WATERSHED

FUNDS MANAGEMENT

2019 IMAP MANAGED ACCOUNT AWARDS

Australian Equities Small Cap Finalist

2019 IMAP MANAGED ACCOUNT AWARDS

Quarterly Update December 2019

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

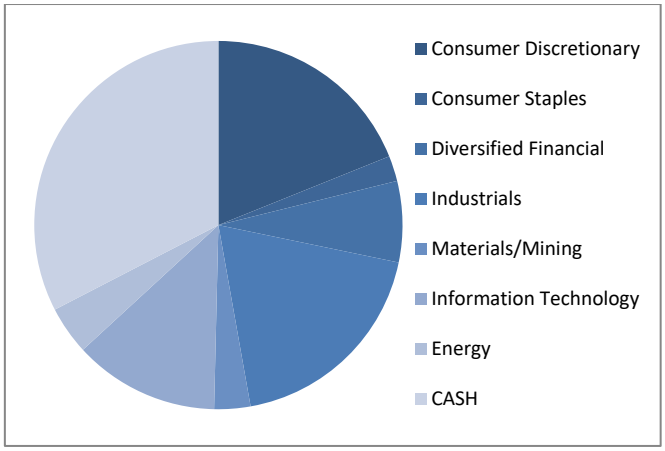
The Portfolio is designed for investors who…

- 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.

Portfolio Structure

No.	Company Name	ASX Code
1	Baby Bunting Group	BBN
2	Afterpay Group	APT
3	NRW Holdings	NWH
4	PWR Holdings	PWH
5	Collins Foods	CKF

GICS Sector	
Consumer Discretionary	18.91%
Consumer Staples	2.23%
Diversified Financial	7.12%
Industrials	18.94%
Materials/Mining	3.17%
Information Technology	12.79%
Energy	4.25%
CASH	32.59%
TOTAL	**100%**



Performance

Net Performance (%)	1m	3m	6m	1yr	2yr	3yr	4yr	5yr	Inception*
WFM Emerging Leaders SMA	(3.05%)	(2.77%)	2.51%	19.30%	7.37%	9.74%	7.62%	12.64%	12.67%
S&P/ASX Small Ords Accum	(0.29%)	0.76%	3.89%	21.36%	5.28%	9.98%	10.77%	10.65%	
Relative Performance	(2.76%)	(3.53%)	(1.38%)	(2.06%)	2.09%	(0.24%)	(3.15%)	1.99%	

*Inception - August 2013

Performance Fee Disclosure All figures & tables stating investment performance returns (AFTER investment management fees, but BEFORE administration fees and taxes) for the Portfolio. The performance returns have been calculated on a daily basis taking into account brokerage costs, and are accumulated for the period shown. Returns are shown as annualised if the period is over 1 year, or as total returns otherwise.

WATERSHED

FUNDS MANAGEMENT

Quarter in Review

Performance Summary

- The Watershed Emerging Leaders SMA had weaker quarter to end the calendar year. The portfolio fell 2.77% compared to the small ordinaries which rose 0.7% resulting in underperformance of 3.53%.

- This resulted in a 19.30% return for the 2019 Calendar year, underperforming the Small Ords by 2.06% after having elevated cash levels for much of the year.

Portfolio Adjustments

During the quarter we made the following changes:

Sold: MLX

Topped Up: AMA (through a rights issue)

Quarterly Performance Attribution

Top Contributors	Key Detractors
NWH	**SIQ**
BIN	**AMA**
WOR	**APT**

Market Summary

Australian small stocks closed out the 2019 calendar year with exceptional returns. The majority of the 21.36% index return came in the first half of the year after markets rebounded strongly from the Federal Reserve pivot and lows of December 2018. The Small Ordinaries Index slightly underperformed its large cap counterparts (the S&P/ASX 200) which returned 23.4% in what was the best calendar year returns in a decade.

Yet it was a tough year for active managers in general with many not positioned for the Fed pivot and the resulting interest rate cuts driving P/E expansion with limited underlying earnings growth. As a result many underperformed the benchmark including us.

We do not expect 2020 to generate the same returns as 2019, and valuations do not leave much room for error in the upcoming reporting season, but the portfolio is skewed to more defensive or higher quality earners with clearly identifiable growth prospects. These characteristics combined with a higher than normal cash weight, should provide the portfolio with protection in any market weakness. The higher cash balance also provides ammunition to act quickly to any compelling investment ideas or market overreactions in the Feb reporting period.

Portfolio Positioning

Elevated cash levels remain a key theme in the portfolio as has been the case for several months. Currently sitting at 32.6% 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 was the largest relative detractor over the December quarter. This was nearly all Afterpay which fell 17% on negative regulatory news flow (which has since bounced back). While Consumer Discretionary was the biggest absolute drag on performance from a sector allocation perspective, with the sector getting hit before the Christmas period on the expectation of softer retail sales. Cash also was a small drag after the benchmark had a slight positive return over the quarter.

NRW Holdings (NWH) which is a civil construction and mining services contractor added the most over the December quarter after acquiring BGC Contracting (its largest acquisition to date) for just under $120 million, helping to increase scale as well as being earnings accretive after adding $1.5bn to NRW's order book.

The disappointing result during the quarter was SmartGroup (SIQ) who's highly respected CEO decided to stand down in November after 19 years with the company. The market was also shocked at the time frame of his departure, with the current CFO to take the helm at the Feb 2020 results. This announcement was then followed up in December with news that changes passed on from its insurance underwriter will hit full year profits by $4m. Both announcements caught the market off guard and lead to SIQ being the biggest detractor in the quarter.

We remain cautious in the current environment but focused on unearthing compelling investment ideas that meet our key quality criteria, with a number of stocks earmarked for investment in market weakness.