Ellerston Global Equity Managers Fund – GEMS C

PERFORMANCE REPORT February 2018

Investment Objective

The investment objective is to generate superior returns for Unitholders with a focus on risk and capital preservation.

Investment Strategy

- Global long/short equity
- Overlays fundamental stock selection with macroeconomic outlook
- Bias toward Australia

Key Information

Strategy Inception Date	1 Dec 2009
Fund Net Asset Value	$191.8M
Liquidity	Monthly
Application Price	A$1.9165
Redemption Price	A$1.9070
No Stocks	132
Gross Exposure	159%
Net Exposure	85%
Management Fee	1.50% p.a
Buy/Sell Spread	0.25%
Performance Fee	16.50%
Firm AUM	A$5,778M

Fund performance^

	1 Month	3 Months	1 Yr	3 Yr p.a	5 Yr p.a	Strategy Since Inception p.a
GEMS C (Net)	-1.13%	4.56%	24.12%	18.12%	16.43%	13.46%

Commentary

Global Market Overview

In February, volatility was back with a vengeance. Equity markets around the world ended the month in the red, with significant intra-month fluctuations. Early in the period, a sudden futures related technical sell-off hit global stock markets, amid concerns over rising inflation and rising interest rates. The VIX index, which measures volatility, saw the sharpest one-day spike in its history. The spike was exacerbated by the so-called “target volatility funds” that scrambled to sell stocks and buy VIX options. US equity markets led the weakness and the yield on US 10-year bonds hit a high of 2.95%. Inflationary concerns and stretched equity valuations weighed on investor sentiment. European and Asian markets were not spared and also ended the month in negative territory.

USA

After logging its strongest January since 1987, the S&P 500 index and the Dow Jones Industrial Average index ended February down 3.7% and -2.6% respectively. Considering the underlying fundamental strength of the US economy and better-than-forecast corporate profit reports, a number of several hundred point swings in the Dow Jones caught many investors unawares. Optimism over the effect of the Trump corporate tax cuts on earnings quickly gave way to concerns over rising inflation and interest rates. Some commentators believe that the fiscal stimulus from the tax cuts could be inflationary given the underlying strength of the economy and tight labour market. Towards the end of the month, the new Chairman of the Federal Reserve, Jerome Powell, provided a bullish assessment of the US economic outlook, but hinted clearly that the Fed could step up the pace of rate rises. This forced a rethink that perhaps the market was getting ahead of itself and was too sanguine on inflation and valuations. Four rate hikes are now expected by the Fed in 2018.

The US dollar was stronger against a basket of currencies, buoyed by the prospect of higher rates. Following Chairman Powell’s hawkish congressional testimony, the dollar index touched a five-week high, maintaining its upward momentum.

Early March saw Wall Street fail to gain ground as the prospects of inflation and interest rate rises, downward revisions to fourth-quarter US GDP, weaker Chinese PMI numbers and a likely trade war stifled positive sentiment.

Europe

European markets were sluggish across the board. The weakness in the US and similar fears about stronger inflation and higher rates pulled markets lower, with the UK's FTSE 100 down 3.4%, Germany's Dax down 5.7% and the French market down 2.9%. Politically, it was heartening that a deal was struck in Germany for a coalition government to be formed, ending the political limbo. The Bank of England left rates on hold and the European Central Bank President indicated that the true amount of economic slack "could slow down the emergence of price pressures", putting Europe slightly at odds with the commentary from the US.

Asia

Asian markets followed the US markets' lead and were weaker in all major jurisdictions. Of the larger bourses, Japan closed down 4.4%, Hong Kong was down 5.6%, India lost 5.0% and the Shanghai B index lost 4.9%. Korean stocks lost 6.2%, the worst monthly decline since June 2013. While global fears of a pickup in inflation and the possibility of stretched valuations were to blame for the weaker performances, a disappointing Chinese official manufacturing PMI print in February also contributed. Chinese PMI dipped to 50.3 from 51.3 in January and was much weaker than consensus expectations of 51.1. This was the lowest reading since July 2016 and was enough to dampen growth expectations.

Commodities

Commodity prices were generally weaker in February with oil going from being one of the best performing commodities in January to being one of the worst performing, ending the month down 4.8% to US$61.60 a barrel. Data released in February indicated that US oil production surged to an all-time high in November, with US producers pumping just over 10 million barrels a day. Gold fell 2% in February, after a volatile month's trading.

Bonds

The month was characterised by Treasury yields continuing to nudge higher, with the US 10-year bond yields hitting 2.95% intra-month, but failing to crack the 3% level. Debate rages on the extent of the bond market correction, but the market now expects the Fed to raise rates more aggressively than it did last month.

Australia

The Australian market performed better than its global peers. The S&P/ASX 200 Accumulation Index ended February up 0.4%. The market traded in a wide 300 hundred-point range as global equity markets corrected. Of the sub-sectors, the ASX Accumulation 200 Industrials Index took line honours with a return of 0.6% while the ASX Accumulation 200 Resources Index took out the wooden spoon returning -0.7%. The Small Ords Accumulation Index delivered a flat return.

Commentary

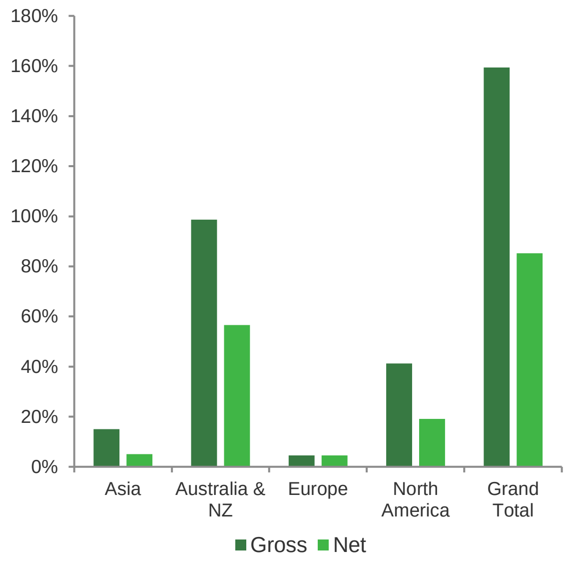
The steady rise in global equities with low volatility ended in February. Rising Bond markets stoked by inflationary fears led to the markets selling off. The U.S. 10 year bond yield went from near 2% in September last year to just under 3% in February. The bond sell-off picked up its pace following January's average hourly wage rise of 2.9% in the U.S.. This led to market concerns that the Fed is behind the curve and that it will need to tighten interest rates more than previously expected. The market is currently pricing in 3 interest rate hikes in 2018, but if average hourly wages continue to increase, then this could easily increase to 4.

While higher interest rates and inflation are a negative for equity markets, improving global economic growth, strong earnings growth, and positive earnings revisions continue to support markets. The additional fiscal spending and tax cuts are providing increased impetus for U.S. economic growth. Corporate tax cuts and a lowering of the tax on repatriated earnings has led to an improvement in corporate cash-flow, which has led to a pickup in buybacks and dividends. Year to date buybacks in the U.S. are over $9 bn and are up 53% year on year. Buybacks have been and will continue to be a strong support for the U.S. market. Corporates have been the largest buyers of U.S. equities over the past few years.

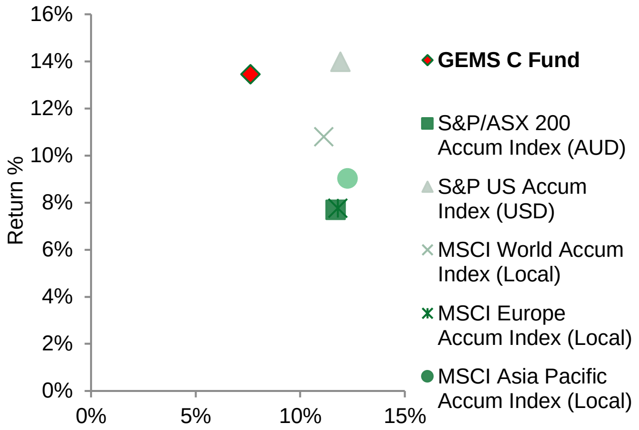
These countervailing forces are likely to keep equities within a trading range. Rising interest rates will curtail a major rise in markets while abundant global liquidity combined with strong earnings will likely provide support during any market sell-offs. The main risk for markets is a big sell-off in bonds leads to expectations of a recession in 2019. However, while inflation has increased, there remain a number of headwinds suggesting that the increase in inflation will be modest. The other risk is President Trump takes a more protectionist trade policy. The Aluminum and Steel tariffs are a negative, but our perception is that they are a political move to appease President Trump's political base and they are a negotiating ploy to get better terms for the U.S. in upcoming trade deals.

The fund continues to have its largest exposure in Australia centered in a number of key holdings with significant upside. These include Healthscope, Longtable Group, Lynas Corporation, PSC Insurance, and Treasury Wine Estates. The U.S. is the fund's next largest exposure. Core holdings in the U.S. include Alphabet, EZCORP, Nutrien, Spectrum Brands, and The Stars Group. Asia remains a core position for the fund, with China and India remaining the two largest overweight positions.

Market Exposure as a % of NAV



GEMS Class C Performance & Volatility ^



Standard Deviation (Since Inception) % p.a. #

The GEMS Class C since inception has achieved higher returns than most major indexes since inception with lower risk over the same time period.

Top Holdings (Alphabetical, Long only)

- ALPHABET INC
- AWE LTD
- EZCORP INC
- HEALTHSCOPE LTD
- LONGTABLE GROUP LTD
- LYNAS CORP LTD
- NEWCREST MINING LTD
- PSC INSURANCE GROUP LTD
- THE STARS GROUP INC
- TREASURY WINE ESTATES LTD

Key Service Providers

- **Registry**: Link Market Services Limited
- **Auditor**: Ernst & Young
- **Prime Broker**: Morgan Stanley Intl & Co PLC & Goldman Sachs International
- **Administrator**: Citco Fund Services (Australia) Pty Ltd
- **Custodian**: 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.

Disclaimer

^ Actual performance for your account may vary from that set out in this newsletter and will vary for investments made in different classes, or at different times throughout the year. Some performance data is estimated and preliminary and subject to change.

^^For the period 1 January 2002 to 30 April 2006, the CPH Group GEMS Portfolio was not operated within a separate fund structure. The underlying investment assets of the CPH Group GEMS Portfolio were owned during that time within corporate entities of the CPH Group for which audited accounts were prepared on an annual basis. Accordingly, in order to provide relevant historical performance information for the period 1 January 2002 to 30 April 2006 (Historical Returns) net returns were calculated on the basis of the actual dollar returns of the CPH Group GEMS Portfolio adjusted to reflect a fund structure similar to the Fund and including all fees. For GEMS B, GEMS A returns have been used between 1 May 2006 and 2 November 2009.
The returns of the Fund and the relevant Indices are net of fees, expenses and taxes and assuming distributions are reinvested.

The returns and risk of the Fund and the relevant Indices are net of taxes, fees and expenses and assuming distributions are reinvested. The performance figures presented are for the Ellerston Global Equity Managers Fund GEMS C Units. The one month return figure may be an estimate and not the final return. This estimate also impacts other performance information provided. Estimated performance figures are preliminary and subject to change. Returns for other classes may differ slightly. Past performance is not indicative of future performance. Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000 is the responsible entity of the Ellerston Global Equity Managers Fund ARSN 118 887 0 95 (Fund). This newsletter has been prepared by Ellerston Capital Limited without taking account of the objectives, financial situation or needs of investors. Before making an investment decision you should consider your own individual circumstances and obtain a copy of the Product Disclosure Statement for the Fund dated 31 January 2014 which is available by contacting Ellerston Capital. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. To the full extent permitted by law, none of Ellerston Capital Limited, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this newsletter and disclaims all liability that may arise due to any information contained in this newsletter being inaccurate, unreliable or incomplete.

The standard deviation is often used by investors to measure the risk of an asset. The standard deviation is a measure of volatility: the more an asset's returns vary from the average return, the more volatile the asset. A higher standard deviation means a greater potential for deviation of return from the average return of the asset.