

# Ellerston Global Equity Managers Fund (GEMS)

Performance Report | November 18

## PERFORMANCE SUMMARY

Net %	1 Month	3 Months	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	Strategy Since Inception p.a.
GEMS A	-4.47	-11.53	-10.02	4.64	11.60	12.10
GEMS B	-4.47	-11.53	-10.02	4.63	11.50	11.93

Past performance is not a reliable indicator of future performance.

## MARKET COMMENTARY

### Market Overview

After tumbling in October, equity markets delivered mixed performances in November. The US and Asian markets were in the black, but Europe and Australia (the worst performing major index) ended the month lower. Overall, emerging markets outperformed developed markets for the first time in eight months. Towards the end of the month, Fed Chairman Powell noted that interest rates “remain just below the broad range of estimates of the level that would be neutral”. The market interpreted this as a signal that the brakes were going to be applied to further Fed rates hikes. This dovish sign allowed risk assets to rally, with global bonds yields falling after rising in the early part of the month. The Fed signalling a softer stance on rates, a fall in inflationary expectations and a sharp decline in oil prices were all reasons proffered for the rally in global bonds. All eyes were on the Trump-Xi meeting post the G20 summit in early December, for any direction on the trade war between the US and China that has been threatening global growth prospects.

### USA

The S&P 500 Index and the Dow Jones Industrial Average Index ended November up 2.0% and 2.1%, respectively. The NASDAQ delivered more modest returns, finishing the period higher by 0.5%.

While the Fed kept policy rates at the 2.0% to 2.25% target range, it flagged a less aggressive stance on increasing interest rates. Coupled with the expectations of a rapprochement between the US and China on trade, markets moved back into a risk-on frame of mind. Investors had been on edge that signs of slowing growth were likely to hamper corporate profits, and this could be exacerbated by rising rates. Following Powell’s more accommodative comments, technology stocks that bore the brunt of the six-week sell-off led the rebound.

In October, US activity indicators softened, but remained at solid levels. The manufacturing ISM retraced to 57.7 (consensus: 59.0, previous: 59.8) while the composite non-manufacturing ISM fell less than expected to 60.3 (consensus: 59.0, previous: 61.6). Non-farm payrolls beat expectations, rising 250k in October (consensus: +200k, previous: +118k) while the unemployment rate held at 3.7%, a 30 year low.

Early in the month, the 2018 US mid-terms saw the Democrats win control of the House, but in the Senate the Republicans increased their majority. The change in the political balance was not expected to have any material impact on the underlying economy. Post the G20 summit in early December, the US agreed to a three-month hiatus on imposing further tariffs on Chinese goods, so the two sides could find a way to ease tensions in the ongoing trade war.

### 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 towards Australia

### Key Information

<b>Strategy Inception Date</b>	1 January 2002
<b>Fund Net Asset Value</b>	A\$161.7M
<b>Liquidity</b>	Quarterly
<b>Class A Redemption Price</b>	A\$ 1.3161
<b>Class B Redemption Price</b>	A\$1.2846
<b>No. Stocks</b>	105
<b>Gross Exposure</b>	142%
<b>Net Exposure</b>	74%
<b>Management Fee</b>	1.50% p.a.
<b>Buy/Sell Spread</b>	0.25%
<b>Performance Fee</b>	16.50%
<b>Firm AUM</b>	Over A\$5b

## Europe

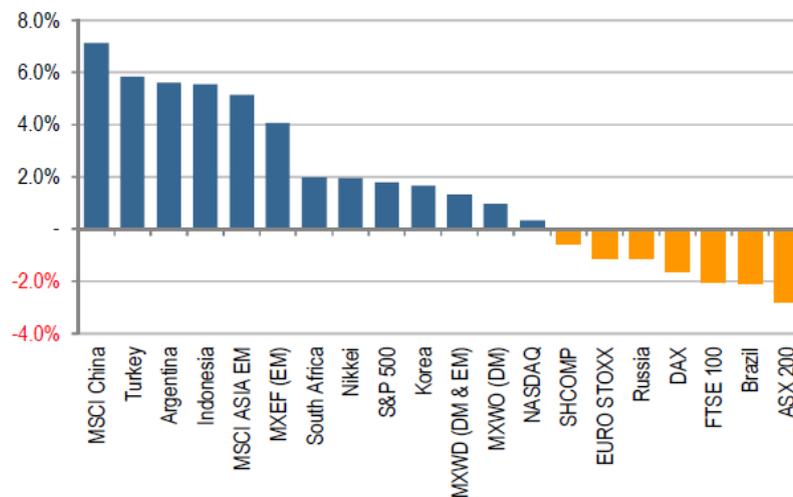
European equity markets were weaker again, as Italian budget concerns and Brexit weighed heavily on sentiment. The Euro STOXX 50 Index closed down 0.7% and is now down 7.1% calendar year to date. Activity indicators in Europe continued to weaken. The flash Eurozone manufacturing PMI for November missed expectations and fell to 51.5 (consensus: 52.0, previous: 52.0), while the composite PMI was also lower at 52.4 (consensus: 53.0, previous: 53.1).

The UK's FTSE 100 was down 1.6% and the GBP came under renewed pressure (given ongoing Brexit uncertainty and despite Prime Minister May securing a deal on withdrawing from the EU). The French market, the CAC 40, was down 1.7% with Germany's DAX falling by the same amount.

## Asia

Asian equities bounced in November. Investors bought into markets that looked oversold after the brutal sell-off in October and were betting that the Fed's less aggressive stance and some abating in trade pressures would support underlying fundamentals. The Hang Seng Index returned +6.2%, the BSE Sensex was up 5.2%, while Japan's Nikkei 225 returned just under 2.0% and Korea's KOSPI Composite Index was up 3.3% (after being the worst performer last month).

### Global Equity Markets' Performance in November 2018



Source: JP Morgan, Bloomberg.

## Commodities

Metals recovered in November, with the LME Metals Index up 1.9%. Brent and WTI also fell sharply again, down 20.8% to US\$59.46 and 22.2% to US\$50.93 a barrel respectively. Iron ore prices also slipped, down 13.4% during the month to US\$65.5/ton (after last month's rally that took everyone by surprise). Gold prices rose modestly (+0.6%) to \$1,223 an ounce.

## Bonds

The US yield curve flattened in November with the spread between long-term rates and short-term rates narrowing by 7.5 basis points. The US 10-year bond yield fell 15.5 basis points to end the month at 2.99% with US 2-year bonds yields falling 8 basis points to 2.79%.

The Australian curve also flattened. The Australian 10-year bond yield fell 3.5 basis points to 2.59% and the 3-year bond yield rose 1.7 basis points to 2.01%.

## Australia

The **S&P/ASX 200 Accumulation Index closed the month down 2.2%**. This followed a poor month in October when the market was down 6.1%. Only two sectors, Financials (+1.4%) and Information Technology (+1.0%) were in positive territory, while all other sectors delivered negative returns, mostly notably, Energy (-10.3%).

The ASX 200 Resources Accumulation Index was the worst performer, down 6.5%, with Bluescope Steel (-21.9%) and South32 (-14.4%) contributing most to the underperformance. The ASX 200 Industrial Accumulation Index fell 1.1%, while the Small Ordinaries Accumulation Index was the best performer with a return of -0.4%, after taking the wooden spoon in October with a return of -9.6%.

The Materials sector (-4.8%) led down by BHP Billiton (-4.7%) and the Energy sector (-10.3%) led down by Santos (-16.9%) and Woodside Petroleum (-10.9%, pummelled by the continued fall in the oil price) were amongst the worst performers in terms of the contributions to the index. **After being a significant underperformer last month, the Financials sector (+1.4%) was the standout contributor to the index.** The sector's performance was led by Australia and

New Zealand Banking Group (+6.5%), Commonwealth Bank of Australia (+2.9%) and National Australia Bank (+1.6%). Also, following a dreadful month in October, Information Technology rebounded strongly with Afterpay Touch Group (+15.5%) and Wisetech Global (+16.5%) leading the charge.

It's worth commenting on the **Energy** sector. On 14 November, there was a broad-based 7% sell-off in the crude oil price and the energy sector on the day. The sell-off was triggered by OPEC's report that supply was increasing and that next year's demand for its crude will be 500k barrels a day lower than its forecast only two months ago. The oil market suffered from a barrage of negative news flow including ineffective Iranian sanctions, stronger production from Saudi Arabia and Russia and higher inventories in the US. Reports coming out of strategists in Abu Dhabi also suggested that on November 6, Trump had apparently requested for the Saudi Crown Prince to keep WTI below US\$70/bbl. Other points of discussion were the weak macro indicators of Chinese economic health, which have also been spurring anxiety in the oil complex.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were BHP Billiton for the second month in a row (-32 points), CSL (-31 points), Woodside Petroleum (-22 points), Lendlease Group (-17 points, following a severe profit warning that saw the stock plunge 28.1%), and South32 (-17 points).

Four of the top five stocks that added to the index's return were financials: Australia and New Zealand Banking Group (+31 points), Commonwealth Bank of Australia (+22 points), National Australia Bank (+8 points), Insurance Australia Group (+7 points) and Qantas Airways (+5 points).

As was expected, the Reserve Bank of Australia kept the cash rate unchanged at 1.5% in November. It signalled that revisions to forecasts were likely to see the RBA achieving its goals of full employment and inflation back to the target mid-point sooner than anticipated. GDP growth in both 2018 and 2019 is now expected to be 3.5% for each year.

In trade weighted terms, the Australian dollar depreciated 2.3%, and 3.3% against the US dollar to end the month at 0.73.

## Outlook and Portfolio Commentary

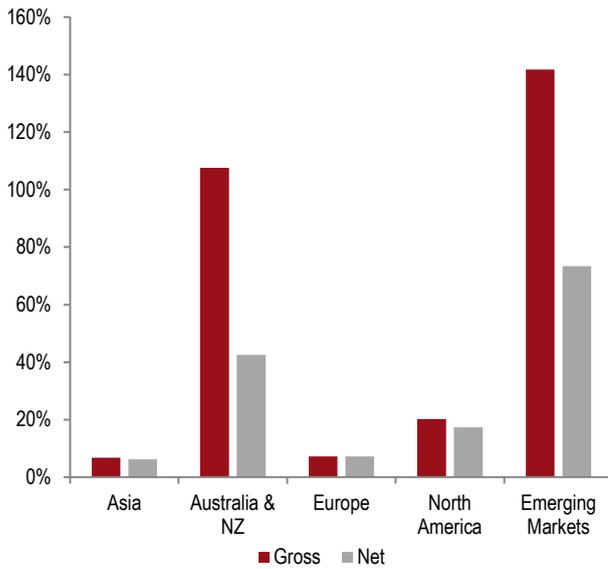
Apart from again doing some selective buying during the month's sell-off, the Fund's strategy and our outlook has not changed fundamentally. We remain in an environment of slower growth, higher inflation and tighter policy, where financial market behaviour has moved from QE to QT, causing macro uncertainty, exacerbated by lingering trade war risks and global interest rates nudging higher.

Globally, we face the effects of tighter monetary policy, subtrend growth in Europe and geo-political tensions (an emerging new Cold War between the US and China). Following the landmark meeting between Presidents Trump and Xi post the G20 summit, the US agreed not to boost tariffs on US\$200 billion of Chinese goods from 10% to 25% on 1 January 2019. Despite the headlines from both sides which hailed the meeting as "highly successful", there are few details on the substance of the agreement. The US stated that existing tariffs on Chinese goods would remain unchanged for 90 days. If no agreement is reached after 90 days, tariffs would then be raised to 25 per cent (as previously threatened). While the very short-term reprieve afforded the market some breathing space, concerns remain about the sustainability of any rallies, given that the trade war could persist, as an agreement may not be reached in 90 days.

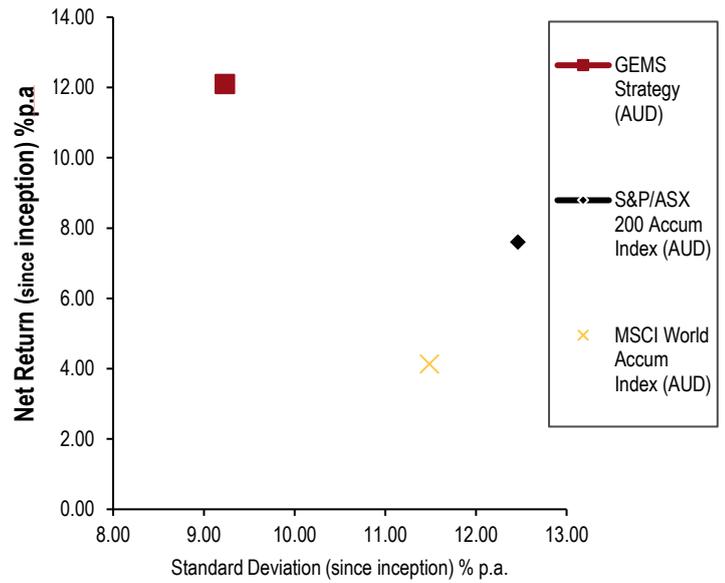
Domestically, uncertainties still include the second-order effects of the above macro drivers, along with sharply slowing credit growth, an indebted consumer, fear of a harder economic landing and a pending Federal election early next year. The recent underperformance of Australia's equity markets has resulted in multiples for the index tracking lower; well below the peak reached in August 2018. Earnings revisions have been negative and deteriorated through the AGM season. Despite the de-rating, valuation levels still remain elevated relative to historical levels and we remain cautious for the other reasons we've outlined. The ASX is on track to deliver its first negative calendar year return since 2011.

As we continue to remain highly aware of the major uncertainties facing investors, we have only moved the overall positioning marginally. Over the month, we have decreased our long exposures slightly in Australia/NZ and North America, in favour of small increases in long exposure to Asia and Europe. Meanwhile, we decreased our short exposure to Asia, shifting our short views to be more exposed to North America. There were no major directional swings in the portfolio's industry sector weightings, however we have increased the hedge in expectation of higher near term market volatility. The aggregate result is a lower level of gross exposure at 142% (versus 145% last month) and a slightly lower net exposure (to 74% from 78%) for the portfolio.

### Market Exposure as a % of NAV



### GEMS Strategy Performance & Volatility ^



### Top Holdings (Alphabetical, Long only)

- ALPHABET
- BP
- CATAPULT GROUP
- CLOVER CORP
- EZCORP
- GRAINCORP
- HEALTHSCOPE
- JB HI FI
- NEWCREST MINING
- PSC INSURANCE

### Key Service Providers

<b>REGISTRY:</b>	Link Market Services Limited
<b>AUDITOR:</b>	Ernst & Young
<b>PRIME BROKER:</b>	Morgan Stanley Intl & Co PLC & Goldman Sachs International
<b>ADMINISTRATOR:</b>	Citco Fund Services (Australia) Pty Ltd
<b>CUSTODIAN:</b>	State Street Australia Limited

Source: Ellerston Capital

### 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.

## ABOUT THE ELLERSTON GLOBAL EQUITY MANAGERS FUND

The Fund aims to achieve its performance objectives by adopting a fundamental “bottom-up” investment approach to stock selection which is focused on identifying and then constructing a portfolio of the highest conviction ideas.

Investment opportunities for the Fund are identified by analysing and understanding the factors affecting (amongst other things): business model, industry structure, management team and overall valuation. Ellerston Capital typically favours businesses that can sustain high returns or improve their return on capital and looks to invest in businesses with a market value below the value we attribute to them.

Benchmark weightings do not drive our stock decisions, our approach is totally benchmark independent.

Due to the high conviction nature of the portfolio and the resulting deviation in portfolio composition relative to benchmark weighting, it is expected that the returns from the Fund will differ significantly from the broader market indices.

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## DISCLAIMER

<sup>^</sup> 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.

<sup>^^</sup> 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 118 887 095 (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 18 December 2017 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.

<sup>#</sup> 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.