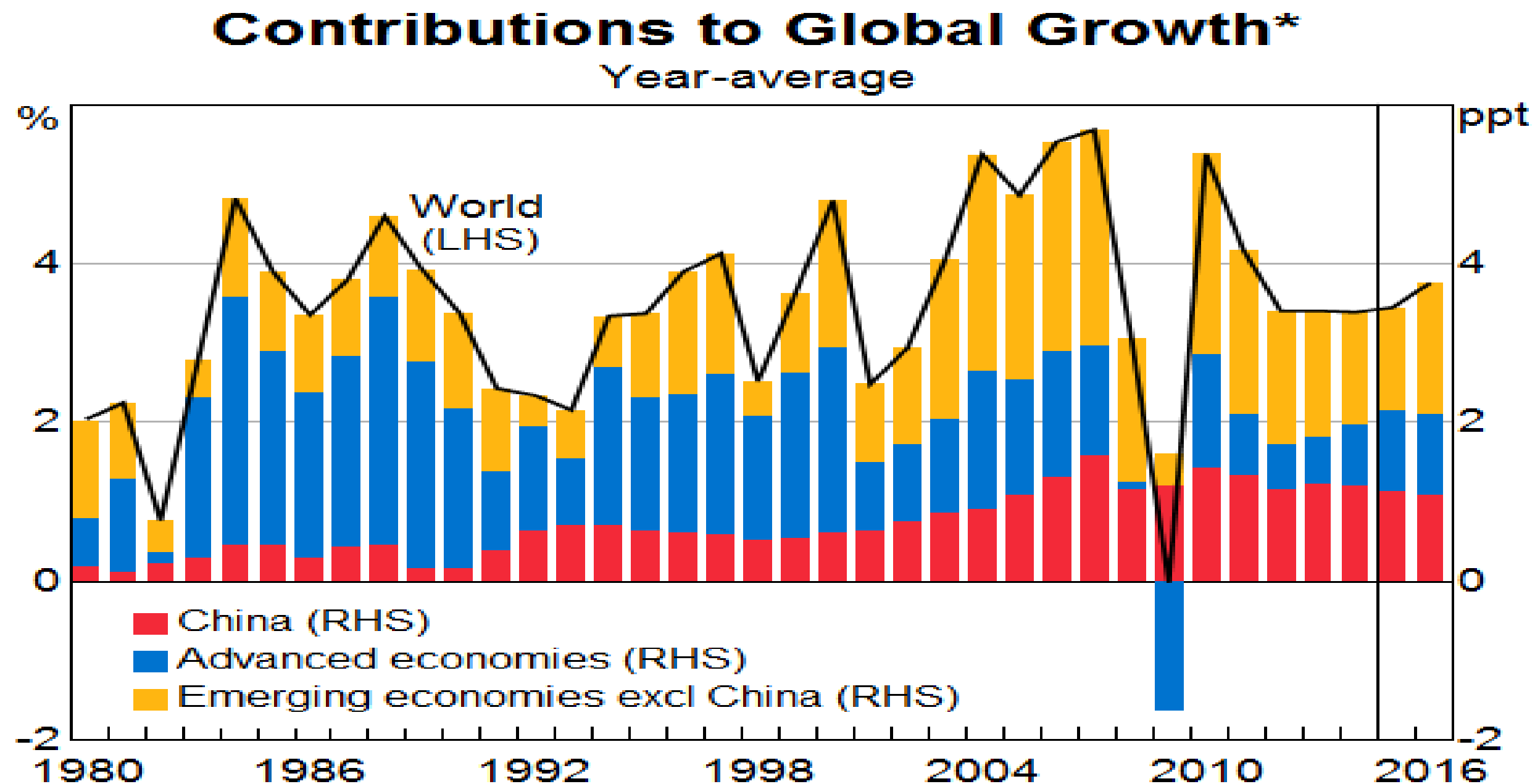
Debt sustainability is a major problem

Global stock of debt outstanding,
\$ trillion, constant 2013 exchange rates



¹Figures do not sum to total, because of rounding.
²Q2 2014 data for advanced economies and China; Q4 2013 data for other developing countries.
Source: Bank for International Settlements; Haver Analytics; International Monetary Fund *World Economic Outlook*; national sources; McKinsey Global Institute analysis

Growth slower and dependent on emerging markets

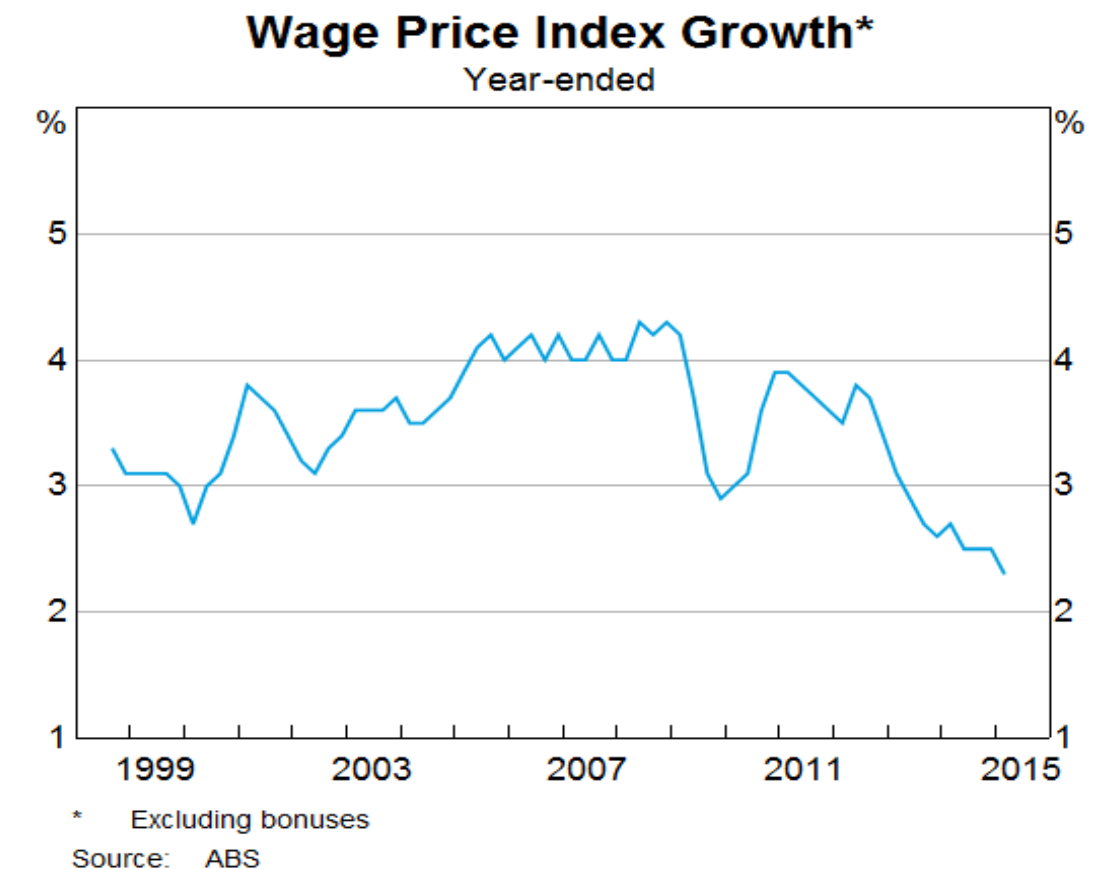
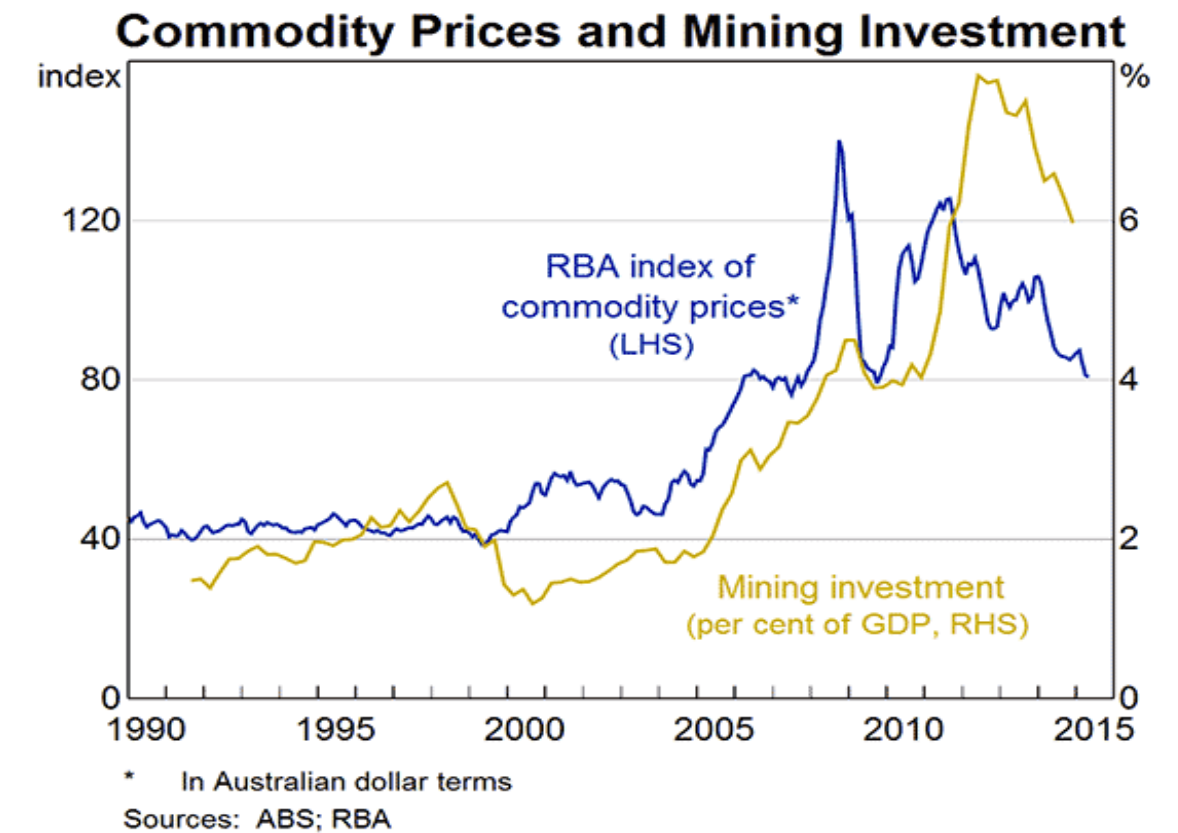


* Aggregated using PPP exchange rates; IMF forecasts for 2015 and 2016

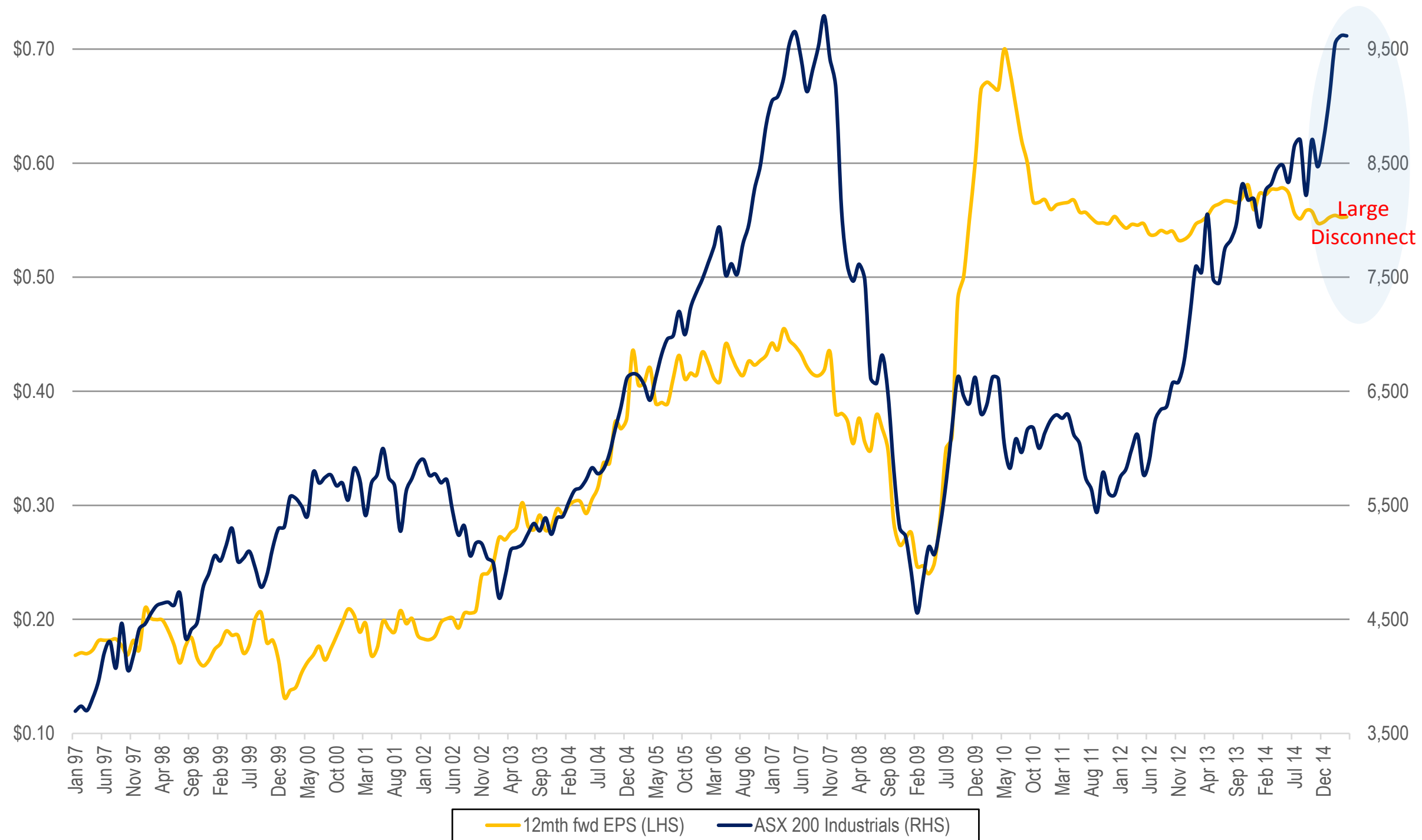
Sources: IMF; RBA

Australia has its own challenges

- Further headwinds from falling terms of trade
- A sharp drop in mining investment. Non mining investment is not picking up as expected
- Further budget tightening - credit rating downgrades are on the horizon
- Outside of Housing most areas of the economy are quite weak
- Ongoing restructuring in the economy and soft growth will see unemployment edge higher

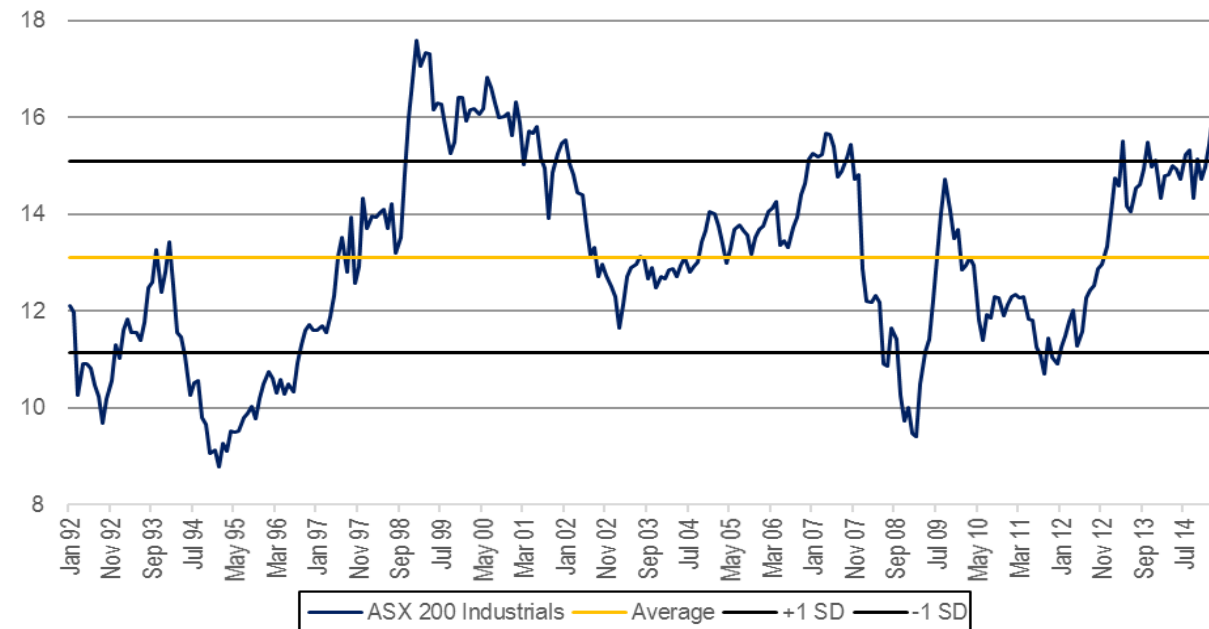


Industrials have moved ahead of earnings...

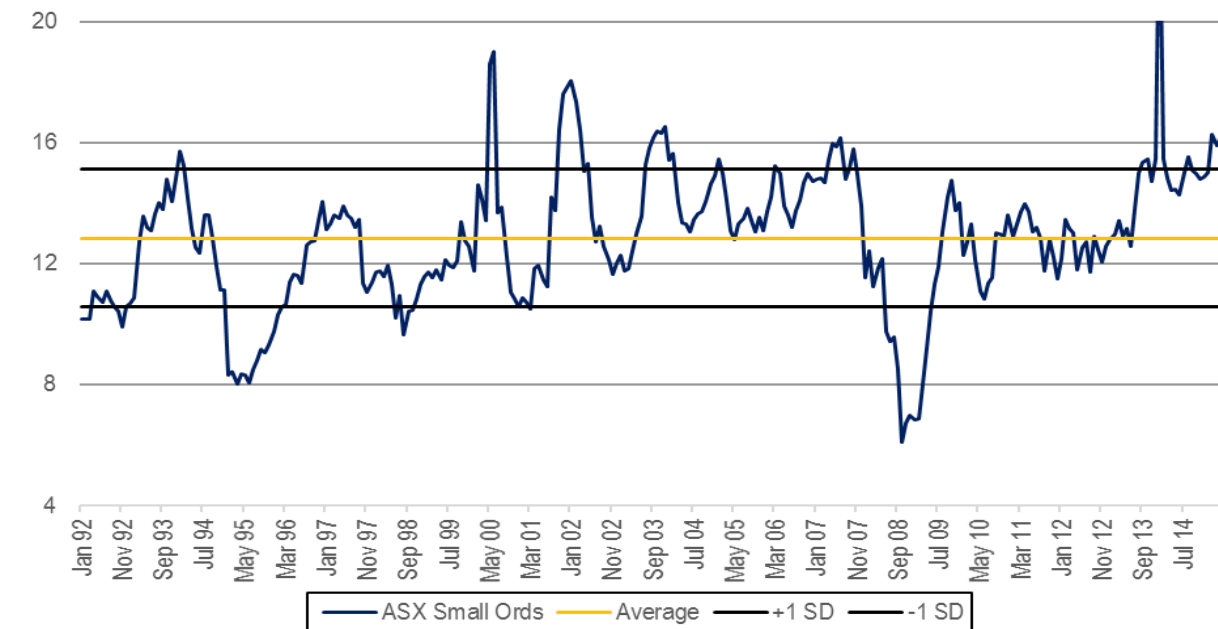


Valuations look full – bulls are exhausted

Industrials



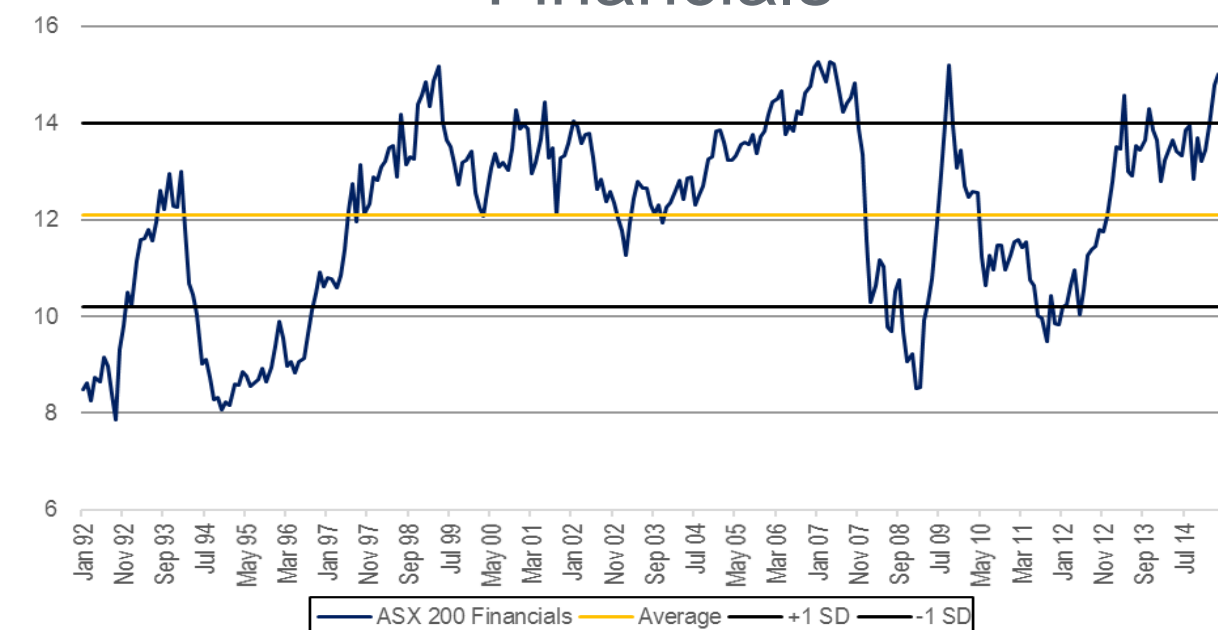
Small Companies



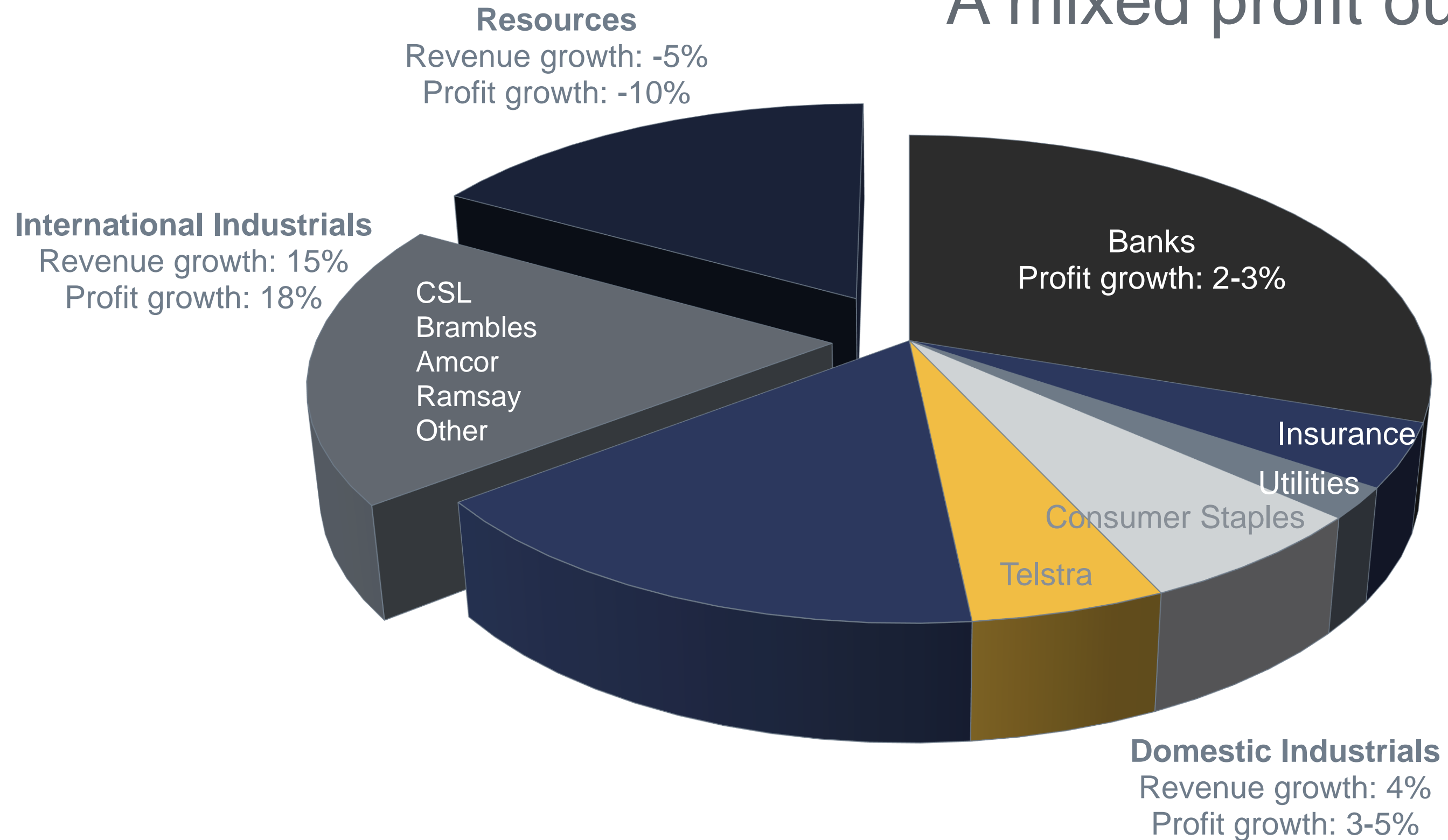
Resources



Financials



A mixed profit outlook

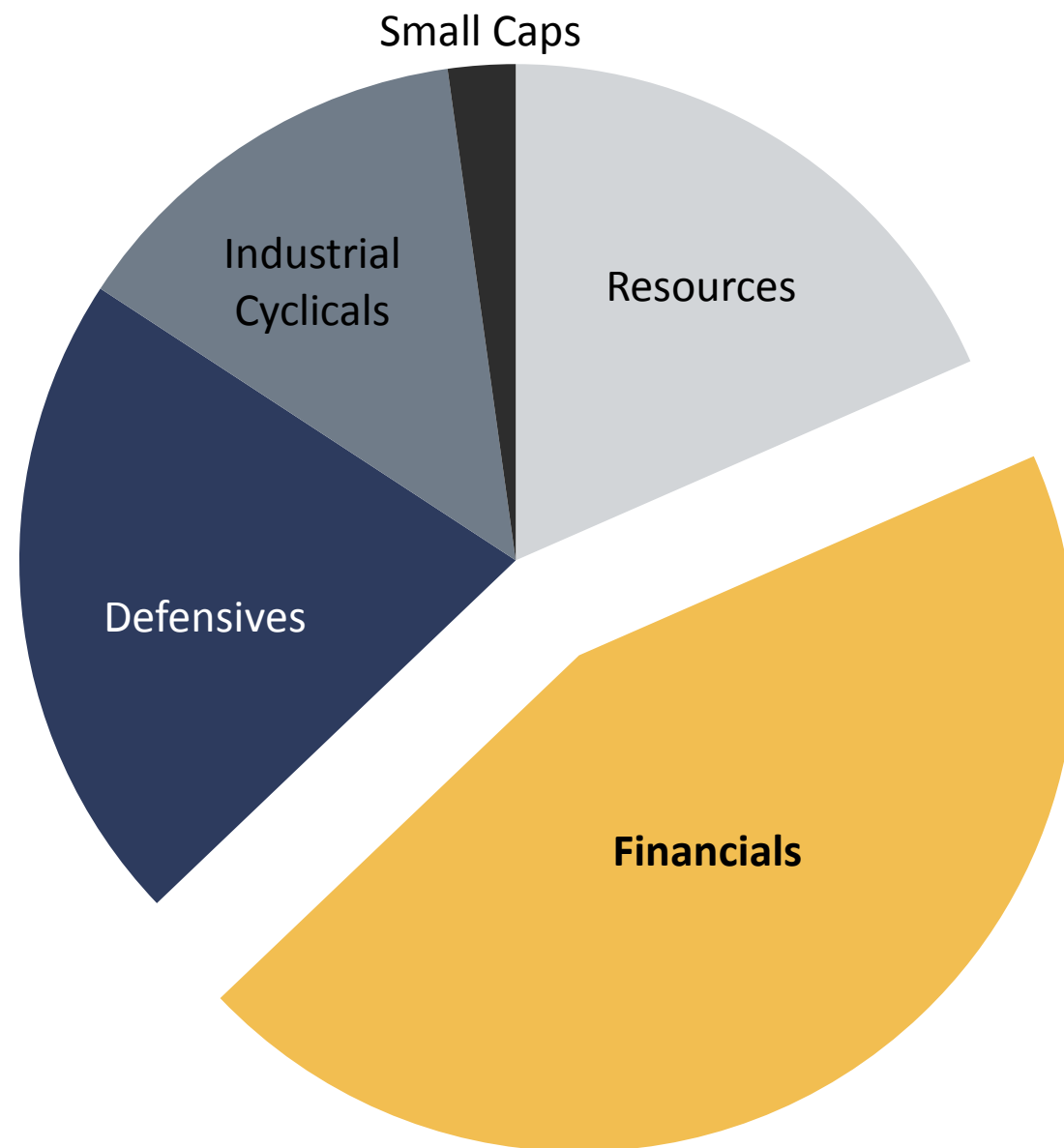


Profit growth is slowing while shares have re-rated

| Industry | Historic P/E | Current P/E | Premium | Historic Growth | | Forecast Growth | |
|---------------------|--------------|-------------|---------|-----------------|-----|-----------------|------|
| | | | | Sales | EPS | Sales | EPS |
| ASX 200 Industrials | 13x | 16x | 22% | 8% | 5% | 5% | 3% |
| Banks | 12x | 15x | 25% | 3% | 5% | 3% | 2-3% |
| Wesfarmers | 15x | 18x | 20% | 23% | 6% | 5% | 6% |
| Telstra | 15x | 18x | 13% | 2% | 0% | 3% | 8% |
| AGL | 14x | 15x | 2% | 10% | 3% | 6% | 5% |
| Origin Energy | 12x | 17x | 39% | 15% | 8% | 0% | 8% |
| Brambles | 18x | 21x | 16% | 0% | 9% | 3% | 5% |
| General Insurance | 11x | 12x | 3% | 3% | 2% | 3% | -3% |
| Woolworths | 17x | 15x | -13% | 8% | 11% | 3% | 0% |

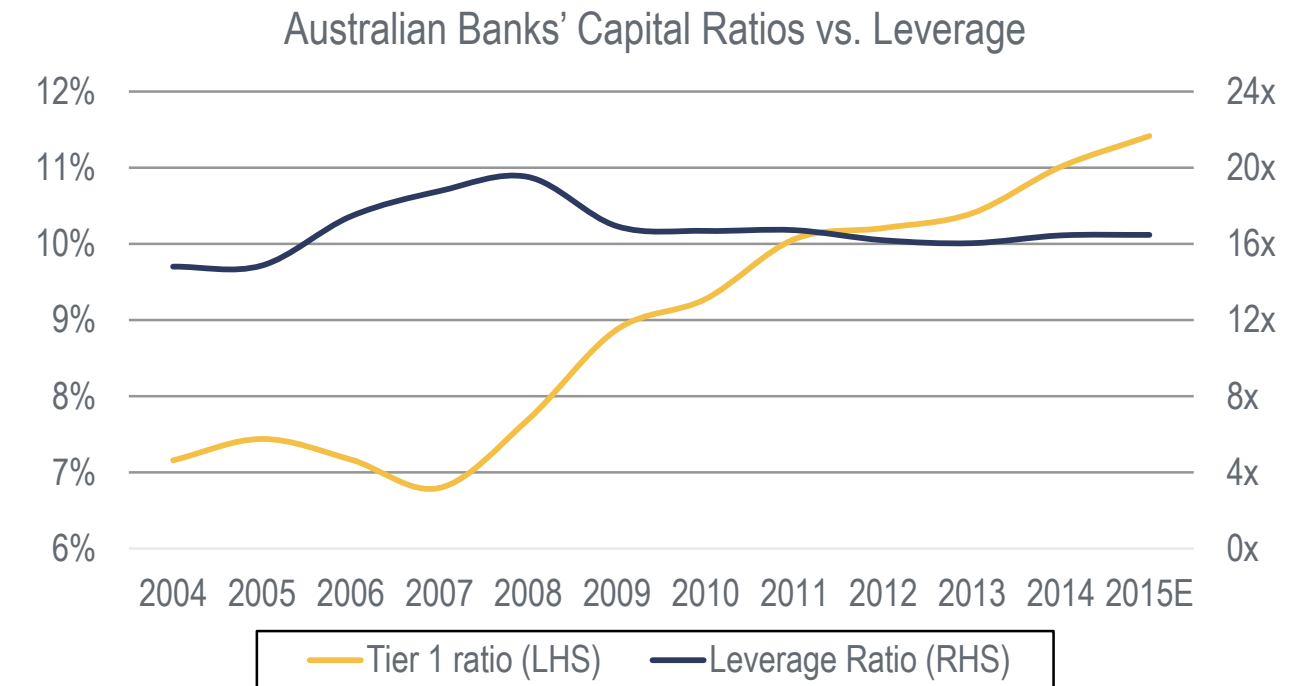
“Should you still own Australian Bank shares?”

Omkar Joshi
Investment Analyst

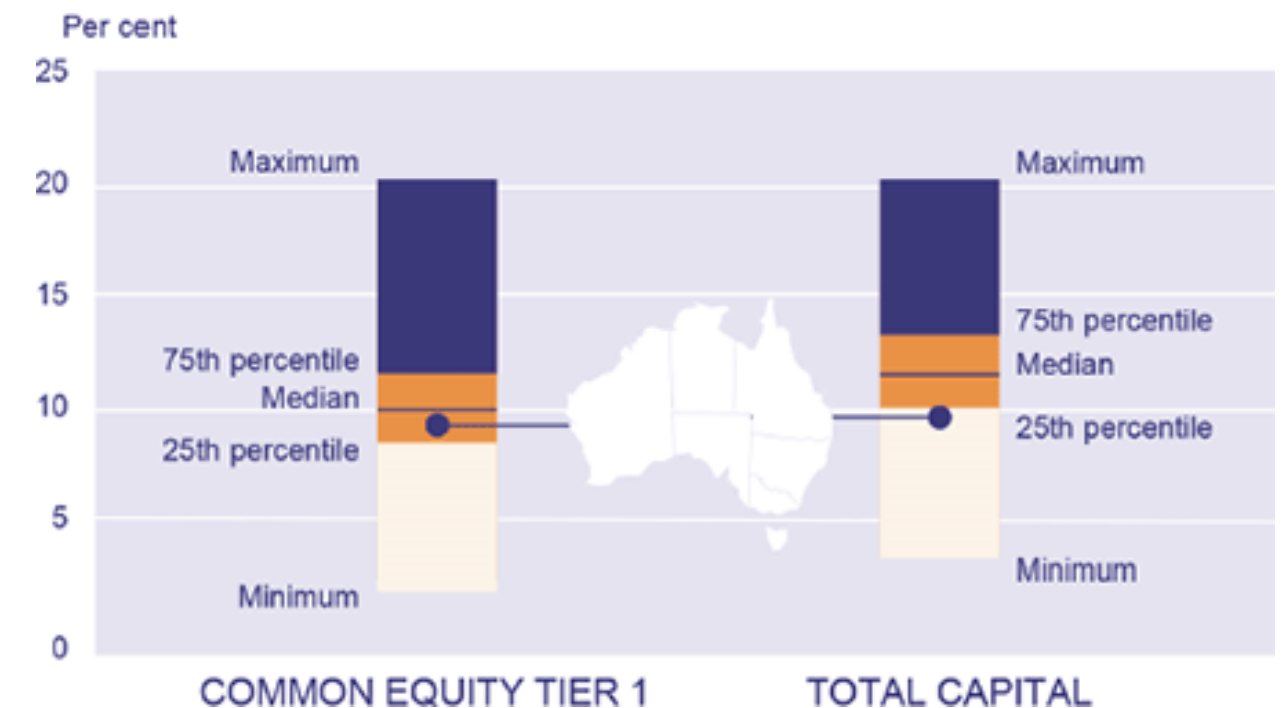


Are the banks well capitalised?

- Since the crisis, the major banks have de-risked but not deleveraged
- Capital ratios have improved due to greater housing lending which has lower capital requirements
- Global peers have closed the gap in terms of capital ratios
- “Australian banks are roughly ‘middle of the pack’ in terms of common equity tier 1 capital ratios” – David Murray AO, Chair of the FSI
- “Largest Australian banks are broadly in the middle of third quartile” – Wayne Byres, APRA Chairman



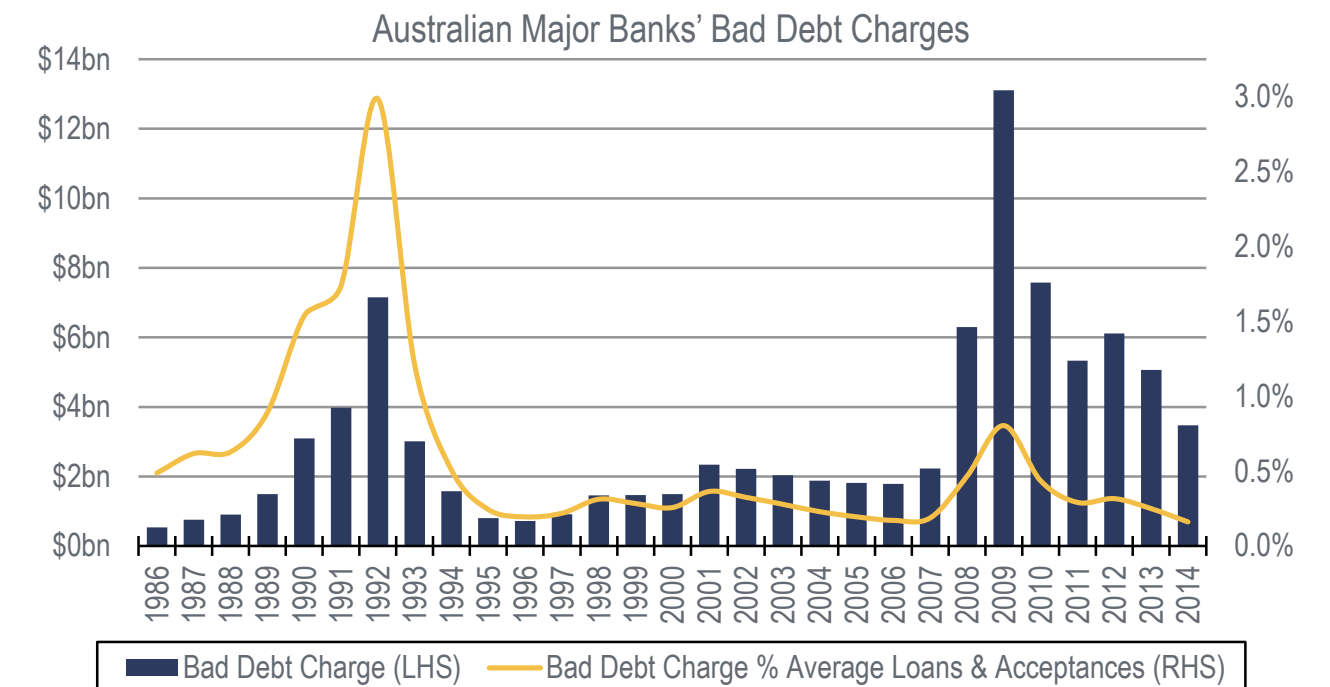
Source: UBS, Watermark Funds Management estimates



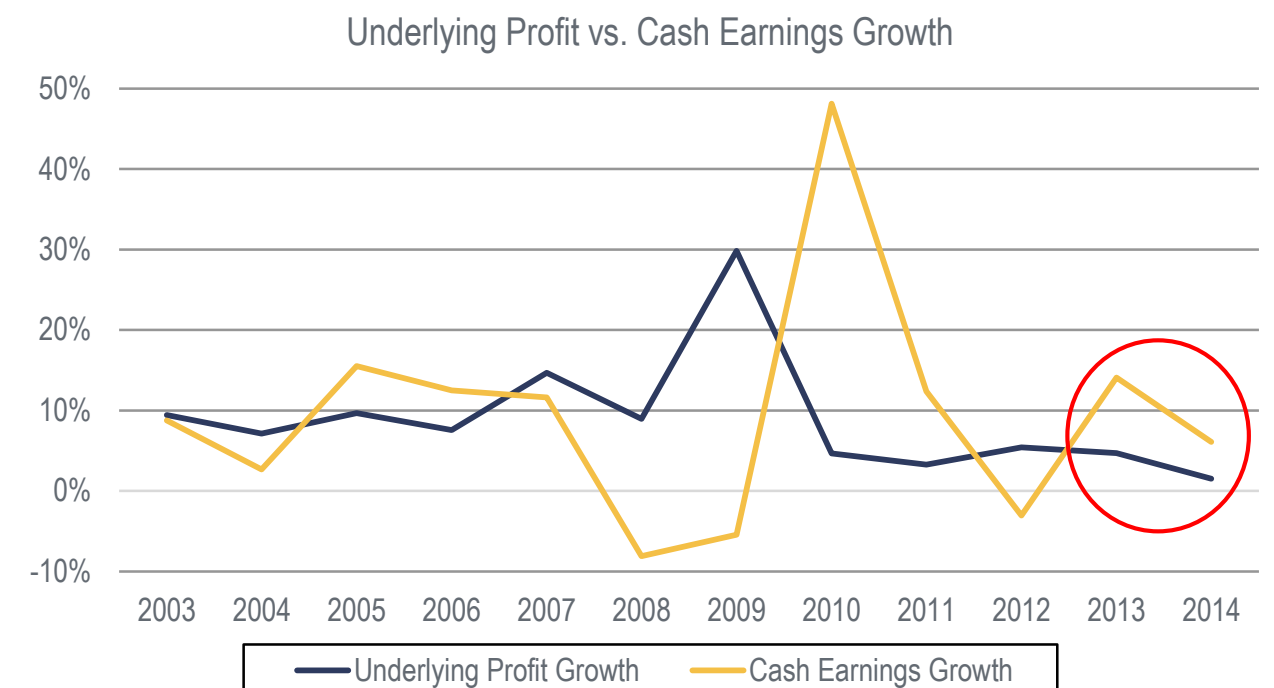
Source: Financial System Inquiry Interim Report

Banking on lower bad debts?

- Bad debt charges appear to have reached a cyclical low point
- Rising net write-offs have been funded through declining provision coverage
- Bad debt charges have benefited from provision write-backs as asset quality has improved
- Underlying profit growth has lagged cash earnings growth for the last two years

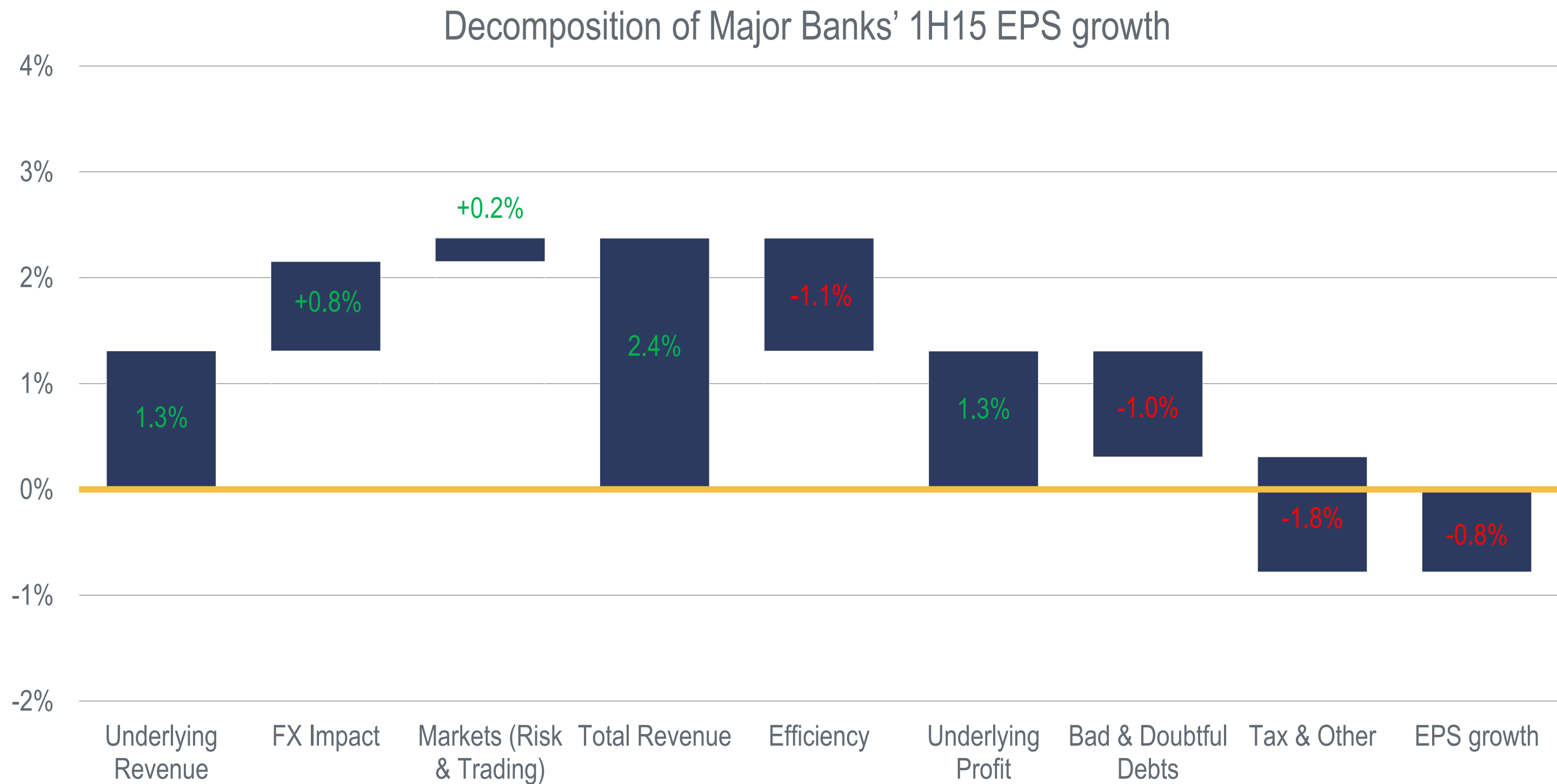


Source: Credit Suisse



Source: UBS

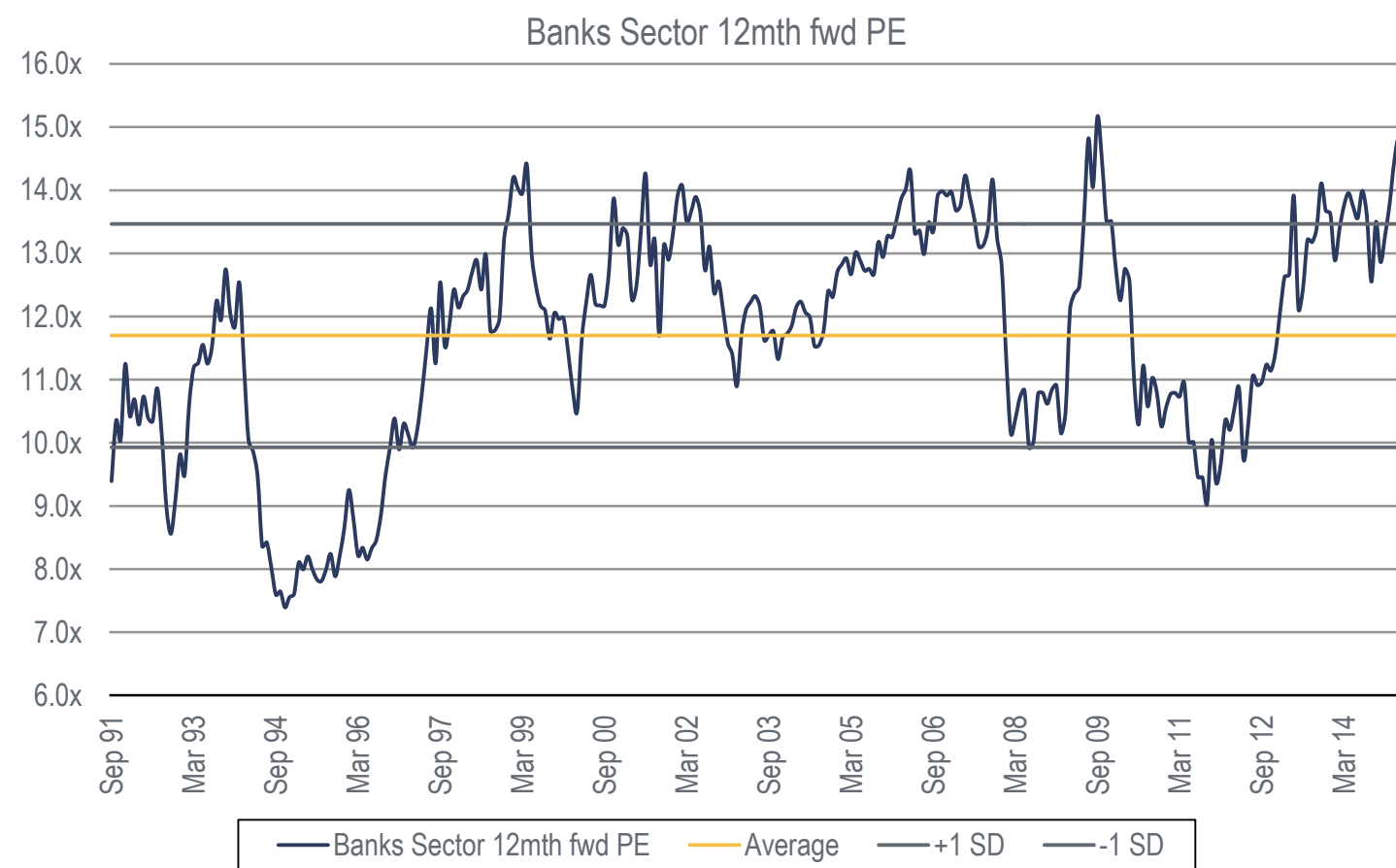
Underlying profit growth is anaemic...



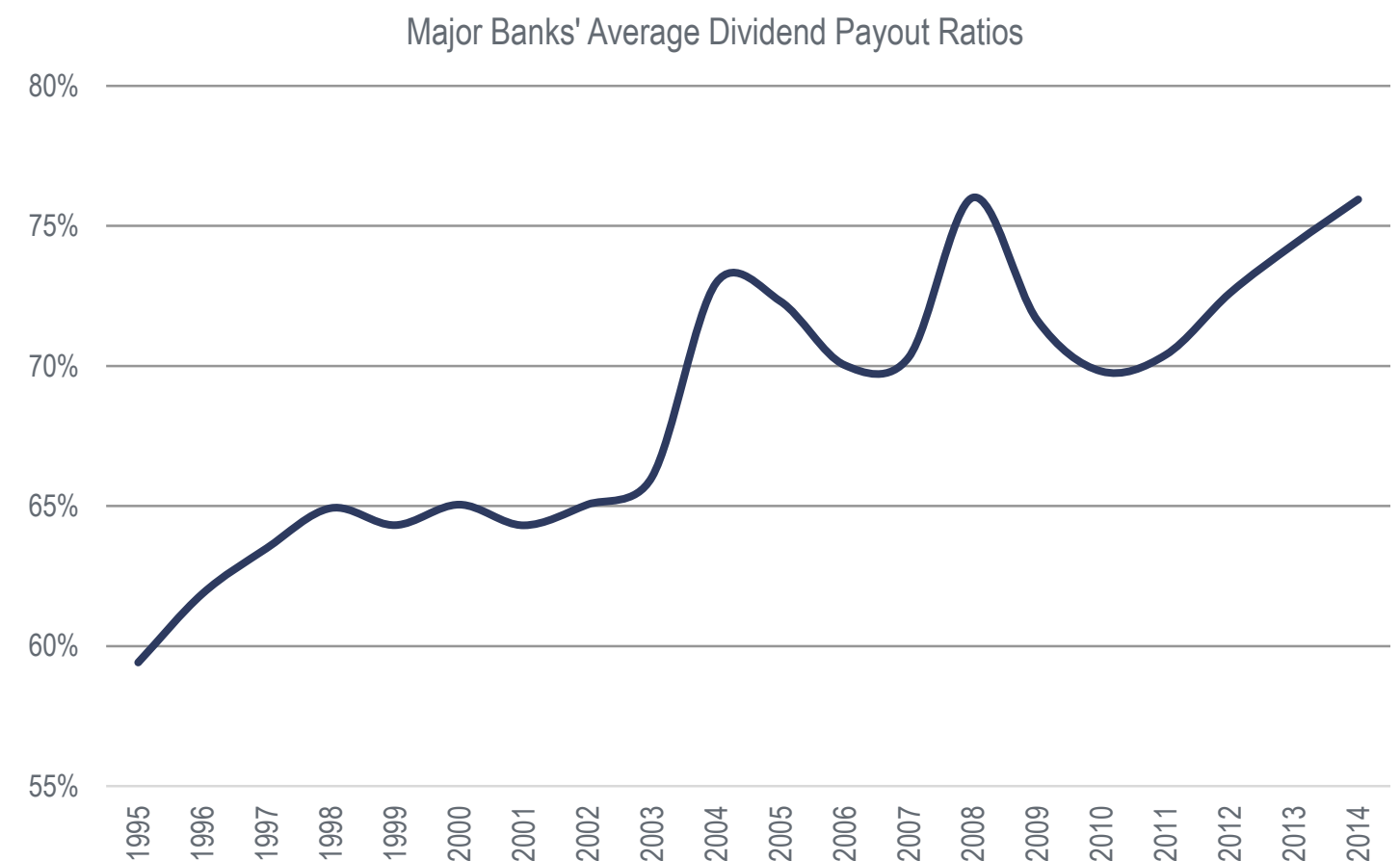
Source: UBS

Banks now appear expensive

- Banks have re-rated significantly and are now trading at historically high P/E multiples
- Higher capital requirements would likely hurt the ability of the banks to continue delivering high dividends to shareholders
- Risks of dividend interruption and dilution from capital raisings do not appear to be fully appreciated in current share prices



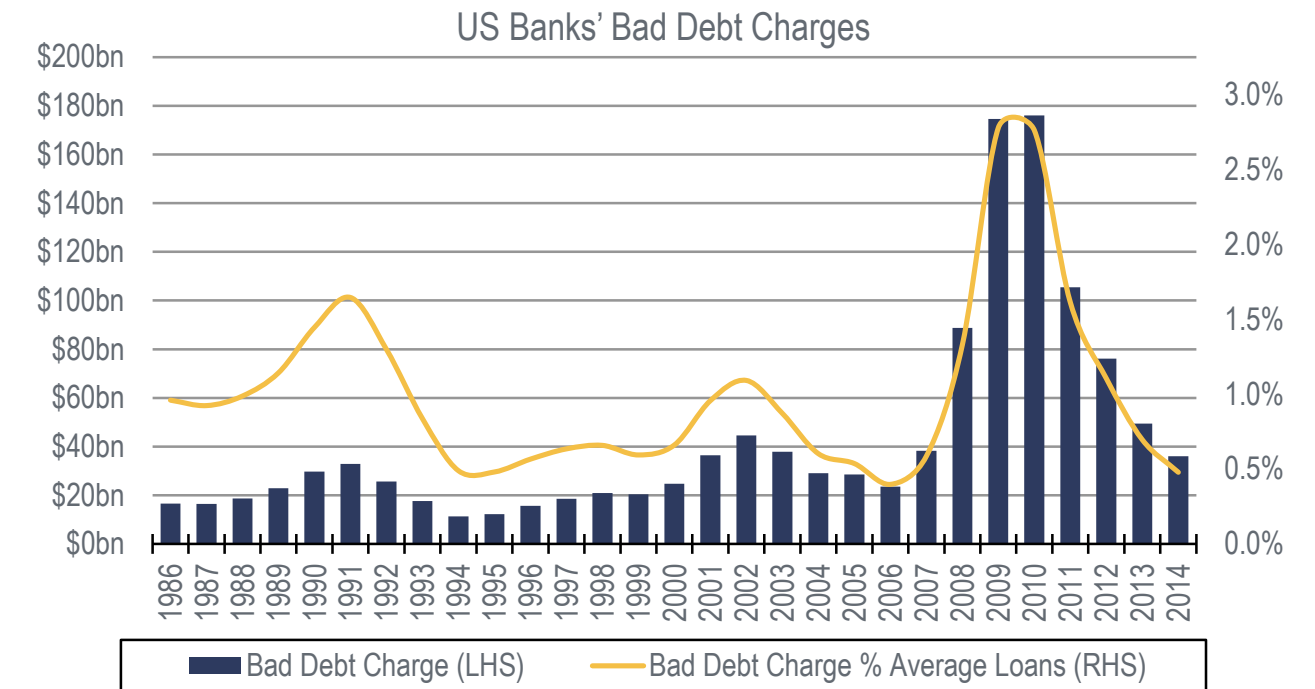
Source: IBES, Reuters



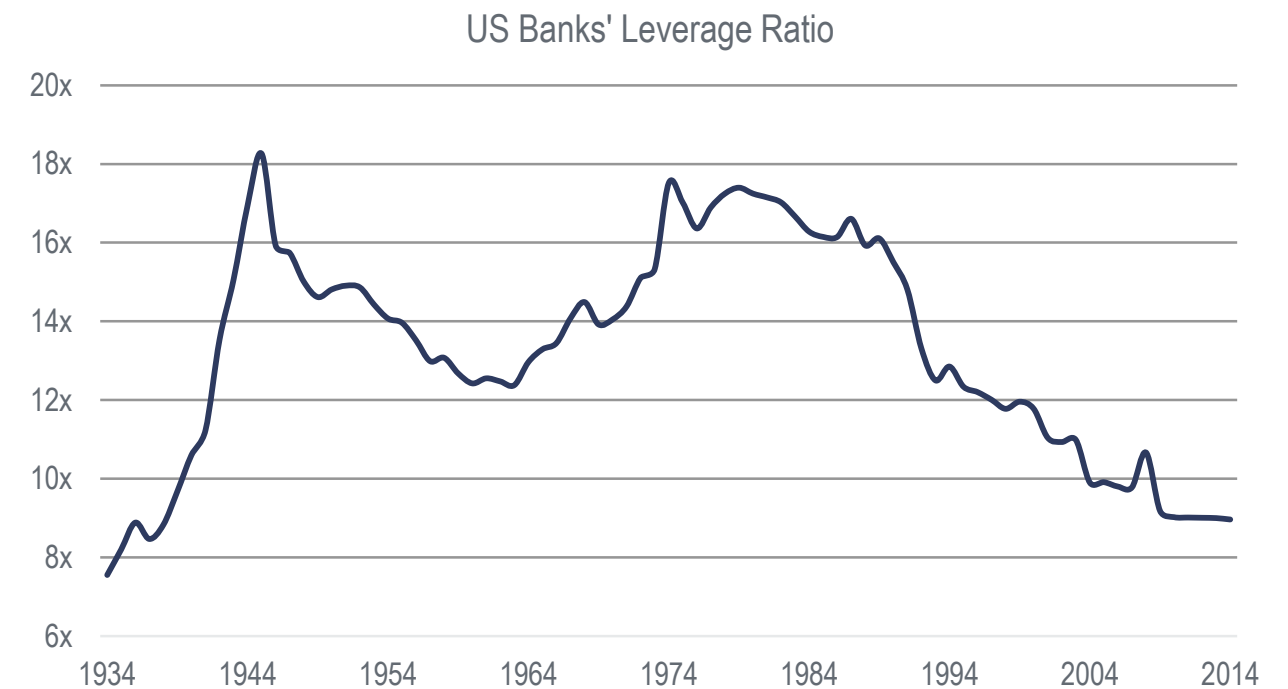
Source: Reuters, Watermark Funds Management estimates

What about the US banks?

- Bad debt charges are declining as asset quality continues to improve and provisioning remains robust
- Leverage is half that of the Australian major banks
- Capital concerns have already been addressed largely with capital returns and dividend payouts increasing
- Net interest margins are heavily levered to a steepening in the yield curve due to funding mix



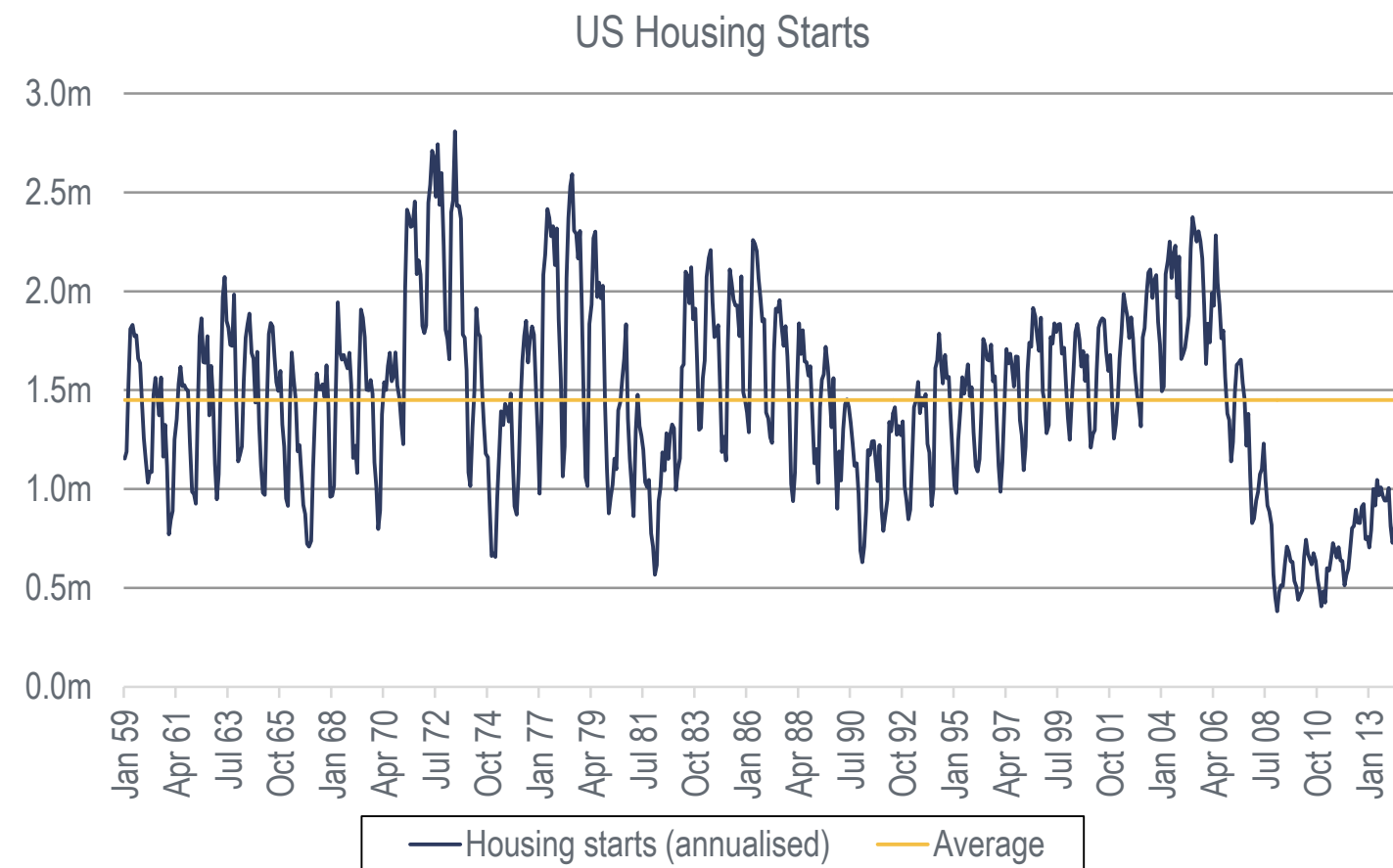
Source: CLSA



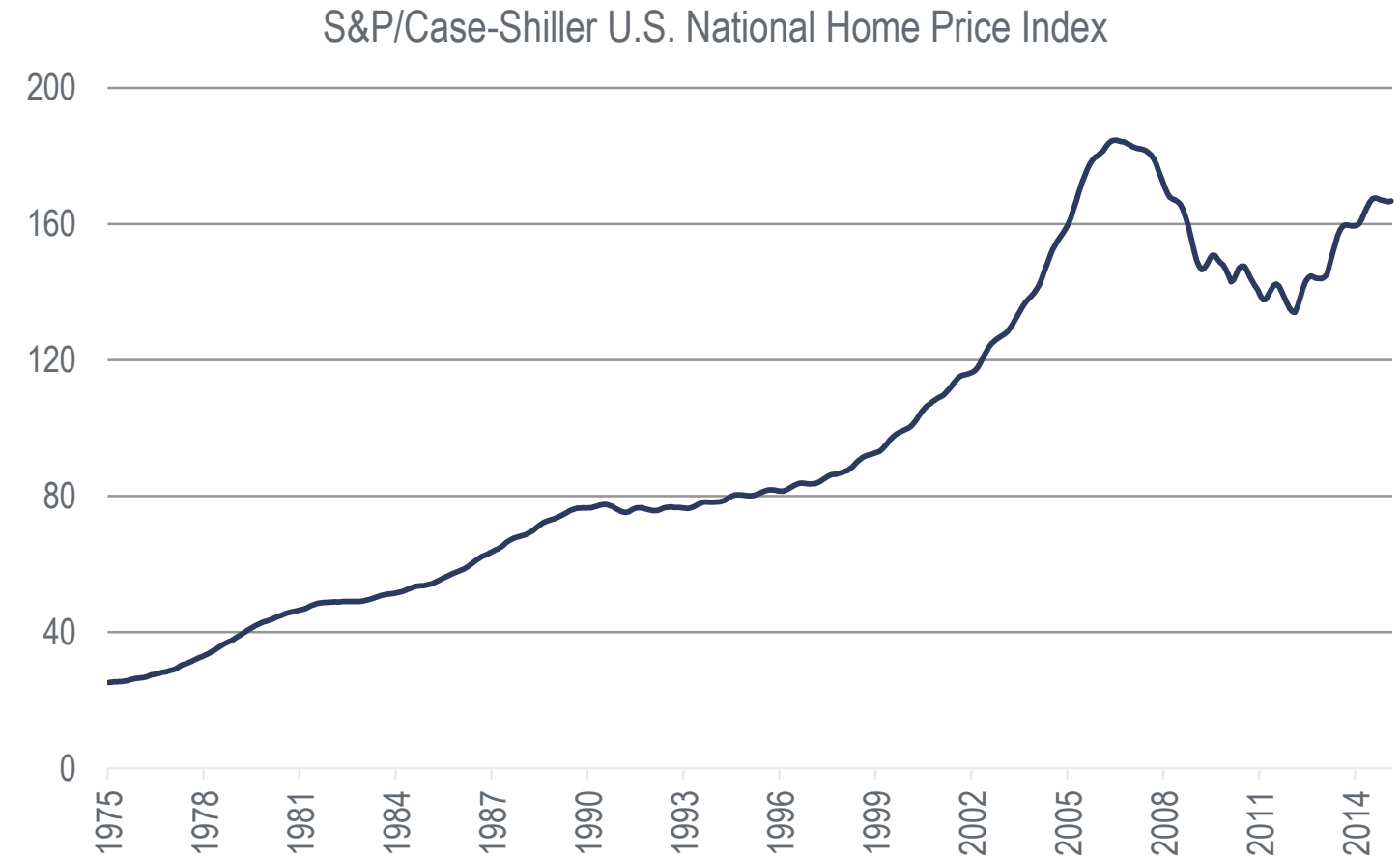
Source: CLSA

US housing continues to recover

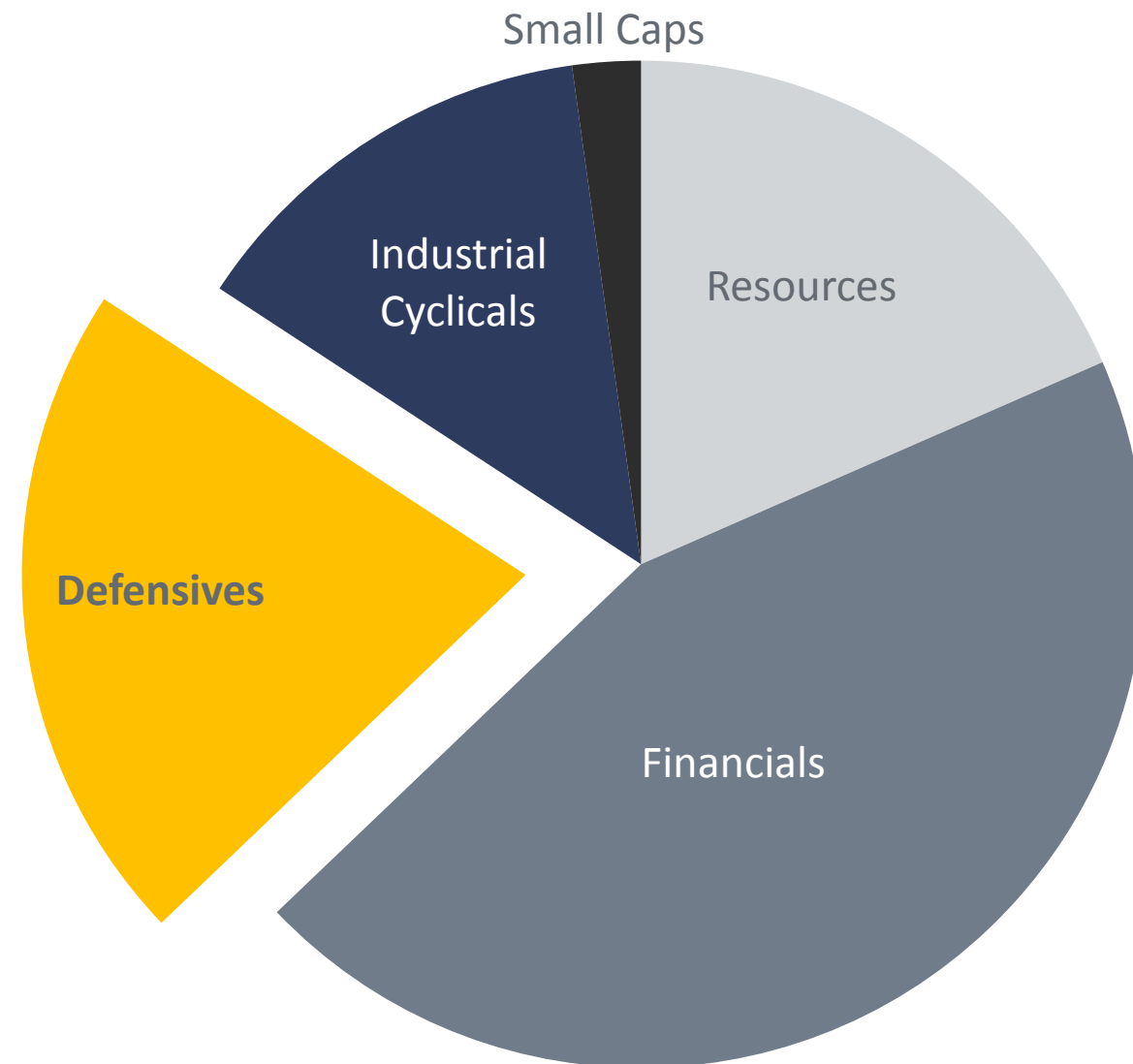
- US housing recovery is continuing with housing starts well below the long term average and the previous peak
- US house prices also continue to recover and remain below the previous GFC peak



Source: US Census Bureau



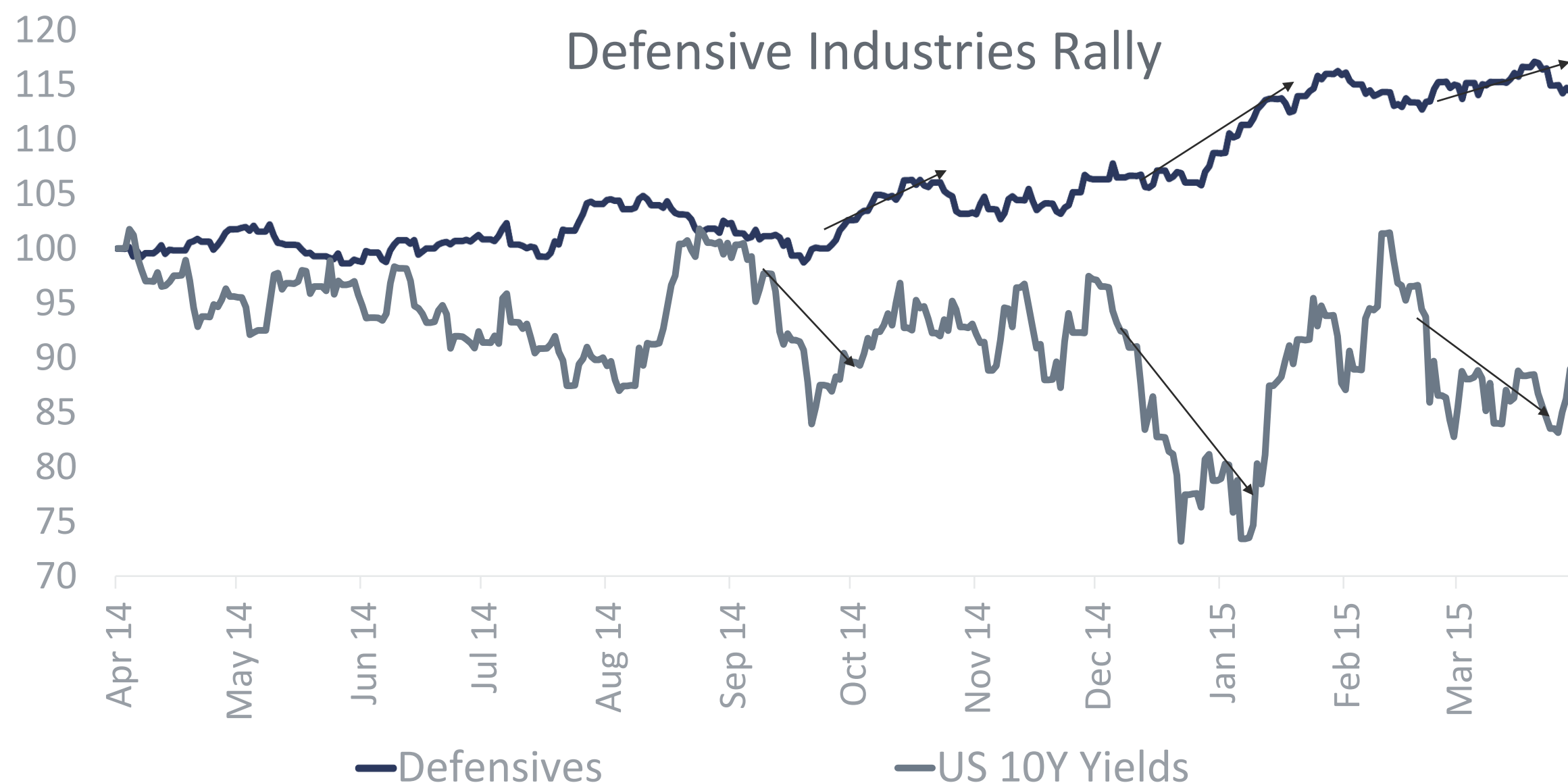
“Is it time to switch back into defensives shares?”



Joshua Ross
Investment Analyst

Defensive valuations appear stretched

- With low bond yields and negative real interest rates in parts of Europe investors continue to chase defensive earnings and yield in equity markets.

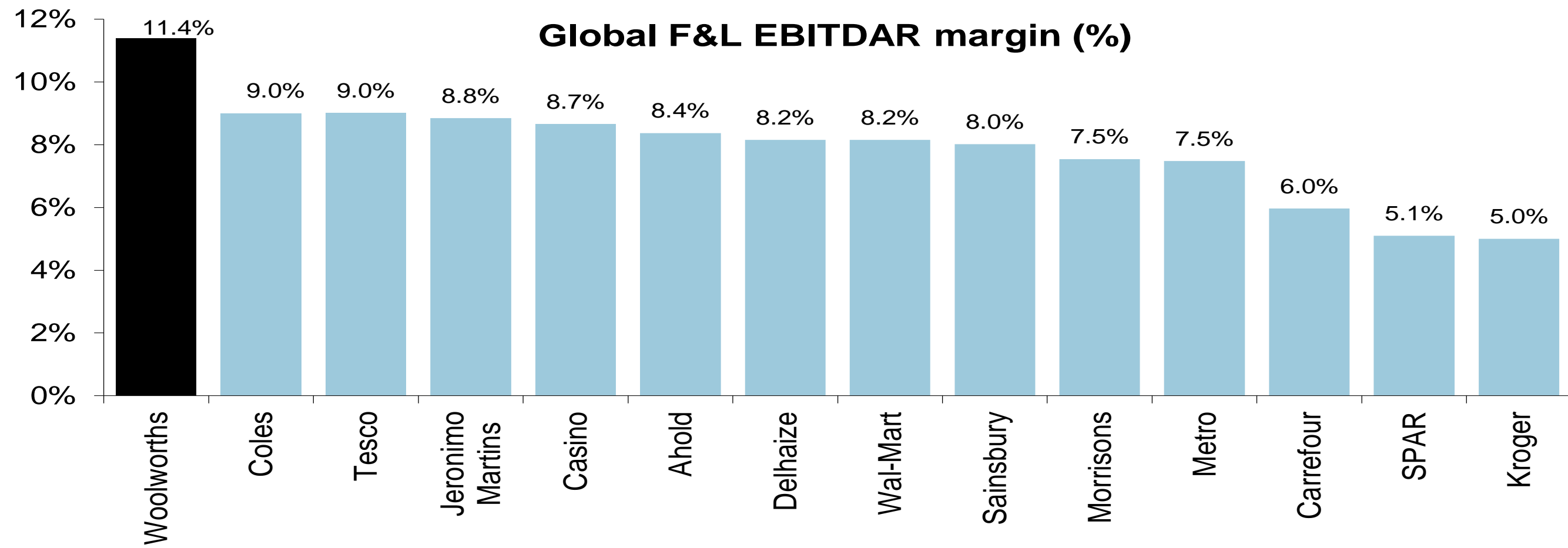


Defensive industries

- Telecom – Consolidation mostly played out. Telstra looks fully valued, protected shareholders on NBN, however mobile division slowing.
- Gaming – Conservatively positioned, valuations look stretched for local casino operators, Tabcorp/Tatts fully priced.
- Infrastructure – Neutral, valuations reflecting low bond yields.
- Healthcare – high growth segment, government funding risks are elevated.

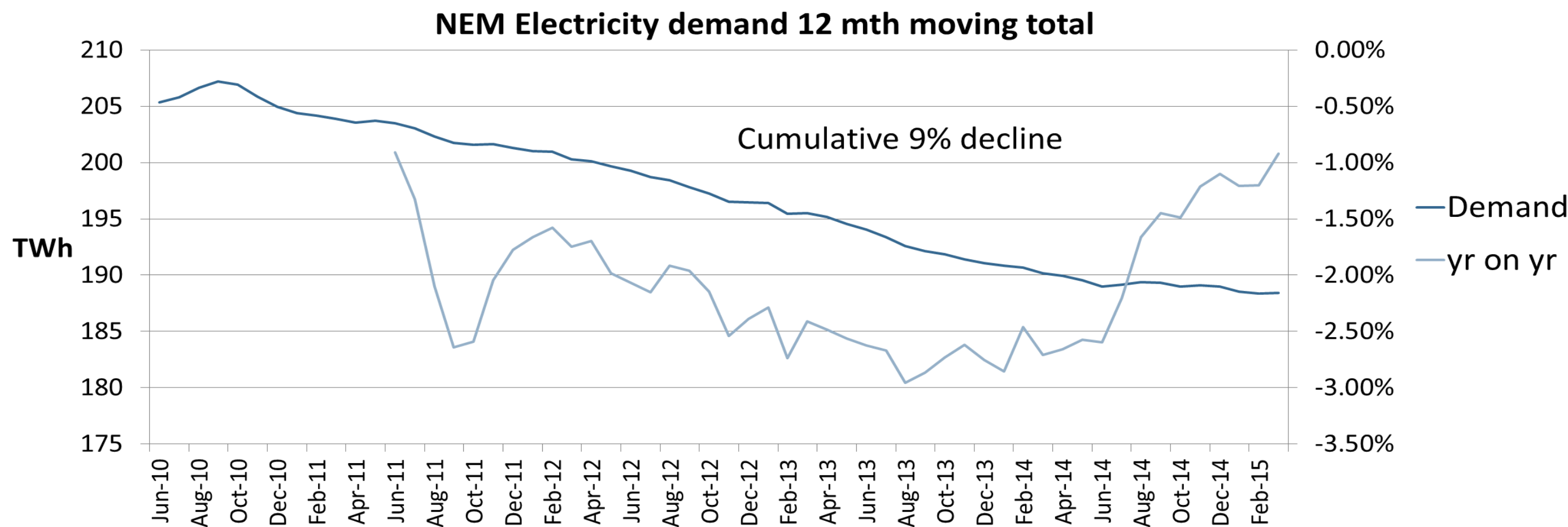
Consumer staples losing defensive appeal

- Consumer Staples have underperformed with Woolworths and Metcash (IGA) coming under considerable pressure.
- The entry of Aldi and Costco discount models are challenging the high priced incumbents. Cautious outlook for Woolworths and Coles margins

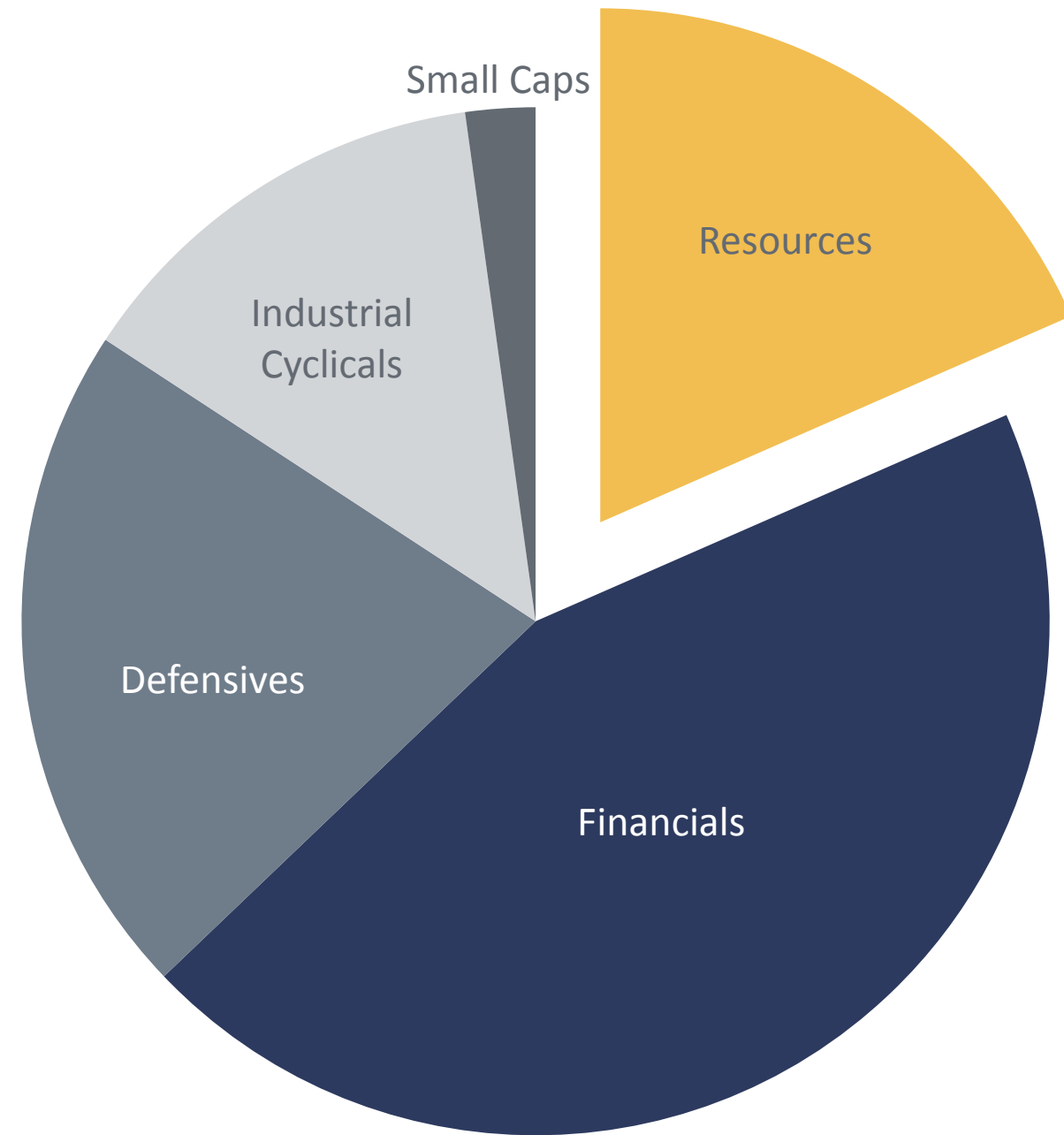


Utilities complicated with structural issues

- Origin, AGL and EA dominate the retail energy industry.
- Falling demand is a structural issue, with excess generation being further distorted by the installation of solar panels in residential market.
- Hedging product for retailers is becoming cheaper as volatility is lower, combined with low wholesale energy prices is a positive for new entrants.

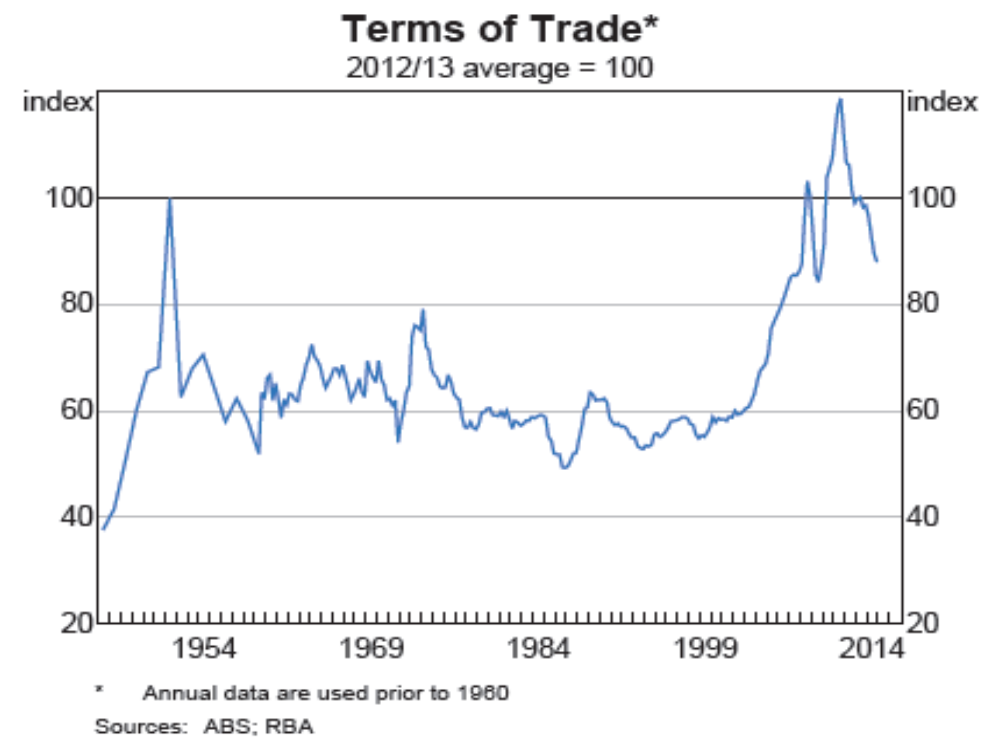
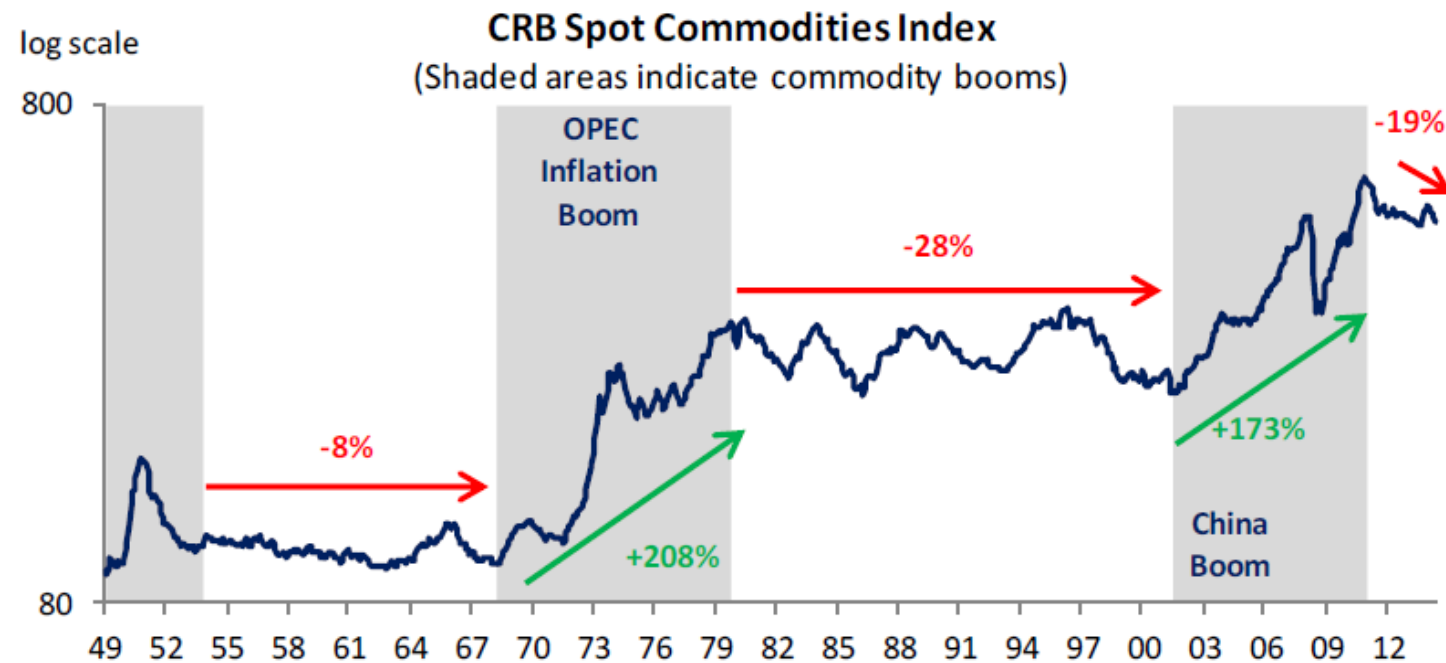


“Where to from here for mining shares?”



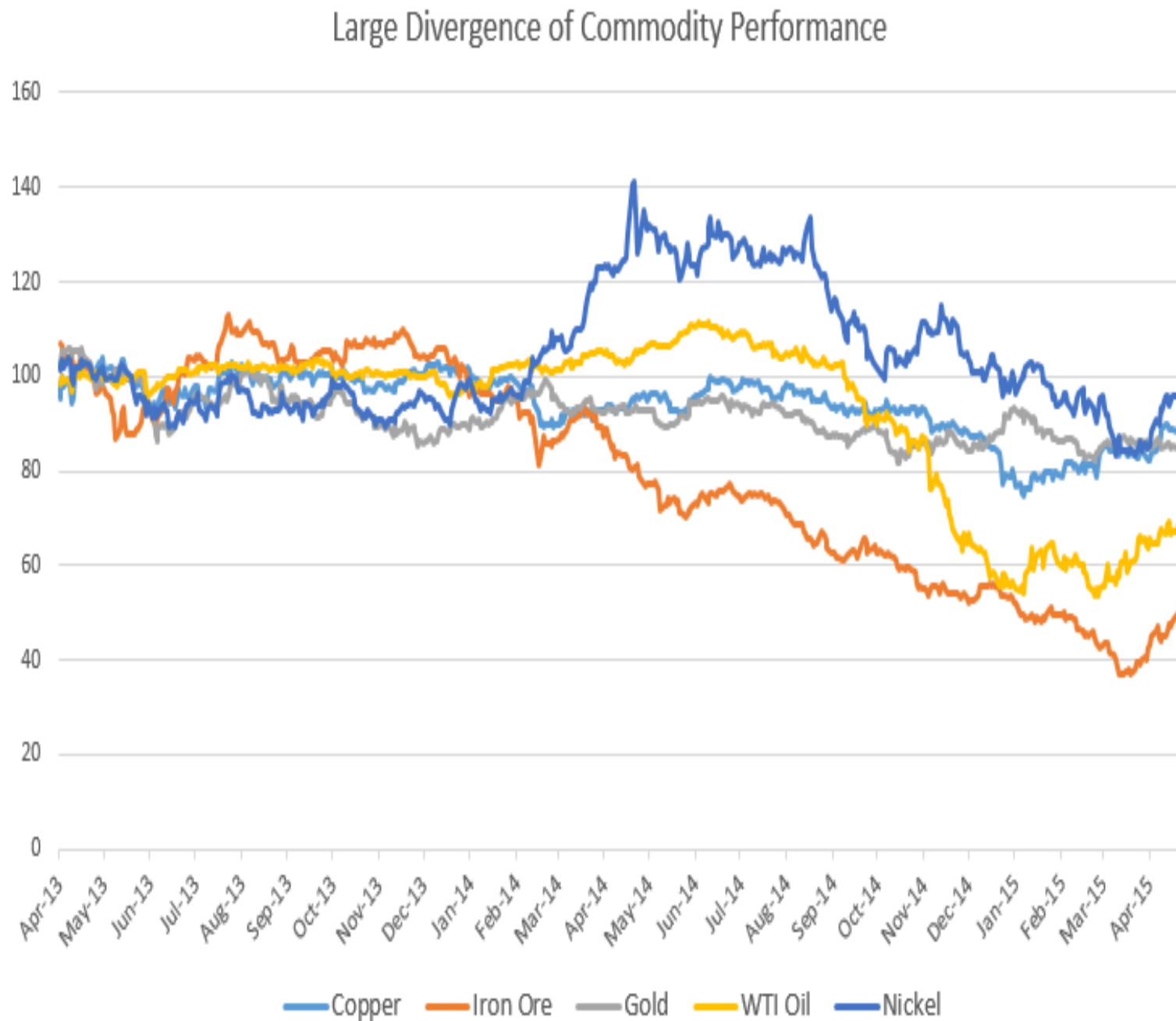
Tom Richardson
Portfolio Manager

Resources – The bear market is still early



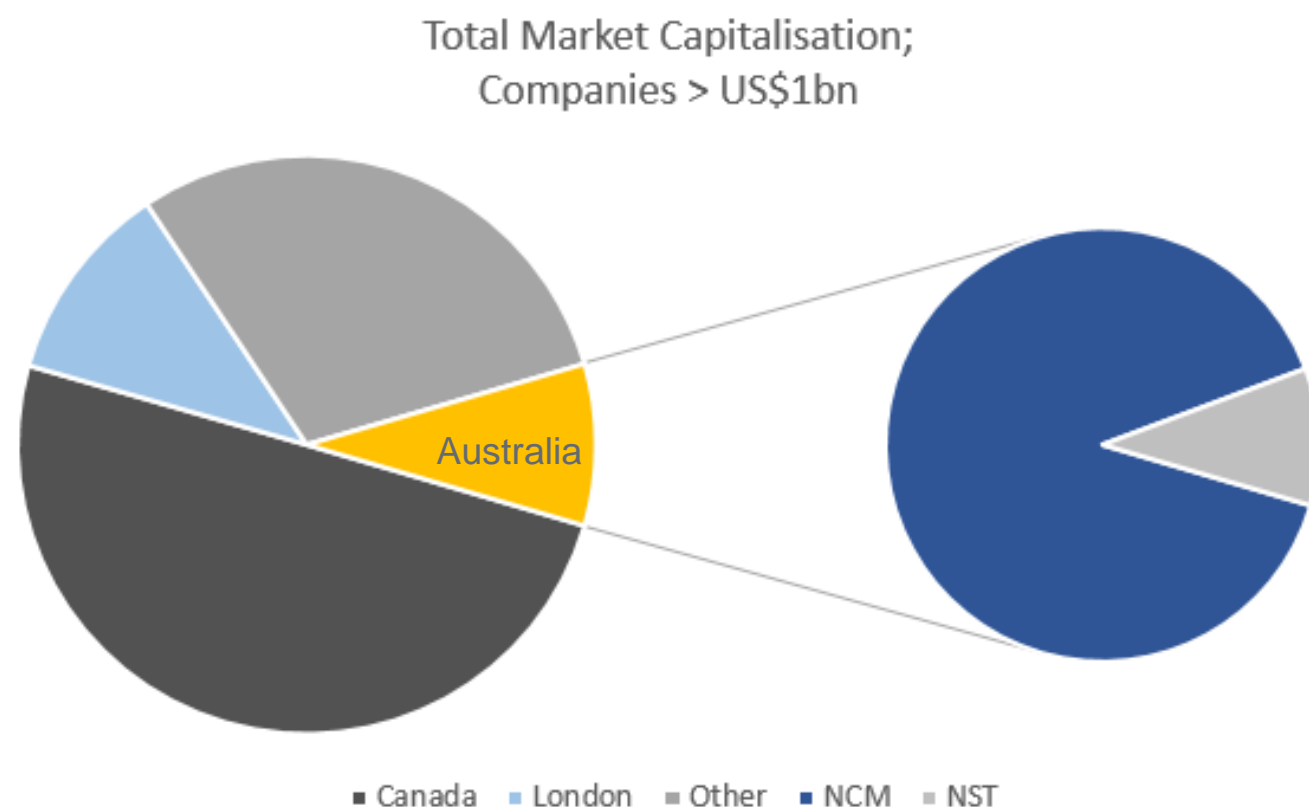
- Commodity markets are oversupplied for a long time. Particularly iron ore, coal, oil and LNG.
- The Chinese economy continues to transition away from an investment led model, decreasing commodity demand. Ex-China growth remains weak.
- Violent counter cyclical rallies will occur at times when prices are oversold, but the trend is lower.
- Australia's Terms of Trade will fall for the next 10 years presenting a significant headwind for the economy.

Time to be selective



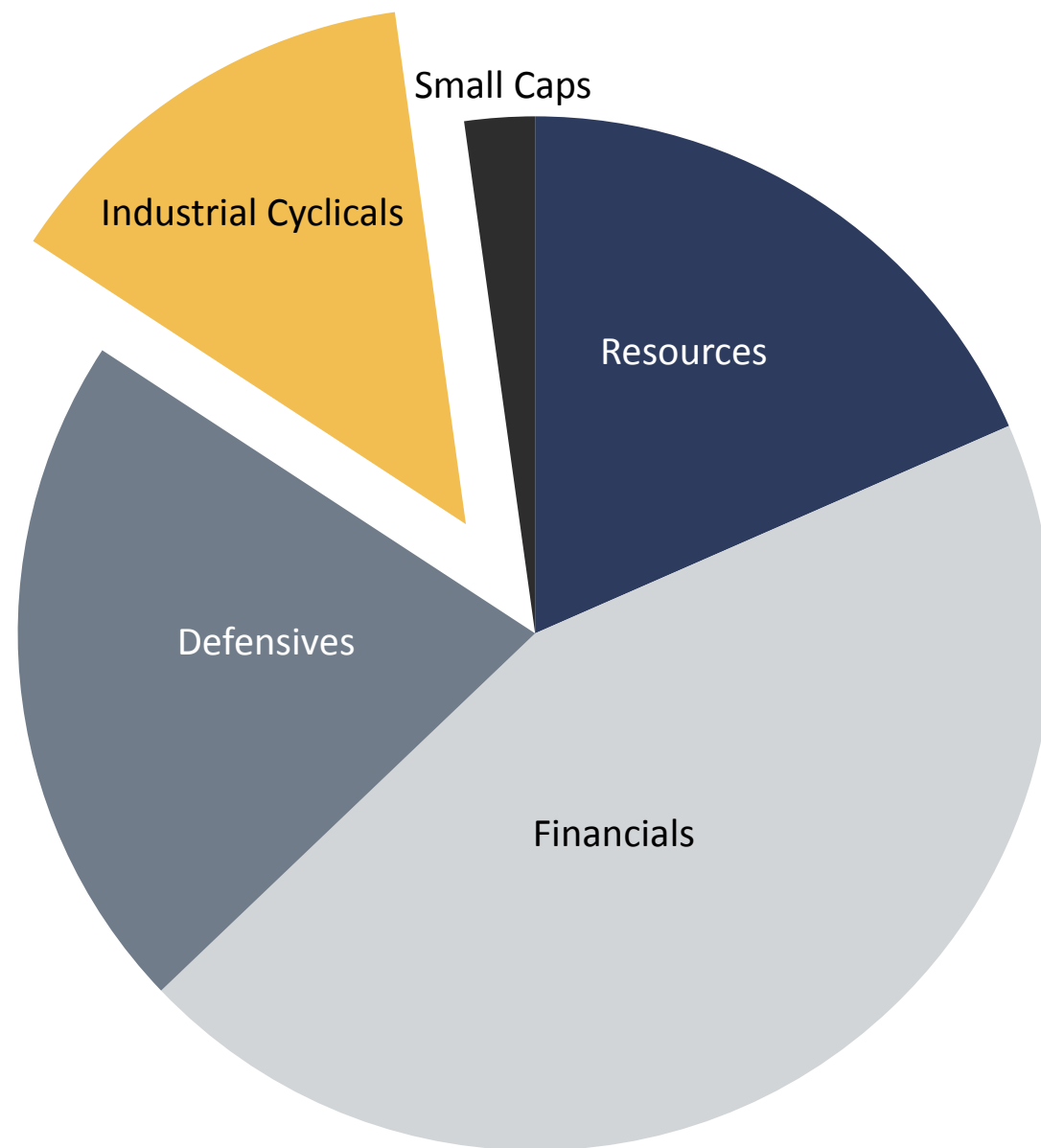
- We continue to have a strong preference for base metals over bulk commodities despite the outperformance.
- US Shale and OPEC positioning have structurally changed the oil market. We are at the beginning of a bear market.
- We will favour low cost producers with strong balance sheets. Companies not in this position will struggle.
- While gold has performed relatively well, we temper our upside case for the time being.

International Opportunities



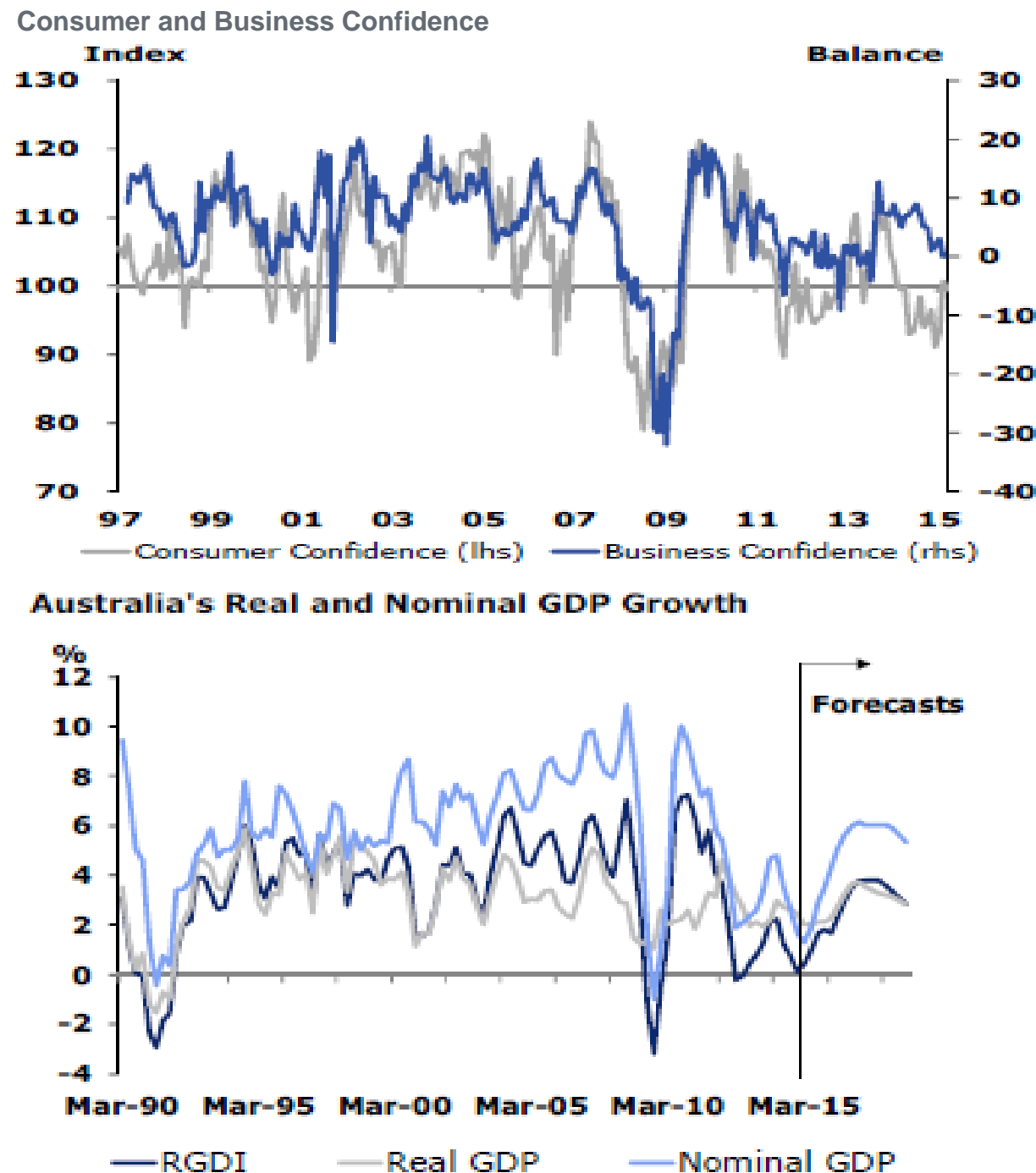
- Precious Metals is one sector where we have launched our international investments.
- Australia has only two gold miners with market caps greater than US\$1bn – there are 10 times more opportunities offshore
- Goldcorp and Tahoe Resources have been added to the portfolio as key resource investments.
- We have modestly added positions, both long and short, in international mining and energy companies.

“Have cyclical shares had their run? ”



Tom Richardson
Portfolio Manager

Cyclicals – Soft economic outlook



- Cyclical companies will struggle in this low growth environment.
- A risk case exists that at some stage we face a downturn.
- Despite numerous rate cuts, consumer confidence remains low. Business confidence now tracking down also.
- Real gross national income remains well below trend.

Source: ABS, Goldman Sachs Global Investment Research

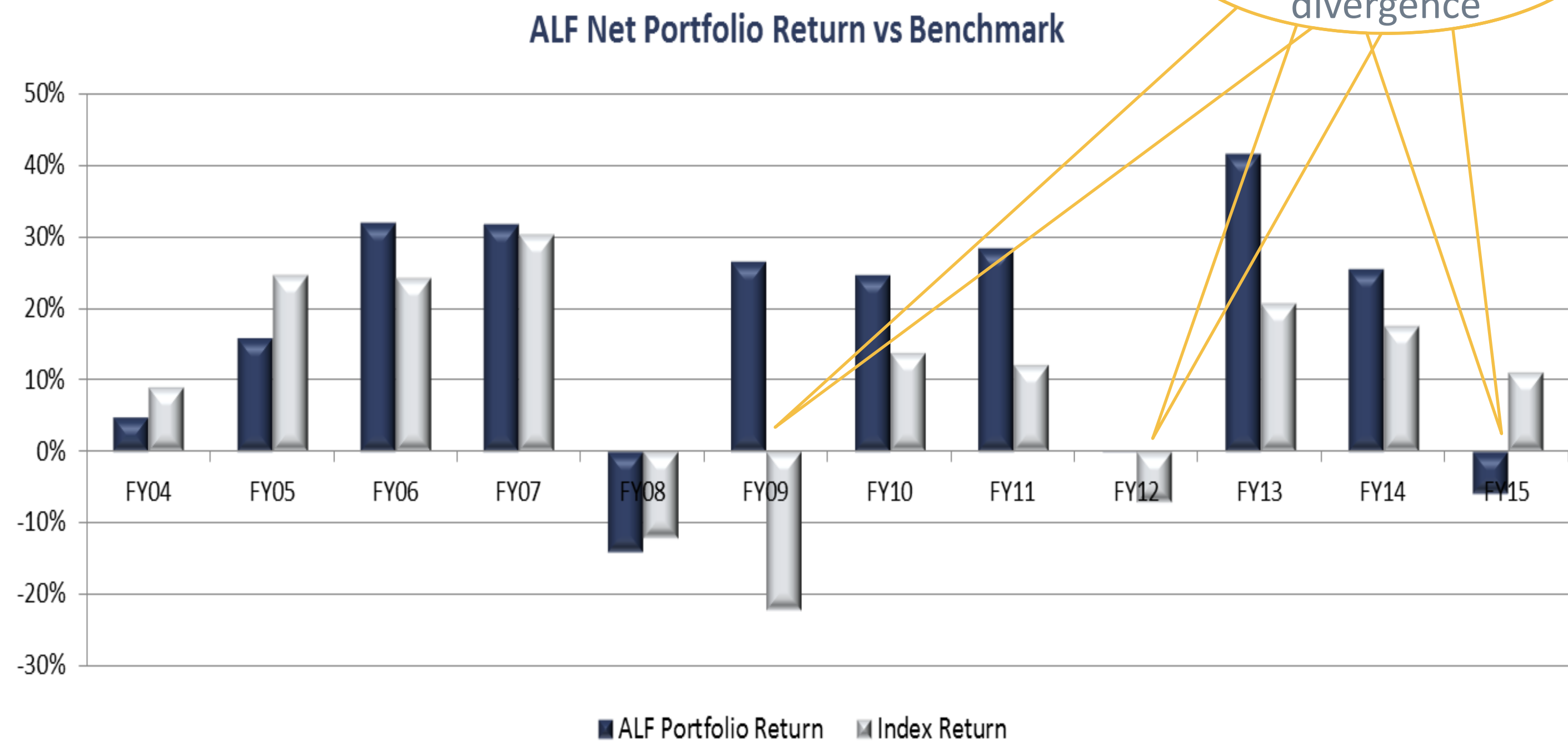
Sector outlook

- MEDIA – Losing eyeballs and dollars. Leakage of ad spend to offshore companies – eg. Google (YouTube), Facebook. New content platforms usurping traditional media.
- RETAIL – Consumer remains in a deleveraging phase.
- CONTRACTORS – Operating environment remains very difficult. Many companies attempting to transition to infrastructure spend and away from mining.
- TRANSPORT – Bouncing along the bottom, with some support from a lower currency.
- BUILDING MATERIALS – One of the few sectors benefitting from the strong housing cycle. Risks are increasing as macro prudential regulation slows momentum.

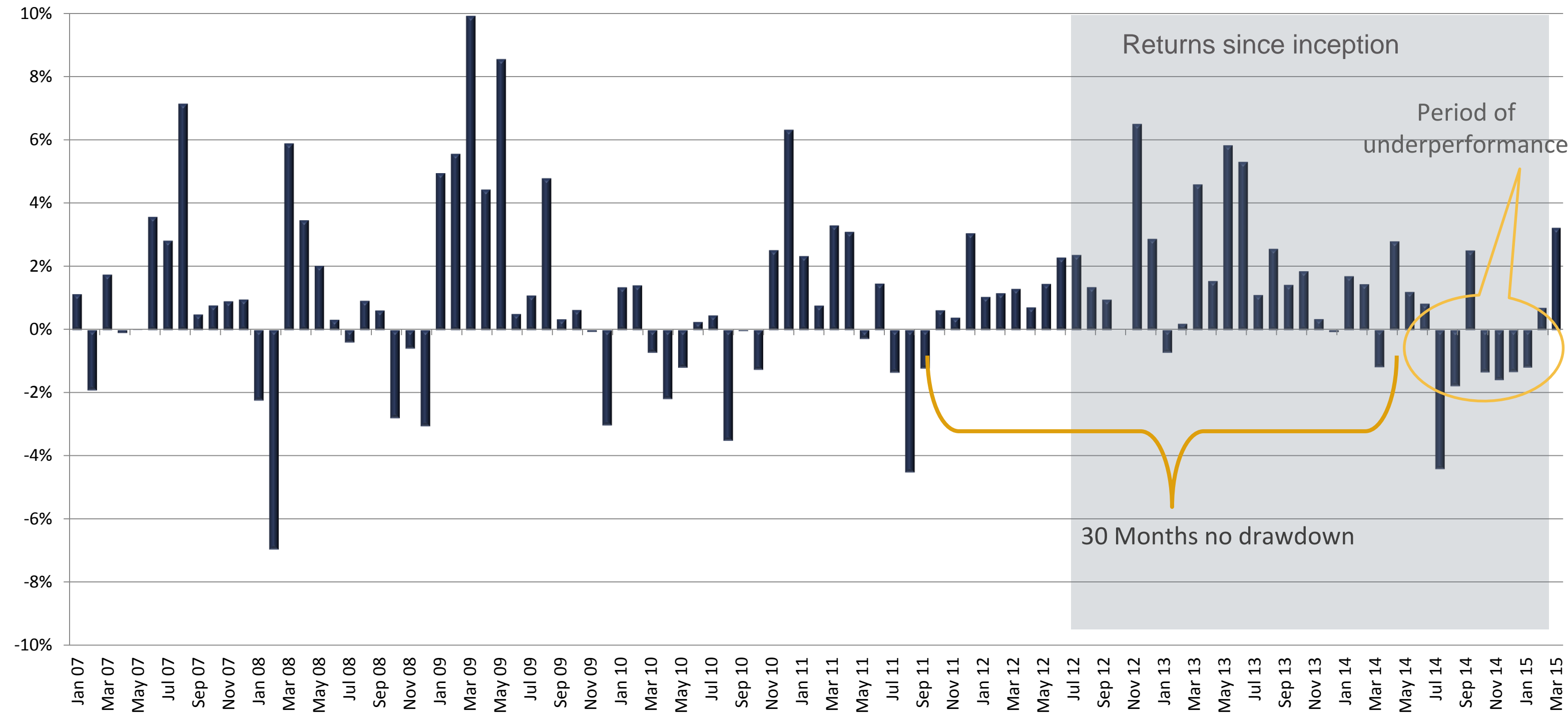
Performance Review



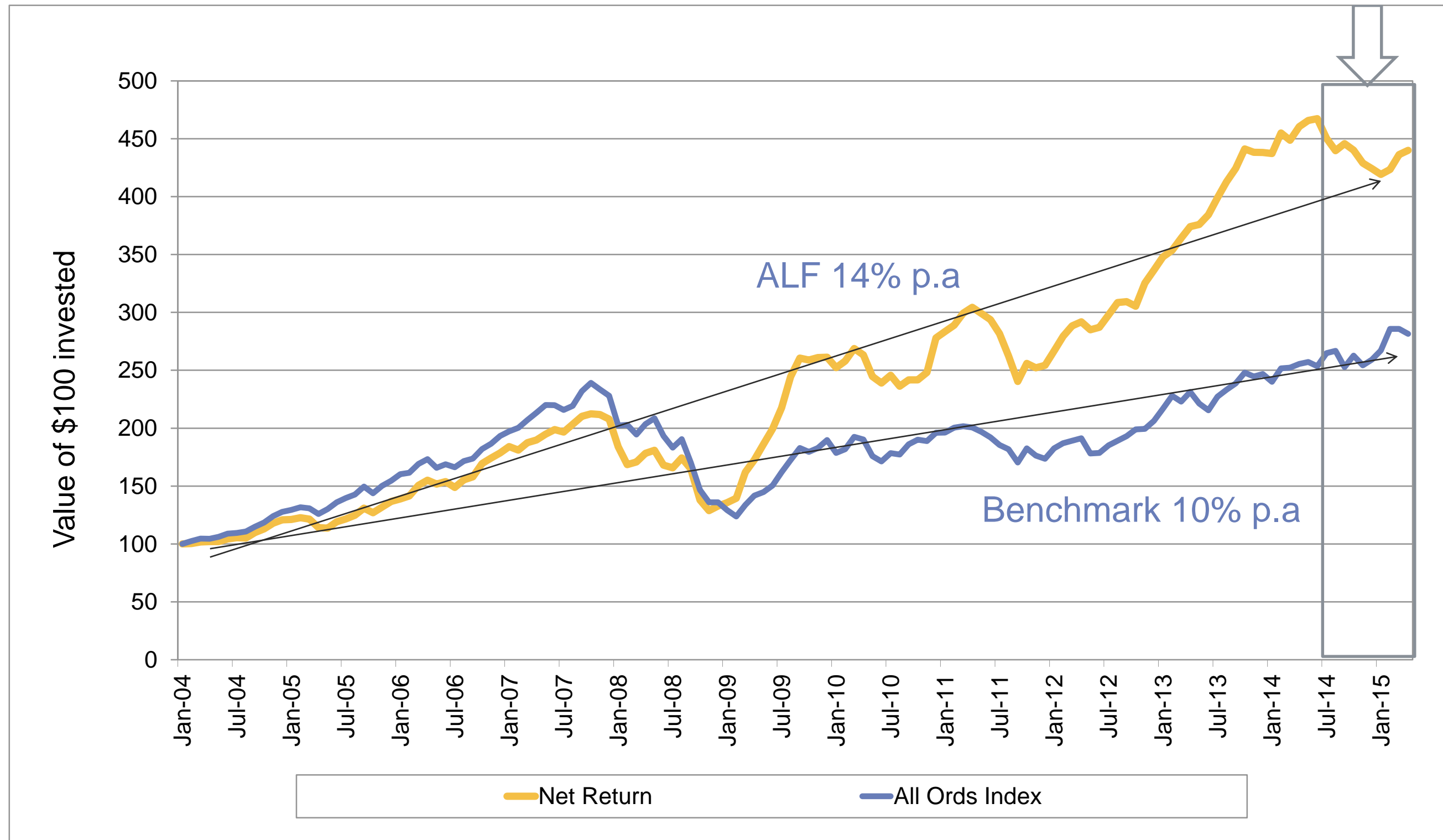
ALF Performance Analysis



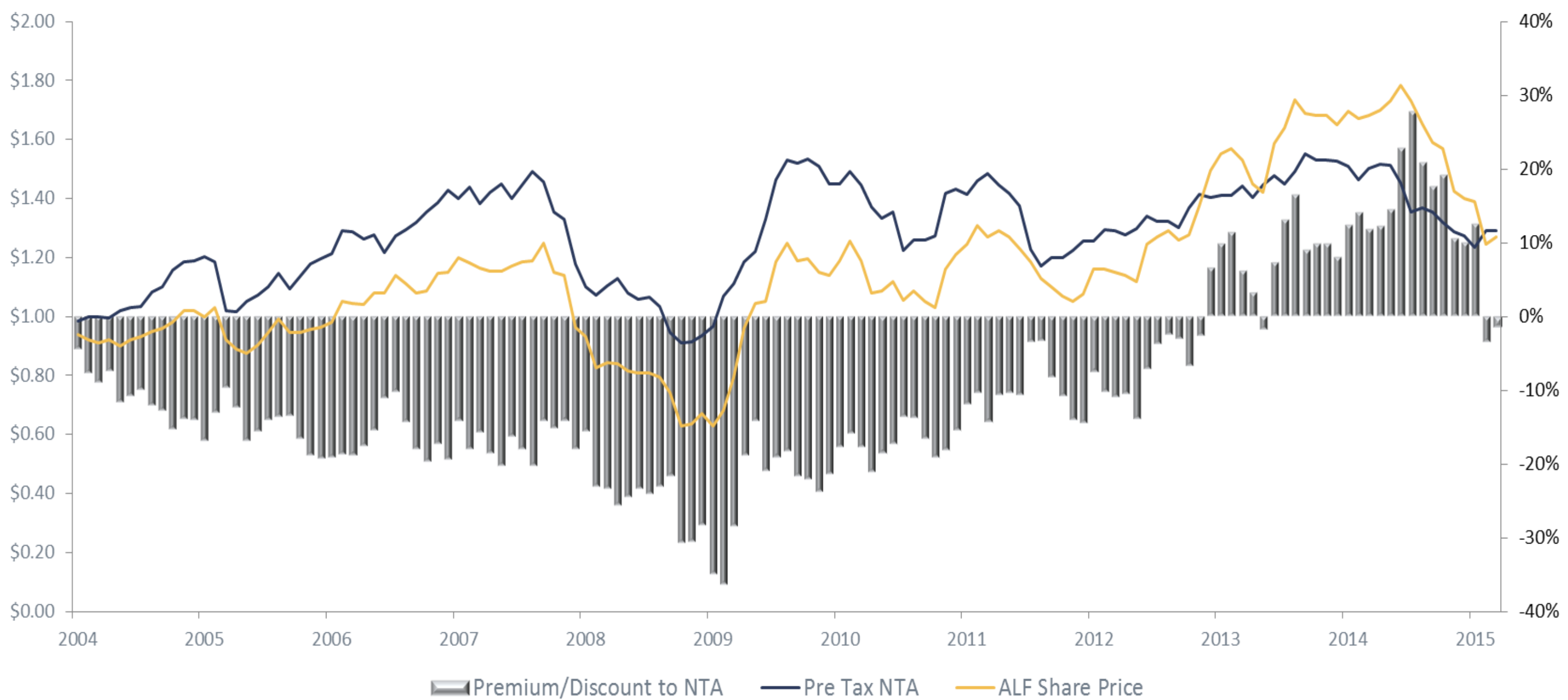
Net Monthly Returns- Market Neutral Strategy



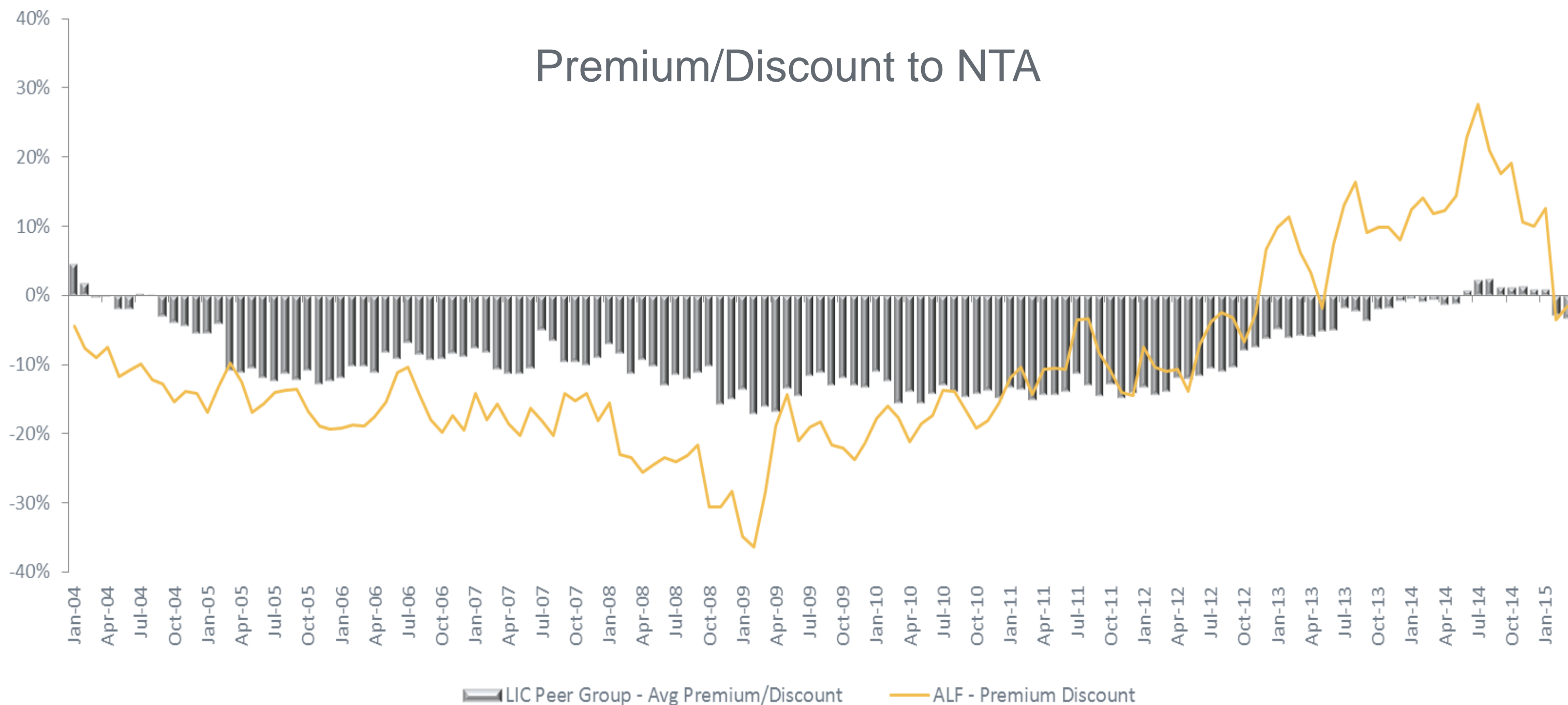
Australian Leaders Fund Vs Benchmark



ALF Performance Analysis



LIC Peer Group - Performance Analysis



*Average of all Australian Equity LIC's

Australian Leaders Fund Ltd

Performance to 30 April 2015

| | 1 Month | 6 Months | 1 YEAR | 3 YEARS (P.A.) | 5 YEARS (P.A.) | SI (P.A.)* |
|---------------------------|--------------|--------------|---------------|----------------|----------------|--------------|
| Long (Gross) | 2.2% | 9.9% | 8.3% | 15.4% | 12.4% | - |
| Short (Gross) | 1.2% | 8.2% | 8.8% | 1.7% | 1.2% | - |
| Net | 0.8% | -0.1% | -4.5% | 14.7% | 13.8% | 14.1% |
| All Ords. Accum. Index | -1.5% | 7.1% | 10.2% | 13.8% | 4.7% | 9.7% |
| Net Outperformance | +2.3% | -7.2% | -14.6% | +0.9% | +9.0% | +4.5% |

* Portfolio inception date is January 2004

Watermark Market Neutral Fund Ltd

Performance to 30 April 2015

| | 1 Month | 3 Months | 6 Months | 1 Year | S.I (P.A.)* |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| Long (Gross) | 2.0% | 11.8% | 10.8% | 9.3% | - |
| Short (Gross) | 1.2% | 5.8% | 8.9% | 9.1% | - |
| Net | 0.7% | 4.6% | 0.8% | -2.4% | 3.9% |
| RBA Cash Rate | 0.2% | 0.6% | 1.2% | 2.5% | 2.5% |
| Net Outperformance | +0.5% | +4.1% | -0.4% | -4.9% | +1.3% |

* Portfolio inception date is July 2013

Cumulative Net Monthly Returns

