ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

PERFORMANCE REPORT March 2018

Fund performance^ (Net)

Net	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2018	-0.03%	0.54%	-0.34%										0.18%
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	-0.34%	0.12%	-0.46%	-0.36%	Positive months	74%
3 Months	0.18%	0.36%	-0.18%	0.32%	No. Relative Value positions	93
6 Months	3.22%	0.74%	2.48%	4.36%	No. Special Situations	32
1 Year	4.92%	1.49%	3.43 %	6.89%	Net Equity Exposure	+24.4%
2 Years p.a	5.09%	1.55%	3.54%	7.32%	Gross Portfolio Exposure	166.5%
3 Years p.a	5.71%	1.71%	4.00%	8.09%	Beta Adjusted	5.8%
Since inception p.a	9.58%	2.01%	7.57%	12.89%	Correlation Coefficient (vs ASX 200 Accum)	-6.17%
					Net Sharpe Ratio (RFR = RBA Cash)	2.03

Performance

With no major winning or losing positions during the month, the Fund decreased in value by 0.3%, underperforming the benchmark return of +0.1%. Net exposure of the Fund was steady at +24.4% with a beta-adjusted net of +5.8%. As anticipated following the reporting season, gross exposure increased during the period, closing the month at 167%.

The largest contributors to performance during March were the spread trades between the Australian and UK listings of BHP Billiton (-5.2%) and Rio Tinto (-7.8%), both of which narrowed during the period. We capitalised on the move in the BHP Billiton spread, reducing the position to 6.6% (gross) by the end of the month.

A paired position between Aventus Retail (+2.4%) and Charter Hall (-2.1%) also added value, with Aventus benefitting from a number of newspaper articles that were published during the period. Private Equity groups including KKR and Blackstone, were speculated to have expressed interest in participating in the sale of Steinhoff Asia-Pacific, which in turn led to a rally in the share price of Aventus. Steinhoff brands, including Freedom, Snooze, Fantastic Furniture and Plush represent 9% of the total rental income that Aventus receives and a sale of the parent to a credible buyer, would give investors comfort that the income was secure. Despite the rally in the period, Aventus shares closed the month at $2.15, a 7% discount to NTA.

The share price of wind farm owner, Infigen Energy (-7.1%) continued to flounder, with increasing concern around the form and timing of the Federal Government's proposed National Energy Guarantee (NEG). The holding is hedged with a short position in AGL Energy (-0.8%) which remained flat in the month. We continue to maintain the pair ahead of news around the refinancing of the Global Debt Facility, expected in April.

Our paired position between Peet (+0.0%) and Cromwell Property (+8.6%) detracted from performance with the major shareholder of Cromwell - Redefine Properties, selling most of it's holding at a modest premium to the prevailing share price. The buyer was ARA Asset Management, a Singapore-based real estate fund manager focussed on the management of REITs and private real estate funds. The sale leaves Redefine with a little over 3% of Cromwell, a holding that is expected to be sold in the near term. There was little news from Peet during the month, with the stock tracking sideways in the period.

Increased speculation around the future of Propertylink (+4.7%) led to a rally in the share price, with the stock outperforming most of its REIT peers in the period. The speculation centres on the intentions of Centuria Capital (+2.6%) and e-Shang Redwood - the two property groups that control almost 40% of the register between them. The move in the Propertylink share price was the largest single stock contributor to performance in the month.

An institutional shareholder in Pro-Pac Packaging (-8.3%) was reducing their holding during March, supplying the market with scrip and putting pressure on the share price and our performance. We met with Pro-Pac in February and remain comfortable with how the business is tracking. The company has a number of bolt-on acquisition opportunities available and is trading at a relatively modest FY19 PE multiple of 10.8x.

Our holding in Superloop (-6.8%) also detracted from performance in the month, despite no new news from the company during the period. With the ASX200 retreating over 3.7% in the month, our long position in index puts added to the value of the Fund.

Activity

Relative Value – Gross Contribution -0.40%

We added to our pair within the building materials sector, with both Fletcher Building (-5.1%) and Adelaide Brighton (-3.0%) underperforming the broader market. Late in the month, Fletcher Building announced that negotiations with the holders of US Private Paper would not conclude by the end of March and instead set a new deadline for the end of May. Adelaide Brighton traded higher earlier in the month following the semi-annual on-market acquisition of shares by the Barro Group, however trended lower with the weakening market.

Our buy/write position in Fairfax Media (-10.6%) was reduced following an intra-month rally in the share price. We still like the outlook for Fairfax, however we felt that the share price strength was unwarranted and capitalised on the move.

We introduced a long position in Investa Office (+1.9%), hedged with a short in Dexus (+0.2%), after the spread between the two REITs widened. Trading at a 12% discount to NTA, Investa represents better relative value to Dexus, with the latter priced at a modest premium to NTA. Nevertheless, the increased volatility in the market meant that by the end of the month, the spread had narrowed such that the pair was unwound.

The spread between out-of-home media companies QMS (+1.0%) and oOH!media (+2.0%) also widened during March. We capitalised on the move, adding to our holding in QMS and hedging the position with a short in oOh!media. The out-of-home sector continues to grow, with traditional media companies on record as looking to gain exposure to the segment. We anticipate that any consolidation within the industry is likely to include QMS and accordingly maintain a long.

We added to paired positions between Tabcorp (-5.0%) and Sky City (+5.2%), Transurban (-1.4%) and Sydney Airport (+1.8%) and Vicinity Centres (-2.8%) and Scentre (-0.3%), in each case capitalising on a widening in the spreads between peers.

We reduced our exposure to IVE Group (-0.4%), following a period of significant outperformance. We still maintain a long position, hedged with PMP Ltd (-16.7%).

Special Situations – Gross Contribution 0.04%

The proposed takeover bid of Integral Diagnostics (+1.4%) by Capitol Health (-0.4%) concluded during the month, with the bid failing to get traction with Integral shareholders. We sold out the bulk of our Integral holding, switching the proceeds into Capitol Health, which we believe represents better value at current levels.

Following the large equity raise in February, the share price of Paragon (-1.9%) has traded sideways - at or marginally below the placement price. We think the outlook for Paragon remains bright, with the company poised to make a number of bolt-on acquisitions that should prove to be accretive. We accordingly added to our holding during the month.

We sold our remaining holdings in National Tire and Wheel (-0.8%), Clover Corp (+35.7%) and Johns Lyng (+2.2%) following a rally in each share price respectively.

Our exposure to hybrid securities was reduced during the month with both the Australian and New Zealand Bank (0.0%) and the Australian Pipeline Trust (+1.5%) suspended and repurchased by each issuer. We also reduced our exposure to the Nufarm Finance Notes (-0.5%) and completely exited our holding in the National Australia Bank Perpetual Notes (+1.0%).

During the month, Brookfield Property Partners (-4.3%) announced an agreed takeover of GGP Inc (-3.4%), following a 6 month period of negotiation. We continued to add to our long position in Westfield Corp (-2.7%), hedging the exposure with Unibail-Rodamco (-0.3%) ahead of the shareholder votes in May. Despite the fall in the implied takeover price of Westfield, we expect that the deal will proceed as announced.

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.6%	0.0%	0.6%
Div Financials	0.0%	0.0%	0.0%
Insurance	0.7%	0.0%	0.7%
Regional Banks	0.0%	0.0%	0.0%
REITs	52.1%	-42.4%	9.7%
Financials	54.4%	-42.4%	12.0%
Builders	3.8%	-2.6%	1.1%
Consumer Disc	3.8%	-0.8%	3.0%
Consumer Staples	0.0%	-0.7%	-0.7%
Contractors	1.1%	0.0%	1.1%
Gaming	0.7%	0.0%	0.7%
General Industrials	2.8%	0.0%	2.8%
Health Care	4.9%	0.0%	4.9%
Information Technology	0.2%	0.0%	0.2%
Infrastructure	1.5%	-1.5%	0.0%
Materials	0.4%	-0.4%	0.0%
Media	4.1%	-2.4%	1.6%
Telcos	0.0%	0.0%	0.0%
Utilities	3.5%	-1.5%	2.0%
Industrials	25.7%	-9.9%	15.8%
Bulk Metals	11.1%	-10.8%	0.3%
Energy	1.6%	0.0%	1.6%
Gold	0.0%	0.0%	0.0%
Resources	12.7%	-10.8%	1.9%
Hedge	0.0%	-5.4%	-5.4%
Index	0.0%	-5.4%	-5.4%
Total	92.9%	-68.5%	24.4%

Market Commentary

Market Overview

In March, trade wars, tariffs, tantrums, and major tremors in technology stocks were front and centre. On March 22, President Trump went ahead with his decision to raise tariffs by 25% on $50 billion of import goods from China, including steel and aluminum, aimed at combating the flood of cheap materials into the United States. Coming hard on the heels of this decision, Trump announced further tariffs on China for its alleged theft of technology and trade secrets. The steel and aluminum tariffs exempt some of America's allies. In contrast, the tariffs on China mark an aggressive move by the Trump administration against China. This stance has elicited a retaliatory response from China. On 4 April, China announced that it would impose an additional 25% tariff on the importation of 106 product categories from the US. China's retaliation suggests the ongoing trade negotiations between the two governments will remain challenging and the possibility of a full-blown trade war can't be ruled out.

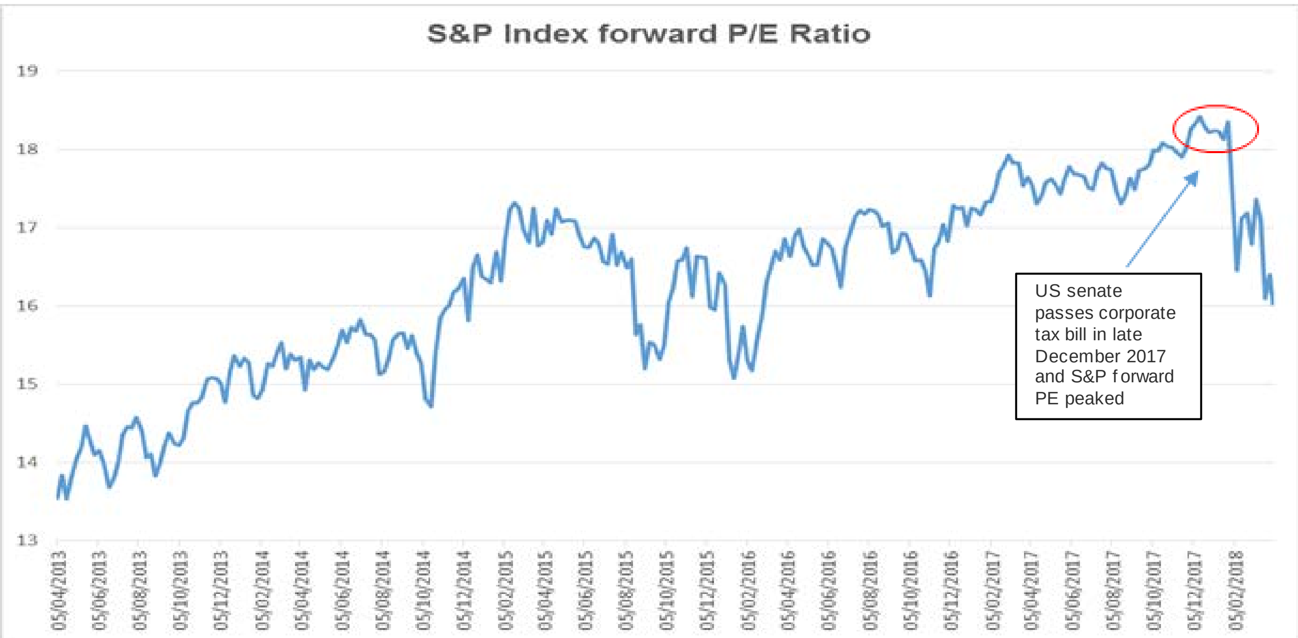
Despite continued positive news on the global economy, the prospect of a trade war and cracks in technology stocks concerned investors, and equity markets sold off across the board.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index ended March down -2.5% and -3.6% respectively. Markets failed to find firmer ground after a weak February, despite the Federal Reserve citing an improved economic outlook when it met for the first time under new Chairman, Powell. At that meeting, as expected, the Fed raised the benchmark lending rate by 0.25% to 1.75%. It also forecast a steeper path of hikes in 2019 and 2020, projecting a total of three increases this year. The statement from the Fed also noted a tighter labour market, with inflation expected to nudge higher in the months ahead. Additionally, the likelihood of a trade war increased, with China announcing tit-for-tat retaliatory tariffs in response to the US tariffs on its goods.

"Tech wreck" hit markets and the so-called FAANG stocks suffered. Facebook was in deep trouble with regulators in the US and in Europe as the company failed to protect the private data of its users. Cambridge Analytica, a data analytics firm, is said to have harvested data from more than 50 million accounts on the social network. Facebook first found out about this in 2015, but failed to do anything at the time. While Amazon fell afoul of President Trump's tweets and this hit sentiment towards the stock. In March, Facebook was down 10.4%, Amazon was down 4.3%, Apple was down 5.8% and Google was down 6.0%, with only Netflix bucking the trend to end the month up 1.4%.

Despite continued evidence that the US economic recovery was broadening, investors seem to be cognizant of the fact that central banks are in tapering mode and reversing prior years of extreme monetary policy accommodation. Higher volatility and concerns over valuations are likely to constrain future returns. The price to earnings (PE) ratio of the S&P has already started to contract, with the forward PE ratio having peaked around the time the senate passed the corporate tax cuts in December - see chart below.



Source: Bloomberg as at 3 April 2018.

Europe

European markets were sluggish across the larger bourses. The weakness in the US and similar fears about higher inflation, easing monetary stimulus and the prospect of contagion from a trade war dragged markets lower, with the Euro Stoxx 50 index down 2.1%, the UK's FTSE 100 down 2.0%, Germany's Dax down 2.7% and the French market down 2.7%.

The Bank of England left rates on hold, as did the European Central Bank (ECB). The ECB's 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, but the ECB did drop its easing bias. Euro composite PMI fell sharply by 1.7and 1.8 points in both February and March respectively. Politically, it was heartening that a deal was struck in Germany for a coalition government to be formed, ending the political limbo and alleviating some of Europe's political anxiety.

Asia

Asian markets followed the US markets' lead and were weaker in all major jurisdictions. Of the larger markets, Japan closed down 2.1%, Hong Kong was down 2.3%, India lost 3.5% and the Shanghai Composite index lost 2.8%. Global fears of a pickup in inflation, stretched valuations and trade war fears were to blame for the weaker performances. This was juxtaposed against easing geopolitical tensions, with the possibility of improving relations on the Korean peninsula.

Commodities

Commodity prices were generally weaker in March. The LME Metals Index was down 4.0%. Aluminium recorded the largest loss during the month, dropping 7.7%, followed by Zinc (-5.6%), Lead (-4.1%) and Nickel (-3.6%). Oil was the standout mover as it climbed to its highest level in six weeks, after crude inventories dropped for the first time in a month and on better-than-expected compliance with OPEC production cuts. Brent and WTI prices rose 7.6% and 5.6% to US$69.3 per barrel and US$64.9 per barrel, respectively. Bulk commodities sold off and Iron Ore crashed (-17.8%) amid falling Chinese steel prices due to winter weakness, while the Gold price rose modestly by 0.5% as the prospects of a trade war escalated.

Bonds

The US curve flattened with the spread between the long-term rates and short-term rates narrowing during the month by almost 14 basis points. US 10-year bond yields reversed its recent trend up and ended the month at 2.74%, down 12 basis points, while the US 2-year bond yield rose 1.6 basis points to 2.27%.

Australia

The Australian market had another tough month. **The S&P/ASX 200 Accumulation Index ended March down 3.8%**. The ASX Accumulation 200 Resources Index took out the wooden spoon for the second month in a row, returning -4.3%, while the Small Ords Accumulation Index returned -2.3% and the Small Industrials Accumulation Index returned -1.7%. The sharp fall in iron ore prices, a Royal Commission on the Banks and the likely fall out from the trade war between the two super powers did not help sentiment in the domestic market.

Front page news from the Royal Commission weighed heavily on the banks. In devastating cross examination and when summarizing the evidence, the Senior Counsel assisting the commission touched on alleged breaches of the law including misleading conduct. While the banks claimed that they have changed many of the questionable practices that were subject of the case studies examined, the banks certainly came away from the first hearing as having fallen well below the standards expected of them. The weakness in the major banks was a key driver of the market.

All sectors were in the red, but the worst performing sector was Telecommunication Services (down 6.4%, led by Telstra down another 6.3% in March, Vocus Group down 9.4% and TPG down 10%). Following closely was the Financials sector, down 5.9%, with the major banks all down over 5%, insurance darling Insurance Australia Group was down 8.8% and asset managers also got hit hard too, with Perpetual down 10.3%, Janus Henderson down 6.9% and Platinum and Magellan down just over 6% each. Worthy of note was the underperformance of the major bank, hit by a combination of poor news flow from the Royal Commission and a rise in short funding rates increasing fears of further net interest margin pressure. Materials also performed poorly with the sector retreating by 4.1%, led down by Rio Tinto (-6.7%) and BHP Billiton (-5.2%), while trendy lithium-exposed mineral exploration company, Orocobre was down a whopping 18%. The best performing sectors were defensive in nature, namely Real Estate (-0.2%) and Utilities (-0.8%). Both benefitted from the fall in long bond yields.

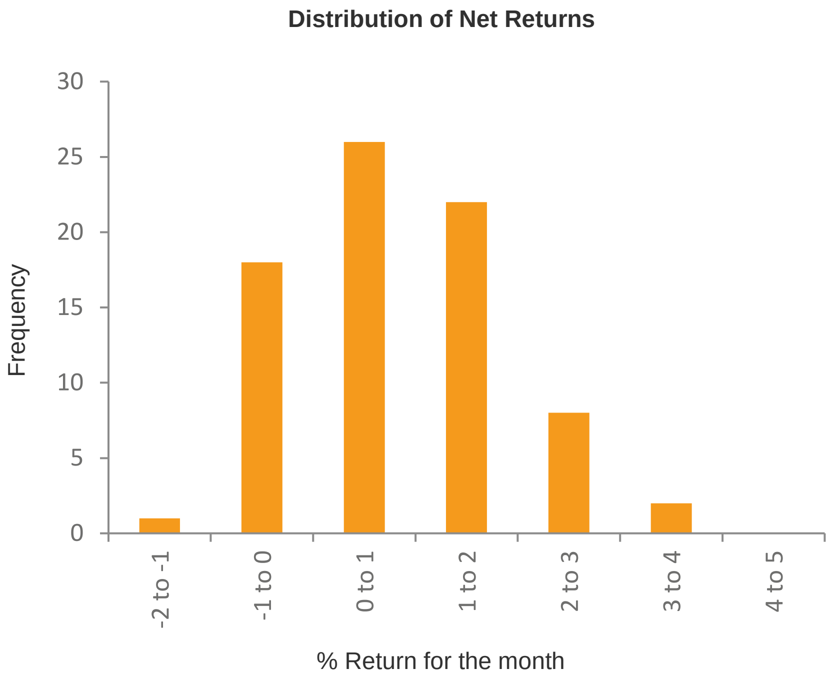
The stocks that added the most to the index in March were Brambles (+3 points), Wesfarmers (+2.8 points), Woodside Petroleum (+1.8 points), Alumina (+1.5 points) and Qantas Airways (+1.3 points). However, the major detractors from the index told the real story in March. The offenders were all large caps - Westpac Banking Corporation (-32.2 points), Commonwealth Bank (-29.1 points), BHP Billiton (-26.3 points), Australia and New Zealand Bank (-24.4 points), National Australia Bank (-19.5 points), CSL (-13.9 points), Telstra (-10.6 points), Rio Tinto (-8.7 points) and Insurance Australia Group (-5.9 points).

The Reserve Bank of Australia (RBA) chose to keep rates on hold at 1.5% in March for the 18th consecutive time. Fourth quarter 2017 GDP growth came in at 0.4%, a little softer than expected, but the prior quarter was revised up to 0.7% from 0.6%. The RBA's commentary on growth was that it expected the economy to "grow faster in 2018 than it did in 2017".

The Australian dollar initially rallied against the US dollar but ended the month down 1.1% at $0.768.

Contribution

Relative Value Gross Contribution	-0.40%	Special Situations Gross Contribution	0.04%
Positive		**Positive**	
RIO TINTO - RIO TINTO PLC	0.47%	S&P/ASX 200 INDEX PUT OPTIONS	0.07%
BHP BILLITON - BHP BILLITON PLC	0.18%	PROPERTYLINK GROUP	0.07%
AVENTUS RETAIL PROPERTY FUND - CHARTER HALL GROUP	0.08%	CLEAN TEQ HOLDINGS LTD	0.04%
CENTURIA CAPITAL - DEXUS PROPERTY GROUP	0.04%	TURNERS AUTOMOTIVE GROUP LTD	0.04%
INSURANCE AUSTRALIA GROUP - SUNCORP GROUP	0.03%	ONEVIEW HEALTHCARE	0.04%
Negative		**Negative**	
AGL ENERGY LTD - INFIGEN ENERGY	-0.24%	SUPERLOOP	-0.11%
ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA	-0.13%	PRO-PAC PACKAGING LTD	-0.10%
CROMWELL PROPERTY GROUP - PEET	-0.11%	INTEGRAL DIAGNOSTICS LTD	-0.03%
PEET - SHOPPING CENTRES AUSTRALASIA	-0.07%	IMPEDIMED	-0.03%
AVEO GROUP - GOODMAN GROUP	-0.06%	ABANO HEALTHCARE GROUP LTD	-0.02%



TOP RELATIVE VALUE POSITIONS

> RIO TINTO - RIO TINTO PLC
> BHP BILLITON - BHP BILLITON PLC
> ADELAIDE BRIGHTON - FLETCHER BUILDING
> CENTURIA METROPOLITAN REIT - GROWTHPOINT PROPERTIES
> AGL ENERGY LTD - INFIGEN ENERGY
> AVEO GROUP - GOODMAN GROUP
> OOH!MEDIA - QMS MEDIA
> ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA
> GOODMAN GROUP - INGENIA COMMUNITIES GROUP
AVEO GROUP - DEXUS PROPERTY GROUP

TOP SPECIAL SITUATION POSITIONS

> S&P/ASX 200 INDEX PUT OPTIONS
> NUFARM FINANCE NZ LTD
> IMPEDIMED LTD
> CARINDALE PROPERTY TRUST
> SUPERLOOP LIMITED
> SUNDANCE ENERGY AUSTRALIA LTD
> WESTFIELD GROUP
> PARAGON CARE LTD
> PRO-PAC PACKAGING LTD
> ONEVIEW HEALTHCARE PLC

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: $1.1859

Redemption price: $1.1799

Market Neutral Fund AUM: $625.32M

Australian Equity Team AUM: $3.56bn

Firm AUM: Over $5 billion

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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