WATERSHED

FUNDS MANAGEMENT

Australian Equities Small Cap Finalist

2019 IMAP MANAGED ACCOUNT AWARDS

Quarterly Update December 2020

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

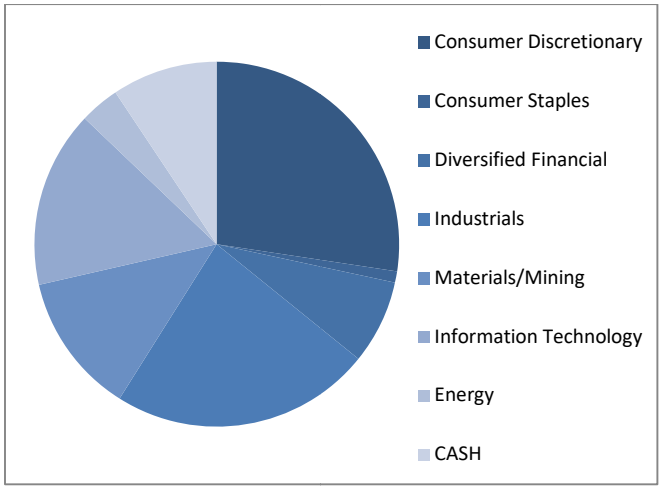
The Portfolio is designed for investors who…

- 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	Mineral Resources	MIN
2	Baby Bunting	BBN
3	Afterpay Ltd	APT
4	Seven Group Holdings	SVW
5	NRW Holdings	NWH

GICS Sector	
Consumer Discretionary	27.38%
Consumer Staples	0.99%
Diversified Financial	7.46%
Industrials	23.11%
Materials/Mining	12.49%
Information Technology	15.70%
Energy	3.51%
CASH	9.36%
TOTAL	**100%**



Performance

Gross Performance (%)	1m	3m	6m	1yr	3yr	5yr	7yr	Inception*
WFM Emerging Leaders SMA	3.68%	12.89%	24.64%	27.60%	13.73%	11.30%	14.43%	14.54%
S&P/ASX Small Ords Accum	2.76%	13.83%	20.28%	9.21%	6.55%	10.44%	8.24%	8.41%
Relative Performance	**0.92%**	**-0.95%**	**4.35%**	**18.38%**	**7.18%**	**0.85%**	**6.19%**	**6.13%**

*Inception - August 2013

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.

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Quarter in Review

Performance Summary

- The Watershed Emerging Leaders SMA had another strong quarter resulting in a very strong Calendar year return, and more notably Calendar year outperformance. The portfolio gained 12.89% for the quarter which slightly underperformed the benchmark. However the portfolio returned 27.60% for the 2020 Calendar year, significantly outperforming the Small Ordinaries by 18.38%.
- The significant bounce was attributable to actively buying stocks in the market weakness, and owning a diversified portfolio of shares with strong balance sheets set to emerge from the pandemic in a stronger industry market position than before.

Portfolio Adjustments

During the quarter we made the following changes:

Bought: ABY, NXL

Topped Up: ABY, NXL, IGO (Entitlement Offer)

Sold: SSM

Quarterly Performance Attribution

Top Contributors	Key Detractors
MIN	**APX**
APT	**ASB**
IGO	**SSM**

Market Summary

The December quarter was yet another where the risk on trade was apparent. News of a vaccine rollout saw investors flood back into equities, which helped the Small Ords put on a healthy 13.8% for the December quarter and surge to record highs. As a result the 2020 calendar year ended it up an impressive 9.21%, which considering the draw down in March and April is an outstanding result.

It is probably no surprise that the top performing sector for the Small Ordinaries was Materials with gold and iron ore prices firming, while laggards such as Real Estate felt the full effects of the shutdown. As was the trend for much of 2020, IT companies and those with an online presence were net beneficiaries as the structural shift online was accelerated.

Portfolio Positioning

The portfolio navigated the tumultuous 2020 calendar year very well and managed to deliver significant alpha in a very volatile market. Having begun the calendar year with high cash levels which provided a good buffer, protecting the portfolio on the downside, but just as importantly allowing the portfolio to be nimble and move to fully invested in a relatively short period of time amidst the dramatic sell off.

New additions to the portfolio over the quarter came via Initial Public Offerings. Given the large scale back due to oversubscription, the portfolio has subsequently topped up both its holdings.

Nuix (NXL) is a global software company which analyses complex data sets and normalises it to coherent and logical data for investigation. The Nuix core engine processes and analyses the data and can then present it via different applications based on the use case. Nuix licenses its platform to government agencies, law enforcement, law firms and large corporates. Key advantages are the speed of the processing engine and the fact that it can analyse most file types and can handle the largest volume of data. With the strong growth outlook for cyber security, we see Nuix as well placed to capitalise on this structural growth trend. The holding makes up 3.5% of the portfolio after topping up post the IPO.

Adore Beauty (ABY) is an Australian leading pure play online beauty retailer. The online platform is a destination for consumers not just for products, but also the education for product use. The company is leveraged to the migration online which has been accelerated by Covid, while also benefitting from the defensive and high frequency purchase profile of the beauty and personal care category. With an addressable market that is set to grow at a CAGR of circa 30% over FY19-24, the company is well placed to capture market share in the fragmented market. With nearly 600,000 customers and growing, and favourable unit economics increasing, we believe Adores growth prospects warrant a higher valuation.

We sold Service Stream over the quarter after a disappointing update in regards to their operating contract with the NBN as an Operate and Maintain agreement which was significantly reduced. Given their exceptional operational track record this came as a surprise and we believe will be an overhang on the stock in the medium term.

The portfolio enters the new financial year with just over 9% cash with the view to deploy into a market that we would expect to be higher in 12 months' time as the world starts to open up.