

## Watershed Australian Share Portfolio

### Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Watershed Australian Share Portfolio is a separately managed account, or SMA, actively managed by Watershed Funds Management. SMAs are professionally managed portfolios of investments whereby the investor receives beneficial ownership of the underlying securities.

#### Investment Objective

The objective of the Watershed Australian Share Portfolio is to provide market-leading, tax effective returns over the medium to long term from a concentrated portfolio of large capitalisation, high quality Australian shares and listed Exchange Traded Funds.

Key Portfolio Features	
<b>Inception</b>	5 Aug 2010
<b>Benchmark</b>	S&P/ASX200 Accumulation Index
<b>Authorised Investments</b>	ASX200 shares Listed ETF's
<b>Number of Stocks</b>	15-30
<b>Cash Allocation</b>	2-20%
<b>Tracking Error</b>	2% to 5% per annum
<b>Investment Horizon</b>	At least 5 years

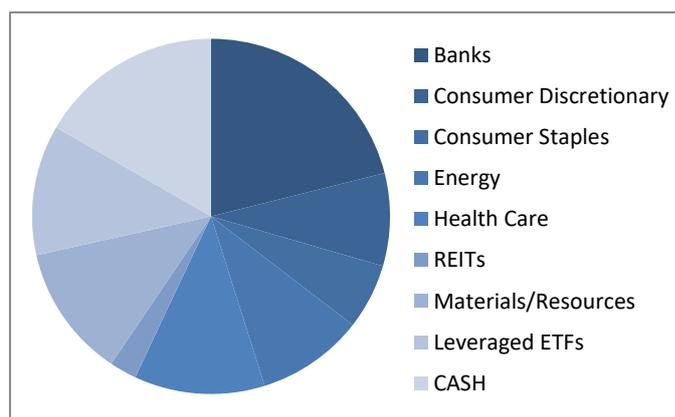
#### The Portfolio is designed for investors who...

- Seek long term capital growth & tax-effective income
- Have a long-term investment horizon of at least five years and accept the risk of price fluctuations.

### Portfolio Structure

No.	Company Name	ASX Code
1	BetaShares Aus Strong Bear Fund	BBOZ
2	CSL Ltd	CSL
3	Commonwealth Bank	CBA
4	BHP Billiton	BHP
5	Westpac Banking Group	WBC

GICS Sector	
<b>Banks</b>	21.08%
<b>Consumer Discretionary</b>	8.43%
<b>Consumer Staples</b>	5.95%
<b>Energy</b>	9.70%
<b>Health Care</b>	11.80%
<b>REITs</b>	2.46%
<b>Materials/Resources</b>	12.07%
<b>Leveraged ETFs</b>	11.86%
<b>CASH</b>	16.65%
<b>TOTAL</b>	100%



### Performance

Net Performance (%)	1m	3m	6m	1yr	3yr	5yr	7yr	Inception*
<b>WFM Aus Share Portfolio</b>	1.52%	2.49%	6.87%	4.74%	10.32%	8.54%	10.40%	7.90%
<b>S&amp;P/ASX 200 Accum Index</b>	1.84%	2.36%	10.52%	12.46%	11.88%	9.50%	10.97%	
<b>Relative Performance</b>	-0.32%	0.13%	-3.65%	-7.71%	-1.56%	-0.96%	-0.57%	

\*Inception - August 2010



## Quarter in Review

### Performance Summary

- The Watershed Australian Share portfolio returned 2.49% for the September quarter, 0.13% ahead of the index. This is a pleasing result given the very conservative positioning of the portfolio in a market that is trading near record highs.
- The overweight cash and short position (currently net long 58%) were a drag on performance in the rally to end of July but are now starting to add value.

## Portfolio Adjustments

During the quarter we:

**Sold:** VEA, JHG, PTM, BLD, BSL

**Increased:** BBOZ

## Quarterly Performance Attribution

Top Contributors	Key Detractors
LLC	BBOZ
TWE	BHP
NAB	WPL

### Market Summary

The global macroeconomic backdrop has continued to become more challenging and is increasingly susceptible to downside risks, which is creating volatility in markets. Investors are faced with concerns on everything from trade disputes, the global manufacturing slowdown and concerns around a potential global recession next year.

The one driving force that has pushed global markets to record highs is the return of central bank easing. The Federal Reserve has cut rates again and recommenced its bond buying programme (though reluctant to call it Quantitative Easing). Similarly in Australia, the RBA has cut rates 3 times to be at historic lows, and the ECB cut the official rate from -0.4% to -0.5% and resumed QE. We however question the effectiveness of these emergency measures this late in the cycle. We believe that the limits of Central Bank policy have been met and

that government regulatory reform and fiscal stimulus is required – not an easy task in a world of high government debt and budget deficits.

There is little disagreement that the US-China trade war remains the biggest threat to the global economic outlook. Uncertainty is undermining business confidence leading to a prolonged capital investment drought which has the potential to impact employment and spill over to the consumer, ultimately leading to recession. Our base case remains that there will not be a meaningful resolution prior to the US Federal election next November. Speculation is also mounting that the US and Donald Trump's next target could be Europe after a favourable ruling by the WTO against Airbus. We expect see more headlines on this in November.

Fears are increasing that we have already begun the transition from globalisation to nationalism which will result in less global trade and ultimately lower growth.

On the corporate front we had a relatively lack luster full year results season in August where earnings growth was essentially flat. This was largely expected given the soft domestic economy (June printed the slowest quarterly growth rate in Australia since coming out of the GFC in 2009) but analysts still expect a rebound in earnings next year, which we believe is overly optimistic. The outlook for the banking and financial sector is flat (at best), we have probably seen peak earnings for the resources sector this cycle and the Industrials sector is trading on a ritzy multiple of almost 23 times earnings. We have seen green shoots in the housing market but 2 months of data does not yet make a trend and consumer spending remains soft.

### Portfolio Positioning

The portfolio remains conservatively positioned given the current environment and what we view as an overvalued market. We increased cash levels over the quarter, divesting stocks leveraged to global growth (construction companies Boral - BLD and BlueScope - BSL) and market leveraged stocks (fund managers Janus Henderson - JHG and Platinum - PTM).

During the quarter the best performing sectors were defensive consumer staples and health care while the more cyclical materials sector was the worst.