

Watershed Emerging Leaders Portfolio

Investment Profile

A Professionally Managed Portfolio of Australian Shares

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

Investment Objective

The objective of the Watershed Emerging Leaders Portfolio is to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of stocks listed outside of the ASX 100. The Portfolio aims to outperform the ASX Small Ordinaries Accumulation Index over the medium to longer term (three to five years) by 2-3% per annum, by undertaking rigorous bottom up stock analysis and active portfolio management.

Key Portfolio Features

Inception	6 Aug 2013
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Authorised Investments	ASX listed companies not in the ASX 100
Number of Stocks	15-30
Cash Allocation	2-40%
Tracking Error	5% to 9% per annum
Investment Horizon	At least 3 – 5 years

The Portfolio is designed for investors who...

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

Performance

Net Performance (%)	1m	3m	6m	1yr	2yr	3yr	4yr	5yr	Inception*
WFM Emerging Leaders SMA	2.55%	5.43%	10.78%	0.68%	14.33%	9.38%	11.67%	13.69%	13.74%
S&P/ASX Small Ords Accum	2.61%	3.11%	6.98%	3.95%	11.83%	8.80%	13.57%	9.61%	
Relative Performance	(0.06%)	2.32%	3.80%	(3.27%)	2.50%	0.58%	(1.90%)	4.08%	

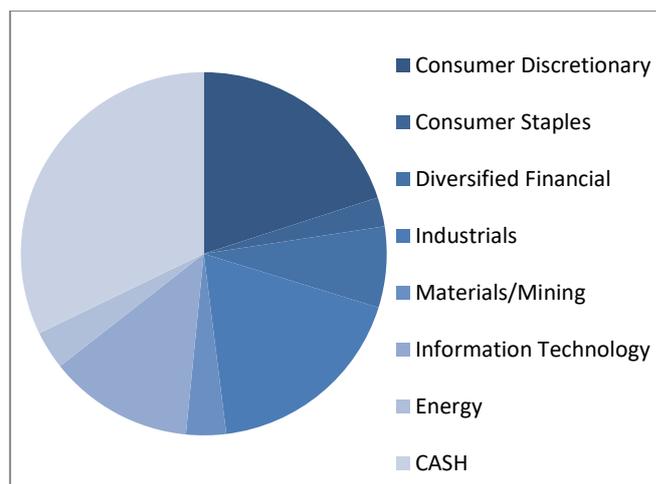
*Inception - August 2013

Portfolio Structure

No.	Company Name	ASX Code
1	Afterpay Touch Group	APT
2	Baby Bunting Group	BBN
3	Collins Foods Ltd	CKF
4	PWR Holdings	PWH
5	Bapcor Ltd	BAP

GICS Sector

Consumer Discretionary	19.98%
Consumer Staples	2.60%
Diversified Financial	7.21%
Industrials	18.24%
Materials/Mining	3.53%
Information Technology	12.82%
Energy	3.41%
CASH	32.21%
TOTAL	100%





Quarter in Review

Performance Summary

- The Watershed Emerging Leaders SMA had a strong quarter to start the new financial year. The portfolio rose 5.43% compared to the small ordinaries which only rose 3.11% resulting in outperformance of 2.32%.
- This performance was achieved with significantly less risk with the portfolio carrying 30% cash through much of this period, reflecting outperformance from stock selection.

Portfolio Adjustments

During the quarter we made the following changes:

Sold: IGO

Trimmed: BIN

Topped Up: AHF (through a placement)

Quarterly Performance Attribution

Top Contributors	Key Detractors
BBN	APX
APT	CLQ
SIQ	WOR

Market Summary

Australian equities have had another favourable quarter albeit with increased volatility largely due to the global political landscape (trade tensions) and fears of weakening global growth. The Small Ordinaries Index outperformed its larger counterparts over the quarter for the second time this year indicating that investors are not overly concerned with the current backdrop. The Emerging Leaders portfolio is positioned more cautiously amid the deteriorating outlook.

During the quarter we had the full year 2018/19 reporting season. The portfolio came through well with the only soft result being Worley Parsons (WOR). This comes after June which averaged nearly a downgrade a day and is a sign that underlying earnings in the portfolio are resilient to deteriorating growth. This is reflective of the portfolios current positioning which is an active call to be overweight more defensive earning companies.

Portfolio Positioning

Elevated cash levels remain a key theme in the portfolio as has been the case for several months. Currently sitting at 32% we feel the caution is appropriate in the prevailing market environment where the small ordinaries remains fully priced. The portfolio holds overweights to cash and defensive sectors such as industrials and consumer discretionary, while being underweight materials.

Information Technology also remains a key overweight, and although the sector as a whole trades at a significant premium to the index, top line growth has delivered healthy returns to investors. Stock selection within this sector has attributed to a lot of the alpha over the quarter and previous time periods.

Mandate restrictions also require the portfolio to sell down its holding in Worley (WOR) in the following quarter after its inclusion into the S&P/ASX100 index in December last year, with requirements to sell within one year of inclusion.

It is also pleasing to see the investment thesis for some of our longer term holdings come to fruition. Baby Bunting (BBN) has been discounted for a long time as competitors going into administration were discounting all their products to clear stock. Baby Bunting has since come out the other side well with strong same store sales growth, an increasing proportion of private label sales (which are much higher margin) and also the success of the Chadstone shopping centre format which is being rolled out into other centres. Chadstone is now the number one store in terms of transaction volume (35% higher than the top 10 store average)

Collins Foods (CKF) is the other long term holding that has delivered strongly in 2019. The KFC operator has achieved solid same store sales growth in Australia, and while the expansion to Europe has disappointed to date with margin weakness reflective of the investment ahead of a significant rollout. The European opportunity is still viewed as compelling and will start to benefit from operating leverage as the network expands. CKF has also successfully trialled Taco Bell in Queensland and is planning a store rollout with Melbourne the next target.

Overall, we continue to be cautious in the current environment but remain focused on unearthing compelling investment ideas that meet our key quality criteria, with a number of stocks flagged for further investigation.