ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | March 19

FUND PERFORMANCE (%)

	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.	Since Inception p.a.
Fund Net	-4.03	-5.59	-12.07	-16.41	-2.63	2.61	4.61
RBA Cash Rate	0.12	0.36	0.75	1.50	1.53	1.81	1.92
Alpha	-4.15	-5.95	-12.82	-17.91	-4.16	0.80	2.69

Source: Ellerston Capital Limited

	Jan	Feb	Mar	April	May	June	July	Aug	Sep	Oct	Nov	Dec	YTD
2019	-0.92	-0.72	-4.03										-5.59
2018	-0.03	0.54	-0.34	-1.19	-0.28	1.05	-2.78	-0.99	-0.80	-2.60	-1.89	-2.54	-11.30
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	63%	Net Equity Exposure	+25%
No. Relative Value positions	87	Gross Portfolio Exposure	212.1%
No. Special Situations	29	Correlation Coefficient (vs ASX 200 Accum)	0.69%
Beta Adjusted	-3.1%	Net Sharpe Ratio (RFR = RBA Cash)	0.55

PERFORMANCE

The Fund returned -4.0% in March, underperforming the benchmark return of +0.1% in the period. The bulk of the negative return came from a break in the merger between Eclipx (-67.6%) and McMillan Shakespeare (+1.7%), a paired position that was held within Special Situations.

Net exposure was +25% with a beta-adjusted net of -3.1%. Gross exposure closed the month at 212.1%.

The spread between the Australian and UK listings of BHP Billiton (+5.5%) and Rio Tinto (+8.3%) narrowed in the period, adding to the performance of the Fund.

Also during the month, house and land developer Villa World (+16.0%) received a takeover bid from the Private-Equity-backed AVID Property Group. The bid was pitched at NTA and was deemed opportunistic, given it was made during a cyclical downturn in the Australian residential property market. Whilst we don't have a position in Villa World, we did have a number of paired positions featuring a long in Peet (+9.6%), Villa World's closest listed peer. The increased interest in the sector led to a rally in the Peet share price, adding to the performance of the Fund.

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	$278.2M
Liquidity	Daily
Application Price	$0.8925
Redemption Price	$0.8881
Management Fee	1.20%
Buy/Sell Spread	0.25%
Performance Fee	20% of outperformance
Firm AUM	Over $5 billion

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After adding value in February, our paired position between Infigen Energy (-11.1%) and AGL Energy (+2.6%) detracted in March with Infigen underperforming as a result of being removed from the S&P/ASX200. We remain confident in the fundamentals of the position and took advantage of the increased liquidity to modestly increase our exposure.

Our holding in Manufactured Housing Estate developer Ingenia Communities (+0.0%) lagged its peers during March, detracting from the performance of the Fund. There was no new news during the period, with the additional supply of shares as part of the Dividend Reinvestment Program (1.2m) blamed for the underperformance. Pairs that featured Ingenia as a long, hedged with Charter Hall (+16.7%) and GPT Group (+6.2%) were the primary detractors.

A paired position between Out-Of-Home media companies oOh!media (+11.9%) and QMS Media (-4.1%) also underperformed during March, with the QMS share price failing to keep pace with its larger rival. Investors remain unconvinced on the QMS strategy, which has seen their assets split into three divisions – QMS NZ (subject to a merger with MediaWorks), QMS Australia and QMS Sport. Whilst we agree that the strategy remains unproven, the fundamentals suggest the stock is cheap, with the company trading on an FY19 EV/EBITDA multiple of just 6.5x, compared with oOh!Media at 7.5x.

As previously mentioned, the largest detractor to performance during March was our long position in Eclipx, hedged with a short in McMillan Shakespeare. During the month, the companies effectively called off their proposed merger, following an earnings downgrade from Eclipx – the second since the merger terms were agreed. Whilst the core business of Eclipx had been trading in line with expectations, the deteriorating performance of Grays and Right2Drive has left NPATA tracking well below FY18. Concerns around a breach in debt covenants (since clarified) added to the uncertainty.

Whilst the position was not overly large in size (long plus short exposure of 5.5%), the impact of the share price moves on performance was extreme, with Eclipx falling a remarkable 56% on the day of the announcement. Given the merger was agreed by both boards, with no ACCC or FIRB risk, we felt the position sizing was appropriate and it was not materially different from previous situations.

Despite the absence of a CEO or CFO, the share price of sports-analytics company Catapult (+17.5%) rallied during the period, adding to the performance of the Fund. Whilst there was no new news released by the company, a bullish research note seemed to renew investor interest in the story.

For the third month in a row, our holding in Johns Lyng (+6.6%) added value, with the market continuing to appreciate the unique business model that is geared to benefit from the damage caused by catastrophic events.

ACTIVITY

Relative Value – Gross Contribution -0.72%

We unwound our paired position between NZ-listed Contact Energy (+12.4%) and Meridian Energy (+15.6%), following a narrowing of the spread between the two companies. Following the position's closure, an opportunity was identified to establish a long in Mercury NZ (+7.5%), hedging the exposure with a short in Meridian once again. By the end of the month, the spread of the second pair had also narrowed and had been unwound.

A paired position was established between Computershare (-1.0%) and ASX (+1.7%), following a period of outperformance by ASX. Despite modest growth, ASX trades at an eye-watering FY19 Price/Earnings ratio of 27.6x, compared with Computershare on just 16.3x. We believe concerns over the impact of falling bond yields on Computershare's earnings are overstated and that the business represents better Relative Value than its Australia-focussed peer.

A liquidity event in the recently renamed Charter Hall Education Trust (+5.4%), provided an opportunity to establish a long position, hedged with a short in Shopping Centres Australasia (+9.5%). During the month, Charter Hall announced the acquisition of 13 early learning centres for a total consideration of $75.3m, funded by an equity raise of $120m. The centres are located in Melbourne, Sydney and Brisbane and are in varying stages of development. With NTA rising by 6c to $2.93 and gearing falling 5% to 25%, we think the equity raise makes sense, with the additional capacity expected to be deployed over the next 12 months.

Following a meeting with management, we established a shareholding in Vital Harvest (+7.7%), a recently-listed A-REIT that owns citrus and berry properties which are triple-net leased to Costa Group (-2.8%). The current lease agreement includes base rent, plus a variable rent component which represents 25% of the earnings before tax of the contributing properties. The company provides exposure to the performance of farming assets within Costa's citrus and berry assets, at a much more attractive multiple (FY20 PE of 9.3x vs 18.6x). The exposure was hedged with Rural Funds (+2.5%).

With the spread narrowing, we unwound our paired position between land developer Peet and Bunnings Warehouse Property Trust (+1.1%). Long positions in Australian Unity Office (+0.4%), hedged with Shopping Centres Australasia and Cromwell Property (+0.7%) were also unwound.

Special Situations – Gross Contribution -3.20%

During the month, we participated in a $60m equity raise for Megaport (-4.0%), with proceeds of the raise earmarked to expand its Data Centre footprint. The equity was issued at a 4.8% discount to last and was accompanied by a modest sell-down by the company's founder (at the same price).

We reduced our exposure to both Eclipx and McMillan Shakespeare following the proposed merger being abandoned.

Following a rally in their respective share prices, we sold out of our holdings in IVE Group (+0.7%) and Ruralco Holdings (-2.2%). We also accepted the unconditional takeover bid for Propertylink (-0.9%), with the position removed from the portfolio accordingly.

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SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Banks	0.0%	0.0%	0.0%
Div Financials	0.4%	0.0%	0.4%
Insurance	0.0%	0.0%	0.0%
Regional Banks	0.0%	0.0%	0.0%
REITs	57.2%	-44.6%	12.5%
Financials	57.5%	-44.6%	12.9%
Builders	1.6%	0.0%	1.6%
Consumer Disc	0.3%	0.0%	0.3%
Consumer Staples	3.8%	0.0%	3.8%
Contractors	0.0%	0.0%	0.0%
Gaming	0.0%	0.0%	0.0%
General Industrials	4.2%	-0.2%	3.9%
Health Care	3.3%	0.0%	3.3%
Information Technology	1.0%	0.0%	1.0%
Infrastructure	0.0%	0.0%	0.0%
Materials	0.0%	0.0%	0.0%
Media	3.6%	-0.5%	3.1%
Telcos	0.0%	0.0%	0.0%
Utilities	4.6%	-2.4%	2.2%
Industrials	22.4%	-3.1%	19.2%
Bulk Metals	32.4%	-32.8%	-0.3%
Energy	0.1%	0.0%	0.1%
Gold	0.0%	0.0%	0.0%
Resources	32.5%	-32.8%	-0.2%
Hedge	2.3%	-9.2%	-6.9%
Index	2.3%	-9.2%	-6.9%
Total	114.7%	-89.7%	25.0%

Source: Ellerston Capital Limited

MARKET COMMENTARY

Market Overview

The rally in global equity markets continued in March, capping off a very strong period, with the MSCI World Index up an impressive 12.6% for the quarter. The ASX 200 delivered its best quarterly return in almost a decade. In March, Developed Markets outperformed Emerging Markets by 0.4%. But the notable feature of the month was the strong rally in global bonds in response to more dovish overtures from the Federal Reserve. The US yield curve inverted for the first time in more than a decade, sparking a debate on the likelihood of a pending US recession and slowing global growth.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index were again in positive territory with returns of 1.9% and 0.2% respectively. The NASDAQ had a stronger month and was up 2.7%. This crowned a very impressive 3-months from each of the S&P 500, Dow Jones Industrial Average and NASDAQ, with returns of 13.7%, 11.8% and 16.8% respectively.

On 19 March, the yield on the US 10-year Treasury note fell to 2.44%, below the yield on the 3-month Treasury note of 2.45%. The inversion of the yield curve followed more dovish commentary from the Fed (with no hikes in rates expected in 2019 now) and a moderation in global activity indicators. This also raised concerns with investors over a likelihood of a recession, given prior inverted yield curves have generally preceded US recessions in the post-war period. The Fed has signalled patience in assessing the outlook beyond 2019 and now has no bias to tighten or ease.

Europe

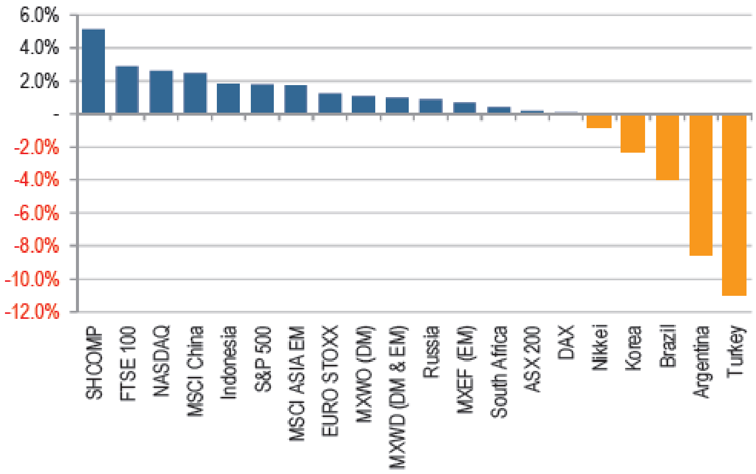
European equity markets also continued to deliver positive returns, with the Euro STOXX 50 Index up 1.8%. Economic data continued to moderate. Euro area composite PMI fell 0.6 points to 51.3 in March, reversing the increase in February. Brexit indecision and uncertainty continued to dominate the headlines in the UK, which proved to be a major distraction for Europe too.

However, most key European indices continued to trend upwards. Despite the chaos of Brexit, the FTSE 100 was up 3.3%, while France's CAC was up 2.3%, but Germany's DAX was roughly flat with a return of +0.1%.

Asia

Asian equities were mixed. The Indian market, as represented by the BSE Sensex, was the standout performer, up 7.9%. It was followed by the Chinese market - the SSE Total Market Index - which was up 5.5%, as optimism on the rebound in the Chinese economy saw investors continue to bid up local shares. The Hang Seng Index posted a more modest 1.6%, but Korea's KOPSI Composite Index (-2.5%) was again in negative territory.

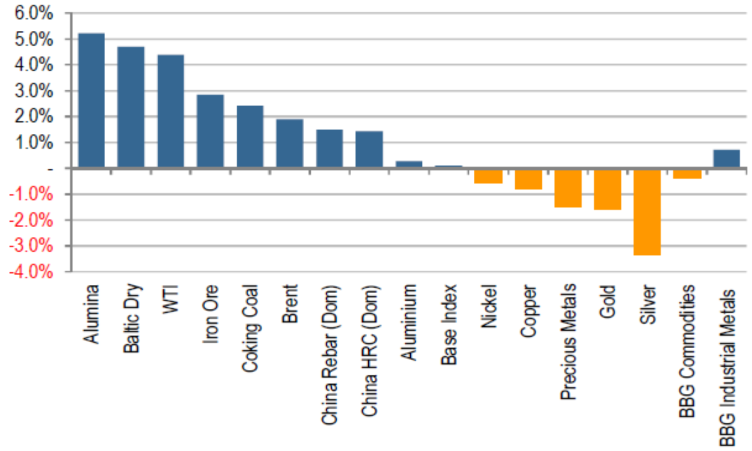
Global Equity Markets' Performance in March 2019



Source: JP Morgan, Bloomberg.

Commodities

Metals were broadly flat in March, with Zinc (+6.6%) being the exception. Lead fell 6.7% along with Tin (-1.4%), Copper (-1.1%) and Nickel (-0.6%). Brent (+1.9% to US$67.58 per barrel) and WTI (+4.4% to US$60.14 per barrel) were higher on tighter supply and more disciplined OPEC compliance. The iron ore price was firmer again, up 2.8% to end the month at US$86.9 per ton, as disruptions by Vale in Brazil and in the Pilbara continued to impact supply.

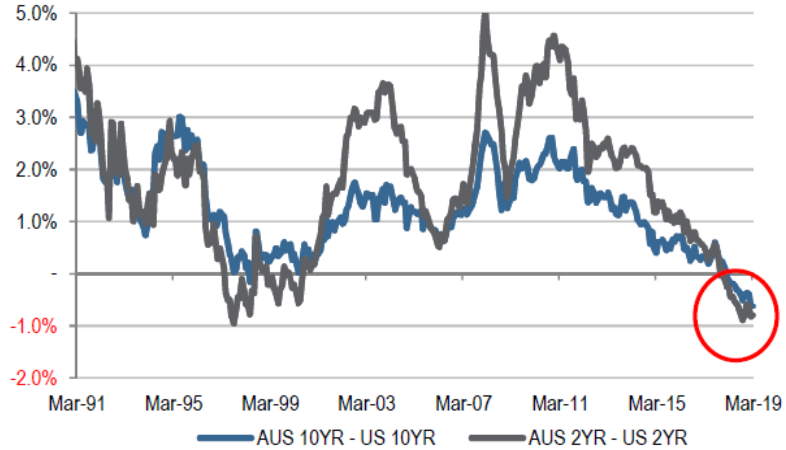


Source: JP Morgan, Bloomberg.

Bonds

Global bonds rallied strongly as the Fed signalled a more dovish stance and the US yield curve inverted. Over the past 40 years, inversion has happened on 5 occasions, with the last instance in 2006. The spread between the long end and the short end narrowed, as the 2-year bond yield fell 25.4 basis points to 2.26% and the 10-year bond yield fell 31 basis points to 2.41%.

The Australian curve flattened too, with the 3-year bond yield falling to 1.39% and the 10-year bond yield falling to all-time lows of 1.772%.



Source: JP Morgan, Bloomberg.

Australia

The **S&P/ASX 200 Accumulation Index ended the month up 0.7%.** The best three performing sectors were Materials (+3.5%), Real Estate (+5.6%) and Consumer Staples (+3.9%). The bottom three sectors were Financials (-2.7%), Energy (-4.1%) and Utilities (+1.3%).

In March, the **ASX 200 Resources Accumulation Index** was once again the best performer, up 2.0% with the most significant contributions coming from BHP Group (+5.5%) and Rio Tinto (+8.4%). The **ASX 200 Resources Accumulation Index** is now up an impressive 19.0% over the past three months. The ASX 200 Industrial Accumulation Index delivered a return of 0.4% and the Small Ordinaries Accumulation Index brought up the rear with a return of -0.1%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Commonwealth Bank of Australia (-35 points), Australia and New Zealand Banking Group (-35 points), Westpac Banking Corporation (-22 points), Woodside Petroleum (-9 points) and AMP (-5 points).

The top five stocks that added to the index return were all leaders, notably, BHP Group (+37 points), Rio Tinto (+17 points), Woolworths Group (+14 points), Telstra Corporation (+14 points) and Transurban Group (+12 points).

In Australia, GDP was very soft for the second consecutive quarter in 4Q, at 0.2% quarter-on-quarter, while 2H18 annualised print of 0.9%, was the worst reading since the GFC. Australia has technically entered a per-capita recession. GDP growth was saved from turning negative by booming public demand which offset flat private demand, as consumption dropped to a near 6-year low.

National CoreLogic dwelling prices fell 0.6% month-on-month in March, which brought the year-on-year decline to -6.9%, the worst fall since February 2009.

Not surprisingly, the RBA left rates unchanged at 1.5% in March. The Australian dollar was unchanged against the US dollar. In trade-weighted terms, the AUD depreciated -0.3%.

CONTRIBUTION

Relative Value Gross Contribution -0.72%

Positive		Negative	
BHP BILLITON - BHP BILLITON	0.28%	AGL ENERGY LTD - INFIGEN ENERGY	-0.43%
RIO TINTO - RIO TINTO	0.26%	CARINDALE PROPERTY TRUST - CHARTER HALL GROUP	-0.33%
CHARTER HALL RETAIL REIT - PEET	0.22%	CHARTER HALL GROUP - INGENIA COMMUNITIES GROUP	-0.32%
DEXUS PROPERTY GROUP - PEET	0.16%	OOH!MEDIA - QMS MEDIA	-0.22%
BWP TRUST - CENTURIA CAPITAL	0.12%	GPT GROUP - INGENIA COMMUNITIES GROUP	-0.20%

Special Situations Gross Contribution -3.20%

Positive		Negative	
JOHNS LYNG GROUP LTD (AT*)	0.15%	ECLIPX GROUP LTD (AT*)	-2.55%
CATAPULT GROUP INTERNATIONAL (AT*)	0.13%	IMPEDIMED LTD (AT*)	-0.22%
MEGAPORT LTD (AT*)	0.02%	ONEVIEW HEALTHCARE PLC-CDI (AT*)	-0.17%
SUPERLOOP LTD (AT*)	0.01%	March 19 Puts on AS51 (5850)	-0.14%
SUNCORP GROUP NOTE (AU)	0.01%	MCMILLAN SHAKESPEARE LTD (AU)	-0.11%

Source: Ellerston Capital Limited

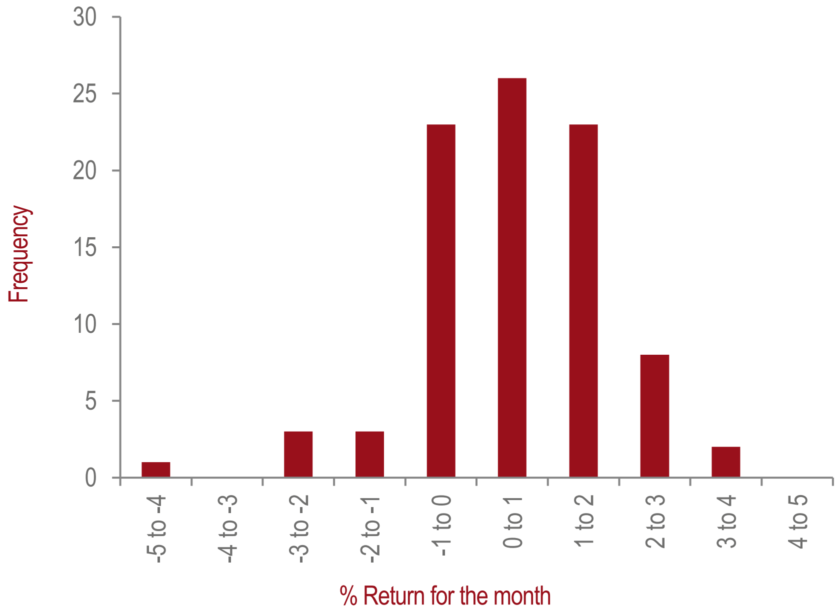
TOP 10 RELATIVE VALUE POSITIONS

- RIO TINTO - RIO TINTO
- BHP BILLITON - BHP BILLITON
- GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP
- CHARTER HALL RETAIL REIT - ELANOR RETAIL PROPERTY FUND
- BWP TRUST - CENTURIA CAPITAL
- AGL ENERGY LTD - INFIGEN ENERGY
- BWP TRUST - CARINDALE PROPERTY TRUST
- CENTURIA METROPOLITAN REIT - GROWTHPOINT PROPERTIES
- CENTURIA CAPITAL - GPT GROUP
- GPT GROUP - INGENIA COMMUNITIES GROUP

TOP 10 SPECIAL SITUATION POSITIONS

- APRIL 19 PUTS ON AS51
- NUFARM FINANCE NZ LTD-NSS (AU)
- SUPERLOOP LTD (AT*)
- SPI 200 FUTURES Jun19
- GRAINCORP LTD (AU)
- JOHNS LYNG GROUP LTD (AT*)
- IMPEDIMED LTD (AT*)
- PARAGON CARE LTD (AT*)
- SUNCORP GROUP NOTE (AU)
- PGG WRIGHTSON LTD (NZ*)

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

Goldman Sachs International

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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