ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | July 18

Fund Performance

	1 Month	3 Months	6 Months	1 Year	2 Years p.a.	3 Years p.a.	5 Years p.a.	Since Inception p.a.
Fund Net	-2.78%	-2.04%	-3.01%	0.90%	2.01%	3.55%	8.19%	8.25%
RBA Cash Rate	0.13%	0.39%	0.75%	1.50%	1.50%	1.64%	1.95%	1.98%
Alpha	-2.91%	-2.43%	-3.76%	-0.60%	0.51%	1.91%	6.24%	6.27%

Net	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2018	-0.03%	0.54%	-0.34%	-1.19%	-0.28%	1.05%	-2.78%						-3.04%
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. Past performance is not a reliable indication of future performance. The benchmark is the RBA Cash Rate.

Portfolio Metrics

Positive Months	71%	Net Equity Exposure	+23.9%
No. Relative Value Positions	103	Gross Portfolio Exposure	155.7%
No. Special Situations	35	Correlation Coefficient (vs ASX 200 Accum)	-8.91%
Beta Adjusted	-0.5%	Net Sharpe Ratio (RFR = RBA Cash)	1.55

Performance

July proved to be an incredibly disappointing month with the Fund producing a net return of -2.8%, compared with the benchmark return of +0.1%. Both Relative Value (-1.5% gross) and Special Situations (-1.2% gross) struggled during the month, with neither strategy producing any positive contributors of note.

The Fund closed the month with net exposure at +23.9% and a beta-adjusted net of -0.5%. Gross exposure remained relatively flat at 155.7%.

As has been the case for CY18 to date, the equity market continues to be driven by momentum, with value effectively being ignored or discounted by investors. This makes it very difficult for a Relative Value strategy, given expensive stocks get more expensive, and value gets cheaper.

Investment Objective

The Fund targets Absolute Returns with an annualised return objective of 5% above the RBA Cash Rate over rolling five year periods.

Investment Strategy

The Fund will seek to provide investors with a return profile that has low correlation with traditional asset classes. The fund aims to generate positive returns in all market environment by reducing the majority of market risk and focusing on capital preservation and alpha generation. The Fund will utilise a Relative Value and a Special Situations strategy.

Key Information

Strategy Inception Date	3 June 2013
Fund Net Asset Value	$565.3M
Liquidity	Daily
Application Price	$1.0784
Redemption Price	$1.073
Gross Exposure	155.7%
Net Exposure	23.9%
Management Fee	1.20%
Buy/Sell Spread	0.25%
Performance Fee	20% of outperformance
Firm AUM	Over $5 billion

Ellerston Capital Limited
ABN 34 110 397 674
AFSL 283 000

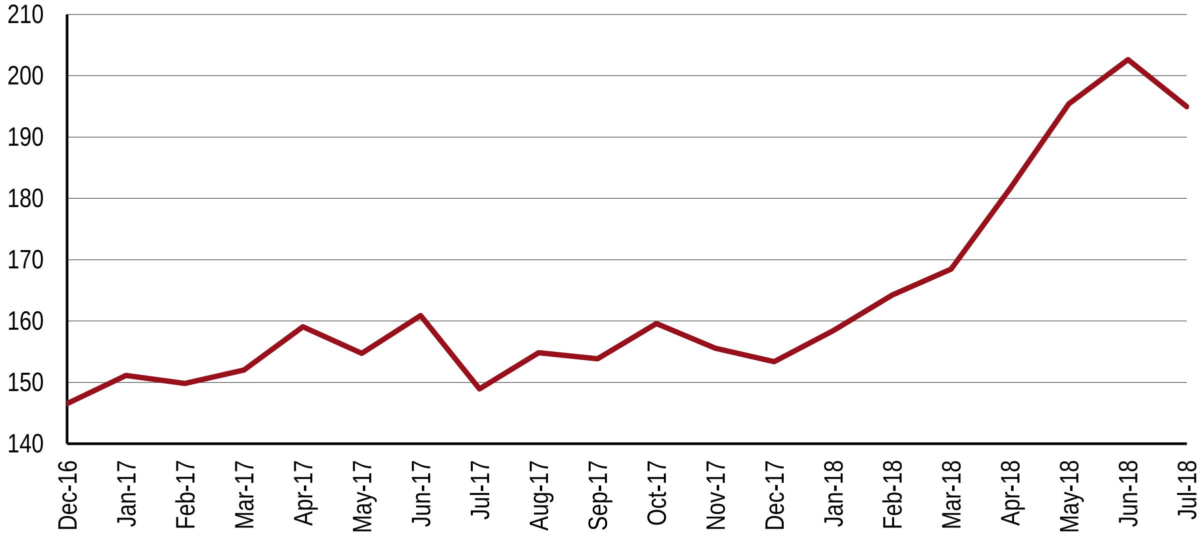
Level 11
179 Elizabeth Street
Sydney NSW 2000

Ph: +61 2 9021 7797
Fax: +61 2 9261 0528

info@ellerstoncapital.com
www.ellerstoncapital.com

APIR Code: ECL0013AU

ASX200 Price momentum factor divided by ASX200 value factor, for 2018 YTD



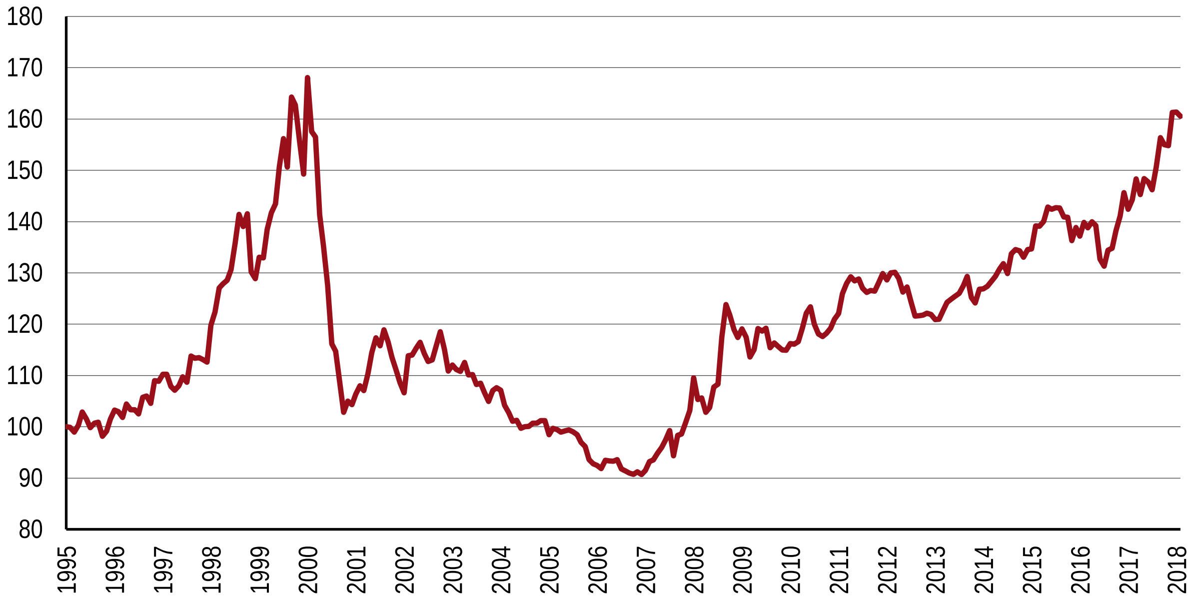
Source: UBS

A longer term chart provides more perspective to the move, with the same measure retreating slightly from 21 year highs at the end of July.

Source: UBS

The significant outperformance of growth stocks over value stocks is also persistent in the US market. In fact, the measure is rapidly approaching dot-com boom levels last reached in late 1999.

S&P 500 Growth Index divided by S&P 500 Value Index, approaching dot-com boom levels



Source: Bloomberg

The outperformance of momentum versus value in Australia leads to situations that don't make sense, when the fundamentals are considered. One example within the portfolio is a paired position between Ruralco (-8.8%) and Elders (-11.2%) - two listed rural services companies. Despite having a superior growth profile and having more diversified earnings, Ruralco trades on almost half the EV/EBITDA multiple of Elders.

Another is within the Out-Of-Home (OOH) media sector, where we hold a long in QMS Media (-4.6%), hedged with a short in oOh!media (+2.1%). QMS currently trades at a 25% discount to oOh!media, despite having better growth and with oOh!Media's recently announced acquisition of Adshel facing ACCC scrutiny. More on both pairs later.

Finally, when we look at our REIT pairs, we see extreme levels of dislocation. The average Price/NTA of our long positions is 1.08x, compared with that of our shorts at 1.28x. This differential between the two is at the highest level we have seen since the inception of the Fund. It seems in the current market environment, investors keep coming back consistently for the same names, regardless of price.

Within Relative Value, the underperformance of Peet (-9.1%) was the biggest detractor to the performance of the fund. Peet is one of Australia's largest land developers and ranks in the top-three by size of its landbank – over 51k lots at 31 Dec 17. Over the past few years the company has diversified away from Western Australia and now has a nationwide footprint, with 90% of 1H18 EBITDA coming from projects on the east coast. The stock trades at a modest premium to NTA, with NTA calculated as the lower of cost or written-down value of land holdings. In addition to development, the company also has a Funds Management division, which contributes about one-third of EBITDA. There was no new news on the company during the period, however an institutional shareholder was known to be aggressively selling shares during the period.

An earnings announcement from Elders during the month led to a fall in both the Elders' share price and that of listed-peer Ruralco, with our paired position detracting from the value of the Fund. The announcement confirmed what most investors already knew – that unfavourable seasonal conditions has reduced the demand for fertilizer and associated rural products. Following the announcement from Elders, Ruralco also updated the market, confirming they expected to deliver a full year net profit of between $26m and $29m – exactly in line with market expectations at the time. Following the share price moves, Elders trades at an FY19 EV/EBITDA multiple of 11.5x, two times that of Ruralco, despite having very similar underlying businesses.

Our paired position between Fletcher Building (+1.6%) and Adelaide Brighton (-1.0%) added to performance during July, with Fletchers building on its recent rally, following an investor day held in June.

Despite the weakening GBP, the spread between the Australian and UK listings of Rio Tinto (-2.7%) narrowed, adding to the performance of the Fund. The GBPAUD cross-rate fell to close at 1.77 from 1.78 at the end of June.

Paired positions featuring a long in Ingenia Communities (+1.9%) added to the Fund's performance, with interest in the Manufactured Housing Estate (MHE) sector continuing to increase following last month's takeover bids for Gateway Lifestyle (-1.7%). Positions hedged with Charter Hall Retail (-1.4%) and Abacus Property (-0.8%) in particular, added value to the Fund.

The share price of Oneview Healthcare (-28.0%) fell during the month, with an institutional seller blamed for the dramatic share price fall. Other than the quarterly cashflow report released late in the month, there was no new news during the period. The quarterly results were in line with market expectations, with the company ending the period with net cash of EUR17.5m.

The performance of Superloop (-10.3%) also disappointed during the month, with the stock trading lower following the commencement of the new CEO, Drew Kelton. Superloop is a specialist telecommunications company with fibre network assets in Australia, Singapore and Hong Kong. The company's assets are highly leveraged to the rapid growth in internet traffic which we expect to continue, given the demand for cloud computing and general data consumption.

The share price of OneMarket (-30.9%) suffered a similar fate to Oneview, with the stock trading lower on no new news, other than the quarterly cashflow report. The report served to illustrate just how cheap the stock is – with a market cap of just $92m and net cash of $224.2m (30 June) the stock is trading at an Enterprise Value (EV) of negative $132.2m.

Flexible packaging company Pro-Pac Packaging (-8.1%) launched their Share Purchase Plan (SPP) during July, with the proceeds used to fund the (previously announced) acquisition of two companies – Perfection Packaging and Polypak. The share price traded lower in the period, with investors selling down existing holdings to purchase new shares at a discount to market. As previously mentioned, the acquisitions are highly accretive, with EPS forecast to be 22% higher within 2-3 years.

Activity

Relative Value – Gross Contribution -1.52%

We increased our long position in Village Roadshow (-14.4%), hedging the long with a short in Ardent Leisure (-3.5%). During in the month, Village announced the sale of Wet 'n' Wild Sydney for $40m, with the proceeds used to retire debt. More surprisingly, the company also announced a pro-rata entitlement offer to raise $51m to further de-lever the balance sheet. Following the asset sale and equity raise, the company's net debt (ND) is expected to fall to <2.0x EBITDA, a more appropriate level for this type of business. Late in the period, Ardent provided an update on FY18 performance with Main Event's sales momentum slowing and further asset write downs leading to analyst downgrades.

A paired position was established between Rural Funds (-4.4%) and Growthpoint Properties (+3.3%) during July, capitalising on an equity raise held by Rural Funds in the period. During the month, Rural Funds announced the acquisition of JBS-owned Australian feedlots located in Queensland and New South Wales. The acquisition is expected to be circa 3% accretive to EPS and importantly provides further diversification from existing crop-based exposure. Proceeds of the raise were also used to fund the previously-announced Comanche beef cattle property in Queensland. Growthpoint remains one of the most expensive mid-cap REITs in Australia, trading at a premium to NTA and with an expected Total Shareholder Return (TSR) of -10.2% (source: Bloomberg).

We also established a paired position between NZ generation-retailers Contact Energy (-1.2%) and Genesis Energy (+4.5%). Contact remains the value play within the sector, and we believe their efforts to reduce gearing via cost-out and divestments will be rewarded by the market. Although Genesis did not have any news-flow in the month, our short position in underpinned by the relatively high level of capex required for the Kupe gas field Phase 2 expansion.

Our exposure to building material companies Fletcher Building (+1.6%) and Adelaide Brighton (-1.0%) was reduced, with the spread between the two stocks narrowing in the period. We also reduced our position between the Australian and UK listings of Rio Tinto.

The month of June was an action-filled month in the Out-Of-Home (OOH) media sector with oOh!media entering a binding agreement to acquire Adshel from HT&E (-0.8%) and JCDecaux entering into an agreement to acquire 100% of the share capital of APN Outdoor (+0.3%). Both transactions require ACCC approval to proceed. To fund the Adshel acquisition, oOh!media held a $330m equity raise, which concluded during July. We underwrote part of the issue, with the shares we received in July set against our existing short position. Our long exposure in QMS Media was modestly increased, with the stock trading at a circa 25% discount to oOh!media despite having better growth.

Special Situations – Gross Contribution -1.15%

We added to our holding in PGG Wrightson (-3.0%), a NZ-based rural services business in the midst of a strategic review. The review is focussed on the company's capital and balance sheet requirements as well as its shareholding structure, which could help unlock value, particularly in the Seed and Grain division. Media speculation continues to suggest that Elders is most likely to make a full or part bid for the company. PGG Wrightson trades on an FY19 EV/EBITDA multiple of 8.5x, a 26% discount to Elders.

Our remaining holding in the Multiplex hybrids (+1.6%) was sold during the month, following a period of outperformance. We also sold out of positions in Gateway Lifestyle (-1.7%), Kina Securities (+17.4%) and Vita Group (-0.5%). Our shareholding in Sundance Energy (-2.6%) was also sold.

Sector Allocation

Sector	Long Equity	Short Equity	Net Equity
Banks	0.6%	0.0%	0.6%
Div Financials	1.3%	-1.3%	0.0%
Insurance	0.8%	0.0%	0.8%
Regional Banks	0.0%	0.0%	0.0%
REITs	51.5%	-48.9%	2.5%
Financials	54.2%	-50.2%	3.9%
Builders	1.7%	-1.7%	0.0%
Consumer Disc	4.9%	-0.6%	4.2%
Consumer Staples	2.0%	-0.4%	1.7%
Contractors	1.7%	0.0%	1.7%
Gaming	0.0%	0.0%	0.0%
General Industrials	2.0%	0.0%	2.0%
Health Care	4.6%	0.0%	4.6%
Information Technology	1.5%	0.0%	1.5%
Infrastructure	0.0%	0.0%	0.0%
Materials	0.0%	0.0%	0.0%
Media	5.6%	-2.4%	3.2%
Telcos	0.0%	0.0%	0.0%
Utilities	4.2%	-0.4%	3.8%
Industrials	28.1%	-5.5%	22.7%
Bulk Metals	4.8%	-4.6%	0.2%
Energy	0.4%	0.0%	0.4%
Gold	0.0%	0.0%	0.0%
Resources	5.2%	-4.6%	0.6%
Hedge	0.0%	-3.3%	-3.3%
Index	0.0%	-3.3%	-3.3%
Total	87.5%	-63.6%	23.9%

Market Commentary

Market Overview

July saw global markets rebound after the torrid month of June. Once again, developed markets outperformed emerging markets. In a reversal of last month, Australia underperformed the major developed markets, but still closed in positive territory. As trade war tensions rose in July, with the US publishing a list of $200 billion of Chinese imports that would be subject to tariffs, emerging markets initially sold off. They quickly rebounded off their lows in June, partly driven by the moderation in US dollar strength. Tech was under pressure in the US and the geopolitical concerns of recent months were off the front pages, simmering in the background.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index ended July up 3.7% and 4.8%, respectively. The US market was supported by strong earnings and widening margins, as companies reported results that generally beat expectations. At the end of July, year-on-year blended earnings per share growth (comprising reported results and estimates for unreported companies) for the S&P 500 Index was tracking at over 21%.

Notable firms reporting included Amazon, which recorded its best quarterly profit number in its history, with net sales increasing by 39% for Q2.

The NASDAQ's performance (+2.2%) was impacted by the selloff in the so-called FAANGs, with Facebook hit the hardest, down 11.2% over the month and recording a scary 19% drop in a day after it disappointed on revenue, user growth figures and earnings. Sentiment towards the FAANGs may be turning and we've previously highlighted the stellar performance of the technology-led NASDAQ over the long-term and over recent years especially. Strong price momentum coupled with high valuations could make that segment susceptible to a sustained switch in sentiment. But not all FAANGs are the same, with Apple continuing to find favour with investors and hitting new all-time highs, approaching US$1trillion in market capitalisation.

US June activity indicators were mixed. The manufacturing ISM bounced to 60.2 (previously 58.7), the composite non-manufacturing ISM also beat expectations, coming in at 59.1 (previously 58.6) and non-farm payrolls beat consensus at 213,000 in June. Disappointingly, June housing starts dropped unexpectedly by 12.3% month-on-month.

The Trump administration's unpredictability on trade has constantly been in the spotlight during the month after reports that talks between Washington and Beijing were set to resume were quickly overtaken by a threat to raise tariffs. As investors continue to weigh the impact of the trade dispute, Fed Chairman Jay Powell was trying to nurture the second-longest US expansion on record by slowly reducing the amount of support that monetary policy provides to growth.

Europe

European equity markets rebounded strongly in July, with the Euro STOXX 50 Index up 3.9%. This was driven by a rebound in the major bourses, with France's CAC 40 rising very strongly, up 3.5%, and Germany's DAX up an impressive 4.1%. The UK's FTSE 100 also joined in the rally and was up a solid 1.5%, despite continued Brexit uncertainty and the resignation of the Foreign Secretary, a staunch supporter of Brexit. Markets in Europe were supported by stronger corporate earnings, including the well-received results from Swiss banking heavyweight Credit Suisse and increased forecasts from Lufthansa, which saw that company's share price soar.

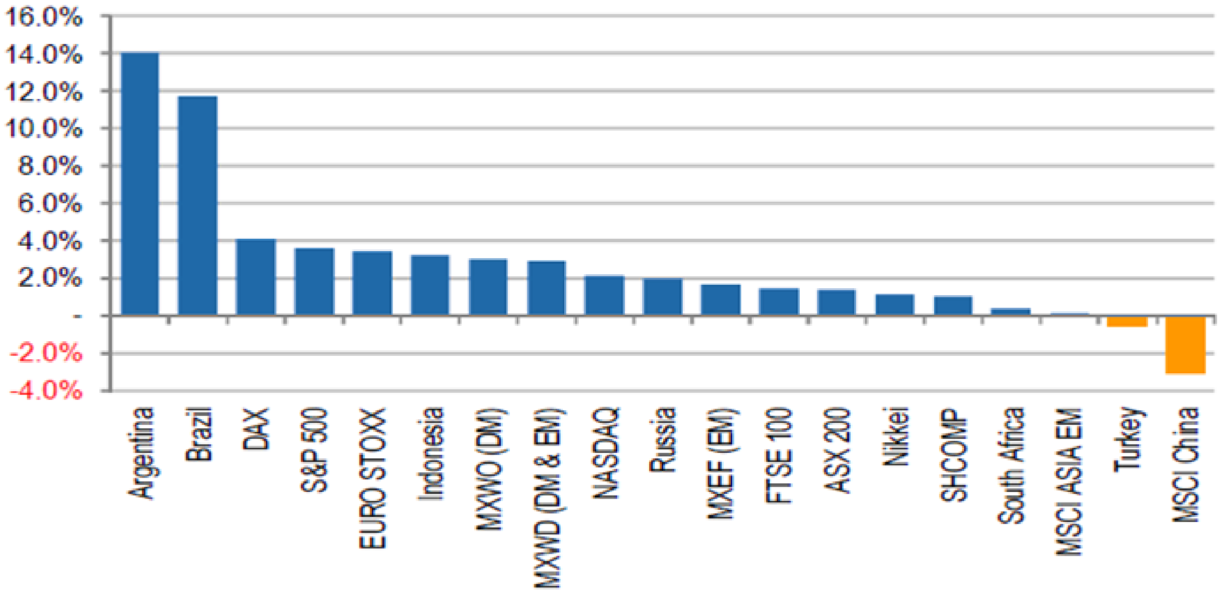
Activity indicators remained resilient, with the Eurozone manufacturing PMI of 55.1 up on the previous month and beating consensus. Inflation held steady at 2%. The European Central Bank's July policy meeting resulted in no change to guidance, with quantitative easing still scheduled to end in December.

Asia

As witnessed last month, fears of a trade war continued to have a dampening effect on Asian equities. Korean stocks were hit again, with the KOSPI Composite Index down 1.3% in July and down 8.8% and 10.6% over three and six months respectively. The Hang Seng finishing down 0.5% in the month. A moderation in the US dollar saw emerging markets rebound off their June lows. Japan's Nikkei 225 was up 1.1%.

Chinese economic data was mixed, with the manufacturing PMI retracing to 51.1 in June (previously 51.1) but the trade surplus was higher than expected. The Chinese yuan continued to depreciate against the US dollar, largely driven by market concerns over slowing Chinese growth. Q2 real Chinese GDP growth came in at 6.7% compared to 6.8% in Q1.

Global Markets' Performance in July 2018



Source: JP Morgan, Bloomberg.

Commodities

Crude oil prices fell US$5.2 per barrel in July following a strong rally in June, after supply concerns in Libya were eased and Saudi Arabia reported a large jump in output. July saw bulk commodities deliver mixed results, with iron ore firming (+4.9%), but coking coal saw prices fall sharply, down 13.2%. Gold prices fell again in July to US$1224/03. With the exception of tin, all base metals declined, with the LME metals index down 5%.

Bonds

Bond yields bounced in July driven primarily by reports that the Bank of Japan (BOJ) was considering modifying their yield curve control policy. The BOJ's intention was to maintain the extremely low levels of short and long-term interest rates for an extended period of time and doubled the plus or minus 10 basis points band for JGBs. This was more dovish than the market expected. US 10-year bonds saw yields nudge higher by the end of July to 2.96%, up from 2.86% at the end of June. The Australian curve flattened again, with the spread between long-term rates and short-term rates narrowing during the month by 9 basis points.

Australia

The Australian market started the new financial year in positive territory, with the S&P/ASX 200 Accumulation Index closing up 1.4%. The ASX 200 Resources Accumulation Index was a drag on the market returning a very modest +0.1%. The ASX 200 Industrial Accumulation Index performed best, up 1.7%, while the Small Ordinaries Accumulation Index took the wooden spoon ending the month in negative territory, with a return of -1.0%.

Returns in July were led by positive returns from the Telecommunications (+7.9%), led by TPG Telecom (+11.4%), Industrials (+3.5%) and Consumer Discretionary (+2.1%) sectors, while Utilities (-1.4%), Information Technology (-1.2%), Consumer Staples (-0.5%) and Materials (-0.1%) were a drag on returns. The Financials sector was in positive territory, too (+2.1%), led by the big four banks rallying and this was a key contributor to the overall market's performance.

The top five stocks that contributed to the index's return were Commonwealth Bank of Australia (+21 points), Australia and New Zealand Banking Group (+18 points), BHP Billiton (+18 points), Telstra (+16 points) and National Australia Bank (+15 points). The bottom five stocks that detracted from the index's overall return were Insurance Australia Group (-7 points), Evolution Mining (-6 points), Rio Tinto (-6 points), Scentre Group (-4 points) and a2 Milk (-4 points).

The Reserve Bank of Australia (RBA) chose to keep the cash rate unchanged at 1.5% and continued to forecast GDP growth to average a bit above 3% in 2018 and 2019. However, it cautioned that "one uncertainty regarding the global outlook stems from the direction of international trade policy in the United States".

On the domestic front, the Australian economy added 51,000 jobs in June, the strongest monthly increase since November 2017, with the unemployment rate steady at 5.4%. The Australian dollar rose very modestly against the US dollar to 0.7424, up 1.4% in trade weighted terms, as the widening interest rate differential was offset by rising iron ore prices.

Contribution

Relative Value Gross Contribution	-1.52%		
Positive		**Negative**	
ADELAIDE BRIGHTON - FLETCHER BUILDING	0.08%	BWP TRUST - PEET	-0.25%
RIO TINTO - RIO TINTO	0.07%	CROMWELL PROPERTY GROUP - PEET	-0.19%
CHARTER HALL RETAIL REIT - INGENIA COMMUNITIES GROUP	0.07%	ELDERS - RURALCO HOLDINGS LTD	-0.17%
ABACUS PROPERTY GROUP - INGENIA COMMUNITIES GROUP	0.05%	GOODMAN GROUP - PEET	-0.14%
ASX LTD - LINK ADMINISTRATION HOLDINGS	0.04%	AVEO GROUP - DEXUS PROPERTY GROUP	-0.13%
Special Situations Gross Contribution	**-1.15%**		
Positive		**Negative**	
KINA SECURITIES LTD	0.05%	ONEMARKET LTD	-0.33%
IMPEDIMED LTD	0.03%	ONEVIEW HEALTHCARE PLC	-0.26%
ABANO HEALTHCARE GROUP LTD	0.02%	SUPERLOOP LIMITED	-0.21%
TURNERS AUTOMOTIVE GROUP LTD	0.01%	SUNDANCE ENERGY AUSTRALIA LT	-0.13%
ACROW FORMWORK AND CONSTRUCT	0.01%	PRO-PAC PACKAGING LTD	-0.10%

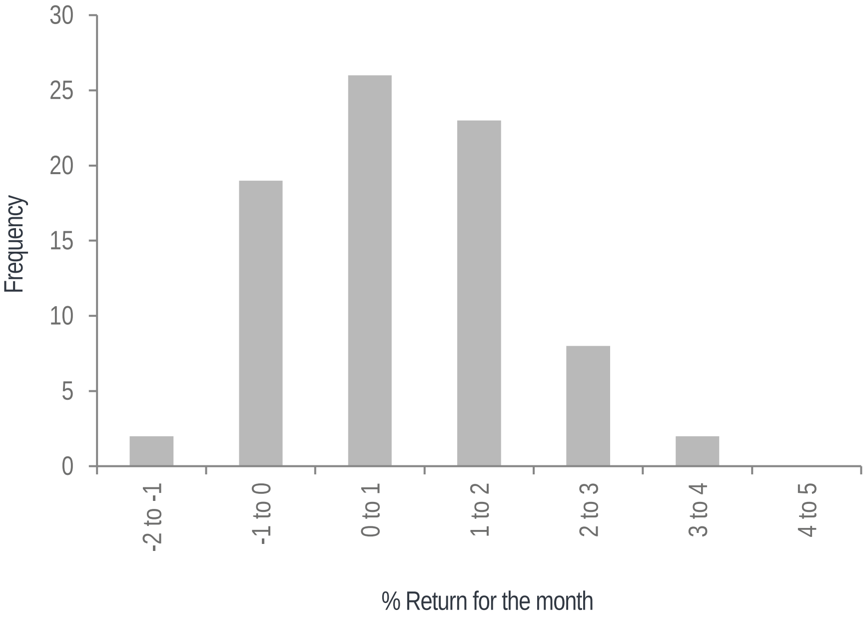
Top 10 Relative Value Positions

> OOH!MEDIA - QMS MEDIA
> RIO TINTO - RIO TINTO PLC
> CENTURIA METROPOLITAN REIT - GROWTHPOINT PROPERTIES
> AVEO GROUP - GOODMAN GROUP
> ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA
> AVEO GROUP - DEXUS PROPERTY GROUP
> BWP TRUST - GDI PROPERTY GROUP
> CROMWELL PROPERTY GROUP - PEET
> CENTURIA CAPITAL - DEXUS PROPERTY GROUP
> BWP TRUST - PEET

Top 10 Special Situation Positions

> INFIGEN ENERGY
> NUFARM FINANCE NZ LTD
> S&P/ASX 200 INDEX PUT OPTIONS
> SUPERLOOP LIMITED
> PRO-PAC PACKAGING LTD
> GRAINCORP LTD
> IMPEDIMED LTD
> PARAGON CARE LTD
> SPOTLESS GROUP HOLDINGS LTD
> ONEMARKET LTD

Distribution of Net Returns



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.

For further information, please contact:

Retail Distribution

Andrew Seddon
0417 249 577
aseddon@ellerstoncapital.com

Simon Glazier
0410 452 949
sglazier@ellerstoncapital.com

Institutional Distribution

Melinda Carter
0439 173 040
mcarter@ellerstoncapital.com

SYDNEY OFFICE
Level 11, 179 Elizabeth Street,
Sydney NSW 2000

MELBOURNE OFFICE
Level 4, 75-77 Flinders Lane,
Melbourne VIC, 3000

Ph: +61 2 9021 7797
E: info@ellerstoncapital.com