



Watershed Income Portfolio

Quarterly Report December 2015

Investment Profile

The Watershed Income SMA is a concentrated portfolio of listed debt and hybrid securities aiming to generate an income return of 2% above the UBS Bank Bill Index net of fees.

A separately managed account, or SMA, is a professionally managed portfolio whereby the investor receives beneficial ownership of the underlying securities.

The Watershed Income portfolio has a bias towards listed bond exposure and highly-rated, floating or variable rate fixed interest securities to minimise interest rate risk.

The portfolio should be viewed as defensive with minimal capital volatility and is not expected to generate any long term capital growth.

Key Portfolio Features	
Inception	30 Aug 2010
Benchmark	UBS Bank Bill Index
Authorised Investments	Listed Bonds Hybrid Securities Listed Debt
Number of Stocks	10-15
Cash Allocation	2-20%
Investment Horizon	At least 2 years

The Portfolio is designed for investors who...

- Seek higher than market, stable, tax-efficient income returns
- Have a medium-term investment horizon and are not expecting any capital gains from their investment

Performance

Gross Performance (%)	1m	3m	6m	1yr	2yr	3yr	4yr	5yr	Inception *
WFM Income Portfolio	(0.80%)	1.38%	(0.35%)	0.17%	1.91%	3.41%	4.38%	4.85%	5.46%
WFM Including Franking	0.46%	2.64%	0.91%	1.43%	3.17%	4.67%	5.64%	6.11%	6.72%
UBS Bank Bill Index	0.19%	0.55%	1.09%	2.33%	2.51%	2.63%	2.97%	3.37%	
Relative Performance	0.27%	2.09%	(0.18%)	(0.90%)	0.66%	2.04%	2.67%	2.74%	

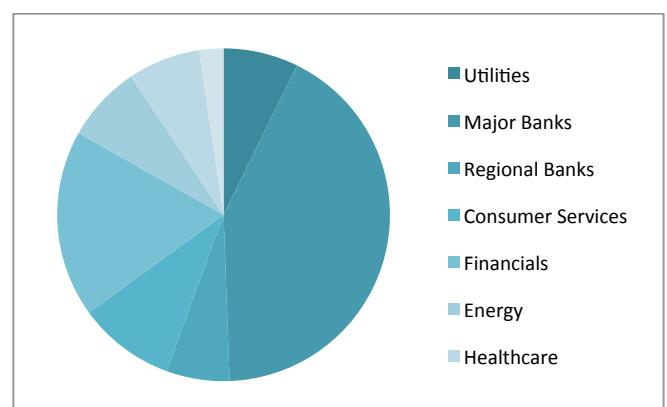
*Inception since August 2010

Portfolio Structure

No.	Company Name	ASX Code
1	NAB Preference Shares	NABPB
2	ANZ Notes	ANZPD
3	CBA Preference Shares	CBAPD
4	ANZ Convertibles	ANZPE
5	APA Group Subordinated Notes	AQHHA

GICS Sector by Issuer

Utilities	7.29%
Major Banks	42.13%
Regional Banks	6.14%
Consumer Services	9.44%
Financials	18.16%
Energy	7.46%
Healthcare	7.03%
CASH	2.35%
TOTAL	100%





Quarter in Review

Performance Summary

- The Watershed Income SMA fell by **0.35%** during the quarter underperforming the UBS Bank Bill Index by **1.44%**.
- The sector sell off into 31 December resulted in a negative quarter the Watershed Income SMA, which only fell by **0.35%** (0.44% including franking credits), below the benchmark UBS Bank Bill Index that rose **1.09%**. Despite a flat 12-18 months the portfolio has achieved its investment objective over the longer time periods of 3 years (4.32% p.a.), 4 years (5.54% p.a.) and since inception (6.91%) all including franking.

Portfolio Adjustments

During the quarter we:

Sold: CBAPC and WBCPF

Bought: CWNHB and also participated in AMPPA

Quarterly Performance Attribution

Top Contributors	Key Detractors
ORG Notes	CWN Notes
RHC Notes	CWN B Notes
ANZ Notes	BEN Prefs

It was a disappointing year for the hybrid and listed corporate debt sector which saw considerable weakness over the past twelve months.

The key driver of the weakness appears to be the number of new hybrid securities issued by the Bank sector, which is by far the largest issuer. The banking sector has been required to increase its capital levels and has continued to utilise hybrids as part of their capital structure. This competition and demand for funding has seen some of the more recent issues priced with higher margins than current issues causing general sector weakness.

Over the December quarter Tier 1 Hybrid securities have traded lower as investors sell down securities to try and take advantage of the cheaper equity prices.

We expect this weakness to be relatively short lived and see significant value in the sector at present, particularly given the current cash rate of 2%. Most of the bank hybrids currently have a running yield of around 6% with some yielding 7% to maturity.

The Income Portfolio currently has a yield of just over 6.0%, which is 4.0% over the cash rate and 3.25% over the 10 year government bond yield. These are levels that we have not seen since shortly after the GFC and represent very good value on a risk reward basis in our opinion. The average franking level of the portfolio remains above 70%.

We still expect to remain in a low rate environment for some time and see this as a very solid yield given the risk characteristics of the sector and high quality nature of issuers in the portfolio.