

Ellerston Australian Small Companies Fund (SCF)

Performance Report | January 19

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 | 3.74 | -4.63 | -5.07 | 10.38 | 8.90 | 8.40 |
| Benchmark | 5.56 | 0.78 | -3.06 | 11.34 | 7.37 | 6.77 |

Source: Ellerston Capital Limited

MARKET COMMENTARY

The Ellerston Small Companies Fund rose 3.74% in January, underperforming the ASX Small Ordinaries Accumulation Index which rose 5.56%. During the month, the Small Industrials Accumulation Index rose 4.85% whilst the Small Resources Accumulation Index rose 8.13%.

The largest contributors to positive attribution were Costa Group (CGC), Berkeley Energia (BKY) and Senex Energy (SXY). Costa Group declined 25% during the month following a disappointing trading update. We do not own the stock. Berkeley Energia rallied after unconfirmed reports that the Spanish government was looking at potentially granting approvals for the Salamanca uranium mine. In October last year, there were unofficial reports that approvals would not be granted causing the share price to plunge. The company is confident of receiving approvals but is yet to receive the required licenses to commence construction. The company has a market capitalisation of \$125m and holds \$100m in cash. Senex Energy rallied with the recovery in the oil price for the quarter. The share price of Senex tends to track the oil price, but this correlation should become less relevant once the domestic gas projects the company is developing in Queensland come into full production over the next few years. Until then, share price performance will continue to be tied to the oil price.

The largest detractors from relative returns were Beach Energy (BPT), QMS Media (QMS), and Ardent Leisure (ALG). Beach Energy rose over 30% for the month, which appears overdone compared to the smaller rise in the oil price. The portfolio does not own Beach, but retains an overweight in the sector through other exposures. QMS Media fell 8% for the month on no new news. The slowing domestic economy is impacting the advertising market, but the 'Out of Home (OOH) segment continues to outperform. The merger of JC Decaux with APN Outdoor, plus Ooh Media with Adshel should result in some improvements in the pricing environment which will benefit all of the OOH players. Ardent Leisure Group fell 8% for the month on no new news.

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 | \$0.9530 |
| Liquidity | Daily |
| Application Price | \$0.9554 |
| Redemption Price | \$0.9506 |
| No Stocks | 57 |
| Management Fee | 1.25% |
| Buy/Sell Spread | 0.25% |
| Performance Fee | 20.5% |
| Firm AUM | Over \$5 Billion |

OUTLOOK

The market experienced a sharp rebound in January, regaining December's losses and half of the Q4 losses from last year. A softer tone from the US Fed really set the market up for a rebound as in a short space of time Powell turned from hawkish to dovish on interest rates and quantitative tightening. Commodity markets also responded positively, despite further evidence of a slowing Chinese economy. Despite taking advantage of the weakness in Q4 last year to add to our positions and reduce cash holdings, the portfolio failed to keep up with the market rebound. The rally was broad based and there were no specific reasons for the underperformance, although we typically underperform in a rapidly rising market.

The market outlook remains uncertain despite a presently more conducive Fed policy. This could quickly flip the other way if labour market strength continues or signs of inflation increase. Profit downgrades in the domestic market are higher this year than previous years, which is reflective on the slowdown in the domestic economy and uncertainties that a change in government will likely present in a couple of months. Our aim has been to construct a portfolio that can weather the expected volatility and our "base case" doesn't assume a continual rise in the market this year. Small caps as a whole have become marginally more attractive, but are still trading at only a small discount to large caps, whereas historically the discount has been larger. Both sectors continue to see EPS downgrades and we don't expect to see a PE expansion due to the relatively high absolute starting point for valuations. This leads us to our "base case" of a sideways to down volatile market in the foreseeable future.

ELLERSTON AUSTRALIAN SMALL COMPANIES FUND PERFORMANCE

| Returns (%) | Net [^] | Gross | Benchmark | Net alpha | Gross alpha |
|----------------------|------------------|-------|-----------|-----------|-------------|
| 1 Month | 3.74 | 3.81 | 5.56 | -1.82 | -1.75 |
| 3 Months | -4.63 | -4.62 | 0.78 | -5.41 | -5.40 |
| Rolling 12 Months | -5.07 | -4.41 | -3.06 | -2.01 | -1.35 |
| 2 Years p.a. | 6.78 | 7.69 | 8.91 | -2.13 | -1.22 |
| 3 Years p.a. | 10.38 | 11.27 | 11.34 | -0.96 | -0.07 |
| 5 Years p.a. | 8.90 | 10.24 | 7.37 | 1.53 | 2.87 |
| Since Inception p.a. | 8.40 | 9.74 | 6.77 | 1.63 | 2.97 |

Source: Ellerston Capital Limited

ELLERSTON AUSTRALIAN SMALL COMPANIES FUND TOP HOLDINGS

| Top 5 holdings as at 31 January 2019 | Sector | % |
|--------------------------------------|------------------|------|
| Cleanaway Waste Management Limited | Industrials | 4.42 |
| Tassal Group Limited | Consumer Staples | 3.96 |
| Austral Limited | Industrials | 3.88 |
| Cooper Energy Limited | Energy | 3.77 |
| Ausdrill Limited | Materials | 3.18 |

Source: Ellerston Capital Limited

[^] 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 \$700 Million |
| FUNDS UNDER MANAGEMENT – SCF UNIT TRUST | \$9 Million |
| APPLICATION PRICE | \$0.9554 |
| REDEMPTION PRICE | \$0.9506 |
| NUMBER OF STOCKS | *57 |
| INCEPTION DATE | 10 October 2013 |

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DISCLAIMER

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