WATERSHED

FUNDS MANAGEMENT

Investment Overview
December 2019

Watershed Growth Model

Investment Objective

The Watershed Growth Model seeks to provide investors with capital growth over the medium to longer term (at least 5 years) through exposure to a diversified portfolio of assets.

The objective of the Watershed Growth Model is to outperform the Morningstar Australia Multi Sector Growth Target Risk AUD Benchmark after costs

Investment Strategy

The Portfolio is an actively managed, diversified portfolio of securities across both growth assets such as Domestic and Global Shares, Property Trusts, Exchange Traded Funds and at times externally managed funds. The portfolio will in generally hold approximately 80% in growth assets and 20% in more defensive assets, but the portfolio has deliberately broad target ranges allowing implementation of tactical asset allocation given macro-economic views and expected asset class and sector returns.

Key Portfolio Features	
Inception	May 2016
Benchmark	Morningstar Aus Msec Growth TR AUD
MER	0.55% p.a
Investment Horizon	5 years +
Number of Holdings	Typically 50 – 70

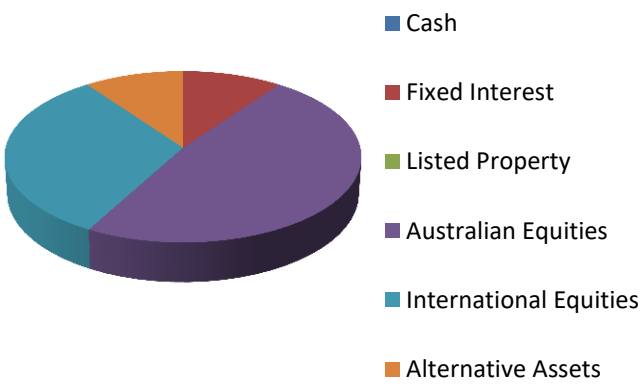
The Portfolio is designed for investors who…

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

Portfolio Structure

Sector Allocations	Range	Strategic
Cash	0-30%	2%
Fixed Interest	0-40%	18%
Listed Property	0-10%	5%
Australian Equities	15-90%	40%
International Equities	0-75%	35%
Alternative Assets	0-15%	0%
TOTAL		**100%**

Underlying Assets	Tactical
Watershed Income	10.0%
Watershed Australian Share	34.6%
Watershed Emerging Leaders	13.4%
Watershed International	18.6%
Watershed International ETF	13.4%
Watershed Alternatives	10.0%



Performance

Net Performance (%)	1m	3m	6m	1yr	2yr	3yr	Inception*
Watershed Growth Portfolio	-0.61%	1.68%	5.64%	18.23%	8.04%	9.26%	**9.93%**
Morningstar Aus Msec Growth TR AUD	-1.32%	1.35%	4.31%	19.13%	9.45%	9.39%	
Relative Performance	0.71%	0.33%	1.33%	-0.89%	-1.40%	-0.13%	

*Inception – May 2016

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.

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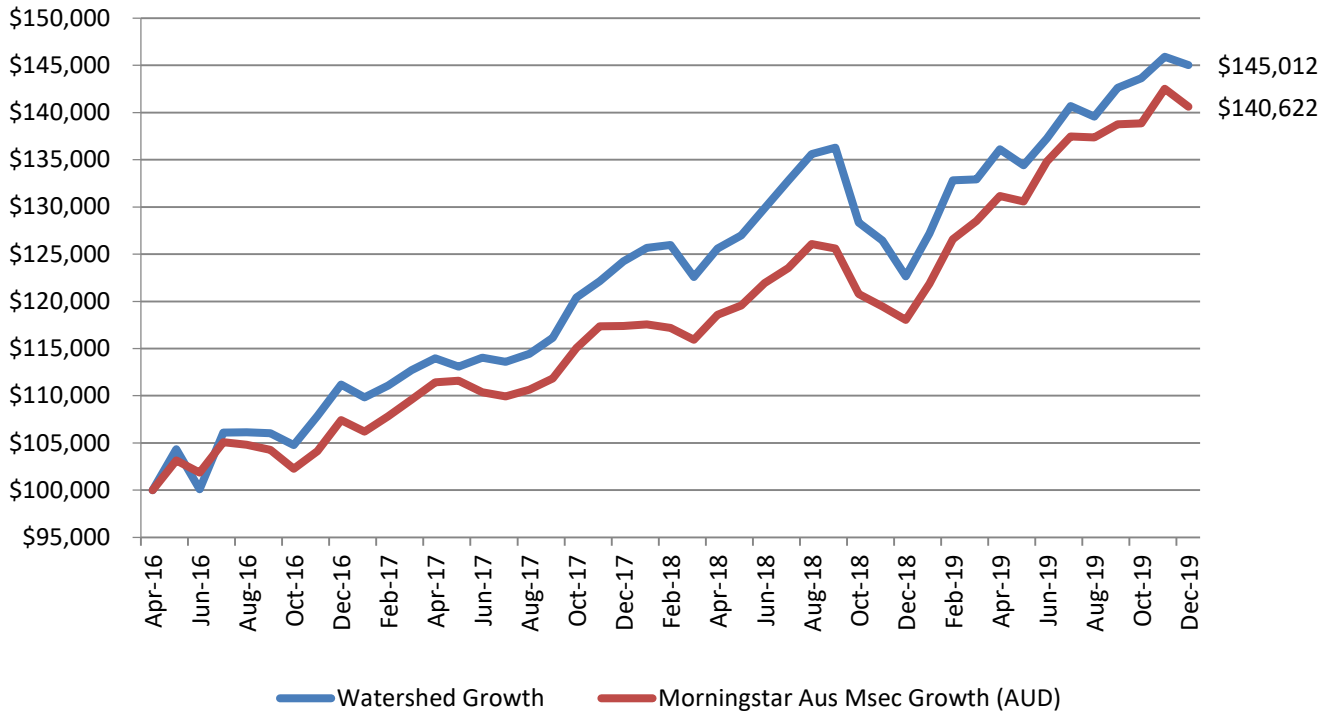
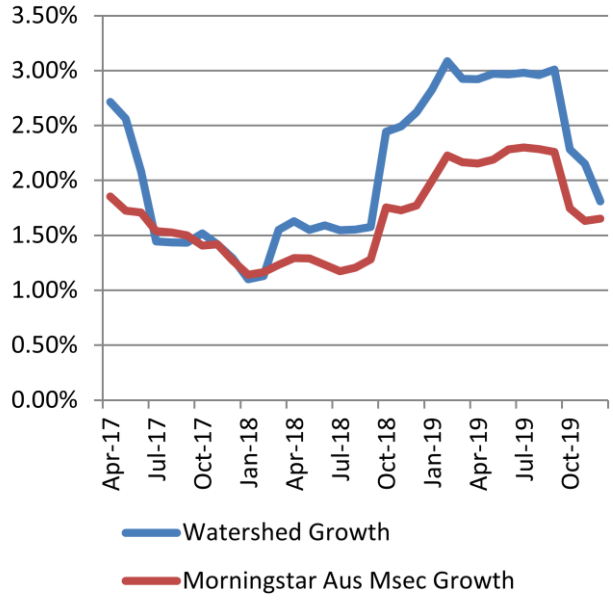
Growth of $100,000 since Inception



Risk Metrics

Key Portfolio Risk Metrics	
Tracking Error	1.08%
Standard Deviation	2.27%
Sharpe Ratio	3.99
Information Ratio	0.90

1 Yr % Rolling Standard Deviation



Portfolio Summary

- The Watershed Growth Multi-asset portfolio outperformed the Morningstar Australian Multi-sector Growth Total Return Benchmark (in AUD) by 0.33% over the December quarter.

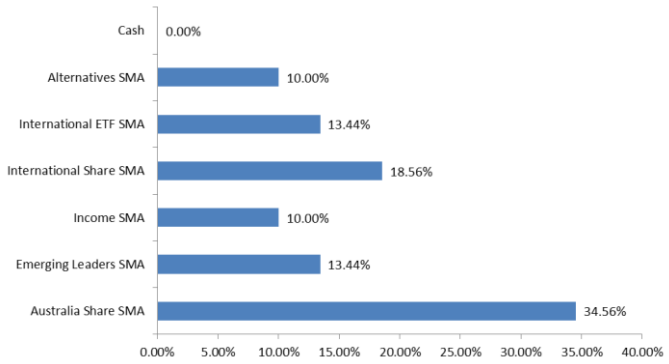
- The portfolio has slightly underperformed the Morningstar index over the 2019 Calendar year given its conservative positioning, with higher than normal cash balances dialling back equity exposure into strength while markets continue to grind higher. However the second half of the year has delivered strong outperformance of 1.33%.

Asset Allocation

When determining optimal Asset Allocations we factor both our long-term views on economic and market variables as well as asset class valuations. We then combine these assumptions to generate risk-return trade-offs for investors with different risk profiles and investment horizons. This long-term asset allocation is referred to as our Strategic Asset Allocation (SAA) and generally remains unchanged throughout the investment cycle. However, in order to exploit dislocation and mispricing in asset classes throughout the cycle we employ active Tactical Asset Allocation (TAA).

Sector Allocations	SAA	TAA
Cash	2%	0%
Fixed Interest	18%	10%
Listed Property	5%	0%
Australian Equities	40%	48%
International Equities	35%	32%
Alternative Assets	0%	10%
TOTAL	**100%**	**100%**

Our most recent tactical changes in December 2019 saw us trimming equities and adding to our Alternatives position. Both tactical changes are consistent with our view that markets are looking fully-valued and that the non-market correlated returns generated by alternative assets will provide downside protection and likely outperform as we head into 2020. Within the equities asset class we also made some minor adjustments. We slightly increased our weightings to large-cap Australian Equities and reduced our weights to Mid-Caps and increased our exposure to US Equities and reduced our Rest of World exposure to increase the defensive positioning of the portfolio.



Market Outlook

The year delivered very strong market returns despite concerns hanging over markets at the beginning of the year, and the fact that most of these issues remain unresolved, namely;

- US and China trade war dispute
- Global growth slowing
- High debt levels and minimal wages growth

The key theme of 2019 was the return of supportive Central Bank activity which subsequently pushed these geo-political and growth concerns to the background and provided investors with a far better year that it really should have. With these returns reflective of an environment where liquidity had greater influence on markets than underlying earnings growth.

The prospect of a "lower for longer" interest rate environment also delivered strong returns for domestic and global bonds throughout last year, as it did for interest rate sensitive asset classes.

The main question we are asking as we head into a new calendar year is how long can the market trade at these elevated levels in the absence of growth in profitability? We suspect the answer is not long, and believe that the forthcoming reporting season might provide a sobering reality with respect to the current corporate climate. As such we believe prudent, defensive asset allocation will be an important driver of portfolio returns in 2020.

It is important to remember that the central bank intervention that drove returns in the major asset classes last year was a preemptive measure taken in the face of a deteriorating global macroeconomic environment. As markets have steadfastly driven higher, we have continued to "fade the rally" and take profits in the face of what we see as misplaced optimism, maintaining a focus on capital preservation, which we believe will be paramount over the near to medium term.

We have adopted this mindset not only at an Asset Allocation level but also at an individual SMA level, with our underlying SMA's defensively positioned and holding elevated levels of cash.

We have held this contrarian mindset for some time now, which makes our very strong 2019 returns, despite our defensive positioning, all the more gratifying.