ELLERSTON CAPITAL

Ellerston Australian Share Fund (ASF)

Performance Report | February 19

PERFORMANCE SUMMARY

Gross %	1 Month	3 Months	FYTD	1 Yr	3 Yr p.a.	5 Yr p.a.	Strategy Since Inception p.a.
ASF	2.64	7.57	-5.16	-2.41	11.60	7.02	10.04
Benchmark	5.98	9.95	2.56	7.05	12.91	7.30	10.19

Past performance is not a reliable indicator of future performance.

MARKET COMMENTARY

Market Overview

In February, global equity markets continued to rally. Developed Markets, led by Australia, rose 3.4% and outpaced Emerging Markets, up 1.1%. Performance was supported by expectations of a positive outcome from the trade talks between the US and China. In fact, on 24 February, President Trump announced that the US would postpone an increase in tariffs on goods from China due from 1 March because of "substantial progress" in trade talks.

USA

Politics in the US continued to be unpredictable, with President Trump declaring a national emergency on 15 February over border security, in an effort to get more funding for his wall on the US-Mexico border. Markets however shrugged off the political noise from Washington and focused instead on a likely positive outcome from the US-China trade talks and encouraging January activity indicators suggesting continued strength in the US economy.

The S&P 500 Index and the Dow Jones Industrial Average Index delivered solid returns in February following on from a very strong January, ending the month up 3.2% and 4.0% respectively. The NASDAQ also returned a very credible +3.6%.

In January, the Fed signalled that it would pause raising interest rates. Data will need to be monitored closely as minutes released in February suggested that the Fed is still modestly biased towards tightening, despite the statement having conveyed a neutral bias. US activity indicators remain sound. Manufacturing ISM rose more than expected to 56.6 (previous: 54.9; consensus: 54.0) and non-farm payrolls beat expectations, rising 304K in January (previous: +222K; consensus: +165K).

Europe

European equity markets also continued to deliver positive returns, with the Euro STOXX 50 Index up 4.4%. This was despite economic data continuing to moderate. The flash Eurozone manufacturing PMI for February disappointed with a reading of 49.2 (previous: 50.5; consensus: 50.3), but the composite PMI rose modestly to 51.4 (previous: 51.0). The major European indices were much stronger, catching the wave of optimism that a resolution between the US and China over trade would be positive for global growth: France's CAC was up an impressive 5.0%, Germany's DAX was up 3.1% and the FTSE 100 was up 2.3%.

Asia

Asian equities were mixed. The standout was the Chinese market, represented by the SSE Total Market Index, up a staggering 14.3%, as optimism on US-China trade talks firmed. The Hang Seng Index posted a more modest 2.7%, but Korea's KOPSI Composite Index delivered a disappointing -0.4%.

Investment Objective

The Investment objective for the Ellerston Australian Share Fund is to outperform the S&P/ASX 200 Accumulation Index (Benchmark).

Investment Strategy

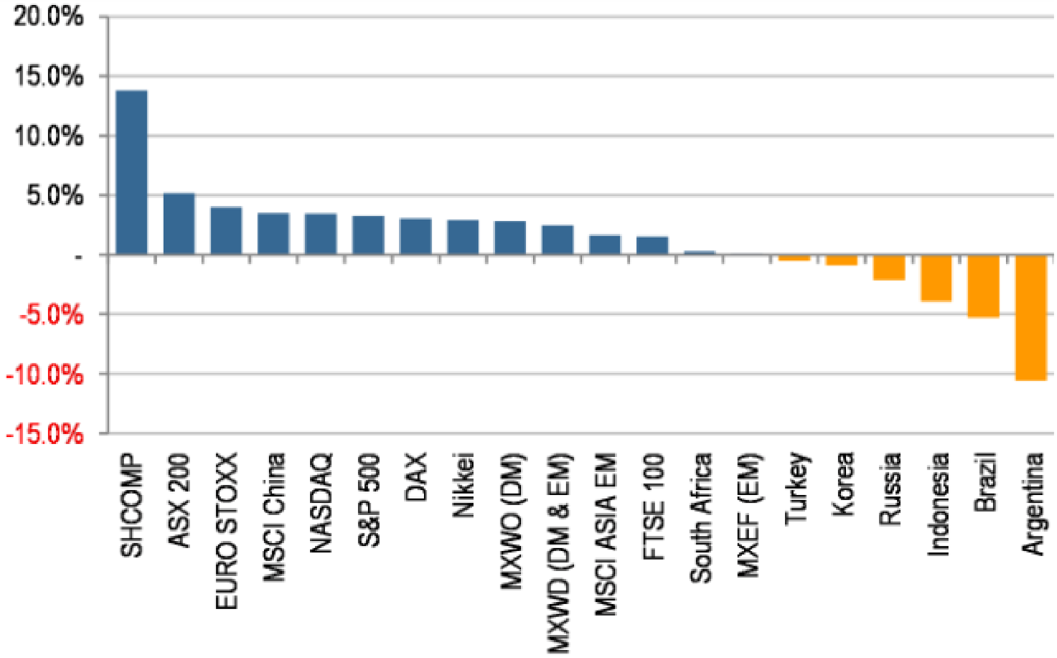
The Fund uses a benchmark-independent, high conviction approach that looks beyond investing in the Top 20 stocks in order to capture the neglected opportunities created by under-researched stocks in the broader Australian market.

Key Information

Strategy Inception Date	1 April 2009
Fund Net Asset Value	$0.9670
Liquidity	Daily
Application Price	$0.9694
Redemption Price	$0.9646
No Stocks	19
Management Fee	0.90%
Buy/Sell Spread	0.25%
Performance Fee	15%
Firm AUM	Over $5 Billion

Questions still remain over the health of the Chinese economy. The February manufacturing PMI softened to 49.2 (previous: 49.5; consensus: 49.6) and the composite PMI also fell to 52.4 (previous: 53.2). Resolution and clarity on trade talks should provide some relief to a softening Chinese economy, which remains an area of concern and focus for markets, especially given the very strong rally in Chinese equity markets in February.

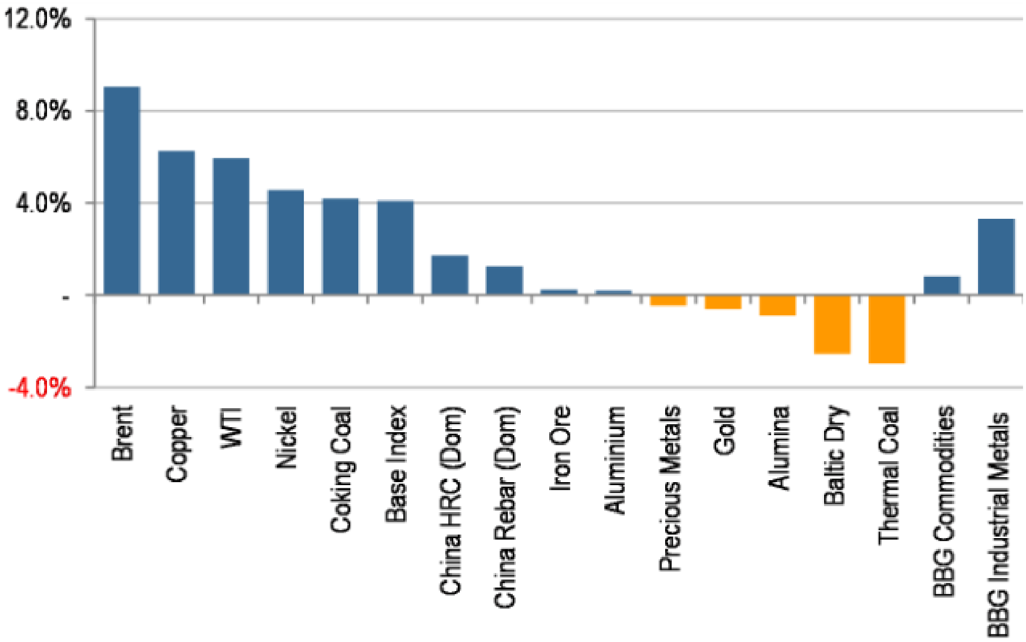
Global Equity Markets' Performance in February 2019



Source: JP Morgan, Bloomberg.

Commodities

The BBG commodities Index rose 0.8% in February. The best performer was Brent, which gained 9.1% to US$66.03 a barrel on falling US inventories, while the worst performer was Thermal Coal, which fell 3.0%. Gold prices fell on the back of a stronger US dollar.



Source: JP Morgan, Bloomberg.

Bonds

Global bonds sold off modestly in February on expectations of a rise in inflation from higher oil prices. US 10-year bond yields rose 8 basis points to close the month at 2.71%. The Australian 10-year bond yield fell again to close the month at 2.10% from 2.24% the previous month.

Australia

Australian shares performed best in the Developed Market. The **S&P/ASX 200 Accumulation Index ended the month up 6.0%.** With the exception of the Consumer Staples sector, all sectors delivered positive returns. The best three performing sectors were Financials (+9.1%), Energy (+7.9%) and Information Technology (+7.6%). The bottom three sectors were Consumer Staples (-1.5%, featuring for the second month in a row in the bottom three), Health Care (+1.0%) and Real Estate (+2.1%).

In February, the **ASX 200 Resources Accumulation Index was once again the best performer**, up 6.9% with BHP Group (+6.9%) and Rio Tinto (+10.5%) building on their strong performances in January as the market rewarded announced capital management initiatives. Woodside Petroleum (+9.4%) was also a significant contributor as investors cheered a better dividend and priced in a strong oil price. The Small Ordinaries Accumulation Index was only slightly behind with a strong return of +6.8% and the ASX 200 Industrial Accumulation Index was also impressive with a +5.8% return.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Coles (-8 points), Cochlear (-8 points), Stockland (-4 points), CSL (-4 points) and Saracen Mineral Holdings (-4 points).

The top five stocks that added to the index return were Commonwealth Bank of Australia (+68 points), Australia and New Zealand Banking Group (+55 points), Westpac Banking Corporation (+54 points), BHP (+46 points) and Macquarie Group (+25 points).

The pressure on house prices in Australia did not abate. National Corelogic dwelling prices fell 0.7% month-on-month in February, putting the year-on-year decline at -6.3% (the worst since March 2009). December residential building approvals fell, -8.4% which took the year-on-year decline to -22.5%.

Activity data was mixed: December retail sales fell more than expected at -0.4% (previous: +0.5%; consensus: +0.0%) but employment in January rose a greater than expected 39K (previous: +17K), with unemployment levels held steady at 5.0%. NAB's business conditions bounced to +7 in January from +3 previously and business confidence rose too.

In a surprise move, the RBA moved to a neutral bias and downgraded its GDP growth forecast modestly. The Australian dollar depreciated 2.4% against the US dollar to close the month at $0.7094. In trade-weighted terms, the AUD depreciated 1.5%.

COMPANY SPECIFIC NEWS

The Market Misses

Blackmores (BKL -27.7%)
BKL reported a very weak 1H19 result, missing consensus expectations by around 10%, driven by a deceleration of sales into China and lower gross margins due to an increase in raw ingredient costs. Furthermore, in its outlook commentary, the company said it was seeing "continuing changes to the way consumers purchase our products as well as higher inventory in the trade and a general softening of consumer sentiment." Subsequently, the company downgraded its expectations and now does not expect 2H profit to be ahead of 1H. To make matters worse, the CEO announced his resignation post the result.

Pact Group (PGH -23.2%)
Ahead of its result in late February, PGH issued yet another profit downgrade, with FY19 EBITDA to be $230-245 million (from $245 million). The company also announced a non-cash impairment charge of $310-340 million. At the result, the Board announced that the interim dividend had been cut to nil and that the company was reviewing a range of capital options given its stretched net debt to EBITDA of 3.3 times versus target of less than 3 times and debt covenants sitting at 3.5 times.

Saracen Mineral (SAR -23.2%)
On the back of a strong share price run over the past 6 months, SAR disappointed the market by releasing underwhelming 1H19 results, with flat EBITDA growth clearly missing market expectations. Despite gold revenue growth of 15%, NPAT (after stripping out a 1H18 one-off earnings boost from the King of the Hills mine sale) declined -6% on 1H18 to $43 million, partly due to increased operating costs at Carosue Dam from higher 3rd party ore purchases processed.

McMillan Shakespeare/Eclipx Group (MMS -21.1%; ECX -11.4%)
MMS 1H19 NPAT was 7% below consensus due to poor performance in two of its non-core businesses; UK asset management and Retail Financial Services. The UK Asset management business was impacted by a weak economic environment and Brexit uncertainty, while margins in the RFS business were lower due to new caps on commissions. The core business of salary packaging and novated leasing continue to perform strongly despite weakness in new car sales. ECX, currently under takeover from MMS, was dragged down by the scrip component of the offer, but continues to trade in line with the deal terms.

Bingo Industries (BIN -20.1%)
BIN issued a shock profit warning during the month with the company now expecting FY19 underlying EBITDA to be flat on the prior corresponding period compared to 15-20% growth previously. The main reason cited was a sharper than expected downturn in the multi-residential market impacting the Building and Demolition collections business, as well as difficulty in increasing prices to offset rising input costs. Later in the month, the stock rallied as it received approval from the ACCC in relation to its acquisition of Dial-A-Dump and at the same time, announced a share buy-back.

Nufarm (NUF -16.0%)
NUF shares declined substantially during the month as seasonal conditions deteriorated further in the key regions of Australia, Brazil and Europe.

Inghams (ING -12.2%)
ING 1H19 results were marginally below consensus, as its New Zealand operations came under significant pressure due to softness in both retail and wholesale demand. Higher feed costs and contract re-negotiations with key customer Woolworths, left the market questioning FY19 earnings.

Mayne Pharma (MYX -13.0%)
The pressure on MYX's core generic drug manufacturing business continues. Increasing competition saw MYX post a 3% decline in generic drug revenues over the last six months and competition is about to enter some of the more profitable generic markets for MYX. The company is trying to diversify into specialty products that have greater patent protection, but the strong growth in this still small division is not enough to offset the declines coming from its much larger generics business.

Cochlear (COH -11.9%)
For a stock like COH, trading on a high earnings multiple, there is very little tolerance for an earnings disappointment. Unfortunately for shareholders, its first half profit result revealed a dramatic and unexpected slowdown in sales of its primary product, cochlear implants. Key competitor Advanced Bionics, is taking market share with its new MRI compatible product, compounding a sales headwind in many European countries (and some developing economies) from budget constraints that cap near term government funding for hearing devices. The market share losses are likely to continue for at least six months until COH can replicate the MRI product features in its competitor's product and get the necessary regulatory approvals.

Bank of Queensland/ Bendigo & Adelaide Bank (BOQ -11.5%/ BEN -8.3%)
BOQ's 1H19 update was essentially a profit warning, while BEN's results also revealed weak underlying trends resulting in both banks underperforming. For both, weakness was across all lines, but particularly in non-interest income which saw continued downward pressure across fees, trading, insurance and other items. Net interest margins were weaker too, as funding cost pressures (observed across the industry) and front book competition took its toll.

The Market Hits

Appen (APX +49.9%)
APC is making a habit of beating expectations and that has been reflected in the re-rating of the company. Its latest result beat consensus by 10% and the company lifted FY19 EBITDA guidance by approximately 5% to $85-90 million. The 50% run in the share price during the month may raise some eyebrows, but sceptics are few.

Automotive Holdings Group (AHG +47.9%)
The stock has rebounded after losing more than half its market capitalisation over the last year. The market has responded positively to the company's announcement that its Refrigerated Logistics business is under strategic review in an attempt to unlock value.

Breville Group (BRG +45.2%)
BRG reported a strong 1H19 result across all geographies. The business demonstrated its ability and desire to migrate from third-party distribution to a direct distribution model in more countries after its successful attempt in the German market. The company reported 7.8% growth in Australia, despite a challenged retail environment over the half.

Ausdrill (ASL +38.1%)
ASL reported solid 1H19 results and provided positive outlook commentary in relation to both underground and surface mining. In addition, the company stated that demand for equipment rental, parts and services continues to grow on the back of the mining re-investment cycle. The integration of Barminco has been completed successfully and the synergy target has been upgraded to $11 million from $5 million. ASL confirmed it was on target to achieve earnings guidance of underling NPAT of $98 million for FY19.

IOOF Holdings (IFL +35.9%)
IFL's results were mostly in line with expectations and the company flagged a once-off step up in higher compliance costs of between $20-30 million (mainly IT to accommodate regulatory demands). However, the new acting CEO managed to convey a sense of methodical progress and humility towards addressing the group's issues with the regulators and completion of the ANZ Wealth transaction. Despite consensus earnings being revised down modestly, uncertainty persisting to the future profitability of the platform business and whether or not to include earnings and synergies from the ANZ transaction, a greater sense of confidence saw IFL's shares re-rated sharply.

Altium (ALU +32.3%)
ALU is another technology stock that delivered a strong set of figures, with 1H19 EBITDA up 37%. However, it was the company's aspirational 2025 targets that caught the market's attention. A commitment by management to get to $500 million in revenue, delivering greater than 40% EBITDA margins ensured that the focus remained very much on the long-term prospects for the group.

Speedcast (SDA +33.3%)
After recently downgrading earnings guidance on Christmas Eve, SDA at least met those numbers. FY19 EBITDA guidance of US$161-170 million was in line with consensus and the company gave a roadmap to recovery in its energy market division. This allayed concerns for a stock that had been significantly de-rated over the previous 6 months.

Viva Energy Group (VEA +31.0%)
VEA finally had a grown up conversation with its retail partner Coles to improve its market position. After haemorrhaging volumes over the last 2 years, the group agreed to new terms. VEA's share price reaction has demonstrated who held the upper hand in the negotiations, but arresting the petrol volume decline will be all-important for any further re-rating.

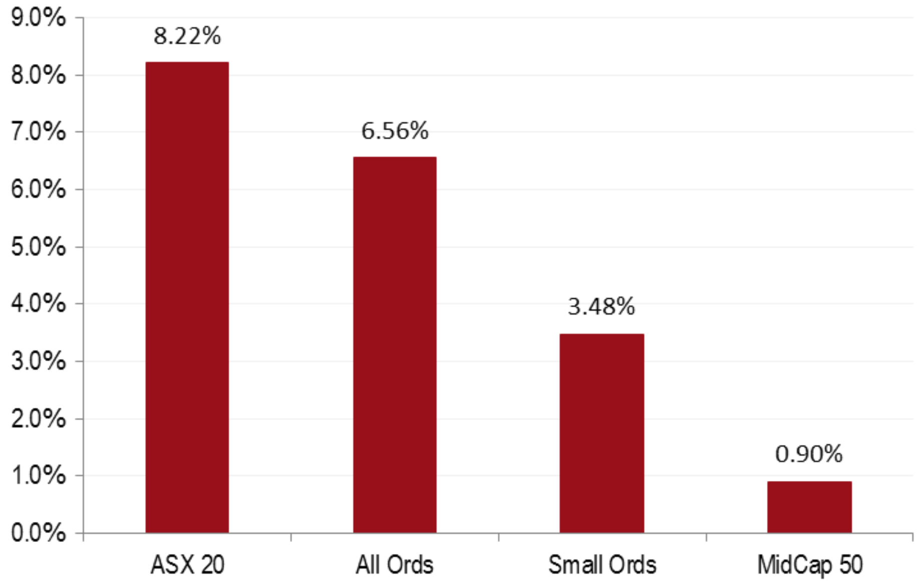
Webjet (WEB +30.6%)
WEB announced a solid but mixed 1H19 result and reiterated guidance for the full year. The company is benefitting from increased scale and growth in B2B, however has guided to a slowdown in its consumer facing business.

FUND PERFORMANCE

The month of February saw investors continue to allocate capital toward the perceived safety of Large Caps, with particular demand for the Banks following the Royal Commission reprieve (at least for now). The fund returned 2.64% for the month, and failed to keep pace with the Benchmark return of 5.98%. Disappointingly, one stock, Nufarm (NUF -16.0%) was a major detractor for the Fund and was responsible for the lion's share of underperformance. This was due to adverse seasonal conditions and an expected weak 1H19 pending result.

The recent trend of Top 20 stocks significantly outperforming their Mid Cap peers has not suited our approach or cause.

Large Caps have returned +8.2% over the past 12M, significantly outperforming Small and Mid Caps



Source: RIMES, Morgan Stanley Research, Performance as at 28/02/2019

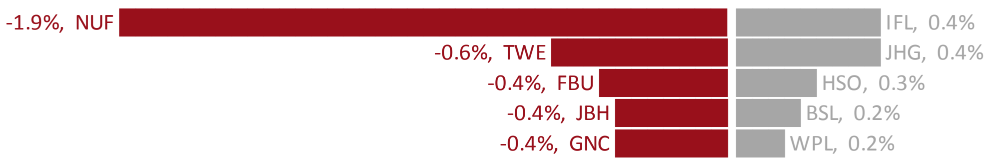
RETURNS[1] (%)	GROSS	BENCHMARK*	EXCESS	NET
1 MONTH	2.64	5.98	-3.34	2.56
3 MONTHS	7.57	9.95	-2.38	7.28
FYTD	-5.16	2.56	-7.72	-5.84
ROLLING 12 MONTHS	-2.41	7.05	-9.46	-3.45
3 YEARS (P.A.)	11.60	12.91	-1.31	10.44
5 YEARS (P.A.)	7.02	7.30	-0.28	5.90
SINCE INCEPTION (P.A.)	10.04	10.19	-0.15	8.86
SINCE INCEPTION (CUM)	158.22	161.77	-3.55	132.13

Past performance is not a reliable indicator of future performance.

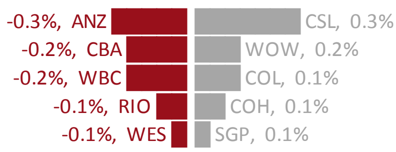
[1] The return figures are calculated using the redemption price for Class A Units and on the basis that distributions are reinvested. The Gross and Excess return figures are before fees and expenses whereas the Net Return figures are net of fees and expenses for the Class A Units. Returns of the Fund may include audited and un-audited results. Past performance is not a reliable indicator of future performance.

* The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2012.

Securities Held



Securities Not Held



The main positive contributors to this month's performance were overweight positions in core holdings, including IOOF (IFL +35.9%), Janus Henderson (JHG +17.5%), Healthscope (HSO +5.5%), Bluescope (BSL +8.1%) and Woodside (WPL +9.4%).

Having zero holdings in CSL (CSL -0.5%), Woolworths (WOW -0.9%), Coles (COL -9.4%), Cochlear (COH -11.9%) and Stockland (SGP -7.4%) also contributed positively.

The main detractors from performance, that more than offset the above, were overweight positions in Nufarm (NUF -16.0%), Treasury Wines (TWE -3.0%), Fletcher Building (FBU +0.2%), JB Hi-Fi (JBH +1.0%) and Graincorp (GNC +2.6%).

Having a zero holding in ANZ (ANZ +11.9%), Commonwealth (CBA +8.8%), Westpac (WBC +9.8%), RIO Tinto (RIO +10.5%) and Wesfarmers (WES +9.3%) also acted as a drag on the portfolios relative performance.

Fund Activity

The Fund has again been very active in February. We introduced a new stock into the portfolio (Macquarie Group) and exited a significant holding (Healthscope). We added to our core holdings where we still feel there is valuation upside. We also continued to trim QBE as the stock rallied strongly into its results.

NEW STOCKS ADDED	STOCKS EXITED
• Macquarie Group	• Healthscope

POSITIONS INCREASED	POSITIONS DECREASED
• Aristocrat Leisure	• QBE Insurance Group
• Computershare	
• Downer EDI	
• IOOF Holdings	
• Woodside Petroleum	

The main activity for the month was the Funds total divestment of its substantial shareholding in long drawn out takeover target **Healthscope (HSO)**, where we have been extremely patient since BGH first made a play for the company back in April 2018 and where our patience was rewarded in this situation. Our exit on market was premised on the stock trading well above the Takeover Offer terms (risk arb players bidding it up), with the scheme meeting not to be held until June 2019. We felt the Funds could be redeployed towards better opportunities elsewhere.

As a reminder and by way of background, on 1 February 2019, HSO announced that it had entered into an Implementation Deed with an entity controlled by Brookfield Business Partners, and its institutional partners, under which Brookfield undertook to acquire 100% of HSO by way of **scheme of arrangement** representing total value of $2.50 per share, and a simultaneous **off-market takeover offer** representing total value of $2.40 per share.

Under the terms of the **Scheme of Arrangement**, HSO shareholders will receive total value of $2.50 per share (inclusive of an interim dividend of 3.5 cents per share). Shareholders will have the option to receive all cash or, subject to certain limitations, to receive the Scheme Consideration as an equity interest in an unlisted company controlled by Brookfield that would own 100% of HSO.

The Scheme Consideration represents:

- **a circa 40% premium to the undisturbed closing price of HSO shares on 22 October 2018 of $1.785 (being the last close price prior to the announcement that HSO had received an unsolicited proposal to acquire all the shares in HSO by way of a scheme of arrangement)**;
- an implied equity value of $4.375 billion and enterprise value of $5.712 billion; and
- **an implied acquisition multiple of circa 14.7 times EV / EBITDA.**

The Scheme of Arrangement is subject to limited conditions and is not subject to financing or due diligence.

Under the terms of the **Takeover Offer**, accepting HSO shareholders will be entitled to receive total value of **$2.40 per share** (inclusive of an interim dividend of 3.5 cents per share). The Takeover Offer is conditional upon, among limited other conditions, Brookfield achieving acceptances from HSO shareholders **representing 50.1%** of HSO's total issued capital and the Brookfield Scheme of Arrangement not being successful.

It is intended that the Takeover Consideration will be paid to shareholders in part by the Company as a special dividend and capital reduction following the completion of the property transactions outlined below, and in part by Brookfield as cash takeover consideration for the transfer of shares.

Property transactions

HSO has entered into agreements to sell 22 properties to Medical Properties Trust ("MPT") and NorthWest for circa $2.5 billion and lease them back, conditional on the Scheme becoming effective or control of HSO passing to Brookfield under the Takeover Offer. Of the 22 freehold properties that HSO has agreed to sell as part of the Brookfield Transaction, 11 will be acquired by MPT while NorthWest will acquire the remaining 11 hospitals.

Timetable

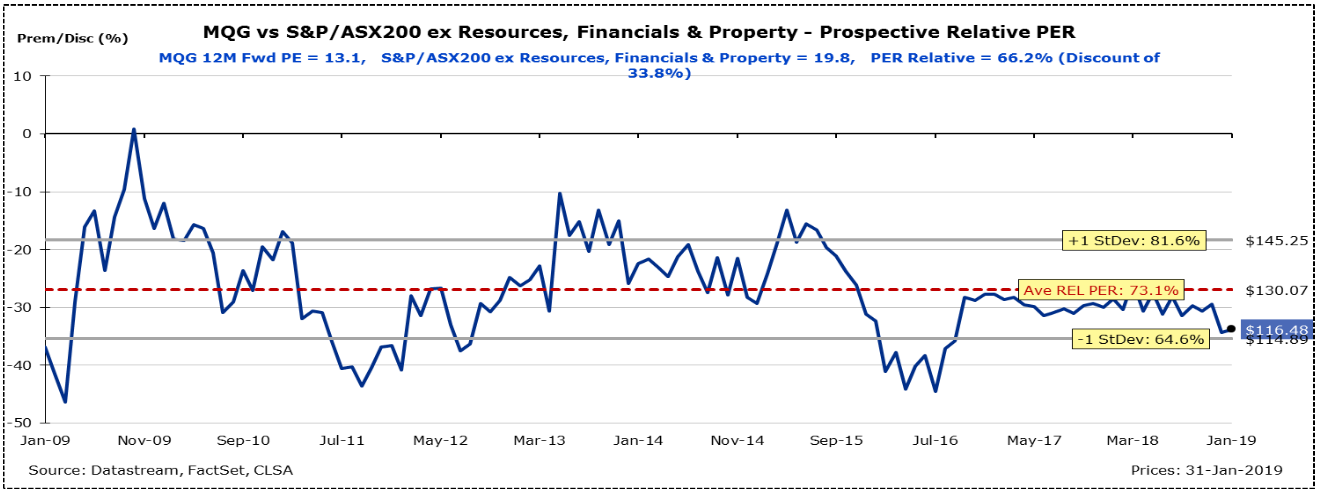
HSO intends to send an Explanatory Booklet to HSO shareholders in April / May 2019. The Explanatory Booklet will contain information relating to the Scheme of Arrangement, the Takeover Offer and the property transactions. It will also contain an Independent Expert's Report on whether the Scheme of Arrangement is in the best interests of shareholders and whether the Takeover Offer is fair and reasonable. A Scheme Meeting is expected to be held in May / June 2019 and, if approved, the Scheme would be implemented shortly thereafter.

Macquarie Group (MQG)

We commenced buying MQG early in February (pre its February operational briefing). We have always considered MQG management to be superior and disciplined allocators of capital, but have viewed the group's earnings multiple to be somewhat stretched at times (especially versus its investment banking peers). However, following a sharp sell-off in December 2018 on concerns over global growth, many higher PE and good quality stocks with a proven track record were de-rated. MQG was among them. We had been watching MQG patiently for an opportunity to enter the stock at an attractive level. In the past, we hadn't fully appreciated the annuity-like earnings that the group was likely to generate from prior year investments. We used the de-rating as an opportunity to initiate a holding in a quality financial company. The key reasons for our investment in MQG are summarised below:

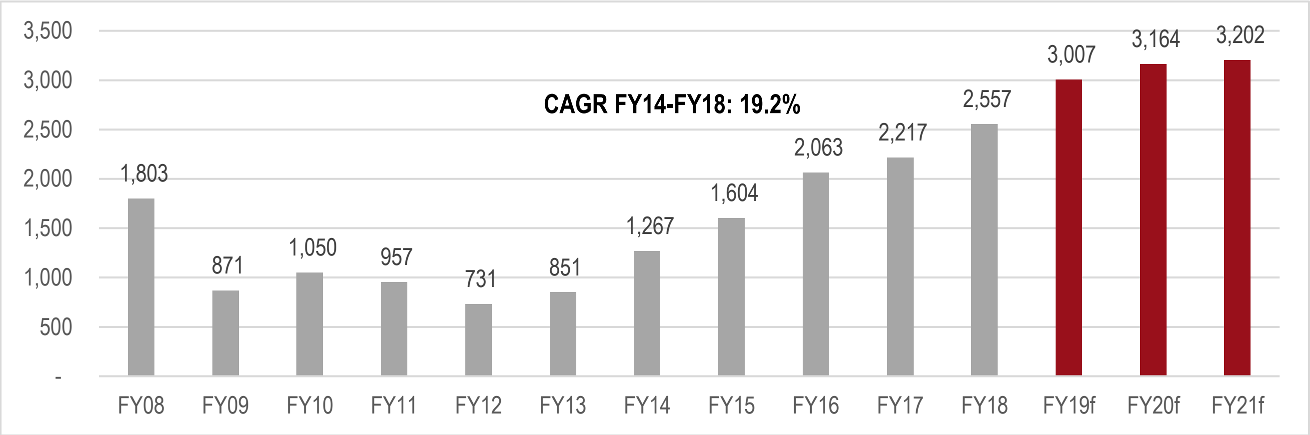
- **MQG is in an earning and ROE upgrade cycle** – following years of disciplined capital allocation, the group is benefitting from a solid pipeline of annuity-style earnings and asset realisations that are driving EPS upgrades and importantly, ROE improvements
- **Incentive structure** – remuneration is incentivised to deliver current year excess ROE above the cost of capital for all staff, three- to four-year forward excess ROE above cost of capital for the executive committee, and 12% EPS growth on a rolling three- to four-year basis
- **Much more diversified business** – MQG is now much more diversified as a group compared to its pre-GFC structure, with annuity-style income having increased from 25% of profit in FY07, to approximately 70% of earnings in FY18
- **Structurally leveraged to growth** – the rebalanced business means the group is leveraged to segments of structural growth like infrastructure, green investments, energy and technology
- **World's largest alternative asset manager** – these asset classes tend to command a higher multiple; MIRA, the sub-division of Macquarie Asset Management and the most significant contributor to the group's ROE, is positioned to exploit infrastructure investment opportunities globally and these generate high returns
- **Strong balance sheet** – the group has term assets covered by term funding, stable deposits and equity, and minimal reliance on short-term wholesale funding; group surplus (as at 31 December 2018) was around $4 billion
- **Disciplined allocation of capital generates superior returns** – buy-back of $1 billion formally cancelled as group now identifies substantial investment opportunities which should generate higher ROEs
- **Well respected management team** – MQG's management team has worked together for a number of years and has a long history of shareholder value creation through most economic and market cycles
- **MQG is expected to deliver double digit EPS growth for the next couple of years and generates a sector leading ROE**.

MQG has been de-rated despite delivering earnings upgrades.



MQG's earnings over the long-term: earnings took a hit with the GFC, but recovered strongly as the group repositioned itself towards more annuity-like income and became less reliant on market-linked income. The compound annual growth rate in earnings from FY14 to FY18 has been 19.2%.

MQG group profit

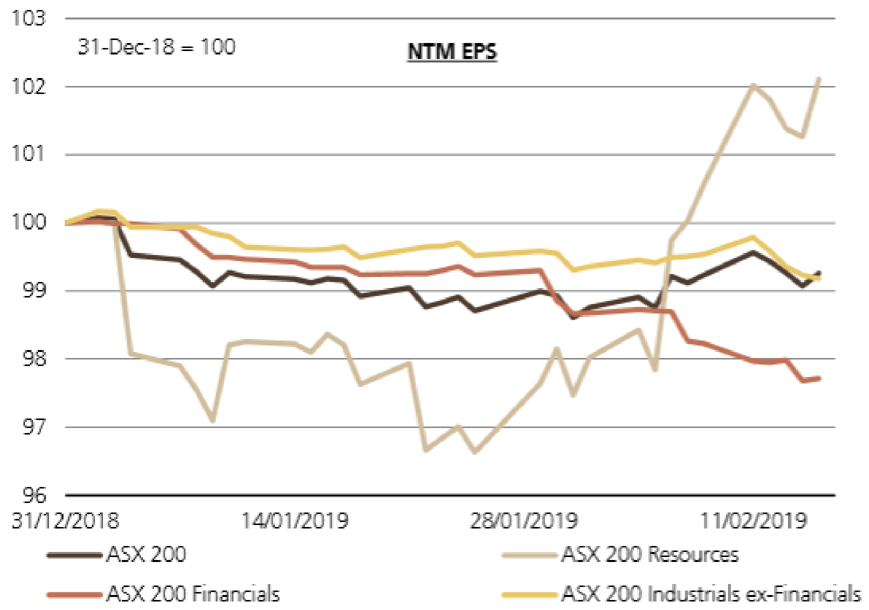


Source: Company Reports, Ellerston Capital

FUND STRATEGY AND OUTLOOK

Our concerns around the sustainability of earnings appear to be playing out. Following the latest Australian reporting season, only 12% of reporting companies upgraded earnings expectations against 36% guiding to lower earnings. This "negative skew" has resulted in earnings growth forecasts of just 3.3% in FY19. This is mostly driven by Resources (+13.5%), as the Industrials ex-Financials are now expecting earnings to contract by 3.4% (Source: UBS, Bloomberg). Dividends and capital management provided the key upside surprise during the reporting season and cost pressures were the key downside surprise (particularly among the financial stocks).

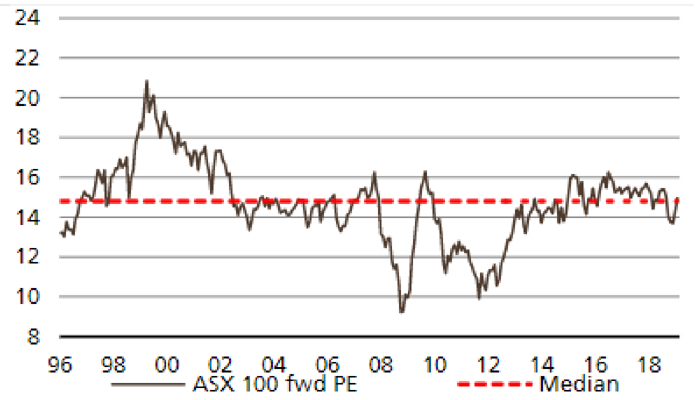
Next 12-month EPS for the market entirely driven by Resource earnings



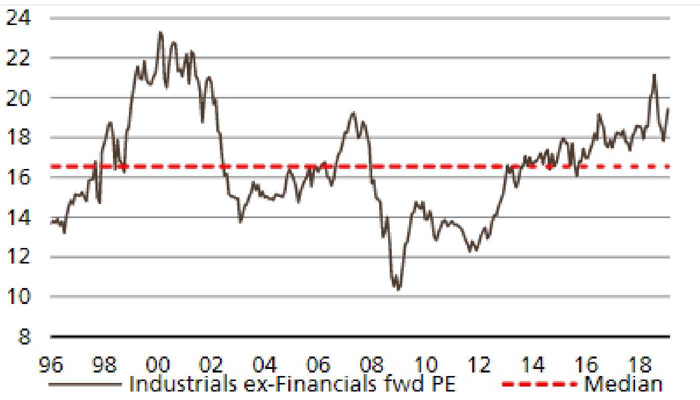
Source: UBS, Bloomberg

Following the rally in February, the **ASX 200 Index is now trading at a PE multiple of around 15.3 times**. Most of last month's rally came from a PE expansion, despite FY19 EPS being downgraded. **Industrials ex Resources, Financials and Property are trading on 20.7 times** (against an all-time high of 21.5 times in August 2018).

The PE of the Australian market is around its 20-year average



Industrials ex-financials above 20-year average, despite fall in FY19 EPS

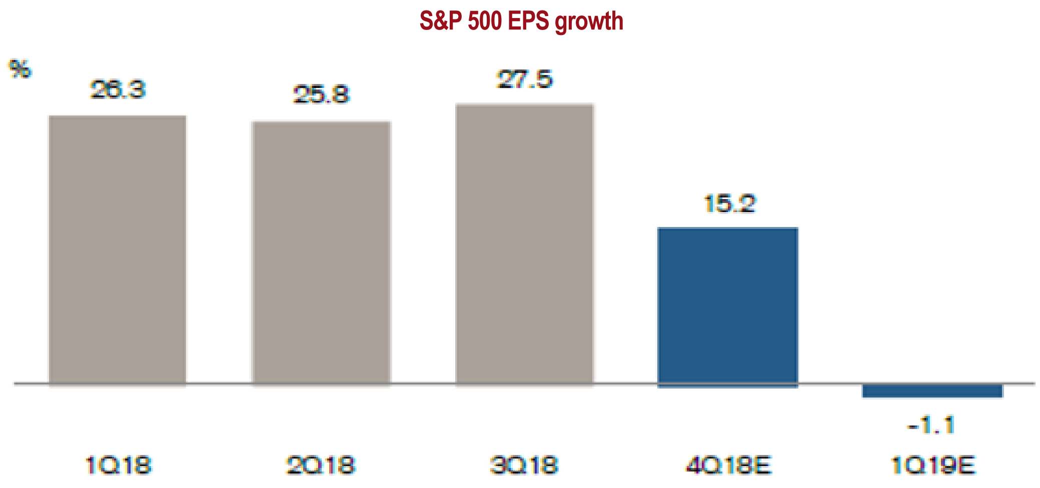


Source: UBS, Factset

Last month, we articulated the concerns investors had over the potential for a monetary policy mis-step by the Fed. So unsurprisingly, the Fed turning dovish with its rate guidance in January had markets cheering. It's unclear if the Fed will maintain its neutral stance if inflation and wage data in the US are stronger than anticipated and the Fed minutes (released in February) suggested that committee members were still modestly biased towards an increase in rates.

February saw markets buoyed by the prospect of a resolution to the US-China trade war. A positive outcome from the trade talks, increasingly reported and tweeted about, appears more likely. As we've said, the markets have been pricing in this outcome and a positive resolution would be needed to support the re-rating we've witnessed.

However, investors remain worried as macroeconomic data is on the weaker side despite some pockets of strength in the US. Increasingly, the prospects for an earnings recession in the US is also being hotly debated by investors. The chart below highlights a substantial turnaround in EPS growth in the S&P 500.



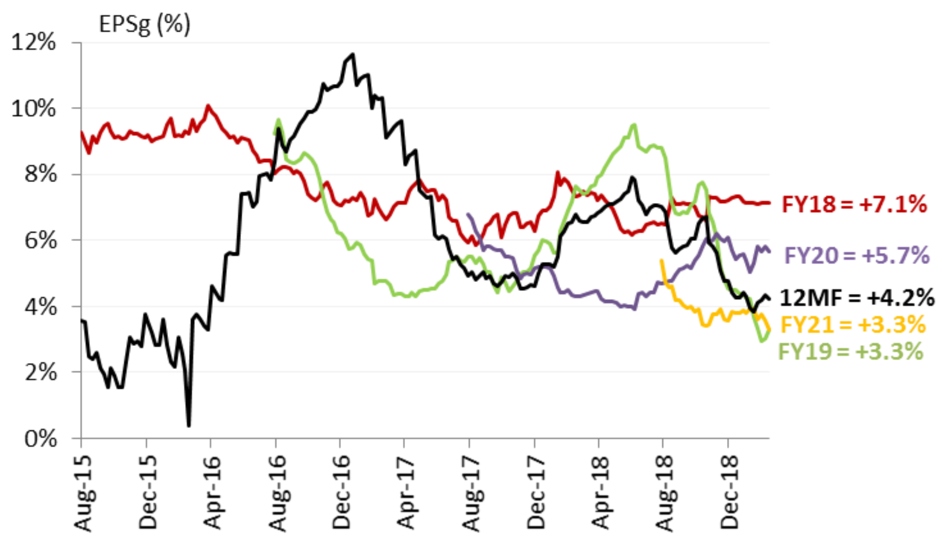
Source: Bloomberg

Four key items have distorted EPS in the recent quarter, causing a substantial decline in EPS growth between 3Q18 and 1Q19. These are: tax changes, changing energy prices, a turn in the semi-conductor cycle and a select group of mega-cap tech stocks reducing earnings (Apple, Google, Facebook and Netflix). Perhaps the underlying dynamics are more benign, but more data points are required to support that conclusion definitively.

We'd like to recapitulate the risks to investment markets we've previously identified. These include the negative effects of a trade war, slowing global growth (especially in China, where there are increasing concerns that the slowdown in their economy might be worse than initially feared) and the uncertainty and incoherence emanating from Trump's White House. Domestically, the risks include the second-order effects of the macro drivers above, along with sharply slowing credit growth, an indebted consumer, fear of a harder economic landing and a pending Federal election this year.

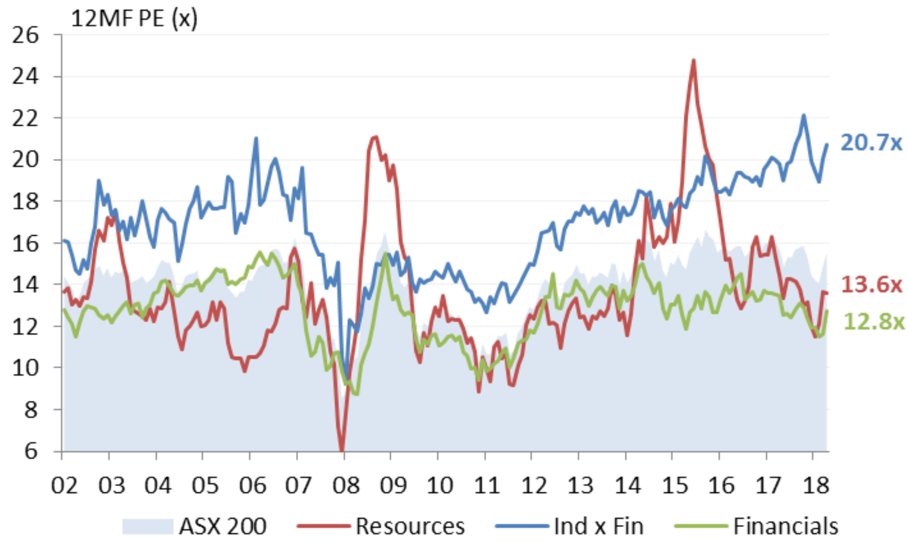
It makes for a very volatile investment environment in 2019. On the positive side, we would expect more capital management initiatives as surplus franking credits are cleared and the prospect of more M&A activity if the AUD weakens further.

The chart below shows that earnings expectations domestically have been marked back to mid-single digits, with FY19 now at just 3.3% growth.



Source: RIMES, Morgan Stanley Research.

Following the rally in the Australian market in February, the Industrials ex-financials valuations are ticking up towards previous highs despite earnings downgrades on average following reporting season.



Source: RIMES, Morgan Stanley Research.

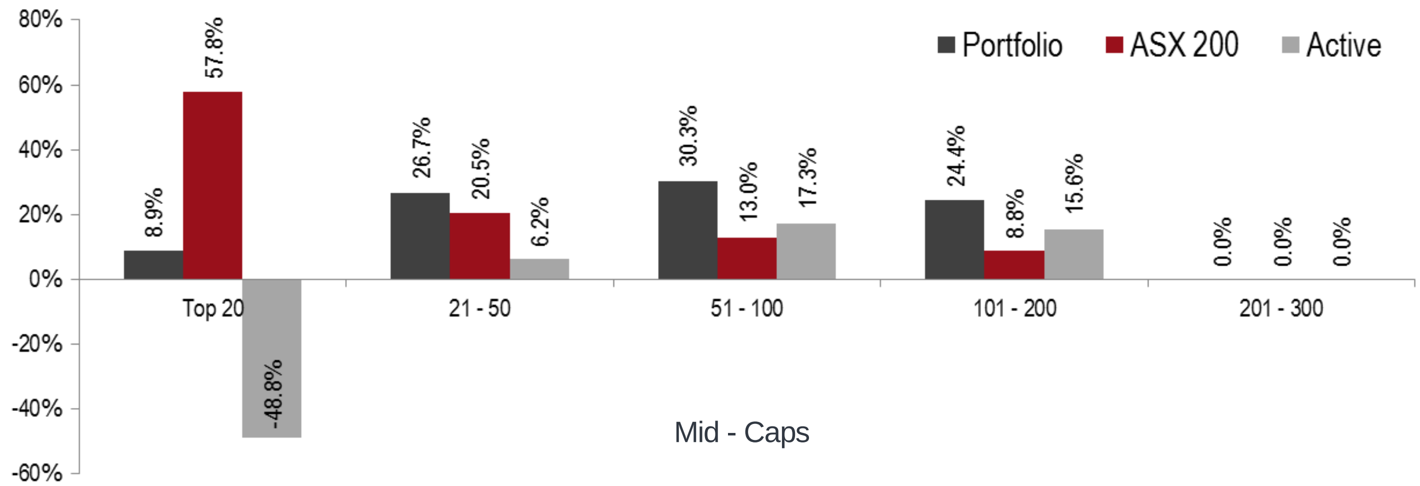
Warm Regards,

Chris Kourtis
Portfolio Manager

ELLERSTON CAPITAL

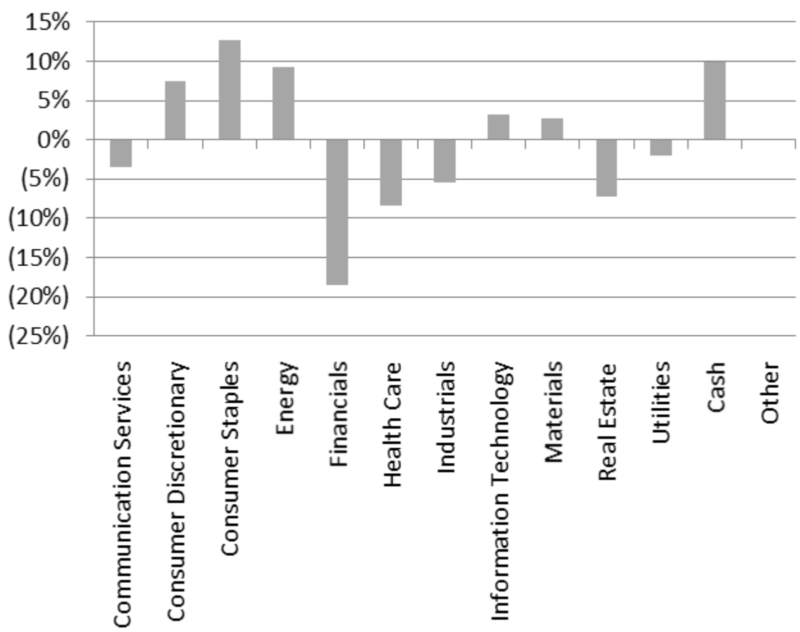
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



^Size Comparison Data as at 26 February 2019
Source: Bloomberg, Ellerston Capital Limited

Active Sector Exposures*



Source: Ellerston Capital Limited

TOP 10 HOLDINGS**
ARISTOCRAT LEISURE
BLUESCOPE
COMPUTERSHARE
FLETCHER BUILDING
GRAINCORP
JB HI-FI
NUFARM
ORIGIN ENERGY
TREASURY WINE ESTATES
WOODSIDE PETROLEUN

* Active sector exposures are determined by subtracting fund sector weights from benchmark weights. Positive percentages represent over-weight sector exposures relative to benchmark and negative percentages represent under-weight sector exposures relative to the benchmark.

** Top 10 Holdings are listed in alphabetical order.

ABOUT THE ELLERSTON AUSTRALIAN SHARE 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.

FUND FACTS

STRATEGY FUNDS UNDER MANAGEMENT	$3.2 BILLION
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$54 MILLION
APPLICATION PRICE	$0.9694
REDEMPTION PRICE	$0.9646
NUMBER OF STOCKS	19
INCEPTION DATE	1 APRIL 2009

Source: Ellerston Capital Limited

For further information, please contact:

INSTITUTIONAL CONTACT

Melinda Carter
+61 3 9002 2041
mcarter@ellerstoncapital.com

RETAIL CONTACT

Andrew Seddon
+61 417 249 577
aseddon@ellerstoncapital.com

Simon Glazier
+61 2 9021 7790
sglazier@ellerstoncapital.com

SYDNEY OFFICE

Level 11, 179 Elizabeth Street,
Sydney NSW 2000

MELBOURNE OFFICE

Level 4, 75-77 Flinders Lane,
Melbourne VIC 3000

Ph: +61 2 9021 7797
E: info@ellerstoncapital.com