Ellerston Capital

Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT June 2017

Fund performance^ (Net)

Net	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2017	0.54%	-0.98%	0.47%	-0.01%	-0.57%	1.64%							1.08%
2016	-0.97%	-1.03%	0.80%	0.10%	1.34%	0.55%	0.71%	1.93%	0.73%	-0.53%	0.29%	0.02%	3.96%
2015	-0.15%	1.09%	1.41%	1.04%	-0.11%	1.29%	0.71%	1.11%	0.88%	0.59%	1.37%	1.09%	10.81%
2014	2.50%	0.33%	0.93%	-0.47%	2.31%	3.60%	1.24%	2.42%	3.16%	-0.82%	1.53%	-0.95%	16.82%
2013						0.48%	1.12%	1.74%	1.38%	2.87%	-0.34%	2.54%	10.18%

^ The net return figure is calculated after fees & expenses. The gross return is calculated before fees & expenses. Past performance is not a reliable indication of future performance. The benchmark is the RBA Cash Rate. The Fund commenced on 3 June 2013.

Return	Net	BM	Alpha	Gross	Portfolio Metrics	
1 Month	1.64%	0.12%	1.52%	1.95%	Positive months	78%
3 Months	1.05%	0.37%	0.68%	1.43%	No. Relative Value positions	103
6 Months	1.08%	0.74%	0.34%	1.75%	No. Special Situations	18
1 Year	4.29%	1.52%	2.77%	6.34%	Net Equity Exposure	+25.0%
2 Year p.a	5.49%	1.74%	3.75%	7.88%	Gross Portfolio Exposure	148.3%
3 Year p.a	7.50%	1.95%	5.55%	10.34%	Beta Adjusted	+4.6%
Since inception p.a	10.42%	2.11%	8.31%	13.95%	Correlation Coefficient (vs ASX 200 Accum)	-11.66%
					Net Sharpe Ratio (RFR = RBA Cash)	2.16

Performance

The Fund returned +1.6% during June, with the benchmark returning +0.1% in the period. Cross sectional volatility returned to the Australian market in June and the Fund was generally well-placed to take advantage. The Fund produced a net return of +4.3% for FY17, with volatility over the period almost 20% lower than the since inception measure.

Net exposure of the Fund was +25.0% with a beta-adjusted net of +4.6%. A number of existing positions were unwound, with the gross exposure falling to 148.3% at the end of the period.

The return of the Fund in June was marred by the performance of retirement living operator Aveo Group (-12.5%), one of our favoured holdings. A Fairfax media campaign attempted to discredit the company, focusing on a number of issues including the cost and complexity of retirement living contracts, occasions when care or services were deficient and the integrity of the majority shareholder (Mulpha). The result was devastating, with the stock the worst performing in the sector, despite trading at the biggest discount to NTA and with the largest return-to-consensus price target.

The impact of the fall in the Aveo share price was partially offset by a fall in the REIT index, which retraced 4.8% in June. However even with weaker peers, paired positions that featured Aveo were the largest detractors to performance in the period. Whilst the company still remains in the media spotlight, we have maintained our position as Aveo provides the best listed way to play the aging demographic in Australia.

Our holdings in Centuria Capital (+4.4%) and Centuria Metropolitan (+5.5%) added value during the month with both stocks outperforming their respective pairs in the period.

A long-term shareholding in Australian Unity Office (+4.6%) contributed to the performance of the Fund, with the manager announcing revaluations on four properties, resulting in an increase of 7.2% to the NTA of the trust. We had the long position hedged with a short in GPT Group which fell over 6% in the period.

After causing us grief in May, our paired positions within the Healthcare and Building Material sectors came good with Healthscope (+9.4%) and Fletcher Building (+6.4%) outperforming Sonic Healthcare (+4.6%) and Adelaide Brighton (+1.8%) respectively. The narrowing in the spreads provided an opportunity to unwind and we reduced our exposure to both pairs.

Despite trading at an 18% discount to NTA, Astro Japan Property (-1.9%) traded lower during the month, whilst still outperforming the REIT sector. Our shareholding in Yowie (-19.2%) also detracted from performance, with the company downgrading FY17 revenue growth to 55% versus previous guidance of 70%. A delay in the Canadian launch was the primary cause behind the revenue downgrade.

The share price of medical technology company Impedimed (+24.8%) rallied during June with the news that their SOZO platform had received CE Mark, allowing the product to be sold in Europe. Later in the month, the company announced that commercial sales of SOZO had commenced, with first shipments to Europe and Australia underway.

Another holding within the medical technology space, Oneview Healthcare (+22.5%) reversed their recent fortune, with the share price bouncing strongly and adding value to the Fund.

Activity

Relative Value – Gross Contribution 1.2%

A paired position was established between NZ-listed REITs Kiwi Property (+0.6%) and Argosy Property (+2.5%). During the month, Kiwi Property raised NZ$161m in new equity to partly fund its development pipeline and maintain gearing at the lower end of its target range. Trading at a modest discount to NTA, Argosy Property has no earnings growth and a return to consensus price target of <2%.

We established a shareholding in renewable energy company Infigin Energy (-16.6%), hedging the position with a short in AGL Energy (-3.2%). We have previously invested in Infigin and appreciate the exposure that the wind farm operator provides. During the month, he company's share price came under significant pressure following an earnings downgrade due to poor fourth quarter wind conditions. The quarter was so poor, it included two of the lowest production months for Infigen's operating assets since they came online in FY12. We feel that the share price reaction was overdone and expect a successful restructure of the company's debt will result in a rerating of the company's shares.

A profit downgrade from Gateway Lifestyle (-7.2%) sent the share price lower, with investors increasing disappointed with the company's seeming inability to forecast earnings. Home settlements are now expected to come in at 240 for FY17, compared with prior guidance of 260-290. The company cited wet weather as the primary cause for the downgrade, with rain in NSW and QLD in particular contributing to delays. Despite the downgrade, we still like the Manufactured Housing Estate and took advantage of the share price weakness, hedging the position with the outperforming (at the time) Dexus (-6.5%).

The increase in volatility resulted in a number of positions being unwound during the month. In particular, paired positions between Mirvac (-4.2%) and Precinct Property (+2.1%), Sydney Airport (-2.5%) and Transurban (-1.7%) and Vicinity Centres (-3.9%) and Dexus (-6.5%) were all closed down during June.

Special Situations – Gross Contribution 0.7%

We participated in the equity raise for Bega Cheese (+9.8%) which was held a modest discount to the prevailing share price. During the year, Bega made a number of acquisitions including the Mondelez Grocery Business which contained Vegemite, peanut butter, salad dressings and cheese. The capital raise gives the company the financial strength and flexibility to grow the dairy and food business.

A sell down in Turners Automotive (-7.1%) by the estate of the largest shareholder, provided an opportunity to establish a shareholding at a discount to market. Turners is a NZ-based integrated automotive and financial services group. The company focusses on three main areas – Origination, Finance and Insurance and Debt Management. Origination is the buying and selling of motor vehicles and equipment. Finance and Insurance focuses on finance and insurance products, primarily for motor vehicles. Debt Management provides business with management of their debt ledgers and collection services. We were able to establish the position at a PE of 11.0x, a reasonable level, given forecast EPS growth of 20% in FY18. The company is also scheduled to "duel" list on the ASX in July – a move that will expand the potential shareholder base.

As anticipated, the merger of Afterpay (+2.6%) and Touchcorp (-0.6%) closed at the end of June, with our holding in Touchcorp shares converting to shares in the newly created Afterpay Touch Group (+9.3%) at the previously announced ratio.

We took advantage of share price strength in Appen (+8.7%) and Superloop (-0.8%) and reduced our holdings.

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.0%	0.0%	0.0%
Div Financials	1.7%	0.0%	1.7%
Insurance	0.8%	0.0%	0.8%
Regional Banks	0.0%	0.0%	0.0%
REITs	46.7%	-34.3%	12.4%
Financials	49.2%	-34.3%	14.9%
Builders	0.6%	-0.6%	0.0%
Consumer Disc	2.8%	-0.1%	2.8%
Consumer Staples	1.0%	-0.3%	0.8%
Gaming	0.0%	0.0%	0.0%
General Industrials	0.5%	0.0%	0.5%
Health Care	9.1%	-1.8%	7.3%
Information Technology	1.2%	0.0%	1.2%
Infrastructure	0.0%	0.0%	0.0%
Media	1.4%	0.0%	1.4%
Telcos	0.0%	0.0%	0.0%
Utilities	0.2%	-0.2%	0.0%
Industrials	16.8%	-3.0%	13.8%
Bulk Metals	17.7%	-17.8%	-0.1%
Energy	0.0%	0.0%	0.0%
Gold	0.0%	0.0%	0.0%
Resources	17.7%	-17.8%	-0.1%
Hedge	0.0%	-3.6%	-3.6%
Index	0.0%	-3.6%	-3.6%
Total	83.8%	-58.8%	25.0%

Market Commentary

US equity markets experienced a volatile June, impacted by the global “risk-off” trade and prompted by the ongoing political events pertaining to Trump's sacking of former FBI Director and the pending Russian intervention probe. The S&P500 ended the month +0.6%, with economic data painting an increasingly positive picture and activity surveys continuing to suggest economic expansion. The S&P500 reached an all-time high of 2,453 mid-month, but couldn’t hold that level, finishing the period at 2,423. The tech sell-off in the US in the middle of the month was the event that really caught investors off-guard, with some of the more crowded names falling by as much as 10%.

During the month, Federal Reserve officials forged ahead with an interest-rate increase and delivered additional plans to tighten monetary policy, despite growing concerns over weak inflation numbers. Policy makers agreed to raise their benchmark lending rate for the third time in six months, maintained their outlook for one more rate hike in 2017 and set out the details on how they intend to unwind their $4.5 trillion balance sheet later this year. The Federal Reserve’s decision brings the Fed funds target rate to a range of 1.0% to 1.25%.

Immediately following the rate hike, US Treasuries rallied, with the yield on 10-year notes falling 9 basis points to 2.13% on the weak readings for inflation, where core inflation (excluding key food and energy components) slowed for the fourth straight month to 1.7% in May.

European markets sold off in June, with British and German politics taking center-stage. The UK market was not immune to the continental election fallout with the FTSE100 falling 2.5% in the month. Whilst the hung parliament in the UK was a surprise to the investment community, the impact was broadly contained to Foreign Exchange markets, with equities globally mostly shrugging it off as a non-event. The euro weakened against most major currencies, while the British Pound weakened heavily against all other major currencies following the election result.

The importance of China in the Asian investment region has been further elevated with the China A-shares finally qualifying for inclusion into the MSCI Emerging Markets Index following a lengthy two year process. The rebalance will be implemented over the next 12-18 months, with the weight of MSCI China A stocks being approximately 0.3% of MSCI Emerging Markets Index after the 5% partial inclusion factor. It is estimated that the expected passive inflows into China A shares could be roughly USD2.1 billion.

The Australian share market (+0.2%) underperformed its global peers in the month of June, after digesting a raft of local earnings downgrades during the so called "confession season". Hot on the heels of a plethora of downgrades in May, companies including QBE Insurance (-8.4%), Infigen Energy (-16.6%), Ardent Leisure (-8.7%) and Retail Food Group (-8.6%), all issued profit warnings and were punished by the market.

On the commodities front, iron ore rallied 14% to end the month at US$65/t as sentiment improved around China with June PMIs holding in expansionary mode. Oil (-4.5%) was weaker in the period as supply concerns ratcheted up. Base metals rebounded, with the LME Metals Index up 3.4% whilst Gold declined 2.2%, halting its recent rally, amidst hawkish comments from major central banks.

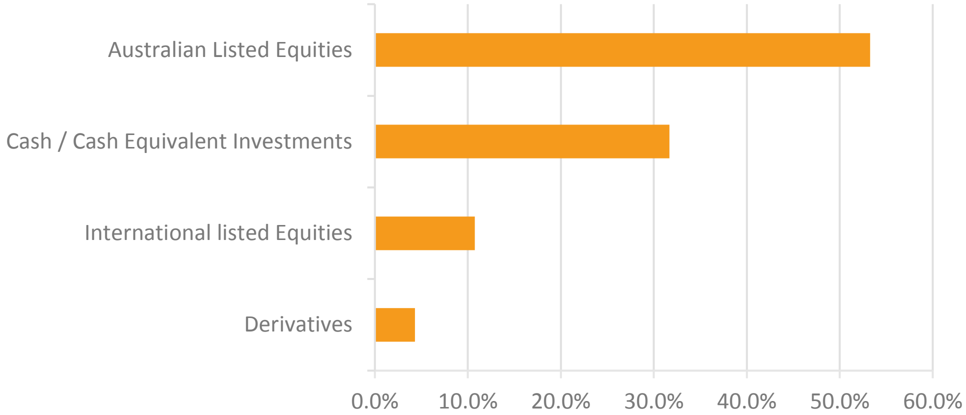
The best performing sector was Healthcare which returned +6.1% (led by CSL (+6.8%) and Cochlear (+6.0%)), whilst the Energy (-6.9%) sector was the weakest performer during the period. The S&P/ASX Small Ords fared better than the broader market in June, posting a gain of 2.0%, led by the Small Industrials which rose 2.4%, with Small Resources flat for the month.

Contribution

Relative Value Gross Contribution	1.2%	Special Situations Gross Contribution	0.7%
Positive		**Positive**	
AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP	0.18%	IMPEDIMED	0.27%
CENTURIA CAPITAL - GPT GROUP	0.14%	ONEVIEW HEALTHCARE	0.26%
HEALTHSCOPE - SONIC HEALTHCARE	0.14%	AFTERPAY TOUCH GROUP LTD	0.14%
ADELAIDE BRIGHTON - FLETCHER BUILDING	0.14%	APPEN	0.14%
GDI PROPERTY GROUP - GPT GROUP	0.12%	BEGA CHEESE	0.10%
Negative		**Negative**	
AVEO GROUP - CHARTER HALL GROUP	-0.13%	YOWIE GROUP	-0.11%
AVEO GROUP - GOODMAN GROUP	-0.12%	NUFARM FINANCE NOTE	-0.09%
AVEO GROUP - MIRVAC GROUP	-0.12%	ASTRO JAPAN PROPERTY GROUP	-0.09%
AVEO GROUP - DEXUS PROPERTY GROUP	-0.11%	HENDERSON GROUP - JANUS CAPITAL GROUP	-0.04%
AVEO GROUP - CHARTER HALL RETAIL REIT	-0.09%	MURRAY RIVER ORGANICS PTY LTD	-0.03%

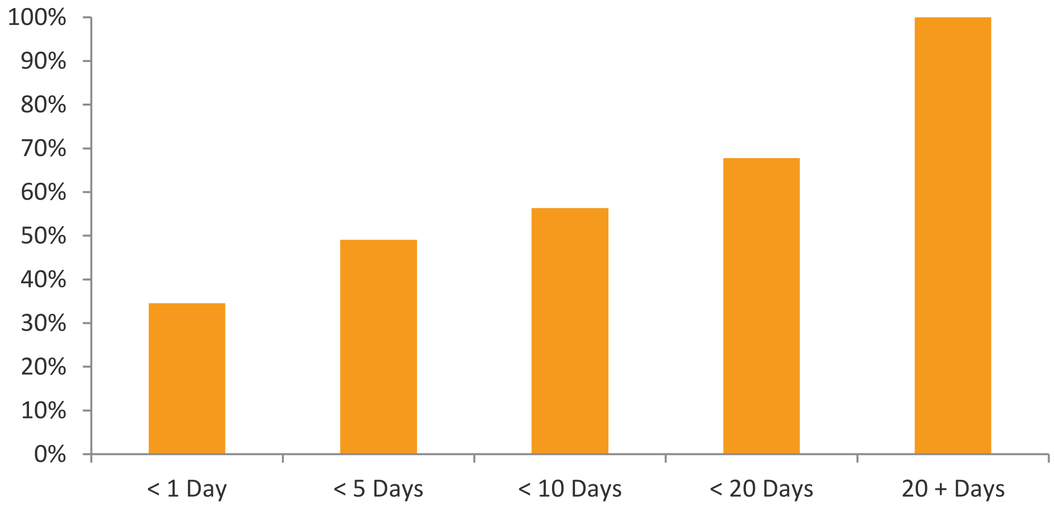
Annual Reporting (including additional ASIC RG 240 benchmark requirements)

1. **Asset Type Allocation^**



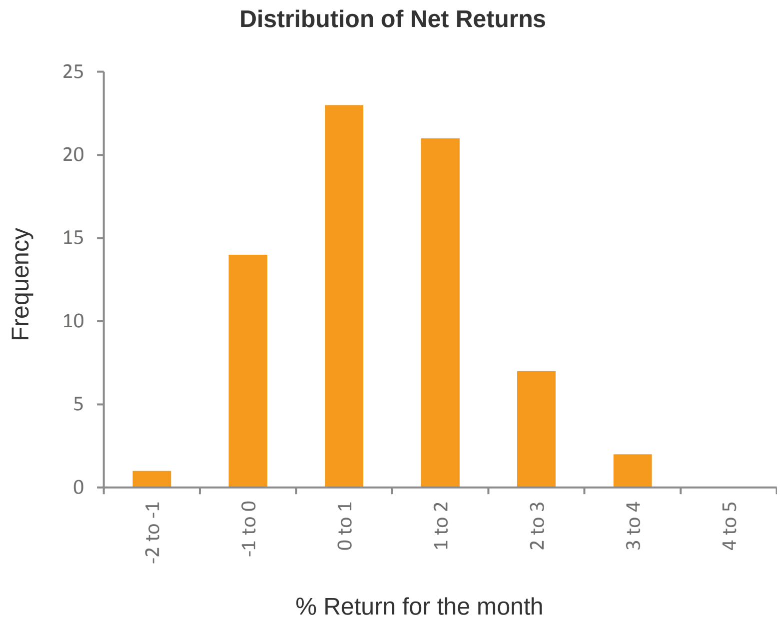
^ based on the funds gross portfolio exposure

2. **Liquidity Profile (Cumulative)**



3. **Maturity Profile of liabilities**

Financial liabilities of the Fund comprise financial liabilities at fair value through profit or loss, due to brokers, management and administration fees payable, interest and dividends payable, distributions paid and payable and other payables. Other payables have no contractual maturities but are typically settled within 30 days. Financial liabilities at fair value through profit or loss include securities sold short, which are settled within 3 days after trade.



TOP RELATIVE VALUE POSITIONS

> RIO TINTO - RIO TINTO PLC
> BHP BILLITON - BHP BILLITON PLC
> GOODMAN GROUP - VICINITY CENTRES
> GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP
> INGENIA COMMUNITIES GROUP - MIRVAC GROUP
> AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP
> AVEO GROUP - GOODMAN GROUP
> CHARTER HALL RETAIL REIT - GDI PROPERTY GROUP
> GDI PROPERTY GROUP - GPT GROUP
> AVEO GROUP - DEXUS PROPERTY GROUP

TOP SPECIAL SITUATION POSITIONS

> ASTRO JAPAN PROPERTY GROUP
> S&P/ASX 200 INDEX PUT OPTIONS
> NUFARM FINANCE NOTE
> NATIONAL AUSTRALIA BANK NOTE
> AFTERPAY TOUCH GROUP LTD
> ONEVIEW HEALTHCARE
> IMPEDIMED
> APPEN
> TURNERS AUTOMOTIVE GROUP LTD
> MULTIPLEX SITES TRUST

Key Information

Fund Inception Date: 3 June 2013

Liquidity: Daily

Management Fee: 1.20%

Performance Fee: 20% of outperformance

Buy/Sell Spread: 0.25%

Application price: $1.1973

Redemption price: $1.1913

Market Neutral Fund AUM: $690.84M

Australian Equity Team AUM: $2.95bn

Firm AUM: $5.3bn

Key Service Providers

> Registry: Link Market Services Limited
> Auditor: Ernst & Young
> Prime Broker & Derivative Counterparty: Morgan Stanley Intl & Co PLC
> Administrator: State Street Australia Limited

Material Matters

During the month there were no material changes to the Fund in terms of its risk profile, investment strategy or changes to investment staff which would impact this strategy. There have been no changes to the key service providers described above.

Closure of the Market Neutral Fund

Please note that the Ellerston Australian Market Neutral Fund was closed on the 31st October 2016. From 1 November, the Fund ceased to accept new or additional applications. Redemptions from the Fund will be processed as normal.

Further Information

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