ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT December 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%	2.14%	4.76%
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	2.14%	0.13%	2.01%	2.74%	Positive months	76%
3 Months	3.04%	0.38%	2.66%	4.03%	No. Relative Value positions	97
6 Months	3.64%	0.75%	2.89%	5.04%	No. Special Situations	32
1 Year	4.76%	1.50%	3.26%	6.88%	Net Equity Exposure	+25.0%
2 Years p.a	4.36%	1.62%	2.74%	6.45%	Gross Portfolio Exposure	168.7%
3 Years p.a	6.47%	1.78%	4.69%	9.09%	Beta Adjusted	+7.0%
Since inception p.a	10.09%	2.04%	8.05%	13.55%	Correlation Coefficient (vs ASX 200 Accum)	-9.61%
					Net Sharpe Ratio (RFR = RBA Cash)	2.13

Performance

The Fund increased in value during December, returning +2.1% net compared with the benchmark return of +0.1%. Net exposure of the Fund was +25.0% with a beta-adjusted net of +7.0%. Gross exposure retreated in the period, closing the month at 168.7%.

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After a period of detracting from the performance of the Fund, our paired position between Fletcher Building (+11.3%) and Adelaide Brighton (+1.7%) turned around, with the pair one of the largest contributors to performance in December. With little news from both companies during the period, the move in the Fletcher share price seemed purely to be a result of the new CEO, Ross Taylor, buying $1m worth of shares, on-market. The purchase provided the market with some comfort that the new CEO was content with the current level of provisioning and the recent series of write-downs may be over.

Another significant contributor in the month was our paired position between Australian Unity Office (+4.7%) and GPT Group (-3.3%). Since listing in 2016, Australian Unity has been one of our highest conviction longs and the stock has been a regular contributor to the Fund's returns over the period. During December, the REIT announced that four of their properties had been externally valued, with the four properties increasing in value by $20.5m or 10.5% over the preceding book value. The revaluations led to a 5.9% increase in NTA, a move that was appreciated by the market.

After trading sideways for the past six months, the share price of Viva Energy REIT (+3.7%) outperformed in December, with the stock adding value within a number of different pairs. Viva Energy owns a network of petrol stations across Australia, the majority of them branded Shell. The REIT has a WALE of almost 14 years and pays a distribution of 6.5% pa. Importantly, the properties have not been valued since the Initial Public Offering (IPO) in mid-2016 and cap rates have firmed significantly over the period. About one-third of the portfolio is due to be valued at 31 December, with the new valuations to be announced with the full year results in February.

The spread between the Australian and UK listing of both BHP Billiton (+8.3%) and Rio Tinto (+6.9%) narrowed in the period, adding value to the Fund.

The share price of Impedimed (+4.6%) was stronger in the month, adding to the performance of the Fund. Late in the period, the company announced that it had received approval from the US FDA to market their SOZO device for chronic heart failure. In a separate announcement, the company announced that the PREVENT Trial (for the prevention of breast cancer-related lymphoedema) had reached a major milestone, with 1,100 patients enrolled in the trial. Interim analysis from the trial is expected to be submitted shortly.

Our holding in MMA Offshore (+27.3%) was a significant contributor during December, with the stock garnering market support following the recapitalisation in November. MMA Offshore is Australia's leading offshore vessel operator and following the recap, is well placed to benefit from increased investment in offshore oil exploration and production.

A long position in Superloop (+0.0%) also added value in the month, with the stock rallying after an institutional investor sold its entire holding.

Activity

Relative Value – Gross Contribution 2.0%

A long position was established in APA Group (-8.6%), hedged with a short in the outperforming Ausnet Services (-3.7%). An analyst downgrade during the month led to a fall in the share price of APA – a reaction which we believe was overdone. Following the fall in the share price, the company now trades on an EV/EBITDA multiple of 12.3x, a level close to 5-year lows.

We increased our exposure to Lend Lease (+2.8%), hedging the holding with shorts in Dexus (-3.6%) and Mirvac (-1.7%). In October, Lend Lease announced the sale of 25% of its retirement business to APG Asset Management at around book value, a solid result. At the same time however, Lend Lease flagged a provision for the Australian construction business, indicating 1H18 EBITDA would be below 1H17. Since the announcement, the stock has fallen -11.8%, to a level that we believe represents value.

The Gateway Lifestyle (+2.2%) Annual General Meeting (AGM) was held during the month, with the company reconfirming FY18 guidance at 7% growth in distributable earnings. Long-term recurring rental income is expected to exceed $50m in FY18, with a development pipeline that will add to that measure over time. The stock was sold down following the AGM and we capitalised on the move, adding to our existing holding and hedging the position with Growthpoint Properties (-0.3%) and Goodman Group (-1.6%). We think the Manufactured Housing Estate (MHE) sector is maturing with a number of transactions in the past 12 months at record low yields for the industry.

We reduced our paired position between printing companies IVE Group (+2.4%) and PMP (+5.1%), following a period of outperformance from IVE. Whilst we like the IVE business model and management, we remain wary of increased competition from PMP, who are searching for a new CEO following the resignation of Peter George last month.

We partially unwound our building materials pair between Fletcher Building and Adelaide Brighton, and fully closed the position between Wagners Holding (+39.5%) and Adelaide Brighton. As previously discussed, the Fletchers share price rallied strongly during the month, while Wagners had a successful IPO with the stock closing +14.8% on its first day of trade.

A long awaited capital raise from National Storage REIT (-4.1%) provided us with the liquidity to cover our short and switch to a long position, the new holding hedged with a short in Mirvac. We like the fundamentals of self-storage, but have felt for some time that National Storage was overgeared and would need to raise equity at some point. That said, the National Storage portfolio finally seems to be maturing, with occupancy approaching 80% and Revenue Per Available Square Metre (RevPAM) holding above $210 per month.

We reduced our exposure to the Aveo (+1.9%) – Charter Hall (-2.1%) pair following a bounce in the Aveo share price. During December, Aveo announced the sale of Gasworks for $248.5m – a 37% premium to book value. The net gain on sale of $61m will increase NTA to $3.48 and provides capacity for the (previously announced) share buyback. The sale is expected to reduce gearing to about 12.5% which is expected to fall further following a revaluation of the portfolio, due in February.

Special Situations – Gross Contribution 0.8%

We continued to increase our exposure to the Capitol Health (-1.7%) takeover of Integral Diagnostics (+2.2%), purchasing shares in Integral at a mid-single digit discount to the announced terms. We met with both companies during the month, and remain confident that the deal will proceed as announced, although the timetable may need to be extended.

Our exposure to MMA Offshore was halved and we completely exited our holding in Hansen Technologies (+9.1%) following a rally in the share price of both companies. We also reduced our exposure to NZ-based Turners Automotive (+5.5%) following the release of their FY18 H1 results.

During the month, Unibail-Rodamco (-2.3%) announced that they had entered into an agreement to acquire Westfield Corp (+13.2%), with the deal unanimously supported by both boards. The deal was pitched at an 18% premium to the undisturbed share price, and with no onerous conditions, looks likely to proceed as announced (in the absence of a superior bid). With the spread trading at around +3% net, we established a modest position, with the expectation that our exposure will increase as the conditions of the transaction are met.

We participated in the sell down of the Private Equity shareholding in MYOB Group (+3.7%) and an institutional block share sale in Superloop. We are familiar with both companies and were content to participate in the sales which were both completed at a modest discount to the market price at the time.

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.4%	0.0%	0.4%
Div Financials	0.0%	0.0%	0.0%
Insurance	0.7%	0.0%	0.7%
Regional Banks	0.0%	0.0%	0.0%
REITs	48.2%	-40.7%	7.5%
Financials	49.3%	-40.7%	8.6%
Builders	1.3%	-0.7%	0.6%
Consumer Disc	4.0%	0.0%	3.9%
Consumer Staples	1.6%	-1.2%	0.4%
Contractors	1.0%	0.0%	1.0%
Gaming	0.0%	0.0%	0.0%
General Industrials	2.3%	0.0%	2.3%
Health Care	4.4%	0.0%	4.4%
Information Technology	0.3%	0.0%	0.3%
Infrastructure	0.0%	0.0%	0.0%
Materials	1.0%	-1.0%	0.0%
Media	3.6%	-1.3%	2.4%
Telcos	0.0%	0.0%	0.0%
Utilities	4.6%	-2.9%	1.7%
Industrials	24.6%	-7.2%	17.4%
Bulk Metals	18.7%	-18.5%	0.2%
Energy	0.2%	0.0%	0.2%
Gold	0.0%	0.0%	0.0%
Resources	18.9%	-18.5%	0.5%
Hedge	0.0%	-1.4%	-1.4%
Index	0.0%	-1.4%	-1.4%
Total	92.8%	-67.8%	25.0%

Market Commentary

In December, the US markets were the star performers again, with the Dow Jones and S&P 500 delivering their ninth-consecutive months of positive returns and ending the calendar year at near record highs. Eurozone and Asia equity markets were a mixed bag over the month, but ultimately delivered credible performances for the calendar year across the geographies. Synchronised global growth, solid earnings, the expected benefits from US tax reform and a spike in global and domestic merger and acquisition activity provided markets with the impetus to close the calendar year strongly, despite ongoing geopolitical uncertainty.

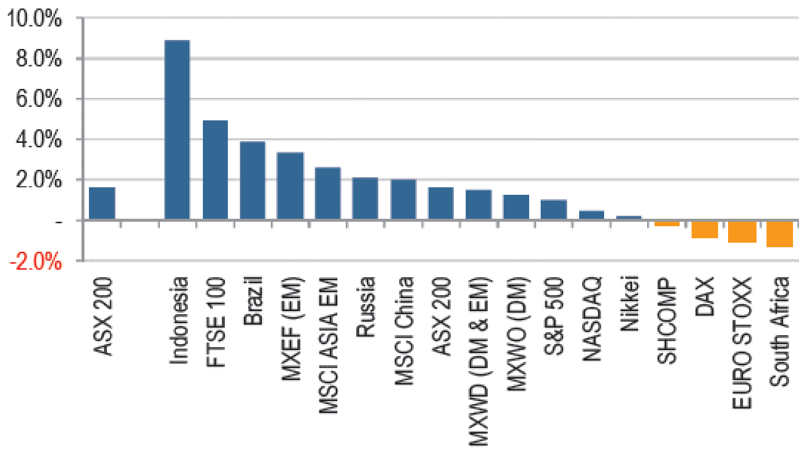
Equity markets in the US continued their stellar run, pushing through yet another record level, with the Dow Jones Industrial Average Index closing the month at 24,719, up 1.8% in the month and delivering a 25.1% return for the calendar year. The broader S&P 500 Index also continued its upward march, up almost 1.0% in December and 19.4% for the calendar year. As widely expected, the FOMC hiked the target range for the Fed funds rate by 25bp to 1.25% - 1.50%. This is the fifth hike of the cycle and the third hike of 2017.

The controversial US tax reform package was finally approved and signed into law, delivering the Trump administration a significant legislative victory. The president and Congressional Republicans are hoping that the bill, which appears to be relatively unpopular with voters, will benefit them politically too. They argue that the bitterly contested and expensive rewriting of the tax code will, in the long run, deliver economic growth by creating more jobs and raising wages. Markets, however, have been more positive about the financial implications for corporations from the tax reform. The headline features of the tax bill include a reduction in the corporate tax rate to 21% from 35%, cutting the top income tax rate to 37% from 39.6% for people earning $500,000 and over, curtailing individuals ability to deduct state taxes from Federal returns and limiting mortgage interest write-offs to new loans of up to $750,000 versus $1 million currently.

The reduction in the corporate tax rate is the most eye-catching and meaningful for equity markets as, simplistically, it results in increased reported earnings. Earnings per share are expected to be boosted by up to 10%, lending further support to the rally, although companies are still working through the voluminous legislation to ascertain the precise impacts of all the changes. Under the new Tax Cuts and Jobs Act, deferred tax assets will obviously be of less value in the future, and the repatriation tax, which covers earnings from foreign subsidiaries will also hit profits. The impact on US economic growth is expected to be positive but modest, with estimates ranging from 0.3 to 0.5 percentage points in 2018 and 2019 - although it's far too early to be definitive.

Economic data released in December confirmed that in the third quarter, the US economy grew at a 3.2% annualised rate (modestly revised down from the previous estimate of 3.3%), but this was its fastest pace since early 2015.

Global Markets Performance



Source: J.P. Morgan estimates, Bloomberg.

In the Eurozone, Composite PMI figures in December of 58.0 beat expectations and was stronger than the print in November (which was a 79-month high), adding to other positive economic data points and solidifying evidence of stronger economic growth. Eurozone inflation also appears to be ticking up slowly, with inflation for November coming in at 1.5%, up from 1.4% in October and 0.6% in November 2016. The political uncertainty in the region was off the front pages and significantly, the Germans continued to make progress towards forming a government. The EU agreed to commence negotiations with the UK on a post-Brexit trade deal, having secured sufficient progress on the first stage. The Euro Stoxx 50 ended the month down 1.9%, but finished the calendar year up 6.5%.

The FTSE 100 had a very strong month as markets took heart from the breakthrough on the first stage of Brexit talks with the EU. The UK, through its concessions, has secured a transition period post March 2019 (when it is scheduled to leave the EU) and moved to the next stage of negotiations. Both the UK and the EU are now preparing to enter the second stage of talks which will deal with the trade arrangements post Brexit. While there is still much to do, the UK has substantially reduced the risk of crashing out without negotiating key aspects of its relationship with the EU going forward. The UK market ended the month up 4.9% and closed the calendar year up 7.6%.

Asian markets were mixed in December: the Japanese market was broadly flat delivering a return of 0.2%, the Hang Seng was up 2.5% and the Shanghai Index was up 0.6%. However, Asian market performance was impressive in the calendar year, with the Nikkei up 19%, the Hang Seng up 36% and the Chinese market up 22%.

Commodity prices rallied through December, supported by positive global IP trends and strong Chinese import data, with Copper hitting a four year peak to US$3.29/lb. The top performing commodity was coking coal which jumped 23.1%, while Nickel (+15%) and Aluminium (+10%) pushed base metals higher.

In Australia, the economy continued to look buoyant, with figures released in December confirming that monthly trend full-time employment increased for the 14th straight month in November. Seasonally-adjusted employment increased by 61,600 in November, substantially ahead of expectations of 19,000, with the unemployment rate remaining flat at 5.4%. The Australian Dollar rose 3.2% through December to settle just above $A/$US 0.78, as the RBA left the cash rate on hold at 1.5% for the 15th straight meeting.

The government’s Mid-Year Economic and Fiscal Outlook (MYEFO) showed an improving budget position, with the bottom line more than $9 billion better than forecasts in May, putting the budget on track to reach a surplus in 2020-21. The improvement was helped by constrained spending, including lower welfare payments, in part due to stronger jobs growth. Rising company profits due to stronger global growth and healthy superannuation returns from firmer equity markets helped boost the government’s tax take.

While the economic stars have seemingly aligned in Australia to provide a politically embattled government with some respite, the economic outlook was downgraded modestly. The MYEFO projections downgraded wage growth to 2.25% from 2.5% for the current year and 2.75% from 3.0%, next year. Economic growth for this year has also been downgraded to 2.5% from 2.75% for the current year, but is expected to return to the forecast 3% for the next three years.

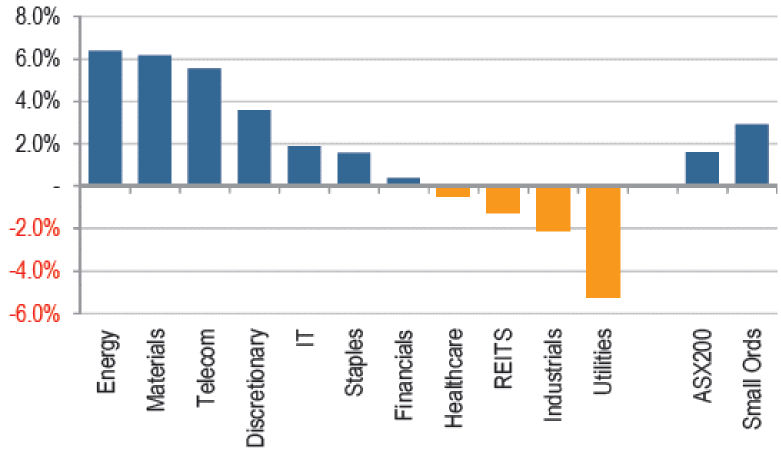
The government’s political fortunes were given a boost after it successfully held the seat of Bennelong (despite a swing of more than 5% to Labour) in the bi-election called as a consequence of the citizenship saga. The government now retains its slim majority in the lower house, which should give it some breathing space as it enters the new calendar year.

The S&P/ASX 200 Accumulation Index continued to keep pace with rising global equity markets and was up 1.8% in December and delivered a credible performance for the calendar year, up 11.8%. The market finished the

year at 6,065.1 points. Small caps outperformed the broader market, rising 2.9% on an accumulation basis, with Industrials advancing 1.2%, while the Small Resources rocketed up 8.9%.

The top performing sectors in December were Energy (+6.4%, with WTI crude oil rallying 5.3% to trade back above US$60/bbl for the first time since June 2015) and Materials (+6.2%, led by BHP and Rio Tinto shares which gained 8.3% and +6.9% respectively), Telecommunication Services (+6.2%) and Consumer Discretionary (+5.5%). After much-anticipation and with some fanfare, Amazon arrived in Australia in December but underwhelmed consumers with its initial offering. Consumer Discretionary stocks performed strongly despite a dismal month from Myer Holdings. The worst performers were Utilities (-4.5%), Industrials (-1.2%) and Health Care (-0.5%). The stocks that drove the index in December were BHP Billiton (+23.2 points), Telstra (+10.8 points), Westfield Corporation (+8.1 points), Rio Tinto (+6.3 points) and Woodside Petroleum (+6.1 points). The main detractors from the index were CSL (-7.9 points), Commonwealth Bank (-4.2 points), Qantas Airways (-4.2 points) and Newcrest Mining (-3.6 points).

AU GICS Sector Performance

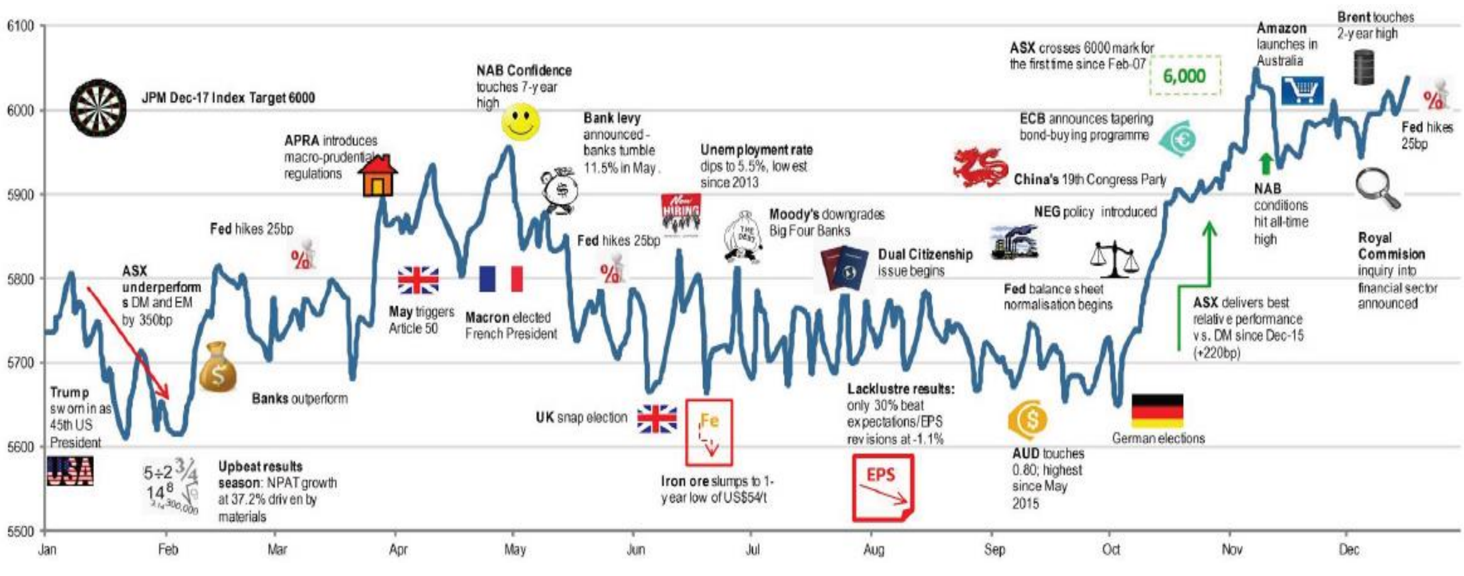


Source: J.P. Morgan estimates, Bloomberg.

In the calendar year, all sectors delivered a positive return with the exception of Telecommunication Services (-21.3%). The other sectors that underperformed the index were Utilities (+8.9%), Real Estate (+6.2%) and Financials (+5.0%). The star performers were Information Technology (+28.0%), Health Care (+26.4%, led by heavyweights CSL +42.5% and Cochlear +41.9%), Energy (+23.3%), Materials (+22.9%) and Consumer Staples (+20.2%). The top performing stock in the ASX200 was the A2 Milk Company, up a remarkable 261.3%, followed hot on its heels by Lynas Corporation (+198.6%) and Wisetech Global (+150.8%). At the other end of the spectrum, Retail Food Group took the wooden spoon, down 45.2%, with G8 Education (-23.1%) and Myer Holdings (-15.9%) also delivering woeful returns for investors.

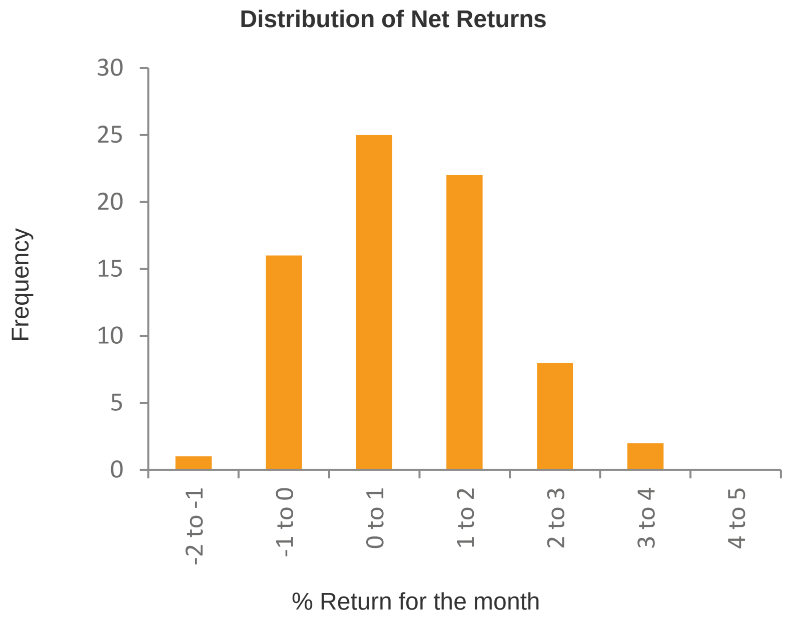
Despite being the last month of the year and the holiday period, December marked the second highest monthly level of ECM issuance during 2017. The largest deal was Transurban's $1.9 billion accelerated entitlement offer to fund its share of the West Gate Tunnel Project, the biggest primary equity raising of the year. Cleanaway Waste Management also announced the $831 million acquisition of Toxfree Solutions, supported by a $590 million entitlement offer. In addition, there were two large block trades executed during the month, with Macquarie Group exiting its $456 million stake in Macquarie Atlas Roads at a 5.7% discount to the last close, while Bain Capital sold down a $350 million stake in MYOB at a modest 0.6% discount to last close.

The year that was: 2017, a pictorial review



Contribution

Relative Value Gross Contribution	2.0%	Special Situations Gross Contribution	0.8%
Positive		**Positive**	
AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP	0.25%	MERMAID MARINE AUSTRALIA	0.24%
ADELAIDE BRIGHTON - FLETCHER BUILDING	0.24%	IMPEDIMED	0.09%
BHP BILLITON - BHP BILLITON PLC	0.14%	SUPERLOOP	0.08%
RIO TINTO - RIO TINTO PLC	0.12%	NUFARM FINANCE NOTE	0.06%
GPT GROUP - VIVA ENERGY REIT	0.11%	YOWIE GROUP	0.05%
Negative		**Negative**	
ELDERS - RURALCO HOLDINGS LTD	-0.12%	S&P/ASX 200 INDEX PUT OPTIONS	-0.02%
GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP	-0.04%	MSL SOLUTIONS	-0.02%
ABACUS PROPERTY GROUP - CENTURIA CAPITAL	-0.02%	MURRAY RIVER ORGANICS PTY LTD	-0.02%
ABACUS PROPERTY GROUP - INGENIA COMMUNITIES GROUP	-0.02%	PARAGON CARE	-0.01%
GOODMAN GROUP - INGENIA COMMUNITIES GROUP	-0.01%	ONEVIEW HEALTHCARE	-0.00%



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
> CENTURIA METROPOLITAN REIT - GROWTHPOINT PROPERTIES
> PEET - SHOPPING CENTRES AUSTRALASIA
> GOODMAN GROUP - INGENIA COMMUNITIES GROUP
> ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA
> AVEO GROUP - MIRVAC GROUP
> GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP

TOP SPECIAL SITUATION POSITIONS

> NUFARM FINANCE NOTE
> IMPEDIMED
> SUPERLOOP
> AUSTRALIA AND NEW ZEALAND BANKING
> CARINDALE PROPERTY TRUST
> S&P/ASX 200 INDEX PUT OPTIONS
> NATIONAL AUSTRALIA BANK NOTE
> PRO-PAC PACKAGING LTD
> ONEVIEW HEALTHCARE
> PROPERTYLINK GROUP

Key Information

Fund Inception Date: 3 June 2013

Liquidity: Daily

Management Fee: 1.20%

Performance Fee: 20% of outperformance

Buy/Sell Spread: 0.25%

Cum Application price: $1.1891

Cum Redemption price: $1.1831

Market Neutral Fund AUM: $654.49M

Australian Equity Team AUM: $3.32bn

Firm AUM: $5.78bn

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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