ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | May 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	0.17	-0.71	-4.80	-12.23	-1.99	2.93	5.07
RBA Cash Rate	0.13	0.38	0.75	1.51	1.51	1.78	1.91
Alpha	0.04	-1.09	-5.55	-13.74	-3.50	1.15	3.16

Source: Ellerston Capital Limited

	Jan	Feb	Mar	April	May	June	July	Aug	Sep	Oct	Nov	Dec	YTD
2019	-0.92	-0.72	-4.03	3.28	0.17								-2.33
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	64%	Net Equity Exposure	+23%
No. Relative Value positions	70	Gross Portfolio Exposure	262.4%
No. Special Situations	26	Correlation Coefficient (vs ASX 200 Accum)	2.05%
Beta Adjusted	-7.8%	Net Sharpe Ratio (RFR = RBA Cash)	0.64

PERFORMANCE

The Fund returned +0.2% in May, in line with the benchmark return of 0.1% for the month. Net exposure was +23% with a beta-adjusted net of -7.8%. Gross exposure ended the month at 262.4%. May was a tale of two halves as low volumes on global trade fears dominated the first half, but was then superseded by the election of a 'pro-business' Coalition Government that sent the ASX to 11-year highs.

We established a paired position between GPT Group (+0.5%) and Stockland (+17.5%) during May, with the renewed confidence in the residential market leading to a spike in the share price of Stockland. Whilst we appreciate the improving sentiment, we expect FY20 to be a tough year for residential settlements and prefer the asset mix of GPT to Stockland.

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	$200.7M
Liquidity	Daily
Application Price	$0.9234
Redemption Price	$0.9188
Management Fee	1.20%
Buy/Sell Spread	0.25%
Performance Fee	20% of outperformance
Firm AUM	Over $5 billion

We participated in the secondary listing of the Investec Australia Property Fund (+4.5%), which has previously been listed only in South Africa. The fund has a portfolio of 28 office and industrial properties located in Australia and is managed by Investec. The listing was cleared at a modest premium to NTA, which compares favorably with listed peers. Our exposure is hedged with short positions in Growthpoint Properties (-0.2%) and Cromwell Property Group (+2.7%).

Early in the month, Dexus (+3.0%) announced a $900m capital raise, with the proceeds used to partially fund their recent $1.4b acquisition of 80 Collins Street, Melbourne. We used the liquidity to cover our short position, which was hedged with a holding in the outperforming Peet. Mirvac (+7.1%) also took advantage of the buoyant sharemarket, raising $750mil in new equity to fund as-yet unidentified new projects. We capitalised on the placement, covering part of our short position which was paired with GPT.

ACTIVITY

Relative Value – Gross Contribution +1.72%

Our paired position between Out-Of-Home media companies QMS Media (+14.8%) and oOH!Media (+12.2%) added value, with both companies holding their Annual General Meetings (AGM) during the month. While guidance was reconfirmed at both meetings, we continue to prefer QMS ahead of oOH!Media, with a number of potential events expected to reduce debt and improve metrics. In particular, the previously announced sale of QMS NZ to MediaWorks for 40% of the new vehicle and $35m in cash is anticipated to close in the next two months.

The spread between the UK and Australian listings of Rio Tinto (+5.2%) and BHP Billiton (+1.0%) widened on the last day of the month, detracting from the performance of the Fund. While the Duel Listed Company (DLC) spreads can be volatile over the short term, we expect they will narrow over time and at some point will close entirely when the securities become fungible.

The combination of an unlikely election result, APRA flagging a loosening of lending criteria and the signalling of future rate cuts resulted in increased interest in the residential property sector. The increase in interest led to the outperformance of land-developer Peet (+14.8%) and Manufactured Housing Estate (MHE) company Ingenia (+3.9%), both of which added to the performance of the Fund.

Paired positions featuring Centuria Capital (+11.1%) also added value during the month, with the company announcing the acquisition of 63% of Heathley, a specialised healthcare property fund manager with $620 million in Assets Under Management (AUM). The acquisition takes Centuria's AUM to $6.2b and introduces a new asset class to Centuria's expanding real estate platform. Heathley also has capacity to increase AUM to over $1.0b in the near term with known potential projects that are already in the pipeline.

Special Situations – Gross Contribution -1.44%

Our holding in Graincorp (-14.2%) detracted from the performance of the Fund after Long-Term Asset Partners confirmed it had withdrawn its indicative takeover proposal. Graincorp also announced their FY19 half year results in the month, revealing an NPAT loss of $48m and an increase in debt to $880m. The withdrawal of the bid spooked investors, with the stock underperforming both peers and the broader market. We believe the proposed de-merger of the global malting business from the grains and oils business will lead to a re-rating of both companies, with the sum-of–the-parts worth substantially more than the current market value.

Following a +20.9% rally in April, the share price of ImpediMed (-40.4%) plummeted during May, following the publication of the peer-reviewed manuscript of the PREVENT interim analysis. Investors were spooked by the comment that the "measured benefit versus the common tape measure was not statistically significant". The reality is that statistical significance can only be properly assessed after all 1,200 patients have been followed for three years. We believe that statistical significance will be achieved at the conclusion of the PREVENT trial and continue to maintain our position accordingly.

It was a volatile month for shareholders in Superloop (+4.4%). Early on, the company announced they had received a conditional and non-binding proposal from QIC Private Capital to acquire all outstanding shares. The board of Superloop then granted QIC a three week due diligence period on an exclusive basis to determine whether a binding transaction could be agreed. Following the due diligence, Superloop were unable to agree to a transaction with QIC and on that basis, the parties agreed to discontinue their period of exclusivity. We continue to maintain our holding in Superloop, with the company poised to capitalise on a three-year capex program that is only now coming to an end.

After settling the sale of the seed and grain business, PGG Wrightson Ltd (-1.9%) announced a capital return of $235 million, which should equate to approximately 31 cents per share. The Board proposal will require court and shareholder approval and is expected to be paid in CY19.

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Banks	0.0%	0.0%	0.0%
Div Financials	0.6%	-0.4%	0.1%
Insurance	0.0%	0.0%	0.0%
Regional Banks	0.0%	0.0%	0.0%
REITs	71.4%	-54.0%	17.4%
Financials	72.0%	-54.4%	17.5%
Builders	1.3%	0.0%	1.3%
Consumer Disc	0.0%	0.0%	0.0%
Consumer Staples	4.4%	0.0%	4.4%
Contractors	0.0%	0.0%	0.0%
Gaming	0.5%	0.0%	0.5%
General Industrials	4.8%	-0.7%	4.0%
Health Care	5.3%	-0.2%	5.2%
Information Technology	0.5%	0.0%	0.5%
Infrastructure	0.0%	0.0%	0.0%
Materials	0.0%	0.0%	0.0%
Media	3.9%	-2.8%	1.1%
Telcos	0.0%	0.0%	0.0%
Utilities	2.6%	-2.1%	0.6%
Industrials	23.3%	-5.7%	17.6%
Bulk Metals	39.9%	-41.3%	-1.4%
Energy	0.0%	0.0%	0.0%
Gold	0.0%	0.0%	0.0%
Resources	39.9%	-41.3%	-1.4%
Hedge	2.5%	-13.2%	-10.8%
Index	2.5%	-13.2%	-10.8%
Total	137.6%	-114.6%	22.9%

Source: Ellerston Capital Limited

MARKET COMMENTARY

Market Overview

Global markets were mostly in the red in May, with the Australian equity market bucking the trend to end the month in the black, as Australian stocks rallied in response to the surprise re-election of the Coalition government. Both Developed Markets and Emerging Markets were materially lower. Global markets turned south after the trade war between the US and China flared up again as negotiations fell apart and weaker global manufacturing PMIs pointed to a disappointing global economic outlook. Correspondingly, global bonds rallied hard with US 10-year bond yields closing the month at 2.12%.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index were sharply lower in May, returning -6.4% and -6.3% respectively. The NASDAQ had an even worse month, down 7.8%.

The US president announced in early May, that he was raising tariffs on $200 billion of Chinese goods from 10% to 25%, as trade negotiations deteriorated. Energy and technology stocks were the worst hit. To make matters worse, towards the end of May, President Trump then announced a surprise 5% tariff on Mexico to try and force Mexico to stop illegal migration into the US. Equity markets took fright and were sold off accordingly.

Europe

European equities were also in negative territory with the Euro Stoxx 50 falling 5.5% in the period. Brexit chaos in the UK continued, with the Prime Minister, Theresa May, announcing her resignation after her Brexit deal found no support (again) in Parliament. But weaker activity indicators across Europe and concerns over global trade drove markets lower, with auto and parts stocks and banks underperforming the most.

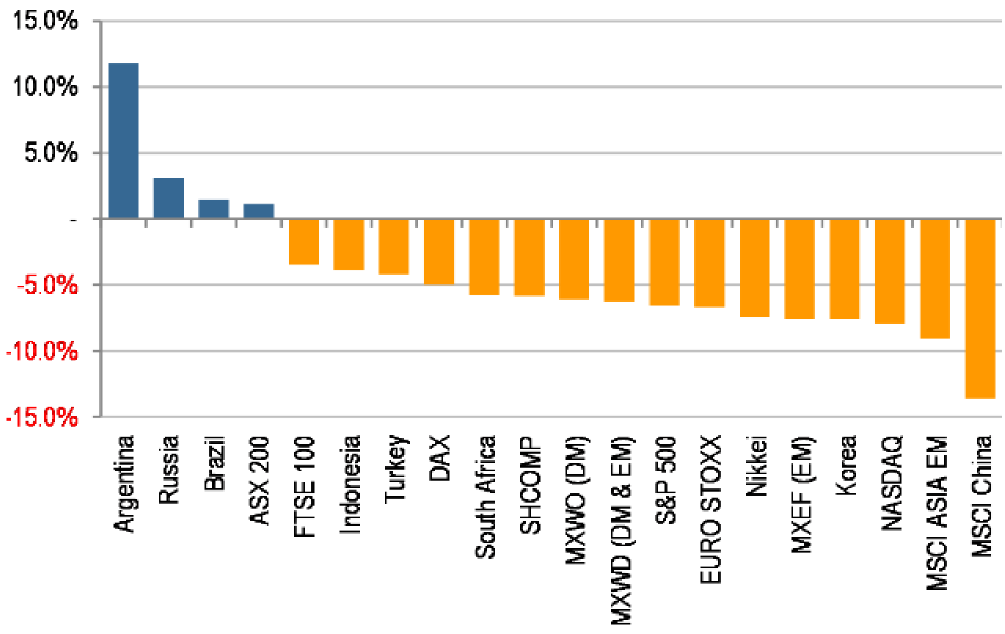
Germany's DAX, the standout outperformer in April, reversed sharply to be down 5.0%, while the UK's FTSE 100 returned -2.9% and France's CAC 40 returned -5.3%.

Asia

Asian equities were not immune to the global sell-off. The resurgent trade war, the ban on Huawei and the impact on related stocks in the region, and weaker than expected economic data all hurt investor sentiment. In China, the manufacturing PMI in May slumped to 49.4 (previous: 50.1).

The major markets, where the related economies would be most negatively impacted by sluggish global growth and a trade war, were substantially weaker. The Hang Seng Index was down 8.4%, Japan's Nikkei 225 was down 7.4%, Korea's KOPSI Composite Index was down 7.3% and the Chinese SEE Total Market Index was down 6.5%.

Global Equity Markets' Performance in May 2019



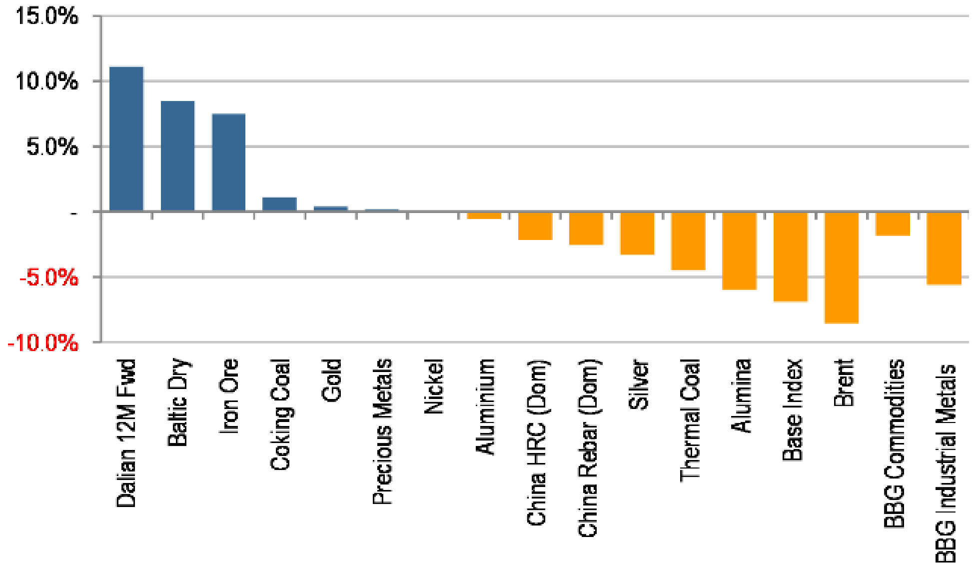
Source: JP Morgan, Bloomberg.

Ellerston Capital

Commodities

Bulk commodities were mixed, with iron ore the standout performer, gaining 7.5% in May on ongoing supply issues in Brazil to end the month at US$102/t. However, both thermal and hard coking coal gave up ground. Fears that global growth was slowing also impacted brent oil prices which fell 8.6% to US$64.49/bbl. This fear was also reflected in the prices of base metals, with copper falling sharply in the period. Copper is now down for three consecutive months and has returned -2.4% year-to-date.

Global Equity Markets' Performance in May 2019



Source: JP Morgan, Bloomberg.

Bonds

Renewed trade tensions and general "risk off" sentiment saw investor flows seek the safety of bonds and move away from riskier equities. In the US, the 10-year bond yields fell 38 basis points to 2.12%, taking the cumulative fall in yields to 56 basis points year-to-date. In Australia, the expectation of a post-election rate cuts by the RBA saw Australian 10-year bond yields drop below 1.5% to end the month at 1.46%, down 33 basis points in the month. 10-year Australian bond yields are now 66 basis points below 10-year US bond yields!

Australia

The **S&P/ASX 200 Accumulation Index ended the month up 1.7%**. The best performing sectors were Financials (+2.6%, for the second consecutive month), Materials (+3.2%), Health Care (+3.3%) and Communications (+7.3%). The bottom three sectors were Consumer Staples (-4.2%), Energy (-3.8%) and Information Technology (-4.0%).

In May, the Small Ordinaries Accumulation Index was the worst performer, down -1.3% while the ASX 200 Industrial Accumulation Index was the best performer, up 1.8%. The ASX 200 Resources Accumulation Index returned 1.4%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Macquarie Group (-21 points), QBE Insurance Group (-10 points), Bluescope Steel (-9 points), Treasury Wine Estates (-9 points) and AGL Energy (-6 points).

Among the top five stocks that added to the positive index return were three of the major banks (again), namely, Commonwealth Bank of Australia (+40 points), National Australia Bank (+31 points) and Australia and New Zealand Banking Group (+25 points), with Telstra Corporation (+19 points) and CSL (+19 points) also contributing.

The surprise re-election of the Coalition government boosted the market as banks rallied strongly (up 5.3% for the month). The main implication of the election result being no changes to negative gearing, capital gains tax and franking credit rebates. As is noted above, the major banks were among the most significant contributors to the index's outperformance as investors concluded that Labor's loss reduced the tail risk to banks, especially credit growth, as changes to negative gearing were off the table. Also, banks' dividends remained attractive to the cohort of investors and particularly retirees who benefitted from franking credit rebates.

The AUD was weaker as a cut in interest rates was increasingly priced into expectations. The AUDUSD ended the month at 0.69.

CONTRIBUTION

Relative Value Gross Contribution +1.72%

Positive		Negative	
BWP TRUST - CENTURIA CAPITAL	0.72%	RIO TINTO - RIO TINTO	-1.07%
OOH!MEDIA - QMS MEDIA	0.57%	BHP BILLITON - BHP BILLITON	-0.77%
INGENIA COMMUNITIES GROUP - NATIONAL STORAGE REIT	0.36%	CHARTER HALL GROUP - PEET	-0.29%
AUSTRALIAN UNITY INVESTMENT REAL ESTATE - NATIONAL STORAGE REIT	0.36%	GPT GROUP - STOCKLAND	-0.09%
AVENTUS RETAIL PROPERTY FUND - CENTURIA CAPITAL	0.34%	CHARTER HALL LONG WALE REIT - GPT GROUP	-0.05%

Special Situations Gross Contribution -1.44%

Positive		Negative	
PEET LTD (AT*)	0.73%	IMPEDIMED LTD (AT*)	-0.97%
SUPERLOOP LTD (AT*)	0.21%	GRAINCORP LTD (AU)	-0.45%
EBOS GROUP LTD (NZ*)	0.13%	May 19 Put Spread on AS51 (5800)	-0.24%
POWERWRAP LTD (AT*)	0.03%	ELANOR RETAIL PROPERTY FUND (AT*)	-0.19%
CATAPULT GROUP INTERNATIONAL (AT*)	0.01%	QMS MEDIA LTD (AT*)	-0.17%

Source: Ellerston Capital Limited

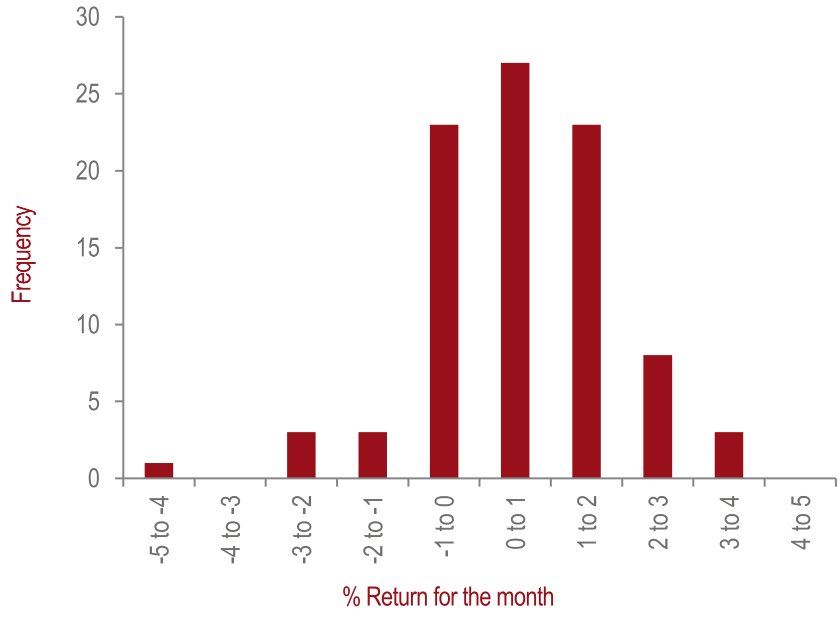
TOP 10 RELATIVE VALUE POSITIONS

- RIO TINTO - RIO TINTO
- BHP BILLITON - BHP BILLITON
- GROWTHPOINT PROPERTIES - INGENIA COMMUNITIES GROUP
- BWP TRUST - CARINDALE PROPERTY TRUST
- GPT GROUP - MIRVAC GROUP
- BWP TRUST - CENTURIA CAPITAL
- AUSTRALIAN UNITY INVESTMENT REAL ESTATE - CROMWELL PROPERTY GROUP
- AUSTRALIAN UNITY INVESTMENT REAL ESTATE - NATIONAL STORAGE REIT
- AVENTUS RETAIL PROPERTY FUND - CENTURIA CAPITAL
- OOH!MEDIA - QMS MEDIA

TOP 10 SPECIAL SITUATION POSITIONS

- June 19 Put Spread on AS51
- NUFARM FINANCE NZ LTD-NSS (AU)
- ELANOR RETAIL PROPERTY FUND (AT*)
- SUPERLOOP LTD (AT*)
- GRAINCORP LTD (AU)
- PARADIGM BIOPHARMACEUTICALS (AT*)
- SUNCORP GROUP NOTE (AU)
- PARAGON CARE LTD (AT*)
- PEET LTD (AT*)
- 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.

SIGNIFICANT EVENT NOTICE

In other Ellerston news, Chris Hall has been appointed to the position of Chief Investment Officer of Ellerston Capital Limited, reporting to the Executive Chairman, Ashok Jacob. Chris joined Ellerston in September 2018 as Senior Investment Officer. Over his 28 years in investment management, Chris has built a wealth of experience in risk oversight, investment process improvement and business expansion – including Asia – alongside producing an impressive track record of investing in equity markets.

Prior to joining Ellerston, Chris was Managing Director and Senior Portfolio Manager and Co-Head of Research for BlackRock's Alpha strategies Group in Hong Kong, where he was the lead Co-PM on the BlackRock Asia Pacific Equity Income fund, BGF Pacific Equity fund and BGF Asean Leaders fund, as well as being a member of the Management Committee overseeing the Asian Fundamental Equities Team with A$35 billion in assets.

Ashok Jacob remains the Executive Chairman of Ellerston Capital Limited and continues to provide guidance and investment insight to the Ellerston team.

CONTACT US

Should investors have any questions or queries regarding the fund, please contact our Investor Relations team on 02 9021 7797 or info@ellerstoncapital.com or visit us at https://ellerstoncapital.com/

All holding enquiries should be directed to our registrar, Link Market Services on 1800 992 149 or ellerston@linkmarketservices.com.au

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