ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | August 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	-0.99	-2.74	-4.50	-0.97	0.54	2.83	7.60	7.91
RBA Cash Rate	0.13	0.39	0.76	1.50	1.50	1.63	1.93	1.97
Alpha	-1.12	-3.13	-5.26	-2.47	-0.96	1.20	5.67	5.94

Source: Ellerston Capital Limited

%	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	-0.99					-4.00
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.

Source: Ellerston Capital Limited

PORTFOLIO METRICS

Positive months	70%	Net Equity Exposure	+24.4%
No. Relative Value positions	94	Gross Portfolio Exposure	134.1%
No. Special Situations	31	Correlation Coefficient (vs ASX 200 Accum)	-9.21%
Beta Adjusted	0.4%	Net Sharpe Ratio (RFR = RBA Cash)	1.46

PERFORMANCE

The Fund returned –0.99% in August, underperforming the benchmark return of +0.1% in the period. Within Relative Value it was generally our short positions that hurt performance, whilst a long position in Pro-Pac Packaging (-29.4%) was the largest detractor within Special Situations.

The Fund closed the month with net exposure at +24.4% and a beta-adjusted net of +0.4%. Given the difficult environment, we have continued to reduce our gross exposure, which closed the month at 134.1%.

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	$560.8M
Liquidity	Daily
Application Price	$1.0677
Redemption Price	$1.0623
Management Fee	1.20%
Buy/Sell Spread	0.25%
Performance Fee	20% of outperformance
Firm AUM	Over $5 billion

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The biggest contributor to performance was our paired position between Village Roadshow (+18.4%) and Ardent Leisure (-3.4%), with both companies reporting in the period. The Village Roadshow result was in line with the previously provided guidance, with Gold Coast theme parks still suffering the effects of the Dreamworld tragedy in 2016. Ardent's result was a miss, with modest downgrades to FY19 and FY20 consensus earnings estimates. The company also announced an impairment to the value of the Dreamworld and SkyPoint assets.

Following on from an equity raise in July, the Rural Funds (+8.0%) share price rallied during August, outperforming its pair in Growthpoint Properties (+0.3%) and adding value to the Fund. The equity raise was used to fund the acquisition of JBS-owned Australian feedlots located in Queensland and New South Wales as well as the Comanche beef cattle property in Queensland. Growthpoint remains one of the most expensive Australian REITs, a point confirmed when the company guided to an anaemic two-year growth profile in the period.

Our paired position between Out-Of-Home (OOH) media companies QMS Media (-1.4%) and oOh!media (+9.0%) detracted from the performance of the Fund during August. During the period oOh!media received ACCC approval for their acquisition of the Adshel business, an acquisition that underwrites EPS growth for the next two years. QMS was also busy in the month, announcing an agreement to acquire the majority interest of TGI Systems and TGI Europe, both internationally recognised sports media companies that service sporting stadiums.

Paired positions featuring shorts in Charter Hall (+6.4%) and Goodman Group (+11.1%) generally detracted from performance during August with both stocks rallying following their respective earnings results. While their respective results were impressive, both share prices have run well ahead of market expectations, and both are trading with negative Total Shareholder Return (TSR) to analyst price targets - Charter Hall with -4.9% and Goodman with -4.8%.

Aventus Retail (-5.2%) announced their FY18 results during the month with the REIT also announcing the proposed internalisation of the company that manages the assets. While the internalisation has clear benefits, the market was surprised by the price of $143m, which represents 9.3x FY19 EBIT, despite the manager having only 7 years of the management contract remaining. The REIT was consequently sold down, underperforming its pair (Charter Hall) and detracting from the value of the Fund.

The biggest detractor to the performance of the Fund was our long position in Pro-Pac Packaging (-29.4%), which downgraded its FY19 earnings guidance during the period. The company cited a number of headwinds, including a lower AUD, higher resin prices, softer agriculture earnings and other cost pressures including electricity costs. The headwinds combined resulted in a 15% downgrade to FY19 consensus earnings – incredibly surprising, given the company had provided FY19 guidance only 7 weeks earlier.

The price of Nufarm ordinary shares (-4.2%) and hybrid securities (-2.9%) fell during the month after a California jury found against Monsanto in the first trial evaluating links between Monsanto's herbicide Roundup (branded glyphosate) and the incidence of cancer. The plaintiff was awarded $289m in damages. Monsanto has advised that they will be appealing the decision – a process that is expected to take a number of years. In a separate issue, a Brazilian judge ruled that the existing registrations of glyphosate would be suspended within 30 days, until the government completes its regulatory review of the product - a review that has been ongoing for 10 years. Post August 31, a Brazilian court overturned the proposed ban on glyphosate, with Nufarm securities rallying in response.

Spotless Group (+5.9%) reported during the period, with earnings falling by 5% year-on-year, driven mainly by margin pressure in Facility Services and Laundry and Linen. Cashflow was also poor, due primarily to the impact of the cashflow-negative Royal Adelaide contract. Despite the result, the share price rallied, with our long position adding value to the Fund.

The share price of Oneview Healthcare (-16.7%) continued to fall during the month, despite the company reporting a FY18 result that was in line with market expectations.

ACTIVITY

Relative Value – Gross Contribution -0.50%

An equity placement in National Storage REIT (-0.1%) proved timely, with the liquidity event enabling the position paired with Australian Unity Office (+6.3%) to be unwound. We were also able to reduce the National Storage – Centuria Capital (-2.8%) pair. An equity raise was not unexpected given the REITs increased gearing level, however the magnitude of the raise was larger than anticipated.

We unwound our paired position between Link Administration (+3.2%) and ASX Ltd (+3.0%) after both companies reported their FY18 results. Whilst we appreciate the embedded value within the Link business, in particular the value of their Pexa shareholding, the strong rally in the share price immediately following their result facilitated an exit with no market impact.

Our exposure to building material companies Fletcher Building (-9.7%) and Adelaide Brighton (-8.4%) was reduced, with the spread between the two stocks continuing to narrow in the period. We also reduced our position between the Australian and UK listings of Rio Tinto (-8.4%) following a narrowing of the spread.

We introduced a paired position between retail landlords Scentre (-0.8%) and Vicinity Centres (+4.1%) during the month, with both REITs trading at a >5% discount to 30 June NTAs. Vicinity is in the midst of a strategic review, with an estimated $2.0b of non-core assets earmarked for divestment over the next 4 months. If the assets are sold, analysts expect a decline in FY19 FFO, with no growth forecast for FY20. We prefer Scentre, with a number of near-term development opportunities and organic growth that we expect will result in the REIT's outperformance.

Special Situations – Gross Contribution -0.40%

NZ-based rural services business PGG Wrightson (+1.6%) announced that they had entered into an agreement to sell the PGW Seeds business for NZ$421m to DLF Seeds – a leading global seeds group. Following completion, PGG Wrightson is expected to make a distribution to shareholders of approximately NZ$292m or NZ$0.387 per share. The previously-announced strategic review is continuing, and we continue to expect that Elders (-11.5%) will acquire the remaining rural service business.

We sold out of our holdings in Spotless Group and Graincorp (+5.4%), following a rally in their respective share prices. We also reduced our position in Superloop (+0.4%), Paragon Care (-8.8%) and Acrow Formwork (+52.0%).

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	0.2%	0.0%	0.2%
Regional Banks	0.0%	0.0%	0.0%
REITs	49.8%	-42.7%	7.0%
Financials	50.6%	-42.7%	7.9%
Builders	1.3%	-1.3%	0.0%
Consumer Disc	3.1%	-0.2%	2.9%
Consumer Staples	0.4%	-0.2%	0.2%
Contractors	1.2%	0.0%	1.2%
Gaming	0.0%	0.0%	0.0%
General Industrials	1.9%	0.0%	1.9%
Health Care	3.9%	0.0%	3.9%
Information Technology	1.7%	0.0%	1.7%
Infrastructure	0.0%	0.0%	0.0%
Materials	0.0%	0.0%	0.0%
Media	4.0%	-2.1%	1.9%
Telcos	0.0%	0.0%	0.0%
Utilities	3.8%	0.0%	3.8%
Industrials	21.2%	-3.7%	17.5%
Bulk Metals	4.7%	-4.6%	0.1%
Energy	0.4%	0.0%	0.4%
Gold	0.2%	0.0%	0.2%
Resources	5.4%	-4.6%	0.8%
Hedge	0.0%	-1.7%	-1.7%
Index	0.0%	-1.7%	-1.7%
Total	77.2%	-52.8%	24.4%

Source: Ellerston Capital Limited

MARKET COMMENTARY

Market Overview

August saw global markets deliver mixed performances. Emerging markets underperformed developed markets once again. US equities delivered another month of strong returns, with the bull market continuing to make the headlines. This was despite both an emerging market sell-off causing a panic in risk assets and tit-for-tat responses in the ongoing trade dispute between the US and China. European equities were weaker, with all the major indices in the red. Europe was buffeted by concerns over trade wars, exposure to Turkey and the prospect of a hard Brexit. Asian equity markets were mixed, with Chinese equities being the hardest hit as concerns over a prolonged trade war impacted returns. The US dollar strengthened on emerging market weakness and global yields fell. Overall, economic news remained solid but geopolitical matters put a lid on investor sentiment.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index ended August up 3.3% and 2.6%, respectively. The tech-heavy NASDAQ ended the month up 5.9%, with gains in Amazon and Apple propelling the sector to a new record high level. The bull market showed no signs of abating.

Trade dispute concerns weighed on investor sentiment at times. In early August, President Trump doubled tariffs on Turkish steel and aluminium which triggered a sell-off in the Turkish Lira and risk assets generally. In late August, China imposed an additional 25% or $16 billion of tariffs on US goods, targeting coal, petroleum and medical instruments in response to Washington's decision to slap tariffs on Chinese goods. Levies now exist on $50 billion of goods moving each way between the two countries. The Trump administration confirmed that it remained committed to imposing tariffs on an additional $200 billion worth of Chinese goods, and President Trump threatened to remove the US from the World Trade Organisation.

Politically, it was a tricky month for President Trump as his lawyer, Michael Cohen, pleaded guilty to breaking the law under Mr Trump's instructions. The investigation into Russian collusion also continues. This led to speculation in Washington on whether the president could be impeached. Stocks however, remained resilient as economic data continued to support the Federal Reserve's view on the strengthening economy and the upward trajectory of interest rates.

Activity indicators in July were softer. The manufacturing ISM declined more than expected to 58.1 (previously 60.2) and the composite non-manufacturing ISM also fell more than expected to 55.7 (previously 59.1). The unemployment rate moved down to 3.9% (from 4.0%) in line with expectations.

The US dollar rose as currency markets were in "risk off" mode after being spooked by ongoing emerging market jitters.

Europe

European equity markets were very weak in August, with the Euro STOXX 50 Index down 3.7%. All the major markets were weaker with France's CAC 40 down 1.9% (despite manufacturing PMI beating expectations), Germany's DAX returning -3.5% (despite a survey of business climate surprising positively) and the UK's FTSE 100 returning a soggy -3.7%. The UK market was hit by the prospect of a 'no-deal Brexit' as the government released papers on its preparations for such an eventuality, including in extreme scenarios, the need to stockpile medicines and having barges with floating electricity generators for Northern Ireland. The equity markets were also impacted by fears of the European banks' exposure to Turkey and the prospect of trade disputes between the US, China and Europe escalating into a full blown trade war.

Inflation in July was 2.1% year-on-year, in line with expectations and supportive of the European Central Bank's announced policy of ending quantitative easing.

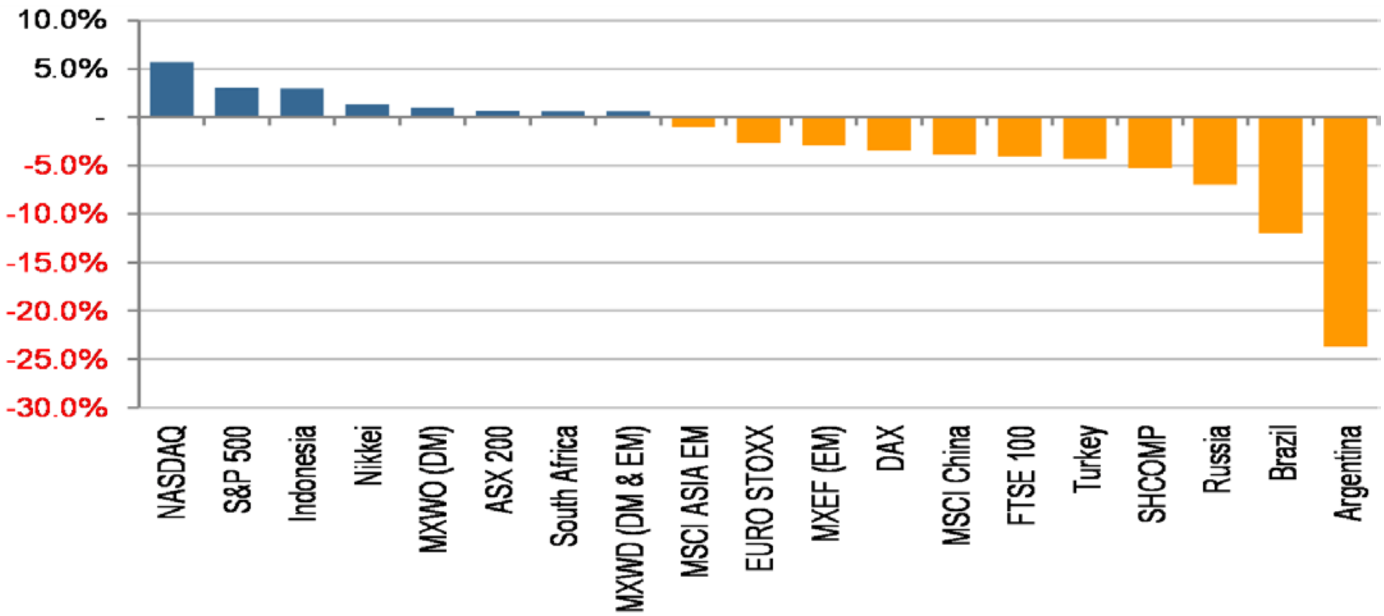
Asia

The prospect of an ongoing trade war and emerging market contagion saw Asian equities deliver mixed returns for the month. Korean equities rebounded, with the KOSPI Composite Index up 1.2% and Japan's Nikkei 225 also in positive territory, returning +1.4%. However, Chinese equities were badly hit, with the SSE Total Market Index down 4.9% in August and down 14.6% calendar year to date.

The region continued to have its fair share of geopolitical tension. There were no noticeable developments in respect of North Korean relations, and the US decided to move forward with military exercises on the Korean peninsula.

The Chinese central bank introduced counter-cyclical measures by encouraging banks to issue more loans as it attempted to cushion the economy from the detrimental effects of the trade war and combat a softening economy. Chinese economic data was worse than expected, with manufacturing PMI retracting to 50.8 in July (previously 51.0). Also, the trade surplus in July of $28.1 billion was less than expected (previous $41.5 billion).

Global Markets' Performance in August 2018



Source: JP Morgan, Bloomberg.

Commodities

The LME metals index was down for the third consecutive month and delivered a return of -3.8%. Aluminium (+2.0%) was the only base metal to rise over the month while nickel fell 8.8%. In bulk commodities, performance was mixed, with iron ore down US$2.00/t and trends in thermal and coking coal mixed. Oil prices rose US$3.17/bbl on supply concerns and a fall in crude inventories. Gold fell 1.5% in August on US dollar strength.

Bonds

Global bond yields fell in August on emerging market fears, with US 10-year yields declining from 2.97% to 2.85%. Australian 10-year yields fell more than their US counterparts, ending the month at 2.52%. The spread between the 2-year US and Australian bond yields remain negative.

Australia

The S&P/ASX 200 Accumulation Index closed the month up 1.4%, a credible effort in light of the political circus that played out in Canberra during the backend of the month. Australia had its seventh prime minister in eleven years after Malcolm Turnbull was challenged in the party room, stood down and was replaced by Scott Morrison, Australia's 30th Prime Minister. The lack of policy certainty represents a real risk for many sectors of the economy. At its best it is unhelpful and at its worst is could impact GDP. Back to markets, the ASX 200 Resources Accumulation Index continued to be a drag on the overall market with a return of -4.4% in the period. The ASX 200 Industrial Accumulation Index performed best, up 2.9%, while the Small Ordinaries Accumulation Index was a close second, with a return of 2.5%. The market's resilience was in the face of a weaker Australian dollar and a volatile reporting season. The reporting season saw revenue and earnings largely in line with expectations but dividends were ahead of expectations. Beats and misses were broadly in line with historical averages but earnings were revised downwards in aggregate for both FY19 and FY20.

The market entered reporting season with valuations looking stretched but emerged higher with momentum and growth styles continuing to outperform value. Valuations continue to look stretched. Volatility on the day of announcements was marked. Updates from banks revealed that regulatory and earnings pressures remained, while resources stocks were weaker as trade friction and China's stimulatory response swayed sentiment.

The best performing sector in August was Telecommunications (+13.1%), led by TPG Telecom (+50.0%, after its merger announcement with Vodafone) and Telstra (+13.0%), buoyed by the potential improvement in industry structure. Information Technology was the second best performer (+12.9%), with the now familiar and highly rated names continuing to rally following earnings updates: Appen (+41.2%), Wisetech Global (+40.1%), Altium (+37.4%) and Afterpay Touch (+27.9%). Healthcare was the next best performer (+10.7%) driven by the continued strength in CSL (+15.6%) after a result that suggested it was set for strong demand for its core product and following broker upgrades. Materials was the worst performing sector (-4.8%) as trade war concerns and fears of being past peak demand for resources in the near-term hit prices. BHP Billiton (-4.7%) and Rio Tinto (-7.5%) weighed on the sector's returns. The Energy sector and Financials sector also produced negative returns.

The top five stocks that contributed to the index's return were CSL (+83 points), Telstra (+26 points), Wesfarmers (+22 points), Macquarie Group (+12 points) and Brambles (+10 points). The bottom five stocks that detracted from the index's overall return were BHP Billiton (-32 points), Westpac Banking Group (-19 points), Origin Energy (-19 points), Rio Tinto (-17 points) and Woolworths (-14 points).

The Reserve Bank of Australia (RBA) chose to keep the cash rate unchanged at 1.5% again. This marked two years since the last rate change. Its guidance remained unchanged. The RBA expects that rising inflation will be "gradual", with unchanged policy consistent with sustainable growth in the economy and achieving the inflation target over time. Australia's wage price index rose 0.6% in the June quarter, with downward revisions to 2H17 wage data leaving the annual rate at a meagre 2.1% and real wage growth around zero per cent. Employment fell by 4,000 as part-time employment fell while full-time employment rose. The unemployment rate declined very modestly to 5.3%, in part due to the participation rate falling 0.2% points to 65.5%.

Economic data points were broadly positive, with June retail sales up a greater than expected 0.4% and the trade surplus was higher than expected.

The Australian dollar fell against the US dollar to $0.723 pressured by weaker iron ore prices, negative interest rate differentials with the USA and general "risk off" sentiment. In trade weighted terms, the Australian dollar fell 2.0%, to 62.1.

CONTRIBUTION

Relative Value Gross Contribution	-0.50%		
Positive		**Negative**	
ARDENT LEISURE GROUP - VILLAGE ROADSHOW	0.33%	AVEO GROUP - GOODMAN GROUP	-0.29%
GROWTHPOINT PROPERTIES - RURAL FUNDS GROUP	0.21%	CENTURIA CAPITAL - DEXUS PROPERTY GROUP	-0.21%
AUSTRALIAN UNITY INVESTMENT REAL ESTATE - GPT GROUP	0.11%	OOH!MEDIA - QMS MEDIA	-0.17%
CROMWELL PROPERTY GROUP - PEET	0.07%	AVEO GROUP - DEXUS PROPERTY GROUP	-0.15%
ELDERS - RURALCO HOLDINGS LTD	0.06%	AVENTUS RETAIL PROPERTY FUND - CHARTER HALL GROUP	-0.14%
Special Situations Gross Contribution	**-0.40%**		
Positive		**Negative**	
IMPEDIMED LTD	0.25%	PRO-PAC PACKAGING LTD	-0.49%
ONEMARKET LTD	0.16%	INFIGEN ENERGY	-0.17%
SPOTLESS GROUP HOLDINGS LTD	0.06%	ONEVIEW HEALTHCARE PLC-CDI	-0.11%
ACROW FORMWORK AND CONSTRUCT	0.05%	NUFARM FINANCE NZ LTD-NSS	-0.10%
ELK PETROLEUM LTD	0.03%	CAPITOL HEALTH LTD	-0.09%

Source: Ellerston Capital Limited

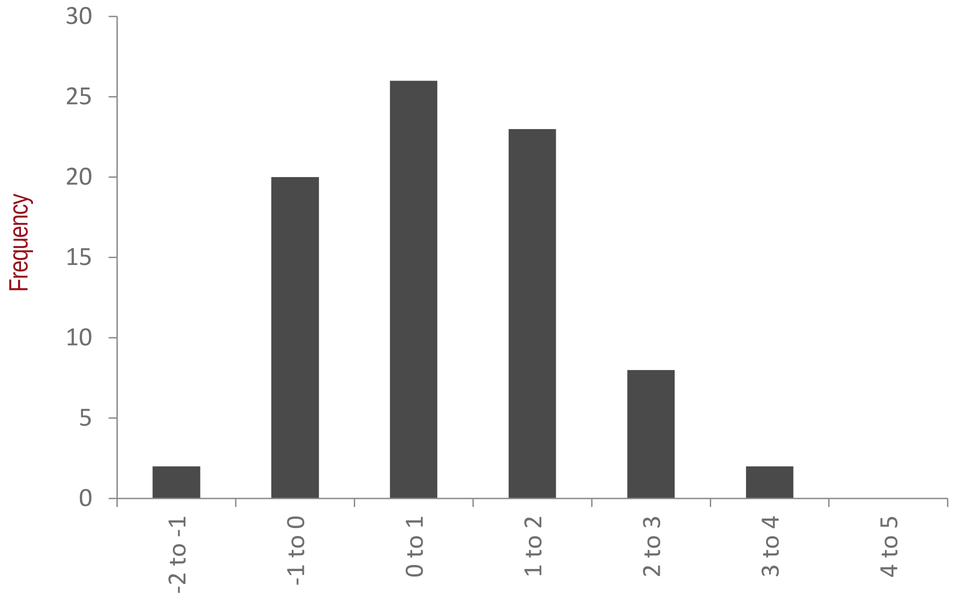
TOP 10 RELATIVE VALUE POSITIONS

- CENTURIA CAPITAL - DEXUS PROPERTY GROUP
- CENTURIA CAPITAL - NATIONAL STORAGE REIT
- AVEO GROUP - GOODMAN GROUP
- BHP BILLITON - BHP BILLITON PLC
- CENTURIA METROPOLITAN REIT - GROWTHPOINT PROPERTIES
- OOH!MEDIA - QMS MEDIA
- AVEO GROUP - DEXUS PROPERTY GROUP
- ELANOR RETAIL PROPERTY FUND - SHOPPING CENTRES AUSTRALASIA
- CROMWELL PROPERTY GROUP - PEET
- GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP

TOP 10 SPECIAL SITUATION POSITIONS

- INFIGEN ENERGY
- NUFARM FINANCE NZ LTD-NSS
- SUPERLOOP LIMITED
- S&P/ASX 200 INDEX PUT OPTIONS
- IMPEDIMED LTD
- PRO-PAC PACKAGING LTD
- ONEMARKET LTD
- CAPITOL HEALTH LTD
- SUNCORP GROUP NOTE
- ABANO HEALTHCARE GROUP LTD

DISTRIBUTION OF NET RETURNS



Source: Ellerston Capital Limited

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.

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