WATERMARK ABSOLUTE RETURN FUND

Monthly update –August 2023 **APIR ETL5025AU**

WATERMARK FUNDS MANAGEMENT

FUND AT A GLANCE

Fund Strategy	Variable Beta
Benchmark	RBA Cash rate
Unit Price 31 August	$0.904
Fund is priced daily	

PORTFOLIO CONSTRUCTION

No. Long Positions	25
No. Short Positions	25
Gross Exposure	61%
Net Exposure	9%

GROSS PORTFOLIO STRUCTURE

Investment Type	%
Listed Securities – Long	35
Listed Securities – Short	-26
Cash	91

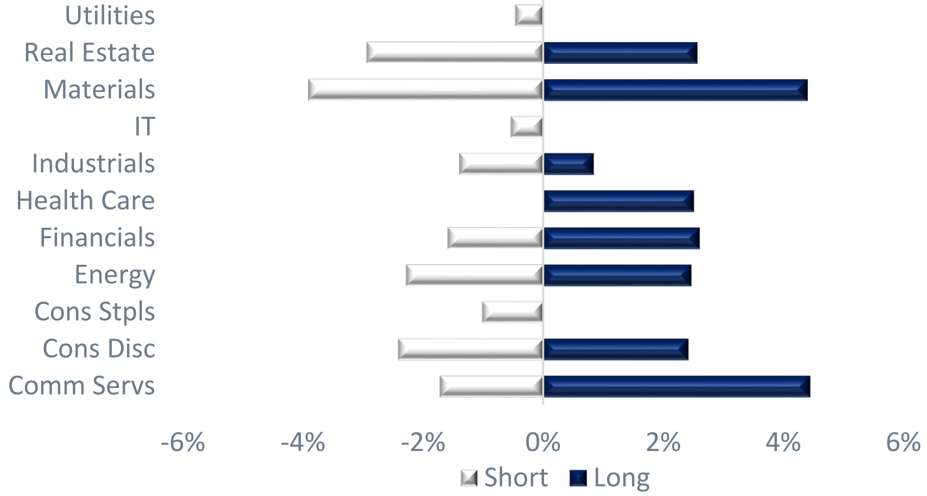
CONTRIBUTION

Top	Bottom
ANZ	ResMed
IRESS	29Metals
TPG	South32

TOP 10 LONG HOLDINGS

- Telstra
- Mirvac
- Suncorp
- ResMed
- Lottery Corporation
- Wesfarmers
- Medibank
- CSL
- Santos
- Viva Energy

SECTOR EXPOSURES



KEY RISK INDICATORS

Beta	Volatility	Information Ratio
-0.11	4.23	0.32

PERFORMANCE (%)

	1 Month	FYTD	1 Year	3 Year	**Inception (pa)
Foundation Units	0.2	-0.7	-7.3	0.4	8.4
RBA Cash Rate	0.3	0.7	3.4	1.3	3.2
Outperformance	-0.1	-1.4	-10.7	-0.9	5.2

***Historic returns from ALF:ASX- same variable beta strategy established in 2004. For calculation of performance fees. Past performance is not an indicator of future performance.*

MONTH IN REVIEW

The Australian share market fell in August, with the All-Ordinaries Index down -1.4% during reporting season with consensus earnings expectations for the broader market revised down for the third consecutive month (-0.8% during the month).

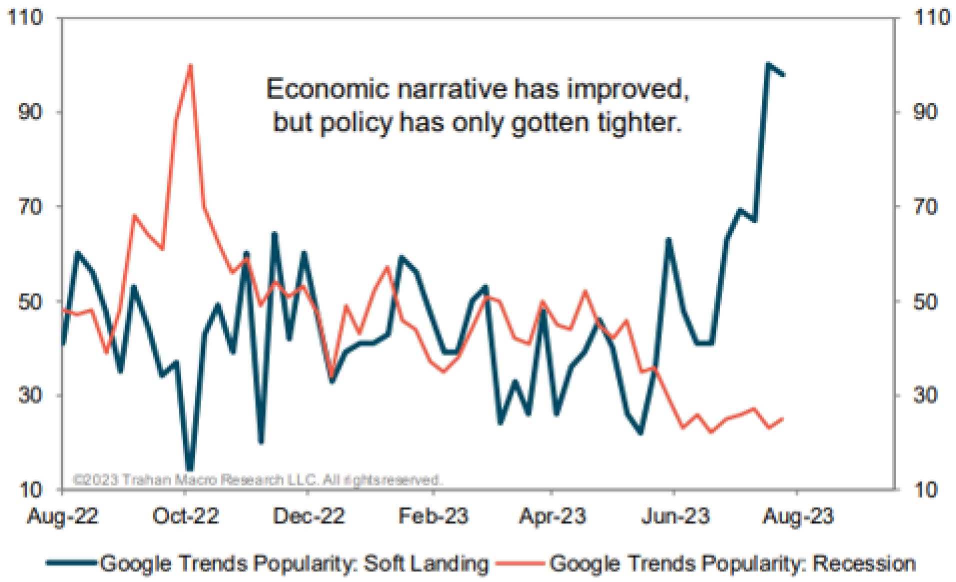
From a sector perspective, the Consumer Discretionary sector outperformed (+4.6%) with earnings beating low expectations over reporting season while the Defensives sector underperformed with earnings misses, partly driven by higher interest costs.

WARF returned 0.2% in August. The share market is likely to move lower in coming months as the economic data slows further.

MARKET OUTLOOK

The soft-landing narrative is now consensus. Investors are confident a global downturn has been avoided and inflation is well contained *Fig 1*.

Figure 1: Soft-Landing Narrative Dominating Investor Sentiment



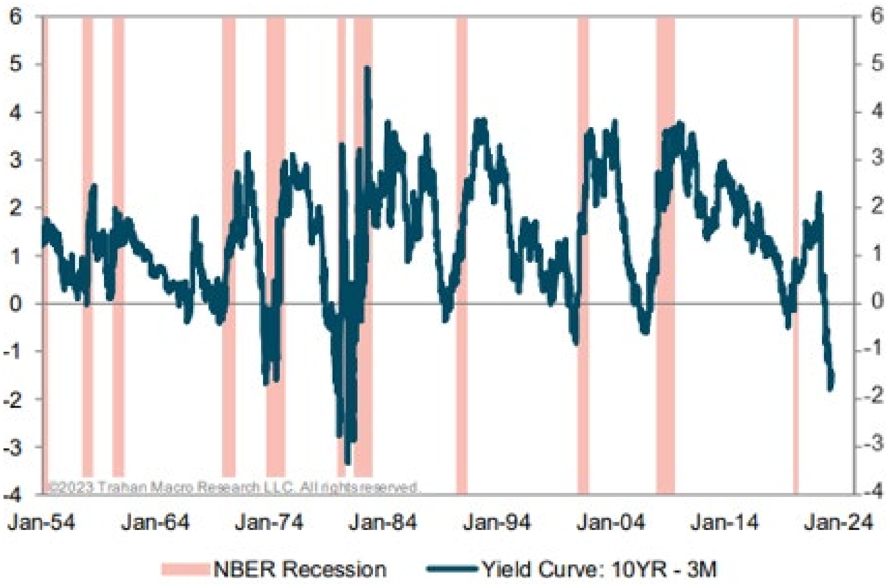
Source: Google Trends

Because the consensus has completely flipped from recession to soft landing it is time to revisit the data. The signal coming from key indicators has not changed and given the usual lags in monetary policy, the full impact of the monetary tightening is still ahead of us.

Key indicators all point firmly to a recession in advanced economies emerging in the 6 months ahead. While US activity has held firm, Europe is likely already in recession and China is struggling with its post COVID recovery.

The yield curve which reflects the quantum of policy tightening relative to the neutral interest rate has an impeccable track record of predicting a downturn. It has not been this inverted for 40 years. A recession has always followed *Fig 2*.

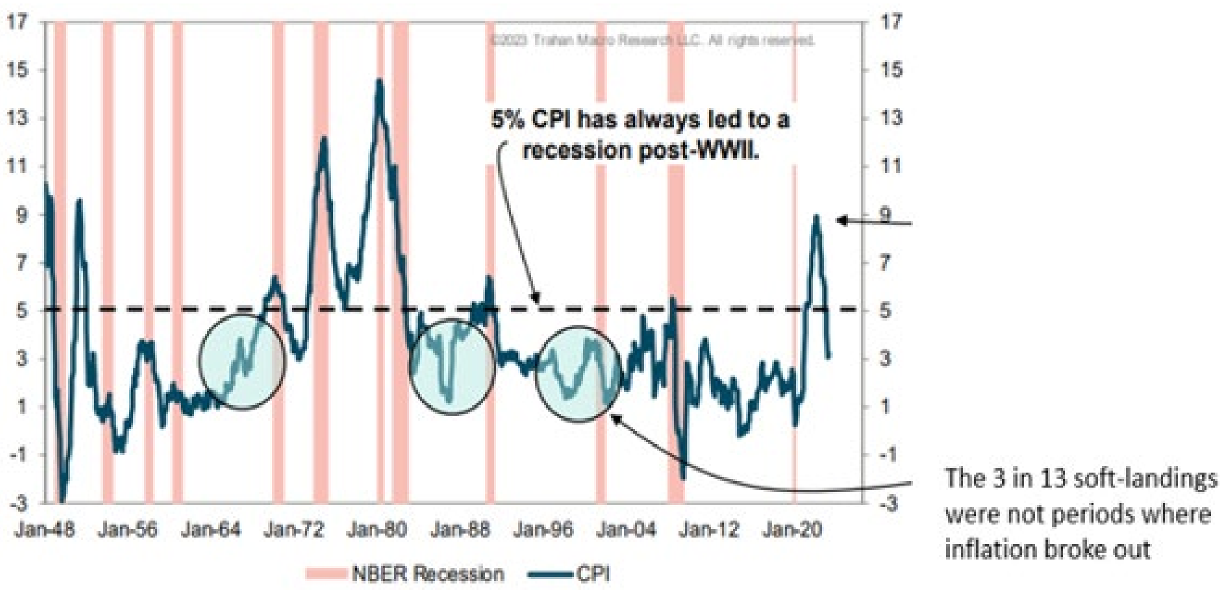
Figure 2: Yield Curve Inversion Is A Strong Recession Indicator



Source: Trahan Macro Research

In the 13 tightening cycles of the post war era, there are just 3 examples where a soft landing ensued, these were not inflationary cycles like the ones we are dealing with here. Every time inflation has broken above 5% a recession has followed *Fig 3.*

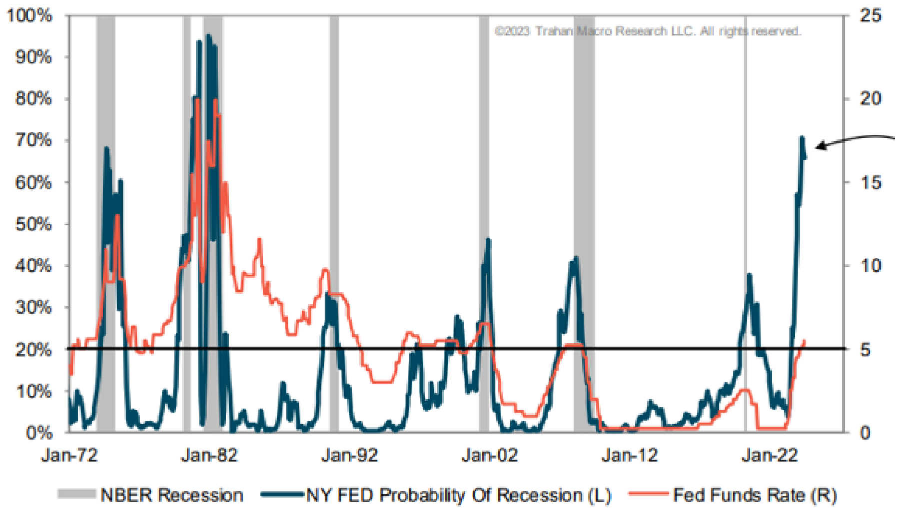
Figure 3: Inflation >5% Has Always Been Followed By A Recession



Source: Trahan Macro Research

Instead of boring you with the full list of indicators, just look no further than the US Federal Reserve's own recession model also at a 40-year high *Fig 4*.

Figure 4: Fed Recession Model At 40-Year Highs



Source: Trahan Macro Research

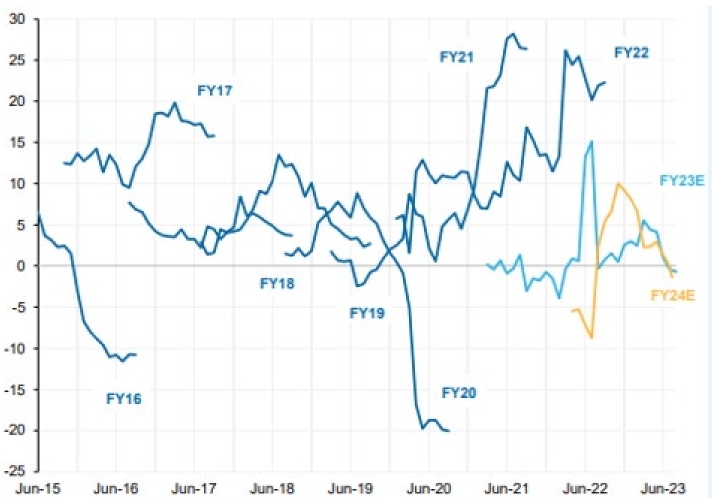
Western economies have proven more resilient than expected, in part given fiscal largess in many countries. Australia has been no different. The risk for markets is now if an alternate scenario emerges.

The spluttering post COVID recovery in China is not helping. According to the IMF, China alone is expected to contribute 30% of the growth in global GDP in the year ahead. China historically has moved counter-cyclically with Western Economies. This has never been more important as Western economies slow in response to policy tightening.

Even with multiple stimulus measures in recent months though targeting- the moribund real estate sector, consumers and provincial government spending, the economy continues to be sluggish. This of course is playing out in weaker commodity prices and mining shares, the weakest sector globally so far this year.

Most Australia public companies have reported results in August, which were solid given the headwinds of a slowing economy and rising costs. Given these ongoing challenges however, the outlook commentary was cautious. Earnings forecasts for 2024 have subsequently been marked down, with no profit growth expected now for the year ahead, following a flat year from profits in 2023 *Fig 5*.

Figure 5: Profit Growth (EPS) Macquarie Estimates



Source: Macquarie Research

Most companies are challenged by inflating costs, notably wages where unit labour costs are rising further given poor productivity trends. Energy and supply chain costs are all shifting higher. Interest costs on debt of course are rising along with interest rates.

Companies with pricing power have been able to offset this with higher prices but this gets harder as the economy slows and consumers become more frugal.

Consumer 'facing' companies are seeing softer trading conditions as household budgets come under pressure. The Australian banks were not immune to these same pressures, with credit growth slowing along with higher interest rates, while new awards have locked in rising labour rates for years to come.

Cyclical shares have benefited from a lower Australia dollar and the resilient economy, while defensive shares have sold off recently as the recession failed to materialise.

This is providing some enticing opportunities in the defensive parts of the share market, with quality names such as *Telstra (TLS)*, *Transurban (TCL)*, *Coles (COL)*, and *ResMed (RMD)* looking cheap relative to cyclical shares which are vulnerable if/when a downturn does arrive.

We are doubling down on the defensive parts of the share market while selling cyclical shares. While mining shares have underperformed recently, it is too early to buy them, we need to see improving trends in China first. Gold may be a shining light amongst the miners once bond yields peak (towards year-end). Bank shares will continue to struggle with household budgets under pressure and cost pressures persisting.

We retain our fully hedged settings with a defensive bias in portfolio construction and a modest investment in Commonwealth and State government bonds.

With the street downgrading profit estimates in a slowing economy and valuations at cycle highs (ERP at just 1%) investors should remain cautious.

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WATERMARK FUNDS MANAGEMENT

MONTHLY NET PERFORMANCE (%) *

YEAR	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY04								0.3	1.1	0.2	0.0	1.8	**3.4**
FY05	1.0	-0.3	3.7	2.3	3.6	2.0	0.3	1.0	-0.7	-4.9	-0.4	3.9	**11.7**
FY06	2.0	2.2	3.9	-2.3	3.1	3.1	1.3	1.6	5.3	2.7	-1.0	0.9	**25.0**
FY07	-3.1	4.4	1.8	6.3	2.5	2.0	2.8	-1.7	2.8	1.1	2.2	1.8	**25.0**
FY08	-1.0	4.1	2.5	0.8	-0.1	-1.4	-11.7	-8.3	1.4	4.4	1.5	-7.1	**-15.1**
FY09	-1.1	5.3	-5.2	-16.0	-6.3	3.2	2.5	3.1	16.2	7.3	10.1	7.1	**24.5**
FY10	9.3	11.2	6.0	0.1	0.5	-0.5	-2.3	1.9	3.5	-1.7	-5.7	-1.9	**20.8**
FY11	2.9	-3.8	2.4	0.1	2.7	10.8	2.2	1.7	3.6	2.0	-1.2	-1.3	**23.6**
FY12	-4.0	-6.7	-8.3	6.5	-1.3	1.0	5.0	4.8	3.8	0.9	-2.3	0.8	**-1.0**
FY13	3.8	4.2	0.0	-1.2	6.7	3.0	2.7	1.2	3.0	2.2	1.6	2.9	**34.2**
FY14	3.9	3.6	2.9	3.7	-0.2	-0.1	0.4	3.1	-1.3	2.4	1.1	0.6	**21.8**
FY15	-3.6	-2.4	1.4	-1.2	-2.5	-1.1	-1.2	1.0	3.0	0.8	-0.5	3.1	**-3.5**
FY16	3.8	4.6	1.9	-2.1	0.6	2.6	0.4	-2.6	1.8	-1.0	1.7	1.8	**13.9**
FY17	-0.3	-0.6	3.9	-0.5	-0.9	-0.2	-0.7	-0.1	0.2	1.2	0.8	-0.5	**2.3**
FY18	0.2	-1.9	-0.4	-3.1	1.3	0.1	-0.6	0.7	0.9	0.9	0.0	-0.6	**-2.4**
FY19	3.0	-2.0	0.2	-2.0	-2.9	-1.4	0.5	0.7	-0.9	-2.3	-0.6%	1.1	**-6.6**
FY20	2.1	1.5	-0.5	1.6	-0.4	-0.1	0.7	-1.1	-2.4	0.9	-0.7	-1.2	**0.3**
FY21	1.2	1.1	0.1	1.4	2.8	-1.1	0.8	3.9	-1.1	1.0	-0.5	-2.4	**7.0**
FY22	0.7	0.5	0.0	2.9	1.1	0.4	-0.2	0.1	0.4	-0.1	0.2	0.2	**6.3**
FY23	-1.0	-0.8	-1.3	-0.6	-1.2	1.0	-1.9	1.1	-0.8	-0.2	-0.5	-2.3	**-8.3**
FY24	-0.9	0.2											**-0.7**

**Historic returns from ALF:ASX- same variable beta strategy established in 2004. Past performance is not an indicator of future performance.*

MANAGING YOUR INVESTMENT

To view or manage your holding please register via the online portal operated by Apex Fund Services (Apex).

The Fund registry Apex will accept applications and redemptions received any business day before 2pm AEST. If you have not provided KYC/AML this will need to be completed to verify your identification and ensure your holding details are up to date.

To verify your identification please complete either the individual or regulated trust KYC forms and return to registry@apexgroup.com for processing.

Product Disclosure Statement Watermark Absolute Return Fund ETL5025AU PDS

For further information about the Online Portal or queries regarding your holding, please contact Apex 1300 133 451 or email registry@apexgroup.com.

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