



Watershed Microcap Portfolio

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Watershed MicroCap 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 MicroCap Portfolio is to provide investors with long-term capital growth and limited tax effective income from a concentrated portfolio of stocks with a market capitalisation of less than \$300 million. The Portfolio aims to outperform the S&P/ASX Emerging Companies 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	30 Oct 2017
Benchmark	S&P/ASX Emerging Companies Index
Authorised Investments	ASX listed companies under \$300m market cap
Number of Stocks	Typically 15-25
Cash Allocation	Default asset, no strategic allocation per say
Investment Horizon	At least 3 – 5 years

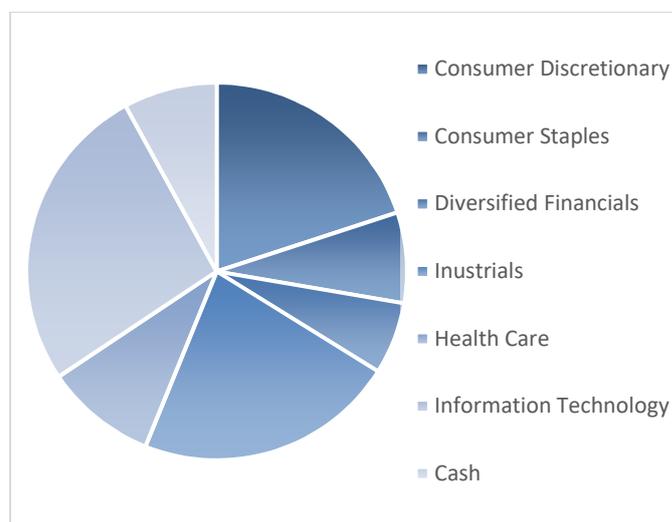
The Portfolio is designed for investors who...

- Seek long term capital growth with limited 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	Alliance Aviation	AQZ
2	Objective Corporation	OCL
3	Data#3 Ltd	DTL
4	Baby Bunting	BBN
5	Praemium Ltd	PPS

GICS Sector	
Consumer Discretionary	22.88%
Consumer Staples	5.21%
Diversified Financial	6.18%
Industrials	21.10%
Health Care	5.79%
Information Technology	29.70%
CASH	9.14%
TOTAL	100%



Performance

Gross Performance (%)	1m	3m	6m	1yr	2yr	3yr	Inception*
WFM Microcap SMA	2.12%	18.52%	62.15%	34.34%	25.57%	18.74%	19.30%
S&P/ASX Emerging Companies Index	-1.00%	21.30%	75.75%	4.67%	8.87%	9.37%	9.64%
Relative Performance	3.12%	-2.78%	-13.60%	29.67%	16.69%	9.37%	9.66%

*Inception - October 2017

Performance Fee Disclosure All figures & tables stating investment performance returns (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.



Quarter in Review

Performance Summary

- The Watershed Microcap SMA has continued its exceptional turnaround from the depths of the pandemic induced sell off. Huge swings in smaller stocks has seen even the Emerging Companies Index experience 40% swings, and while the Microcap portfolio significantly outperformed on the way down it has underperformed the two subsequent quarters, and even after returning a phenomenal 62.15% in the last 6 months, this still trails the index after it delivered a 75.75% return.
- However strong long term absolute performance has been cemented after outperforming the index by 29.67% in the last twelve months, in a calendar year of three very distinct quarters. The portfolio remains strongly ahead over all longer time periods as well.

Portfolio Adjustments

During the quarter there were no changes to the portfolio:

Bought: N/A

Quarterly Performance Attribution

Top Contributors	Key Detractors
OCL	PAR
DTL	AMX
PPS	TRS

The Emerging Companies index has had its first negative month since the Coronavirus hit markets hard in February and March. However the small 1% fall in September was unable to stop another strong quarterly return that once again significantly outperformed its large cap counterparts.

The August full year reporting period provided a good gauge on the economic impact on company profits. Key themes that we have mentioned in our other updates were the impact of fiscal stimulus and the effects as it begins to roll off, cost management and the strength of balance sheets, and the path to recovery and the

figures with losses less than the market expected well received as demonstrated by the REIT (Real Estate Investment Trust) sector.

Portfolio Positioning

The portfolio retains a healthy position in technology stocks which have been big beneficiaries of the switch to online, while also benefitting from additions to consumer discretionary holdings during the depths of the market panic. These are leveraged to the economy opening back up but have also accelerated investment in their online presence and have been helped significantly from the governments Job Keeper stimulus package.

Key contributors during the quarter are reflective of this thinking with Objective Corp, Data3 and Praemium all beneficiaries of the accelerated shift in technology. While key laggards were those that typically ran ahead of themselves in the subsequent market recovery.

The portfolio maintains its high growth bias, and during the selloff saw plenty of opportunity to pick up some quality companies at severely discounted valuations, albeit being clouded in uncertainty, taking a medium term view of a market recovery.

Several consumer retailers fitted this description of beaten up cyclical stocks highly leveraged to the economy opening back up. Specialty fashion retailer Lovisa (LOV), and speciality baby store Baby Bunting (BBN) temporarily fell below a \$300m market cap to enter into the investable universe, hit by foot traffic in their bricks and mortar stores. Lovisa we have since trimmed after a rapid rebound, and Baby Bunting has shown the defensiveness of its earnings and its ability to pick up its online presence. The Reject Shop (TRS) was the other retailer acquired that is an attractive turnaround story centred around their competitive pricing, product range consolidation and the stripping out of unnecessary costs. TRS was also trimmed after strong price action, locking in gains, while restrictions were still in place.

As portfolio managers our role is to remain dispassionate during the wave of hysteria that can accompany rapidly falling markets and doomsday headlines that inevitably accompany a pandemic. Though painful and frightening, the path beyond a stock market crash tends to be a very profitable journey for people that can remain calm and objective, as has been the case thus far in the current market recovery. Pleasingly, the adjustments we made to the portfolio in the previous three quarters have already reaped significant rewards with the portfolio surpassed its previous highs and delivering strong long term returns.