

## 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

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

Gross Performance (%)	1m	3m	6m	1yr	3yr	5yr	7yr	Inception*
<b>WFM Emerging Leaders SMA</b>	-1.21%	-1.73%	10.94%	71.44%	13.06%	12.49%	12.64%	13.78%
<b>S&amp;P/ASX Small Ords Accum</b>	0.79%	2.10%	16.22%	52.16%	8.33%	10.68%	8.43%	8.42%
<b>Relative Performance</b>	<b>-2.00%</b>	<b>-3.82%</b>	<b>-5.28%</b>	<b>19.28%</b>	<b>4.73%</b>	<b>1.81%</b>	<b>4.21%</b>	<b>5.36%</b>

\*Inception - August 2013

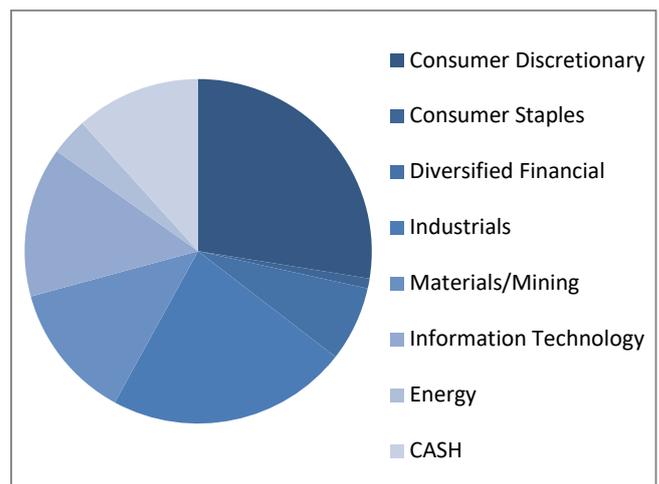
**Performance Fee Disclosure** All figures & tables stating investment performance returns (BEFORE administration fees and taxes) for the Portfolio. The performance returns have been calculated on a daily basis taking into account brokerage costs, and are accumulated for the period shown. Returns are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

### Portfolio Structure

No.	Company Name	ASX Code
1	Mineral Resources	MIN
2	Baby Bunting	BBN
3	IGO Limited	IGO
4	Seven Group Holdings Limited	SVW
5	NRW Holdings	NWH

#### GICS Sector

<b>Consumer Discretionary</b>	27.53%
<b>Consumer Staples</b>	0.92%
<b>Diversified Financial</b>	7.03%
<b>Industrials</b>	22.50%
<b>Materials/Mining</b>	12.81%
<b>Information Technology</b>	14.08%
<b>Energy</b>	3.49%
<b>CASH</b>	11.64%
<b>TOTAL</b>	<b>100%</b>





## Quarter in Review

### Performance Summary

- The Watershed Emerging Leaders SMA had a weak quarter suffering from the rotation out of growth stocks. The portfolio fell 1.73% for the quarter which underperformed the benchmark by 3.82%.
- Having now had 12 months since the market low in March last year the portfolio has delivered significant outperformance returning 71.44% on an absolute basis and outperforming the benchmark but a considerable 19.28%.

## Portfolio Adjustments

During the quarter we made the following changes:

**Trimmed:** APT

## Quarterly Performance Attribution

Top Contributors	Key Detractors
PWH	NXL
BIN	APX
BBN	NWH

### Market Summary

The Small Ordinaries index continued to grind higher over the March quarter, however beneath the surface there was a much bigger story unfolding. Key contributors to the underperformance were the high growth stocks that were beneficiaries from the lockdowns last year. As we have mentioned in other updates, there was a rotation out of the higher growth names into more of the cyclical stocks that were beaten up last year but are set to benefit the most from the economic recovery. This theme played out across all markets as bond yields soared on inflation expectations as record stimulus is being pumped into global markets.

Inflation is the key trigger point for markets and what central banks globally are watching very closely. It determines how they set monetary policy which in turn results in how assets are valued. The impact of rising bond yields essentially decreases the present value of future cash flows for companies expected to make most of their money in the future.

These higher growth stocks get valued on their future cash

generating ability, and purely on valuation have seen a big retracement after trading on historically high valuations (given record low rates). The Emerging Leaders portfolio is inherently more focused on this part of the market and was a key reason for the underperformance this quarter.

While these growth companies have been big beneficiaries of the pandemic (migration online, discretionary retail spending etc) and delivered strong outperformance through the last three quarters of 2020, the first quarter of 2021 has seen some rotation into the more cyclical stocks leveraged to the economic recovery (financials, travel stocks etc). These stocks, including gold, make up a reasonable component of the Small Ordinaries, and helped lead the index higher.

We expect some volatility to ensue in the short term as inflation numbers begin to cycle the depths of the lock down, but we feel that this rotations will be just that – short term. The recent market dynamic has been more about valuation than underlying stock performance, and inevitably the higher quality companies will once again outperform as they are growing at much faster rates.

### Portfolio Positioning

The portfolio actively bought the dip in March 2020 and navigated the pandemic exceptionally well to deliver significant outperformance. Since then we have taken some profits to increase cash as growth names rapidly rebounded to pre-Covid levels.

During the March quarter, the only transaction was to halve the position in Afterpay after a phenomenal year that saw it trading above \$140. A key beneficiary of the move online and consumer discretionary retail spending saw Afterpay customer numbers and transaction values grow at record levels whilst also moving into new geographies. Nevertheless the short term valuation looked stretched, and the position had once again grown considerably within the portfolio so it was trimmed back to 3.5%.

Bingo Industries (BIN) has had a takeover offer from overseas private equity group CPE Capital for \$3.50 a share as consolidation in the industry continues. Due diligence is still underway as the market awaits an outcome.

The portfolio ends the quarter with 12% cash as a bit of a buffer, and we anticipate the market will see more volatility as investors grapple with the prospect of inflationary pressures, and will be looking to deploy funds in any weakness.