ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT September 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%	-0.40%	0.87%	0.12%				1.67%
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	0.12%	0.12%	0.00%	0.25%	Positive months	77%
3 Months	0.59%	0.37%	0.21%	0.98%	No. Relative Value positions	103
6 Months	1.64%	0.75%	0.89%	2.42%	No. Special Situations	31
1 Year	1.44%	1.50%	-0.05%	2.75%	Net Equity Exposure	+24.5%
2 Year p.a	4.38%	1.68%	2.70%	6.42%	Gross Portfolio Exposure	149.2%
3 Year p.a	5.32%	1.86%	3.46%	7.59%	Beta Adjusted	+5.5%
Since inception p.a	9.94%	2.07%	7.86%	13.35%	Correlation Coefficient (vs ASX 200 Accum)	-10.71%
					Net Sharpe Ratio (RFR = RBA Cash)	2.07

Ellerston Capital Limited
ABN 34 110 397 674
AFSL 283 000

Level 11
179 Elizabeth Street
Sydney NSW 2000

Tel: 02 9021 7797
Fax: 02 9261 0528

info@ellerstoncapital.com
www.ellerstoncapital.com

APIR Code: ECL0013AU

Performance

The Fund returned +0.1% during September, in line with the benchmark return of +0.1% in the period. Net exposure of the Fund was +24.5% with a beta-adjusted net of +5.5%. Gross exposure continues to fall with the measure closing the month at 149.2%.

After a positive contribution in August, paired positions that featured a long in Aveo (-8.1%) detracted from the performance of the Fund in September. Despite the relatively steady earnings from owning a portfolio of Retirement Villages, the share price of Aveo continues to be volatile, albeit less so than earlier in the year when the negative media campaign had more momentum. We continue to believe that the Deferred Management Fee (DMF) model remains appropriate for Retirement Villages but continue to closely monitor the holding and the associated risk.

The share price of Ingenia (+3.5%) rallied towards the end of the month, adding to the performance of the Fund. Paired positions featuring Ingenia hedged with shorts in Mirvac (-1.3%), Growthpoint (-0.9%) and Goodman (-0.6%), featured amongst the top five contributors within Relative Value.

However, it wasn't all one way for our positions within the Manufactured Housing Estate (MHE) industry during September. A pair between Gateway Lifestyle (-6.2%) and Growthpoint detracted from performance, with Gateway giving back most of August's gains. There was no new news on either company in the period, however the Short Interest in Gateway, which peaked in August, has continued to moderate. We believe that part of the buying last month in Gateway was short-covering, and hence more short-term.

Our paired position between Australian Unity Office (+3.1%) and GPT Group (-0.8%) continued to add value, with the share price of Australian Unity hitting an all-time high during the month. Since listing in June last year, the market has continued to warm to the Australian Unity story, helped along by a 14% increase to NTA at June 2017. In addition, the development opportunity at Valentine Road in Parramatta is only beginning to be appreciated by investors. The current proposal to build a 25,000sqm tower adjacent to their existing building could potentially add $50m to the Fund or +16% in NTA per share.

The performance of our healthcare positions was mixed during September with a welcome rebound in the share price of Impedimed (+27.2%) providing the largest contribution to performance. Oneview Healthcare (-29.8%) however, continued to detract from the performance of the Fund, with the stock drifting lower, despite announcing a contract win during the month.

Following the appointment of Louis Carrol as non-executive Chair of Yowie (+35.9%), the share price staged a significant rally. Mr Carrol joins the Yowie board after a successful international career, including executive roles at Mars in Australia and the UK and more recently as the Chairman of ASX-listed Covermore, which was acquired by Zurich earlier in the year.

Activity

Relative Value – Gross Contribution 0.1%

We increased our position in QMS Media (-2.7%) during the month, continuing to hedge the long with a short in oOh!media (+1.9%). Since reporting in August, QMS has de-rated from an EV/EBITDA multiple of 11.5x to almost 8x – a 12% discount to oOh!media, despite their higher forecast growth profile. By underwriting part of the QMS Dividend Reinvestment Program, we were able to purchase the QMS shares at a 2.5% discount to the prevailing market price.

We continued to increase our exposure to Infigen (+0.0%) hedging the exposure with a short in AGL Energy (-2.6%). Infigen's current generation is from wind turbine assets, while the development pipeline comprises equity interests in approximately 1,100 MW of large-scale wind and solar assets. A key catalyst for the stock heading into year-end is the refinancing of their global debt facility, which we believe will dramatically reduce their interest costs and enable the company to recommence paying ordinary dividends to investors. We also expect that the company will be able to capitalise on high electricity prices this summer, as a majority of their generation is sold on the spot market, as opposed to being locked into longer term, lower priced contracts.

Following a narrowing in the spread, we unwound our paired positions between Metlifecare (-4.0%) and Mirvac (-1.3%), and Charter Hall (-5.3%) and Centuria Metropolitan (+1.9%). An unexpected addition to the ASX300 in September, Centuria Metropolitan staged a mid-month rally on huge volume, providing an opportunity to exit the Charter Hall pair.

Early in the month, the share price of Westpac Bank (+2.1%) came under pressure and we were able to establish a long, hedging the exposure with a short in the outperforming Australia and NZ Bank (+0.7%). By the end of the month, the performance had reverted and we unwound the pair for a modest profit.

The paired position between Rio Tinto Ltd (-1.9%) and Rio Tinto Plc (-7.3%) was reduced during September, following a narrowing of the spread.

Special Situations – Gross Contribution 0.2%

We established a position in the ANZ Bank Convertible Preference Shares (+0.2%) ahead of their expected redemption in March next year. A sell down of the securities that were rolled into the new series of Preference shares provided increased liquidity at a modest discount to the prevailing price.

NZ-based retirement village operator Arvida Group (-4.3%) announced the NZD106m acquisition of three villages in the month, with the bulk of funding provided by an underwritten rights issue. The rights traded for two weeks, with the share price trading lower during the period. We believe the increase in supply is short term and took advantage of the weakness to purchase both the ordinary shares and rights.

We participated in the upcoming initial public offer of the Johns Lyng Group – an integrated Building Services group, focussing on rebuilding and restoring property and contents. The company has evolved over the past 65 years and is now increasingly focused on insurance work – more than 60% of FY17 revenue was from the Insurance Building and Restoration division. With no debt and strong growth forecast, we believe the stock is relatively cheap at an EV/EBITDA multiple of 10.8x and should trade well when it lists in late October.

A sell down of shares in Bravura Solutions (-0.6%) by Private Equity shareholder Ironbridge provided a liquidity event, at an 11.9% discount to market. We capitalised on the liquidity, initiating a long within Special Situations.

Following the approval of the Blackstone proposal to purchase the entire property portfolio, Astro Japan Property (-0.1%) was suspended and delisted. We expect to receive the bulk of the proceeds from the asset sale during October.
Our remaining position in Appen (+11.8%) was sold during September.

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.5%	0.0%	0.5%
Div Financials	0.2%	0.0%	0.2%
Insurance	0.8%	0.0%	0.8%
Regional Banks	0.0%	0.0%	0.0%
REITs	45.8%	-37.5%	8.3%
Financials	47.4%	-37.5%	9.8%
Builders	0.5%	0.0%	0.5%
Consumer Disc	4.6%	-0.1%	4.6%
Consumer Staples	1.0%	-0.1%	0.9%
Gaming	0.0%	0.0%	0.0%
General Industrials	0.3%	0.0%	0.3%
Health Care	4.5%	0.0%	4.5%
Information Technology	1.9%	0.0%	1.9%
Infrastructure	0.0%	0.0%	0.0%
Materials	1.0%	-1.0%	0.0%
Media	2.8%	-0.7%	2.1%
Telcos	0.0%	0.0%	0.0%
Utilities	1.2%	-0.1%	1.1%
Industrials	18.1%	-2.0%	16.1%
Bulk Metals	14.9%	-15.0%	-0.1%
Energy	0.2%	0.0%	0.2%
Gold	0.0%	0.0%	0.0%
Resources	15.0%	-15.0%	0.0%
Hedge	0.0%	-1.5%	-1.5%
Index	0.0%	-1.5%	-1.5%
Total	80.4%	-55.9%	24.5%

Market Commentary

Against the backdrop of North Korea's declaration that it would not hesitate to shoot down US warplanes (even if flying in international air space), US stocks brushed aside rising political tensions and squeezed higher, just as Fed Chair Janet Yellen warned that the Federal Reserve should be wary of tightening monetary policy too gradually. The S&P 500 rallied 1.9% to finish at 2,519.4, while technology shares continued to soar (with the NASDAQ up over 20% CYTD) and the US small cap Russell 2000 rose to new record highs on expectations of pending tax cuts (given small caps pay relatively higher tax rates). The Dow Jones and S&P 500 have now both notched up eight consecutive positive quarters, with the Nasdaq recording its fifth consecutive positive quarter. Bloomberg's dollar index jumped the most since January, as the Fed Chair said raising interest rates gradually was the appropriate policy stance considering the uncertainty surrounding inflation. The US 10-year treasury yield ended the month at 2.33%.

Investors were also monitoring the ongoing saga of US President Donald Trump's domestic policies in an attempt to gauge the chances of meaningful tax reform in the world's biggest economy. Trump and Republican leaders won initial approval from conservative groups when they announced their long-awaited tax plan. The Grand Old Party leaders released a framework where they proposed a cut to 35% (from just under 40% currently) for the top individual tax rate, and 20% for corporate taxes (down from the current 35%). Under the proposed tax overhaul, businesses would also be allowed to immediately write off their capital spending for at least five years.

Markets have oscillated between risk-on and risk-off stances since early August, as tensions continued to simmer on the Korean Peninsula, with an assortment of geopolitical risks further clouding the outlook. In Europe, markets are particularly concerned that gains by the far-right party in Germany's recent election signal a new populist undercurrent on the continent. Despite this, the Euro Stoxx 50 performed strongly, up 5.1% (led by Germany's DAX which surged 6.4%) with the euro falling to a five-week low, the steepest drop of the year immediately following U.K. Prime Minister Theresa May's, comments on the state of Brexit negotiations.

Theresa May said in an official speech that Britain would broadly honor its financial commitments to the European Union (EU). She also asked for a transition period of at least two years post the March 2019 exit date, during which the current trading conditions and rules would apply with the UK, tying the so-called divorce bill to transition. While the speech was welcomed in Brussels, it didn't go far enough for London-based banks, which are still pressing ahead with their relocation plans regardless. However, EU chief Brexit negotiator Michel Barnier said it could take months before the divorce talks can move on to trade in a blow to Theresa May's hopes for faster progress. His comments dampened any remaining optimism that May's speech would encourage EU leaders at their October summit to agree that "sufficient progress" has been made on the divorce for discussions to turn to trade. The pound strengthened as investors focused on Barnier's comments on the new dynamic and comments from the governor of the Bank of England on the likelihood of rising interest rates.

Commodity prices were fairly sanguine, with WTI crude closing up 9.4% to a five-month high of US$51.67/bbl after Turkey threatened to shut down Kurdish crude shipments and markets became more confident that Saudi Arabia had been successful in brokering higher compliance rates within OPEC. Further, the arrival in the United States of Hurricanes Harvey and Irma and seasonal refinery maintenance added to supply side concerns.

In Asia, the Nikkei closed at 20,356.3 (+3.6%), with Japan's Prime Minister Shinzo Abe dissolving the lower house of the national parliament on 28 September, ahead of an election to be held on 22 October, which was called 12 months earlier than needed. South Korea's Kospi rose 1.3% and Hong Kong's Hang Seng bucked the trend, falling 1.5% to 27,554.3

(but still up an astonishing +25% CYTD) after hitting an air pocket late in the month as Chinese property developers tumbled on fresh mainland home curbs. China's Shanghai Composite Index fell -0.4% in September, whilst S&P Global Ratings downgraded China's long-term sovereign credit rating by one notch to A+ from AA-, citing "a prolonged period of strong credit growth has increased China's economic and financial risks".

China's official PMI surprised on the upside, rising to a 65-month high of 52.4 in September from 51.7 in August, against expectations of a small decline (Consensus: 51.6). By sector, the improvement was across the board, but largely led by new orders (mainly export driven) for large enterprises, while small enterprises remained below the expansion/contraction threshold of 50.

The improvement in the official PMI may not necessarily reflect rising aggregate demand, but more likely the impact of supply-side reforms, in particular, anti-pollution measures taken in August and September - which had the effect of benefitting larger enterprises. Smaller, sub-scale companies were instead forced to cut or suspend production. Moreover, supply-side reforms have also been driving up input prices.

The **ASX/S&P 200 Accumulation Index closed the month broadly flat (-0.02%)** in September, and has traded within a tight range of approximately 100 points since May. Like international equity markets, the Australian market, has proven to be resilient, despite the global geopolitical uncertainty and the decline in the price of Iron Ore (down ~20% in September). Lithium stocks were the best performers in September, as the commodity rallied on the news that China was considering a ban on the sale of internal combustion engine vehicles. Gold stocks were weaker as the commodity underperformed while the US economy continued to strengthen. Retail stocks were weaker as fears of disruption from the imminent arrival of Amazon continued.

In Australia, small caps continued to outperform their larger cap peers, with the S&P/ASX Small Ordinaries Accumulation Index rising 1.31%. The Small Industrials Accumulation Index advanced 1.05% while the Small Resources Accumulation Index index finished up 2.43%.

The best performing sectors for the month were Healthcare (+2.2%), Financials (+1.1%) and Energy (+1.2%). The worst performing sectors were Telecommunication Services (-4.6%), Utilities (-3.7%) and Materials (-1.6%).

The top five positive stock contributors to the index were National Australia Bank Limited, CSL Limited, Westpac Banking Corporation, South32 Limited and Macquarie Group Limited, in total contributing approximately +43 points. The top five detractors were BHP Billiton Limited, Telstra Corporation Limited, Fortescue Metals Group Limited, Wesfarmers Limited and Newcrest Mining Limited, summing to a total contribution of 39 points to the downside.

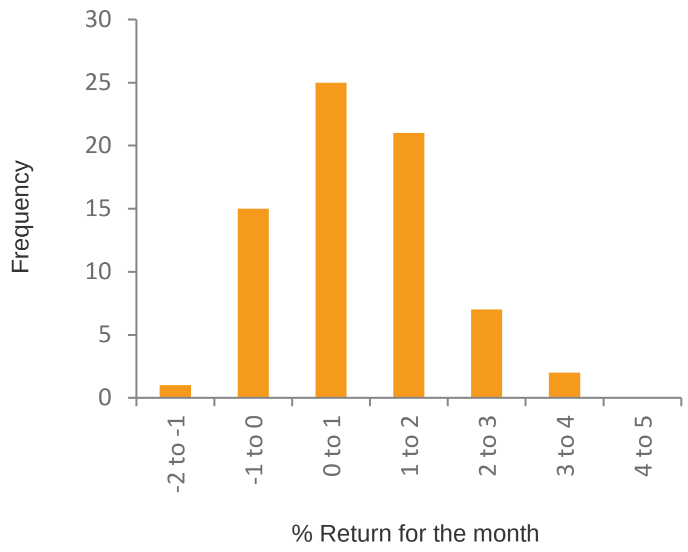
The Australian dollar was weaker as the Reserve Bank of Australia kept rates on hold at 1.5% for the twelfth consecutive meeting.

Australian equity capital market activity ramped up in September, with a flurry of deals completed. M&A-related equity raisings dominated the issuance, the largest being Macquarie Atlas Roads Group's (MQA) $450 million accelerated non-renounceable entitlement offer to acquire Autoroutes Paris Rhin Rhone (APRR) motorway group in Europe. Seven Group (SVW) raised $375 million via a placement to acquire the remaining stake in Coates Hire. Beach Energy (BPT) raised $301 million via an accelerated non-renounceable entitlement offer to acquire Origin's upstream oil and gas assets, Lattice Energy, for $1.58 billion. Additionally, the two main block trades included the PNG government selling 2.1% of Oil Search (OSH) for $209 million and Ironbridge Capital selling its 28% stake in Bravura Solutions (BVS) for $93 million.

Contribution

Relative Value Gross Contribution	0.1%	Special Situations Gross Contribution	0.2%
Positive		**Positive**	
INGENIA COMMUNITIES GROUP - MIRVAC GROUP	0.09%	IMPEDIMED	0.32%
AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP	0.08%	YOWIE GROUP	0.11%
GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP	0.08%	HANSEN TECHNOLOGIES LTD	0.06%
GOODMAN GROUP - INGENIA COMMUNITIES GROUP	0.08%	BRAVURA SOLUTIONS LTD	0.04%
GDI PROPERTY GROUP - NATIONAL STORAGE REIT	0.06%	MURRAY RIVER ORGANICS PTY LTD	0.02%
Negative		**Negative**	
AVEO GROUP - DEXUS PROPERTY GROUP	-0.14%	ONEVIEW HEALTHCARE	-0.34%
AVEO GROUP - GOODMAN GROUP	-0.09%	S&P/ASX 200 INDEX PUT OPTIONS	-0.05%
AVEO GROUP - GPT GROUP	-0.07%	TURNERS AUTOMOTIVE GROUP LTD	-0.03%
AVEO GROUP - MIRVAC GROUP	-0.07%	CAPITOL HEALTH LTD	-0.02%
GROWTHPOINT PROPERTIES - GATEWAY LIFESTYLE	-0.06%	SUPERLOOP	-0.01%

Distribution of Net Returns



TOP RELATIVE VALUE POSITIONS

- BHP BILLITON - BHP BILLITON PLC
- RIO TINTO - RIO TINTO PLC
- MIRVAC GROUP – VIVA ENERGY REIT
- AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP
- INVESTA OFFICE FUND - MIRVAC GROUP
- INGENIA COMMUNITIES GROUP - MIRVAC GROUP
- GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP
- GOODMAN GROUP - INGENIA COMMUNITIES GROUP
- PEET - SHOPPING CENTRES AUSTRALASIA
- GDI PROPERTY GROUP - GPT GROUP

TOP SPECIAL SITUATION POSITIONS

- ASTRO JAPAN PROPERTY GROUP
- NUFARM FINANCE NOTE
- AUSTRALIAN AND NEW ZEALAND BANKING
- IMPEDIMED
- NATIONAL AUSTRALIA BANK NOTE
- S&P/ASX 200 INDEX PUT OPTIONS
- HANSEN TECHNOLOGIES LTD
- TURNERS AUTOMOTIVE GROUP LTD
- ONEVIEW HEALTHCARE
- BRAVURA SOLUTIONS LTD

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: $1.1540

Redemption price: $1.1482

Market Neutral Fund AUM: $658.05M

Australian Equity Team AUM: $2.86bn

Firm AUM: $5bn

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

Contact:

Andrew Seddon 0417 249 577
aseddon@ellerstoncapital.com

Simon Glazier 0410 452 949

sglazier@ellerstoncapital.com