

Ellerston Australian Small Companies Fund (SCF)

Performance Report | December 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.
SCF	-4.40	-16.02	-6.98	6.53	7.55	7.78
Benchmark	-4.18	-13.70	-8.67	7.45	5.62	5.78

Source: Ellerston Capital Limited

MARKET COMMENTARY

The Ellerston Small Companies Fund fell 4.40% in December, underperforming the ASX Small Ordinaries Accumulation Index which fell 4.18%. During the month, the Small Industrials Accumulation Index fell 3.87% whilst the Small Resources Accumulation Index fell 5.05%.

The largest contributors to positive attribution were Resolute Mining (RSG), OceanaGold Corp (OGC), and Cooper Energy (COE). Resolute Mining rallied, along with other gold stocks, as the precious metal rose 5% during the month. There was no new company specific news to drive the share price. We have increased our weighting in gold over the last 3 months on the view that \$US strength is unlikely to continue over the next year as the monetary tightening cycle moves closer to the end than the beginning. Consequently, the portfolio has benefitted from this positioning, although as gold attracts more interest, we are likely to reduce the weightings in the portfolio. OceanaGold also rallied with the upward move in the gold price. The company did receive some positive news in that they received preliminary approval for the extension of mine life for their New Zealand asset, Waihi. Cooper Energy rallied 8% as the oil price stabilised. The business has been caught up in the energy market sell off even though the majority of their gas offtake is on fixed price contracts that commence from the middle of this year, when the Sole asset commences production. Once production commences we would expect to see a re-rating of the business.

The largest detractors from relative returns were GTN Ltd (GTN), Senex Energy (SXY), and Ausdrill (ASL). GTN Ltd issued a profit warning during the month on weaker Q2 earnings in the Australian Traffic Network (ATN) business. ATN has been affected by a slowdown in advertising spend in the domestic radio market. Quarterly results can see some volatility and we would expect the Australian earnings to stabilise. Overall, the weighting to ATN will reduce over time as the Canada and Brazil markets are growing faster, which should result in a re-rating of the business over the next year. Senex Energy fell substantially during the month as the oil price fell another 10%. The company's current earnings are mainly generated in oil, but as the Western Surat project ramps up and Atlas comes on stream this will see most earnings generated from gas projects. Earnings will then be a combination of fixed priced domestic contracts and "oil-linked" export earnings. With oil probably towards the lower end of its price range we think the business is now attractively priced and have been adding to the position. Ausdrill has been caught in the down draft affecting all mining services businesses. Nothing has changed in the business, although it should be noted that of all the mining services businesses, Ausdrill has the highest exposure to gold projects and its client's share prices have all seen share price increases over this period.

Investment Objective

The Investment objective for the Ellerston Australian Small Companies Fund is to outperform the S&P/ASX Small Ordinaries Accumulation Index (Benchmark).

Investment Strategy

The Fund's active, research-driven approach seeks to identify a concentrated portfolio of smaller companies with sound businesses, attractive earnings profiles and supportive industries, which are trading at a discount.

Key Information

Strategy Inception Date	10 October 2013
Fund Net Asset Value	\$0.9341
Liquidity	Daily
Application Price	\$0.9364
Redemption Price	\$0.9318
No Stocks	58
Management Fee	1.25%
Buy/Sell Spread	0.25%
Performance Fee	20.5%
Firm AUM	Over \$5 Billion

OUTLOOK

2019 will certainly be an interesting year and making predictions on returns appears to be harder now than ever with so many different economic and geo-political scenarios that could unfold. This time last year we thought the market was going to be relatively flat after the strong returns of H2'17, as earnings would have to catch up to share price movements. That proved to be roughly right until October, after which we saw the rapid declines of the December quarter. This year, we believe that there is probably 5-10% downside to good valuation support locally with some upside risk on a stabilising macro, but not excessive.

Despite the macro uncertainties, bottom up is looking better. From a valuation perspective, after the 16% pull back in the industrials sector from the top, with many moves significantly higher than this, many companies are now looking attractively priced, which has seen our cash levels reduce as we add new investments and top up existing holdings. Our cash levels are generally a good indicator of where we see valuation support. So with PE multiples reducing, the starting point for making money has become easier. The risk locally is if we see a recession and the subsequent hit on the earnings line. This risk is probably greater than it has been since 2008, but by no means certain. However, this has led us to reduce exposure risk to domestic cyclicals. Within resources, we still like gold and believe that oil is now more attractive after the rapid decline in the last 3 months. Valuations generally don't look attractive enough in other areas so most of our exposure is in these two sectors.

ELLERSTON AUSTRALIAN SMALL COMPANIES FUND PERFORMANCE

Returns (%)	Net ^A	Gross	Benchmark	Net alpha	Gross alpha
1 Month	-4.40	-4.34	-4.18	-0.22	-0.16
3 Months	-16.02	-15.86	-13.70	-2.32	-2.16
Rolling 12 Months	-6.98	-6.32	-8.67	1.69	2.35
2 Years p.a.	3.45	4.31	4.70	-1.25	-0.39
3 Years p.a.	6.53	7.46	7.45	-0.92	0.01
5 Years p.a.	7.55	8.89	5.62	1.93	3.27
Since Inception p.a.	7.78	9.12	5.78	2.00	3.34

Source: Ellerston Capital Limited

ELLERSTON AUSTRALIAN SMALL COMPANIES FUND TOP HOLDINGS

Top 5 holdings as at 31 December 2018	Sector	%
Austal Limited	Industrials	4.20
Cleanaway Waste Management Limited	Industrials	4.16
Tassal Group Limited	Consumer Staples	4.10
Cooper Energy Limited	Energy	3.60
OFX Group Limited	Financials	3.14

Source: Ellerston Capital Limited

^A 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 ASX Small Ordinaries Accumulation Index. The Fund commenced on 10 October 2013.

*This is the typical number of stocks in the portfolio. The Information Memorandum does allow for 20 - 60 stocks.

Past performance is not a reliable indicator of future performance.

ABOUT THE ELLERSTON AUSTRALIAN SMALL COMPANIES FUND

The Fund employs an active, research-driven investment approach which seeks to identify a portfolio of smaller company securities with the aim of delivering superior returns to the Benchmark over time.

The Fund will invest in companies that are believed to have the potential to deliver significant upside over the medium term and where there is a reasonable margin of safety to mitigate the downside risk. We will actively manage the positions of the Fund.

Investments will generally be made in companies that have a sound business franchise with an attractive earnings profile, that operate in growth industries and trade at a discount to valuation.

FUND FACTS

STRATEGY FUNDS UNDER MANAGEMENT	Over \$600 Million
FUNDS UNDER MANAGEMENT – SCF UNIT TRUST	\$9 Million
APPLICATION PRICE	\$0.9364
REDEMPTION PRICE	\$0.9318
NUMBER OF STOCKS	*58
INCEPTION DATE	10 October 2013

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