



WATERSHED

FUNDS MANAGEMENT



Trade Update – June 2021

‘Concerned About A Speed Bump’

Markets have continued their upward momentum at the start of June in what is traditionally a weak month coming into the end of the Financial Year with portfolios being reshuffled, tax loss selling etc.

Central Banks remain confident that inflation will not exceed targeted levels, and with markets legging higher it suggests that until now the broader market has been in agreement. However conviction in this assessment would appear to be wavering as evidenced by a shift in rhetoric and a steepening in the short end of the yield curve implying credit markets believe rates may rise sooner than anticipated. The recent US 5% inflation figure that was initially brushed off by markets as transitory may well have precipitated this uncertainty along with robust domestic employment data showing more jobs are being created than there are people to fill them. This in turn could drive wages growth with industries needing to increase salaries to attract workers and as a by-product further fuelling inflationary pressure.

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Inflation is undoubtedly one of the key risks to the share market outlook and is one we are watching very closely.

The possibility of economic overheating was acknowledged at the most recent meeting of the US Federal Reserve where inflation and GDP forecasts were revised upwards. Interestingly the notes from this meeting also reveal that 7 members of the FOMC now forecast a rate hike next year (up from 4 at the last meeting). This has markets concerned that stimulus may be unwound sooner than previously anticipated, and investors will be anxiously watching the forthcoming Fed meetings in August (Jackson Hole meeting) and September where the roadmap to tapering is expected to be announced.

These issues aside - conditions have broadly remained favourable for equities and this has seen global markets push to record levels. The ASX200 has pushed up to now be trading at 7342 points at today's close (blue line), similar to the S&P 500 (green) and Nasdaq (red) which are all at record levels.



But these record levels have not yet been matched by a commensurate increase in earnings and as such markets are also trading at record high valuations. The following Bloomberg data table shows that the ASX200 is currently trading on a PE of almost 20x (19.71x) and has a forward PE of 18.42x Dec 22. Our market rarely trades at/over 20 times for long and the market's Dividend Yield has fallen to just 3.6%. We believe these valuation levels, and the prevailing backdrop of inflationary pressure and pending tapering, warrant overall caution.

ASX 200 valuation metrics below:

		2021 Y Est	2022 Y Est
		12/31/2021	12/31/2022
12 Months Ending			
Valuation Metrics			
 	Price/Earnings	19.71	18.42
 	Price/Earnings, Positi...	18.06	18.26
 	Price/Earnings before ...		
 	Price/Book Value	2.36	2.28
 	EV/Sales	3.26	3.14
 	EV/EBIT		
 	EV/EBITDA	11.13	10.66
 	Dividend Yield	3.59	3.72
Fundamentals			
 	Gross Margin		
 	Operating Margin		
 	Profit Margin		
 	Return on Assets	1.96	2.04
 	Return on Equity	12.59	12.56

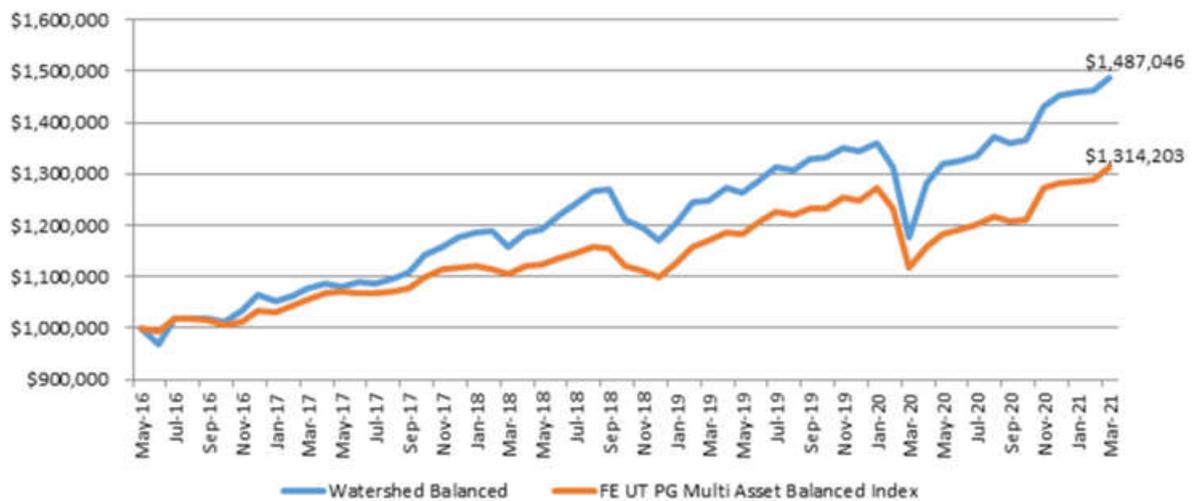
Similar lofty valuation metrics apply to the Nasdaq which is now trading on 32.7x this year and 27.6x next years earnings. Valuation metrics below:

		2021 Y Est	2022 Y Est
		12/31/2021	12/31/2022
12 Months Ending			
Valuation Metrics			
 	Price/Earnings	32.68	27.61
 	Price/Earnings, Positi...	26.87	24.33
 	Price/Earnings before ...		
 	Price/Book Value	6.45	5.57
 	EV/Sales	3.98	3.50
 	EV/EBIT		
 	EV/EBITDA	24.53	20.91
 	Dividend Yield	0.67	0.75
Fundamentals			
 	Gross Margin		
 	Operating Margin		
 	Profit Margin		
 	Return on Assets	17.64	15.64
 	Return on Equity	35.36	55.51

BALANCED MULTI-ASSET CLASS

Balanced Mandate	1mnth	3mnth	6mnth	1yr	3yr
WFM Balanced	1.59%	2.27%	9.43%	26.49%	8.67%
Vanguard Balanced Index	1.70%	1.23%	6.96%	16.76%	7.63%
Elston Balanced Portfolio	2.53%	3.97%	15.96%	29.85%	6.59%
iShares Enhanced Strategic Balanced Portfolio	2.14%	1.33%	7.40%	16.53%	6.35%
CFS FC Inv-FirstChoice Moderate	1.88%	3.41%	10.80%	21.39%	6.18%
Mercer Moderate Growth	1.51%	1.89%	7.00%	15.27%	6.08%
Quilla Moderate Portfolio	2.41%	1.95%	7.72%	12.74%	5.94%
FE UT PG Multi Asset Balanced Index	1.99%	2.36%	8.84%	17.54%	5.94%
Evergreen Premier Balanced Portfolio	2.16%	2.72%	9.69%	25.11%	5.76%
Lonsec Managed Portfolio – Multi-Asset Balanced	2.64%	1.93%	6.87%	14.44%	5.19%
Morningstar Balanced Portfolio	1.43%	2.21%	8.51%	13.45%	4.59%

*Performance numbers are sourced from HUB24 and FE Analytics and are net of fees.



As such we have locked in some profits, and have put a bit of protection into the portfolios (via cash and/or shorts) given the likely adverse market reaction if tapering begins earlier than expected.

We have recently made the following changes to the portfolios:

Australian Share Portfolio

- The portfolio has added a short position via the BetaShares Strong Bear Fund (BBOZ). The fund is currently 2.2 times leveraged to deliver a 2.2% return for each 1% fall in the S&P/ASX 200 Index.
- Given the cash (4%) and short position (5.5%) in the portfolio, the market exposure has been dialled back to circa 84% which we feel is appropriate given the market is trading on a multiple of nearly 20x earnings.
- The allocation also provides some purchasing power if a 5-10% selloff does occur like we are anticipating.

International ETF Portfolio

- The rest of world portfolio has added to its Nasdaq Short position (SNAS) increasing the position to 8% of the portfolio.
- The position is focussed on higher growth tech companies on the Nasdaq that are trading at lofty valuations as opposed to the broader S&P 500 Index
- This position dials back US exposure roughly 2% for a multi asset portfolio.

Multi Asset Portfolio

- All of this reduces the equity exposure to circa 56.5% for a Balanced Portfolio (versus the 60% neutral setting), so moving further underweight at a time when global equity markets keep breaching record levels.
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If you would like to know more, please don't hesitate to contact

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Watershed Funds Management

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