

# Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT July 2017

## Fund performance<sup>^</sup> (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%	-0.40%						0.68%
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%

<sup>^</sup> 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	-0.40%	0.13%	-0.53%	-0.29%	Positive months	76%
3 Months	0.66%	0.38%	0.28%	1.04%	No. Relative Value positions	104
6 Months	0.14%	0.74%	-0.60%	0.68%	No. Special Situations	22
1 Year	3.14%	1.50%	1.64%	4.99%	Net Equity Exposure	+24.7%
2 Year p.a	4.91%	1.72%	3.19%	7.13%	Gross Portfolio Exposure	154.1%
3 Year p.a	6.92%	1.92%	5.00%	9.64%	Beta Adjusted	+1.3%
Since inception p.a	10.09%	2.09%	8.00%	13.58%	Correlation Coefficient (vs ASX 200 Accum)	-11.03%
					Net Sharpe Ratio (RFR = RBA Cash)	2.08

## Performance

The Fund returned -0.4% during July, with the benchmark returning 0.1% in the period.

Net exposure of the Fund was +24.7% with a beta-adjusted net of +1.3%. Gross exposure increased modestly to close the period at 154.1%.

Paired positions featuring a long in retirement living operator Aveo Group (-12.6%) detracted from the performance, with the stock continuing to underperform most of its peers. Whilst there was no new news in the period, the negative media campaign weighed heavily on the stock, with the Fairfax press in particular, continuing to call for an inquiry. Whilst we see genuine value in the company and the business model, we expect significant headwinds in the medium term and are managing the exposure accordingly.

The spread between the Australian and UK listing of both BHP Billiton (+11.0%) and Rio Tinto (+4.0%) narrowed during the month, adding value to the Fund.

Our paired position between printing companies IVE Group (+4.7%) and PMP Ltd (-1.3%) was a positive contributor following the announcement of a new agreement between IVE and Pacific Magazines. The agreement covers the entire stable of Pacific Magazines' mastheads and has a four year duration. On the short side, PMP continued to underperform following the company's trading update and subsequent profit downgrade in June.

The share price of Oceania Healthcare (+12.8%) continued to rally during July, with the company releasing full year results – their first as a listed entity. Pleasingly, the result was broadly in line with prospectus, while the adjusted NAV per share increased to NZD0.92 at the end of the period. There were modest upgrades to consensus EBITDA of between 2% and 4% pa for each of the next three years. Our long position in Oceania is hedged with a short in GPT Group (+0.0%), which was unchanged over the period.

Following a period of underperformance, the share price of NZ-based Metlifecare (+4.1%) rebounded in the month, outperforming both its pairs in Dexus (-1.1%) and Mirvac (+1.9%).

The share price of Appen (+4.5%) was buoyed by an upgrade to the price target of a well-regarded sell-side analyst in the month. The analyst assumed the renewal of the Microsoft contract (due to expire on 30 June) with resultant eps upgrades of between 7 - 9% pa in each of the next three years.

Our holding in Afterpay Touch (+5.1%) continued to add value following the conclusion of the merger between Afterpay and Touch at the end of June.

The long position in index put options detracted from the performance of the Fund, with the market trading water in the period and volatility continuing to come under pressure.

## Activity

### Relative Value – Gross Contribution -0.3%

Ahead of reporting season, we unwound a number of existing pairs within the REIT, Building Materials and Healthcare sectors. In particular, paired positions between Goodman Group (+1.1%) and Vicinity (+7.0%), Adelaide Brighton (-0.2%) and Fletcher Building (-1.4%), and Healthscope (-5.9%) and Sonic Healthcare (-8.0%) were all closed during the period.

We established a buy/write position in Fairfax Media (-10.0%), following the end of takeover talks with Hellman and Friedman and a consortium that included TPG Group. The company remains committed to its previously announced plans for the separation of Domain, with the timetable suggesting a conclusion by the end of CY17. Following the share price retreat, Fairfax was identified as a long, with a number of media peers suggested as appropriate shorts. Given the potential for changes to Australian media laws, we felt there was too much risk in establishing a short within the sector and instead opted to hedge the exposure with September 2018 call options.

### Special Situations – Gross Contribution 0.1%

Activity within Special Situations was relatively muted during July, ahead of what promises to be a busy reporting period in August.

We continued to add to our position in Astro Japan Property (+0.0%) with the stock stubbornly trading at an 18% discount to NTA, the second largest in our investable universe (the largest being the previously mentioned Aveo Group).

We continued to reduce our holdings in Appen, Afterpay Touch and Superloop (+1.6%) during the month. Following a period of outperformance, we also reduced our position in the National Australia Bank Income Securities (+2.3%).

## Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.0%	0.0%	0.0%
Div Financials	1.3%	0.0%	1.3%
Insurance	2.2%	-1.4%	0.8%
Regional Banks	0.0%	0.0%	0.0%
REITs	48.5%	-37.3%	11.2%
Financials	52.0%	-38.7%	13.3%
Builders	0.0%	0.0%	0.0%
Consumer Disc	3.6%	-0.1%	3.5%
Consumer Staples	0.8%	-0.2%	0.7%
Gaming	0.0%	0.0%	0.0%
General Industrials	0.4%	0.0%	0.4%
Health Care	6.9%	-0.3%	6.6%
Information Technology	1.1%	0.0%	1.1%
Infrastructure	0.0%	0.0%	0.0%
Media	2.7%	-0.6%	2.1%
Telcos	0.0%	0.0%	0.0%
Utilities	0.8%	-0.6%	0.2%
Industrials	16.3%	-1.7%	14.6%
Bulk Metals	18.0%	-17.8%	0.2%
Energy	0.1%	0.0%	0.1%
Gold	0.0%	0.0%	0.0%
Resources	18.1%	-17.8%	0.3%
Hedge	0.0%	-3.6%	-3.6%
Index	0.0%	-3.6%	-3.6%
<b>Total</b>	<b>86.4%</b>	<b>-61.7%</b>	<b>24.7%</b>

## Market Commentary

The S&P500 (+2.1%), NASDAQ (+3.4%) and Dow Jones (+2.7%) all hit record highs in July whilst the VIX index of volatility fell to its lowest level since 1993. Robust earnings by growth bellwether Caterpillar set the pace and buoyed sentiment with the company beating 2Q consensus expectations by 18% and raising 2017 EPS forecasts.

U.S. markets were also supported by a string of positive key economic data points. These included U.S. consumer confidence which reached its highest level since 2001, a better than expected ISM manufacturing print in June and non-farm payrolls which grew at a stronger-than-expected +222,000 versus the previous month's disappointing +152,000.

Almost every global equity market posted gains during the month, with emerging markets outperforming in particular (MSCI World Emerging Markets Index returned +5.0% in local currency). The Japanese (-0.5%) and German equity markets (-1.7%) were the notable laggards. Miners were by far the best performing sector globally, helped by firming commodity prices.

On 12 July, in a speech before the U.S. Congress, Fed Governor Janet Yellen made comments that were widely interpreted as 'dovish'. The Federal Reserve unanimously decided to keep interest rates unchanged and said it expected to start winding down its massive holding of bonds "relatively soon", a sign of confidence in the U.S. economy. The central bank kept its benchmark lending rate in a target range of 1.00% to 1.25%, stating it was continuing the slow path of monetary tightening that has seen rates increased by a single percentage point in the period since 2015.

The immediate reaction to the 'dovish' comments was a rally in equities and a fall in the U.S. dollar. Weak U.S. CPI also added to doubts about the path of future rate hikes.

The ASX200 Accumulation Index was virtually flat for the month, underperforming its global peers, with July marking the 4<sup>th</sup> consecutive month of underperformance versus other Developed Markets. The Australian market fared relatively poorly despite a strong performance from both the Miners and Banks. The All Industrials fell 1.0%, while the All Resources rallied 5.0%, with top mining stocks BHP Billiton (+11.0%) and Fortescue Metals (+10.0%) soaring on account of strong quarterlies, with Fortescue flagging another stepdown in costs in FY18.

Materials registered the biggest gain, rising 3.6%, followed by Banks (+2.3%) and Consumer Staples (+1.0%). The market struggled because of significant underperformance from the rest of the market - specifically from industrial stocks with large overseas exposures, which fell victim to the sharply rising Australian dollar. The Australian Dollar continued its recent rally in July, taking its cumulative two-month gain to 7.3% and reaching a two year high.

The noticeable feature of the domestic market was the strong performance of the Banking sector.

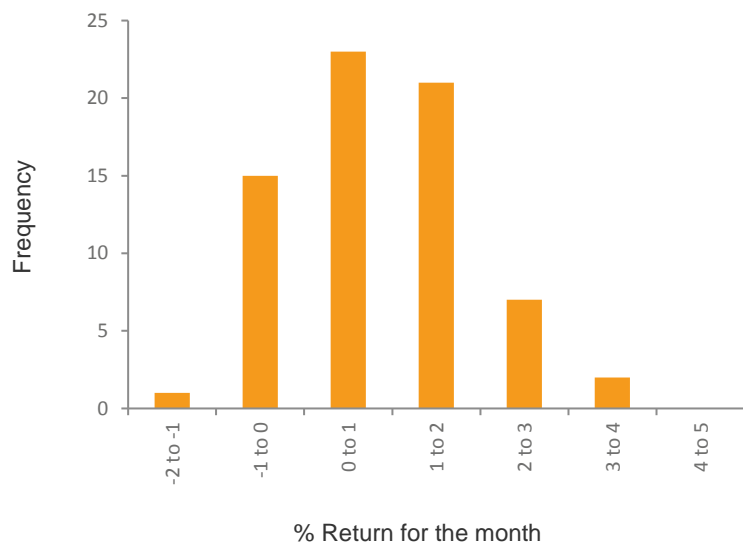
APRA finally announced on 19 July 2017 its "unquestionably strong" bank common equity Tier 1 (CET1) ratio target of at least 10.5% by January 2020. This was a fairly benign outcome, slightly better than the market had expected and should position the banks well, ahead of the pending "Basel 4" amendments. The announcement sparked a rally in the banks with the sector up 3.3% on the day of the announcement and up 5.0% over two days.

Monetary policy was unchanged as the RBA left the cash rate at 1.5%.

## Contribution

Relative Value Gross Contribution	-0.3%	Special Situations Gross Contribution	0.1%
<b>Positive</b>		<b>Positive</b>	
BHP BILLITON - BHP BILLITON PLC	0.24%	AFTERPAY TOUCH GROUP LTD	0.07%
RIO TINTO - RIO TINTO PLC	0.24%	NUFARM FINANCE NOTE	0.06%
IVE GROUP - PMP	0.11%	NATIONAL AUSTRALIA BANK NOTE	0.06%
GPT GROUP - OCEANIA HEALTHCARE	0.09%	APPEN	0.05%
DEXUS PROPERTY GROUP - METLIFECARE	0.04%	MURRAY RIVER ORGANICS PTY LTD	0.04%
<b>Negative</b>		<b>Negative</b>	
AVEO GROUP - GOODMAN GROUP	-0.23%	YOWIE GROUP	-0.14%
AVEO GROUP - DEXUS PROPERTY GROUP	-0.21%	IMPEDIMED	-0.11%
AVEO GROUP - MIRVAC GROUP	-0.17%	S&P/ASX 200 INDEX PUT OPTIONS	-0.09%
AVEO GROUP - CHARTER HALL RETAIL REIT	-0.11%	ONEVIEW HEALTHCARE	-0.06%
AVEO GROUP - GPT GROUP	-0.09%	MSL SOLUTIONS	-0.01%

### Distribution of Net Returns



#### TOP RELATIVE VALUE POSITIONS

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

#### TOP SPECIAL SITUATION POSITIONS

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

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#### 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: \$1.1426  
 Redemption price: \$1.1370  
 Market Neutral Fund AUM: \$664.44M  
 Australian Equity Team AUM: \$2.84bn  
 Firm AUM: \$5.2bn

#### 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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