Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT November 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%	1.09%	-0.20%		2.57%
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	-0.20%	0.12%	-0.32%	-0.18%	Positive months	76%
3 Months	1.01%	0.37%	0.64%	1.50%	No. Relative Value positions	104
6 Months	3.14%	0.75%	2.39%	4.23%	No. Special Situations	34
1 Year	2.59%	1.50%	1.09%	4.17%	Net Equity Exposure	+23.1%
2 Years p.a	3.83%	1.64%	2.19%	5.75%	Gross Portfolio Exposure	177.7%
3 Years p.a	5.39%	1.81%	3.58%	7.69%	Beta Adjusted	+5.6%
Since inception p.a	9.77%	2.05%	7.72%	13.14%	Correlation Coefficient (vs ASX 200 Accum)	-10.48%
					Net Sharpe Ratio (RFR = RBA Cash)	2.06

Performance

It was a disappointing month in November with the Fund returning -0.2% against the benchmark return of +0.1%. The performance was particularly disappointing given the contribution from Special Situations was +0.8% (gross), with Relative Value proving to be a performance headwind during the period. Large-cap REITs were very strong, with the sector rising almost 5% in the month.

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Net exposure of the Fund was +23.1% while the beta-adjusted net of +5.6% continues to be below the since-inception-average. Gross exposure continues to increase, closing the month at 177.7%.

Our long in Ruralco Holdings (+4.6%) failed to keep pace with Elders (+38.7%) during the month, with the paired position detracting from the performance of the Fund. Elders delivered a very strong FY17 result, which exceeded consensus expectations and led to material upgrades in FY18-20. Ruralco also reported stronger-than-expected FY17 results, however the magnitude of the upgrades were more modest and the stock underperformed its larger peer.

Our pair within the Building Materials sector detracted from performance in the month, with the share price of Fletcher Building (-4.5%) underperforming Adelaide Brighton (+3.2%) which rose during the period. There was no major news on either company in the period, however a significant holder of Fletcher Building is known to be liquidating their portfolio.

A research report on Infigen Energy (-5.5%) that valued the company at 15% below the prevailing market price weighed on the stock during November. The report made some very conservative assumptions around the value of Large-scale Generation Certificates (LGCs) and placed no value on Infigen's development pipeline. We think the outlook for Infigen is more positive, with the potential re-financing in CY18 the catalyst to lead to a re-rating. Our holding is hedged with a short position in AGL Energy (-1.1%), which outperformed over the period.

The paired position between printing companies Ive Group (+3.9%) and PMP Limited (-34.7%) added to the performance of the Fund in November. During the period, PMP downgraded earnings for FY18 and FY19, citing a higher-than-anticipated cost base in their newly merged entity. The company also announced the retirement of the long-standing CEO, with Peter George leaving last month. At the Ive AGM, management announced the acquisition of Dominion Print Group – a provider of creative services, digital and offset printing and logistics. The acquisition represents the final deployment of the capital that was raised in August. More importantly, the company also reconfirmed FY18 guidance and provided confidence that the issues within PMP were company-specific.

Our exposure to the Manufactured Housing Estate (MHE) industry also contributed during the month, with both Ingenia Communities (+6.4%) and Gateway Lifestyle (+10.2%) outperforming the broader REIT sector. At the Ingenia AGM, management upgraded gross profit margins and earnings, and provided more certainty around the timing of asset sales. Gateway reconfirmed earnings at their AGM, but also provided YTD settlement numbers that were ahead of market expectations. The market appreciated both updates, with the stocks trading higher in the period.

The spread between the Australian and UK listing of both BHP Billiton (+2.9%) and Rio Tinto (+2.2%) widened during the month, detracting value from the Fund.

The largest contribution during November came from our long position in ImpediMed (+32.0%) following a positive update at the company's Annual General Meeting (AGM). At the meeting, the company disclosed that they expect two publications on the results of the lymphoedema trial very shortly. The company also provided some colour around the revenue model for SOZO which gave the market confidence that they would be cash flow neutral in FY20.

Our long position in Pro-Pac Packaging (+12.8%) also added value in the month. During November, the company completed the acquisition of Integrated Packaging Group, which was funded by an entitlement issue and debt. We spent some time with management at the Reservoir and Somerton operations in Victoria during the month and came away impressed with their operations. Identified synergy benefits of $2m seem low, given they now have seven sites in Victoria post the acquisition. Following the recent rally in the share price, the company trades on an EV/EBITDA multiple of 9.8x, relatively modest when compared with the market.

The share price of both Hansen Technologies (+6.8%) and Clover Corp (+36.2%) rallied in the month, following positive updates at their respective AGMs. Both names were positive contributors to performance in the period.

The share price of Oneview Healthcare (-28.4%) continued to struggle, with our holding detracting from the performance of the Fund. During the month, the company announced an equity raise of $30m, to fund the company through to positive cash flow. The market continues to be frustrated with the lower-then-expected growth rates which are somewhat explained by the turmoil in the US healthcare system.

Activity

Relative Value – Gross Contribution -1.0%

A long position was established in Spark Infrastructure (+2.8%), hedged with a short in the outperforming Ausnet Services (+8.7%). Ausnet reported their 1H18 earnings in the period, with the result modestly ahead of consensus expectations. Both the interim dividend and FY18 DPS guidance were inline. We think Ausnet looks expensive, trading at over 24x FY18 earnings and with a return to consensus price target of -7%. In comparison, the consensus price target for Spark is in line with the current share price.

We added to our shareholding in renewable energy company Infigen Energy (-5.5%), continuing to hedge the exposure with a short in AGL Energy (-1.1%). As previously mentioned, Infigen continues to work towards a restructure of their debt which we believe will result in a rerating of the company's shares.

The long awaited de-merger of Domain Holdings (-8.4%) and Fairfax Media (-9.7%) occurred during November with our position in Fairfax reducing in value, with the reduction neutralised by a new shareholding in Domain. The Fairfax business now holds the metropolitan and regional newspapers, magazines and entertainment publications but still retains a 60% shareholding in Domain. We think Fairfax looks cheap at 12.8x FY18 earnings and have increased our covered call position accordingly. Domain, on the other hand looks expensive, and we have been reducing our position into share price strength.

We continued to add to our long position in IOOF Holdings (+3.6%), hedging the exposure with a short in Janus Henderson (+8.6%). Last month, the company announced the acquisition of ANZ's OnePath Pensions and Investments business together with four Aligned Dealer Groups. Despite the recent share price underperformance, we believe the transaction is a landmark deal, taking out a major competitor and delivering substantial scale. We also believe the integration risks are more than factored into the share price at current levels.

Following a narrowing in the spread, we closed down paired positions featuring a long in Kiwi Property (+3.8%) hedged with shorts in Argosy Property (+2.4%) and Precinct Properties (+3.8%).

Special Situations – Gross Contribution 0.8%

An equity placement in MMA Offshore (+25.1%) provided an opportunity to establish a position in the company at a modest discount to market. MMA Offshore is Australia's leading offshore vessel operator but has been over-geared in a period where vessel demand has been low. Following the recapitalisation, the company will have more appropriate gearing and will be better placed for a recovery in the market. With the recapitalisation completed at $0.20 per share and a post-equity raise NTA of A$327m, we believe there is enough margin in the position to maintain a long.

We also participated in the equity raise of Elk Petroleum (+1.6%), to fund the acquisition of a majority stake in the Greater Aneth Oil Field in the Rocky Mountains. The acquisition makes Elk one of the largest producers listed in Australia and diversifies production away from their existing asset base. Following the acquisition, the company trades on a consensus PE ratio of <4x FY19 earnings, one of the cheapest oil producers in the sector

Following a rally in the share price of ImpediMed, Superloop (-3.6%), Hansen Technologies, Clover Corp and Murray River Organics (-1.2%) we sold down existing long positions.

We also continued to reduce our holding in the ANZ Bank Convertible Preference Shares (+0.3%), Multiplex SITES (+0.8%) and the National Australia Bank Income Securities (+0.6%).

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.4%	0.0%	0.4%
Div Financials	1.3%	-1.2%	0.0%
Insurance	0.8%	0.0%	0.8%
Regional Banks	0.0%	0.0%	0.0%
REITs	50.8%	-44.6%	6.1%
Financials	53.2%	-45.9%	7.4%
Builders	3.5%	-2.8%	0.7%
Consumer Disc	4.0%	0.0%	4.0%
Consumer Staples	1.6%	-1.0%	0.7%
Contractors	1.0%	0.0%	1.0%
Gaming	0.0%	0.0%	0.0%
General Industrials	0.4%	0.0%	0.4%
Health Care	3.5%	0.0%	3.5%
Information Technology	1.8%	0.0%	1.8%
Infrastructure	0.0%	0.0%	0.0%
Materials	1.2%	-1.2%	0.0%
Media	3.5%	-1.1%	2.4%
Telcos	0.0%	0.0%	0.0%
Utilities	4.4%	-3.0%	1.4%
Industrials	25.2%	-9.2%	16.1%
Bulk Metals	17.8%	-17.7%	0.0%
Energy	0.2%	0.0%	0.2%
Gold	0.0%	0.0%	0.0%
Resources	18.0%	-17.7%	0.3%
Hedge	0.0%	-0.6%	-0.6%
Index	0.0%	-0.6%	-0.6%
Total	96.5%	-73.4%	23.1%

Market Commentary

In November, with the US market doing a lot of the heavy lifting, most world equity markets continued to deliver positive returns. Eurozone equities bucked the trend and underperformed the rest of the world, despite strong economic data coming out of the region. Markets were spurred on by continued evidence of synchronised global growth, a falling US Dollar and upward earnings revisions, but were also tempered by pockets of geopolitical uncertainty.

Equity markets in the US were stronger, with the Dow Jones Industrial Average Index punching through the psychological 24,000 threshold for the first time (up 3.8% in November). The S&P500 Index (up 3.1%) also hit fresh highs as investor sentiment and confidence in the strengthening economy firmed. US equity markets were driven higher by buoyant retail sales pushing up consumer-focused sectors, with Wal-Mart surging (+11.4%) after beating earnings expectations and Amazon also continuing to power ahead (+6.5%). Ongoing strength from the technology and financial sectors also fueled the market. Financial stocks were well bid after newly appointed Fed Chairman Jerome Powell said that the current regulations on the sector were "tough enough", adding that he favoured the "tailoring" of regulations to alleviate the burden placed on smaller banks.

There was also increased optimism that the much talked about US tax reform package would become a reality, after the US House of Representatives finally passed the tax reform bill. In early December, President Trump secured a major political victory when his controversial tax reform legislation got through the Senate.

The release of the minutes of the last meeting of the Federal Open Market Committee confirmed that "labour market conditions generally continued to strengthen and that real gross domestic product (GDP) expanded at a solid pace in the third quarter, despite hurricane-related disruptions”. The minutes also noted that real GDP was expected to rise at a solid pace in the fourth quarter, boosted in part by a rebound in spending and production after the negative effects of the hurricanes in the third quarter were reversed.

In Europe, the Eurozone flash PMI for November rose to a much better-than-expected 57.5 (a 79 month high), but despite a raft of positive economic data points, political uncertainty featured again, weighing down investor sentiment. Germany was thrown into political disarray following the collapse of talks to form a coalition government. Chancellor Angela Merkel’s conservative Christian Democratic Union party is now in fresh talks with its old partner, the Social Democratic party, to form a “grand coalition”. Ireland narrowly avoided a political crisis from a policing scandal that could have caused the collapse of the minority government. Spain continued to work its way through the tricky situation of Catalonia wanting independence from Madrid’s control, with seemingly little progress made during the period.

Against this muddied backdrop, it was a poor month for European equities with the Euro Stoxx 50 down -2.8%, and the French and German markets down -2.4% and -1.6% respectively. The Spanish equity market was the worst performer in the region, down almost 3.0%. Only the Swiss market bucked the trend, rising 0.8%.

In the UK, the government delivered its autumn budget which contained fairly bleak economic forecasts. In particular, the growth rate for the current year was slashed to 1.5% (from 2% as recently as March 2017). More worryingly, growth forecasts for the medium term were also cut, with the UK economy forecast to grow on average at just below 1.5% over the next four years. The Bank of England raised rates by 25 basis points to 0.5% - the first rate hike in over 10 years and the FTSE100 ended the month down 2.2%.

Asian market performance proved to be a mixed bag, with the Nikkei up 3.2% and the Hang Seng up 3.3%, while the Chinese Shanghai Composite market fell 2.2%, with South Korea falling 1.9%. The markets in Asia traded mixed on the back of expanding global growth and better regional corporate earnings delivery. However they were also plagued by persisting geopolitical tensions in the region, as the US Pentagon confirmed that North Korea again fired a missile that travelled over 1,000 kilometers before crashing into the Sea of Japan.

The big bond story for November was flattening yield curves around the globe, while the weakening US Dollar and strengthening Euro were the main stories within forex markets.

On the commodities front, iron ore rallied over US$10 a ton to US$68.50 a ton, while Brent crude advanced $US2.20 to US$63.57 a barrel after OPEC and non-OPEC producers (led by Russia), agreed to extend oil output cuts until the end of 2018. The 6.0% rally in crude in November, leading to gains of 22% over the past 3 months, was a welcome relief for global energy shares.

In Australia, the political fortunes of the government didn't improve, with the Liberal party's popularity, as measured by the opinion polls, continuing to tumble. **The S&P/ASX 200 Accumulation Index once again seemingly ignored the politics and finished up 1.64% in the month,** reaching its highest level since January 2008. Investors kept their faith and took comfort in firming global growth, benign inflation, low interest rates and stronger earnings expectations.

The big news domestically broke on the last day of the month when speculation around a Royal Commission into the financial sector ended after the Prime Minister, Malcolm Turnbull, succumbed to political pressure and announced an inquiry into the banking, superannuation and financial services industries. The Royal Commission headed by a former High Court judge, will have a 12-month reporting period, with the draft terms of reference limiting the scope of the inquiry to primarily conduct issues. It will not address matters covered by other inquiries like competition and pricing, macroprudential policy, regulation or oversight. The draft terms of reference noted that the Commission will not inquire into matters that might prejudice, compromise or duplicate any other inquiries. While the announcement removes uncertainty, the Royal Commission itself will be a costly exercise for the financial institutions and likely distract management. It's very hard to speculate on the likely impact of the inquiry at this very early stage. Suffice to say that this would confirm and probably worsen the negative sentiment toward the financial sector, and the banks in particular. The media will no doubt be unsympathetic towards the banks and will probably be seeking blood.

Not surprisingly, the Reserve Bank of Australia kept rates on hold for the 14th consecutive month at its November meeting and was also more upbeat on domestic and international growth in the commentary that accompanied the rates decision.

The main drivers of the S&P/ASX 200 Index in November were Commonwealth Bank (+20 points), BHP (+16 points), Wesfarmers (+15 points), CSL (+13 points), Origin Energy (+11 points) and Insurance Australia Group (+9 points). The main detractors from the index were the three major banks - National Australia Bank (-35 points), Westpac (-13 points) and ANZ Bank (-12 points), also Orica (-9 points), following a disappointing full year result and Telstra (-8 points) continuing its poor run.

The best performing S&P/ASX 100 Index stocks during the month included Santos, after a takeover proposal was received and rejected by the Board (+12.9%), Origin Energy (+12.5%), Northern Star Resources (+11.7%), TPG Telecom (+10.2%) and Insurance Australia Group (+9.3%). The worst performers were Orica (-17.3%), Corporate Travel (-15.4%), ALS Limited (-12.7%), Graincorp (-8.7%), Qantas (-7.8%) and National Australia Bank (-6.5%).

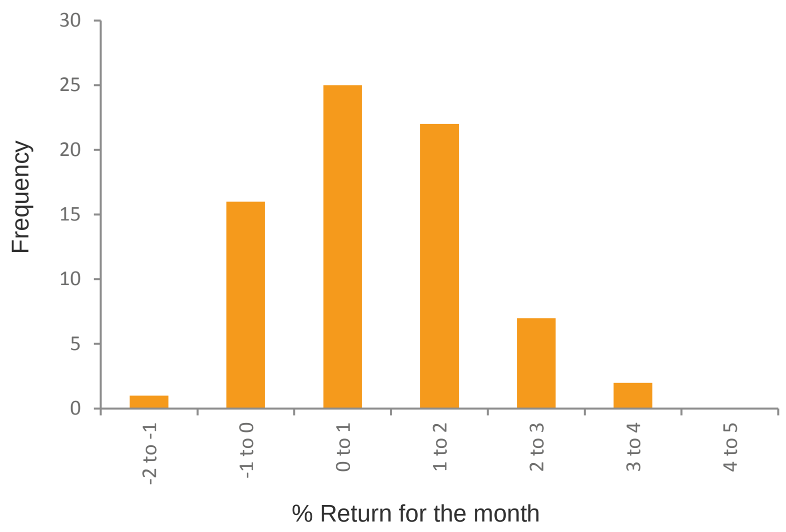
Small caps again outperformed their larger cap peers, with the Small Ordinaries Accumulation Index returning 3.9%. Small Industrials Accumulation Index advanced 2.8% and Small Resources Accumulation Index finished up 8.1%, led by Obocobre (ORE up an astonishing 29.3%) and followed by other lithium "thundering herd" securities.

Telecommunication and Financials were the worst performing sectors in November, returning -1.6% and 0.0% respectively, while the Real Estate, Information Technology and Energy sectors took line honours returning 4.7%, 4.4% and 4.0% respectively.

Contribution

Relative Value Gross Contribution	-1.0%	Special Situations Gross Contribution	0.8%
Positive		**Positive**	
GROWTHPOINT PROPERTIES - GATEWAY LIFESTYLE	0.12%	IMPEDIMED	0.47%
IVE GROUP - PMP	0.12%	PRO-PAC PACKAGING LTD	0.14%
INGENIA COMMUNITIES GROUP - MIRVAC GROUP	0.11%	CLOVER CORP	0.09%
DOMAIN HOLDINGS AUSTRALIA LTD - DOMAIN HOLDINGS AUSTRALIA LTD	0.09%	NUFARM FINANCE NOTE	0.08%
BWP TRUST - GDI PROPERTY GROUP	0.06%	HANSEN TECHNOLOGIES LTD	0.08%
Negative		**Negative**	
ELDERS - RURALCO HOLDINGS LTD	-0.18%	ONEVIEW HEALTHCARE	-0.24%
AGL ENERGY LTD - INFIGEN ENERGY	-0.17%	YOWIE GROUP	-0.03%
ADELAIDE BRIGHTON - FLETCHER BUILDING	-0.16%	COSTA GROUP HOLDINGS LTD	-0.02%
CHARTER HALL RETAIL REIT - PEET	-0.14%	S&P/ASX 200 INDEX PUT OPTIONS	-0.01%
PEET - SHOPPING CENTRES AUSTRALASIA	-0.13%	JOHNS LYNG GROUP PTY LTD	-0.01%

Distribution of Net Returns



TOP RELATIVE VALUE POSITIONS

- BHP BILLITON - BHP BILLITON PLC
- RIO TINTO - RIO TINTO PLC
- AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP
- AGL ENERGY LTD - INFIGEN ENERGY
- ADELAIDE BRIGHTON - FLETCHER BUILDING
- GOODMAN GROUP - INGENIA COMMUNITIES GROUP
- GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP
- ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA
- INGENIA COMMUNITIES GROUP - MIRVAC GROUP
- PEET - SHOPPING CENTRES AUSTRALASIA

TOP SPECIAL SITUATION POSITIONS

- NUFARM FINANCE NOTE
- AUSTRALIA AND NEW ZEALAND BANKING
- IMPEDIMED
- NATIONAL AUSTRALIA BANK NOTE
- PROPERTYLINK GROUP
- PRO-PAC PACKAGING LTD
- HANSEN TECHNOLOGIES LTD
- ONEVIEW HEALTHCARE
- COSTA GROUP HOLDINGS LTD
- TURNERS AUTOMOTIVE GROUP 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: $1.1642

Redemption price: $1.1584

Market Neutral Fund AUM: $645.13M

Australian Equity Team AUM: $3.18bn

Firm AUM: $5.37bn

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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