Ellerston Capital

Ellerston Overlay Australian Share Fund (OASF)

Performance Report | April 19

PERFORMANCE SUMMARY

Gross %	1 Month	3 Months	FYTD	1 Year	3 Years p.a.	5 Years p.a.	Strategy Since Inception p.a.
OASF	3.52	5.23	-2.31	-5.46	8.96	7.04	10.63
Benchmark	2.37	9.29	5.76	10.41	11.10	7.52	10.90

Past performance is not a reliable indicator of future performance.

MARKET COMMENTARY

Market Overview

Global markets climbed again in April and ended the month close to the all-time highs reached in January 2018. The MSCI World Index was up 4.5% in AUD terms with Developed markets outperformed Emerging markets by 1.4%. The developed market that stood out was Germany's DAX (+7.1%) and April also saw continued strength in the US markets. Gains were driven mostly by an expansion in the Price to Earnings (P/E) multiples of the markets. Strength in global PMI data, accommodative central banks, renewed talk of a resolution to the US-China trade dispute, and expectations of a recovery in Chinese growth all buoyed markets.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index recorded very strong gains with returns of +4.1% and +2.7% respectively. The NASDAQ had an even stronger month, up 4.8%.

The US market was driven by a much higher than expected Q1 GDP growth print of 3.2% annualised. While the US economy is expected to slow from its above-trend pace of growth, an accommodative monetary policy and better manufacturing data spurred investor optimism. Also, last month's fears of an imminent recession from a temporarily inverted yield curve were allayed.

Europe

European equity markets also continued to deliver positive returns despite manufacturing being a weak spot. Manufacturing PMI only improved slightly to 47.8 in April but the Euro STOXX 50 Index was up strongly, rising 5.3%. The ECB left rates unchanged and expects them to remain at current levels at least through 2019. Markets were encouraged by a new series of targeted longer-term refinancing options announced by the ECB to safeguard bank lending conditions. Growth in Italy and Spain surprised on the upside, lifting Eurozone Q1 GDP to 1.5% annualised. Despite the political uncertainly, UK economic data was also a positive surprise.

Accordingly, the key European indices continued their upward trend. As previously mentioned, Germany's DAX was the standout performer, while France's CAC 40 and the FTSE 100 were also up strongly with returns of +4.9% and +2.3% respectively.

Asia

Asian equities caught the global rally. Japan's Nikkei 225 was up almost 5%, Korea's KOPSI Composite Index up 2.9% while the Hang Seng Index rallied 2.3%. In China, GDP grew 6.4% year-on-year in 1Q19 – this was above market expectations. Not too surprisingly, Chinese equities lost some momentum in April after a strong rally in Q1. The SSE Total Market Index was up 0.8%.

Investment Objective

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

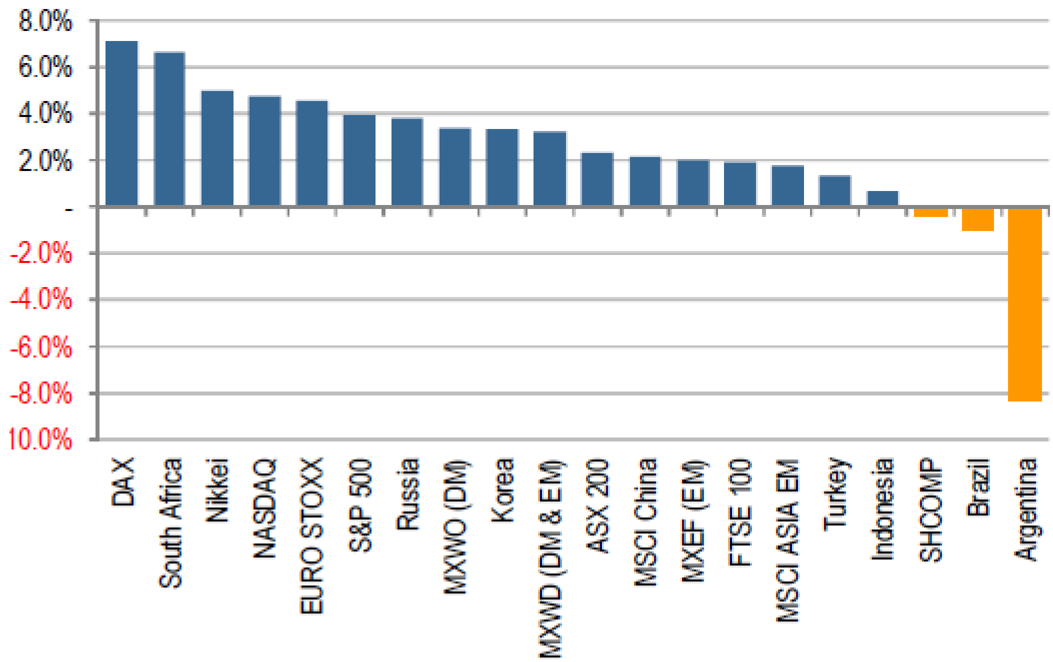
Investment Strategy

The Fund uses a benchmark-independent, high conviction approach that looks beyond investing in the Top 20 Australian equity stocks in order to capture the neglected opportunities and uses derivatives to enhance income

Key Information

Strategy Inception Date	4 January 2012
Fund Net Asset Value	$1.1006
Liquidity	Weekly
Application Price	$1.1034
Redemption Price	$1.0978
No Stocks	20
Management Fee	0.90%
Buy/Sell Spread	0.25%
Performance Fee	15%
Firm AUM	Over $5 Billion

Global Equity Markets' Performance in April 2019

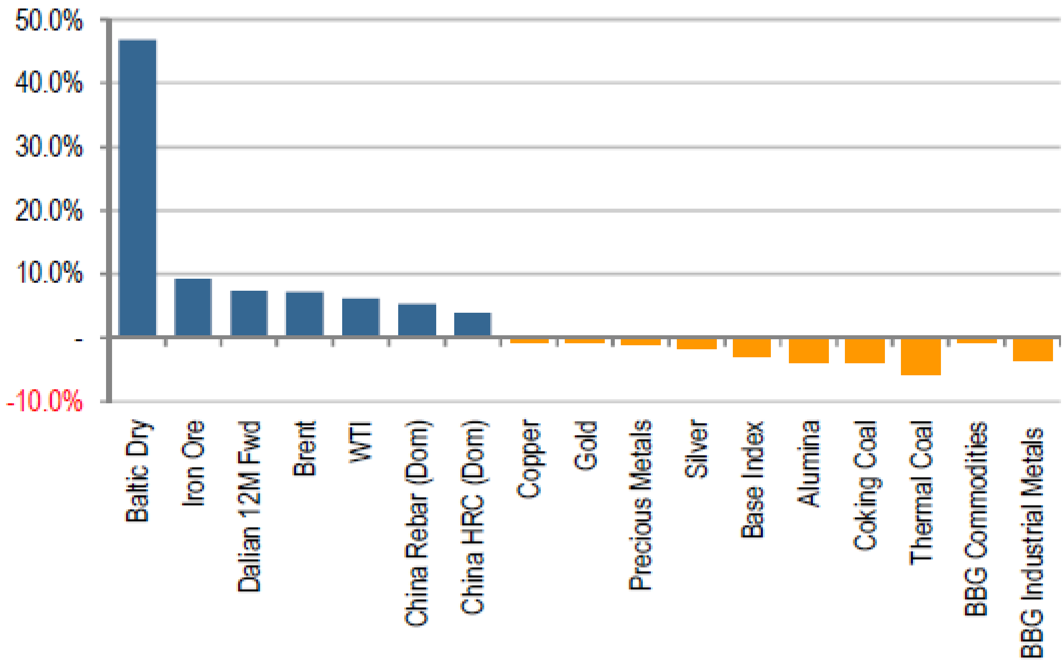


Source: JP Morgan, Bloomberg.

Commodities

In April, base metals fell, led by Aluminium (-6.7%) and Nickel (-5.9%), giving back some of the strong gains made in Q1. The LME base Metal Index fell 2.8%. Oil had another strong month, with Brent +7.2% and WTI +6.0%. The strength was in part due to action taken by the US to end a set of waivers on importing oil from Iran, and continued optimism that OPEC and Russia would cut supply. Iron ore prices held at elevated levels as ongoing supply-side tightness persisted, alongside robust Chinese steel demand. The key 62% index rose over 9% to US $94.9 per ton. Thermal coal fell 5.9%.

Commodity Performance in April 2019



Source: JP Morgan, Bloomberg.

Bonds

Global bonds rallied strongly in March as the Fed signalled a more dovish stance and the US yield curve inverted. But in April, fears of a likely recession in the US abated and the inversion was considered temporary. The US 10-year bond ended the month at 2.50% with the 2-year bond ending at 2.27%.

In Australia, an expectation of a rate cut has led to the short end falling. The 2-year bond fell 14 basis points to 1.32%. The spread between LIBOR and OIS tightened and is now trading below its 5-year average.

Australia

The **S&P/ASX 200 Accumulation Index ended the month up 2.4%** - trading to a 12-year high of 6,388 into month end. The best three performing sectors were Financials (+4.4%), Consumer Staples (+7.4%) and Consumer Discretionary (+5.0%). The bottom three sectors were Materials (-2.0%), Real Estate (-1.9%) and Utilities (-0.5%).

In April, the Small Ordinaries Accumulation Index was the best performer, up 4.1%, followed by the ASX 200 Industrial Accumulation Index, up 3.7%. The ASX 200 Resources Accumulation Index was the laggard and returned -2.5%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were BHP Group (-19 points), South32 (-12 points), Scentre Group (-9 points), Rio Tinto (-5 points) and GPT Group (-5 points).

Among the top five stocks that added to the positive index return were three of the major banks, namely, Commonwealth Bank of Australia (+41 points), Westpac Banking Corporation (+33 points) and Australia and New Zealand Banking Group (+20 points), with Woolworths Group (+12 points) and a2 Milk Company (+10 points) the remaining two.

In Australia, the budget occupied the headlines at the start of the month with a forecast return to surplus in 2019/20. Both the Coalition government and the Labor opposition then promised significant spending if elected to power when the Federal election is held on 18 May.

A weak Q1 CPI reading and concerns over slowing growth have the markets expecting a rate cut from the RBA either in May or June. The AUD fell 0.9% through April, dropping to a low of USD 0.6988 but ended the month at USD 0.7048.

COMPANY SPECIFIC NEWS

The Market Misses

Pilbara Minerals (PLS -22.8%)

After a strong March due to declaring commercial production at its Pilgangoora Mine and a solid March quarter production update, market concerns about weak lithium pricing impacted PLS and the sector.

Galaxy Resources (GXY -22.3%)

Despite some big announcements such as new CEO Simon Hay starting from 1 July, GXY performed poorly this month after releasing disappointing March quarter production results and lithium weakness. In addition the part sale of its Sal de Vida operations in Argentina has been unable to get bids at similar valuations to POSCO's previous investment, impacting sentiment and valuation.

Evolution/ Regis Resources/ Northern Star (EVN -12.8% / RRL -9.6% / NST -8.5%)

Like the lithium names above, the gold miners suffered as the underlying commodity rolled over on improved economic and risk factors. The precious metal sold off from ~US$1300 to US$1270/oz during the month, dragging the sector down with it.

South32 (S32 -10.5%)

S32 was hit with a weak production update across nearly all commodities with coal, alumina and manganese all disappointing. In a relatively tough month for the broader mining sector, earnings downgrades of ~5% meant S32 suffered more than most.

Viva Energy Group (VEA -9.8%)

VEA provided a soggy market update as the surge in oil impacted the retail business. Whilst refining benefited, its retail fuel arm suffered from weak volumes and margin compression as the market was slow to pass on the higher prices. The $30-$35 million hit represented a downgrade of ~5%.

Flight Centre Travel – (FLT -8.7%)

FLT downgraded FY19 guidance range by 14% due to weakness in the Australian leisure business. The company has blamed a weakening macro environment and a number of internal disruptions that effected profitability. Their corporate offer remains strong, particularly in the US, but it has been unable to offset the domestic pressures.

The Market Hits

Eclipx Group (ECX +58.6%)

ECX retraced some of its underperformance after falling sharply last month when McMillan Shakespeare terminated its take-over offer following two profit warnings from the company.

DuluxGroup (DLX +31.8%)

Nippon Paint has entered into an agreement to acquire 100% of DLX shares for $9.80/share in cash by way of a Scheme of Arrangement, representing a 28% premium to the prior close and a remarkable EBITDA multiple of 16.1x.

Nearmap (NEA +23.5%)

NEA ran strongly across the month as news emerged that the aerial imagery technology company would be added to the S&P/ASX 200 index. Strong financials and early success in the US has driven enthusiasm for the group.

Magellan Financial Group (MFG +22.5%)

As at the end of March, MFG had A$79.4 billion in funds under management, +21.7% on the prior corresponding period. Solid investment performance and continued inflows, both in the retail and institutional space, have propelled the share price over the last 12 months. MFG's earnings delivery and rerating see the stock trading on a P/E of almost 23x FY20 consensus earnings.

Afterpay Touch (APT +22.1%)

APT continued its dramatic surge north as brokers scrambled to upgrade earnings and price targets. The announcement that the company would launch in the UK during 2H19 also fuelled enthusiasm for the group.

Healius (HLS +18.6%)

The stock continued its recent rebound on the back of media speculation it will receive a takeover bid from a consortium of private equity firms. The company received and rejected an approach from its largest shareholder, China based Jangho, back in January. Favourable pre-election announcements from the federal government and opposition regarding a boost to Medicare funding for the services HLS provides, has also been helpful for the share price.

Breville Group (BRG +18.2%)

BRG reiterated FY19 guidance of just above 11% EBIT growth and continued to highlight the success of the company's overseas growth strategy with its launch into Switzerland at the beginning of April.

a2 Milk (A2M +17.2%)

During the month, A2M provided a 3Q19 update which indicated that trading across all regions has tracked to company expectations with FY19 guidance unchanged. Incrementally, A2M indicated that the weakening AUD (vs NZD) will act to dilute 2H19 EBITDA margins and that recent increases in dairy pricing will have 'some impact' in FY20.

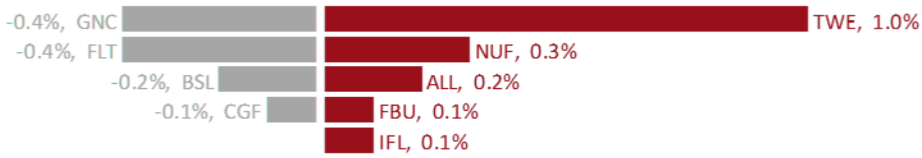
FUND PERFORMANCE

We were pleased to outperform in a rising market. The Fund delivered a return of +3.52% in the month of April, outperforming the benchmark return of +2.37% by 1.15%.

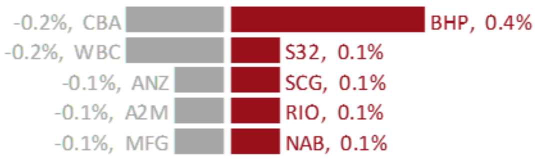
Returns[1] (%)	Gross	Benchmark	Excess	Net
1 Month	3.52	2.37	1.15	3.43
3 Months	5.23	9.29	-4.05	4.97
FYTD	-2.31	5.76	-8.07	-3.15
Rolling 12 Months	-5.46	10.41	-15.86	-5.71
3 Years (p.a.)	8.96	11.10	-2.14	8.07
5 Years (p.a.)	7.04	7.52	-0.48	6.08
Since Inception* (p.a.)	10.63	10.90	-0.26	9.53
Since Inception* (cum)	109.77	113.48	-3.71	94.90

Source: Ellerston Capital Limited

Securities Held



Securities Not Held



Source: Ellerston Capital Limited

The main positive contributors to this month's performance were overweight positions in Treasury Wines (TWE +15.2%), Nufarm (NUF +7.4%), Aristocrat Leisure (ALL +6.4%), Fletcher Building (FBU +4.7%) and IOOF Holdings (IFL +6.1%).

Having zero holdings in BHP (BHP -2.8%), South 32 (S32 -10.5%), Scentre Group (SCG -7.1 %), Rio Tinto (RIO -2.6%) and National Australia Bank (NAB +0.32%) also contributed positively.

The main detractors from performance were overweight positions in Graincorp (GNC -2.0%), Flight Centre (FLT -8.7%), Bluescope Steel (BSL -3.6%), and Challenger (CGF -0.7%).

Having a zero holding in Commonwealth Bank (CBA +5.5%), Westpac Bank (WBC +6.1%), ANZ Bank (ANZ +4.5%), A2 Milk (A2M +17.2%) and Magellan Financial (MFG +22.5 %) also acted as a drag on the Fund's relative performance.

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[1] Returns are calculated using the Fund's redemption price and are net of fees and expenses. Returns are also calculated on the basis that distributions are reinvested.
Returns of the Fund may include audited and un-audited results.
The benchmark was changed to the S&P/ASX200 Accumulation Index on 4 January 2012. Past performance is not a reliable indicator of future performance.
*Since Inception is 4 January 2012.
Source: Ellerston Capital Limited

FUND ACTIVITY

The Fund was active in April. We added to some of the new positions recently introduced into the portfolio and to our core holdings where we believed that valuation upside was still compelling.

We exited our position in Tabcorp Holdings and reduced our holdings in JB Hi-Fi, QBE Insurance Group and IOOF Holdings following share price rallies resulting in a narrowing of valuation upside.

NEW STOCKS ADDED	STOCKS EXITED
	• Tabcorp Holdings

POSITIONS INCREASED	POSITIONS DECREASED
• Orica	• JB Hi-Fi
• Star Entertainment Group	• QBE Insurance Group
• oOh! Media	• IOOF Holdings
• Treasury Wine Estates	

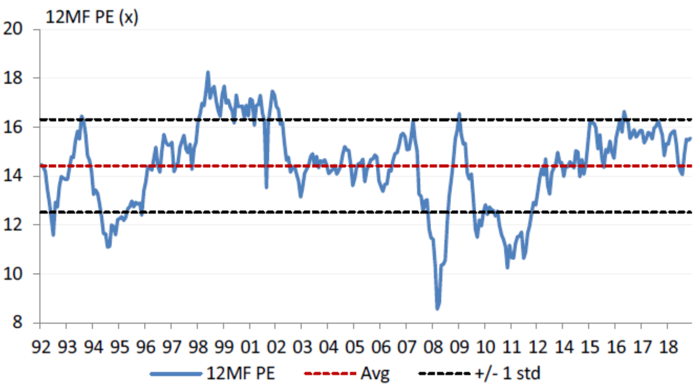
Tabcorp Holdings (TAH)

We exited the position in TAH during the month. The valuation is no longer attractive enough to compensate for several near-term earnings headwinds. The Lotteries business remains well placed for long-term growth now the monopoly position has been reinforced by tighter regulation and the migration to digital distribution continues. However, the benefits of the recent Powerball game changes have been realised and a favourable run of luck in the lotteries business in FY19 will create a material growth headwind for FY20. The wagering division is yet to realise the majority of the synergies that arise from the Tatts acquisition but the environment remains extraordinarily competitive and we are not convinced Tabcorp is seeing the revenue benefits from its decision to ramp up promotions and special offers for its customers.

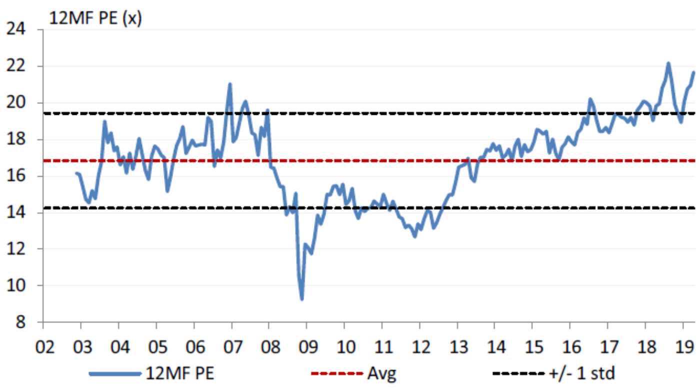
FUND STRATEGY AND OUTLOOK

Our strategy remains unchanged. Our concerns on the sustainability of earnings and stretched valuations for the market as a whole remain. Following the rally in the market last month, valuations are stretched even further, despite a subdued earnings growth profile. Forward consensus multiples are **15.5x for the broader ASX 200 Index** and **21.7x for the Industrials ex-Financials**.

ASX 200 PE: 15.5x



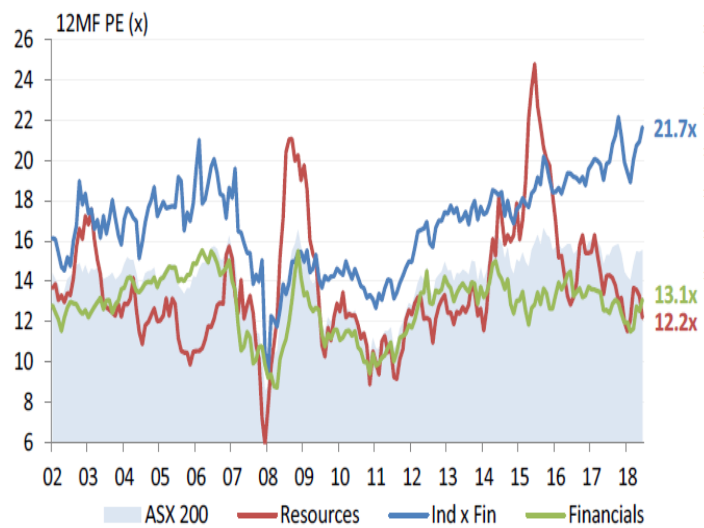
ASX 200 Industrials ex-Financials: 21.7x



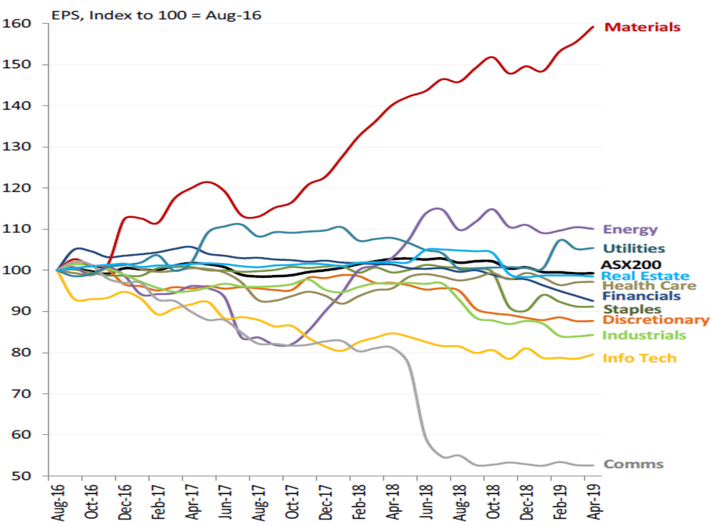
Source: RIMES, IBES, Morgan Stanley Research.

The Industrials ex-financials valuations are now trading at previous highs. As we've said before, this re-rating is hard to justify without the commensurate earnings growth to match. To reiterate the context for the P/E re-rating for the Industrials, as at the end of April, it is even more noticeable that most of the EPS revisions have been from the Materials sector, with other sectors lagging!

12-month forward PE



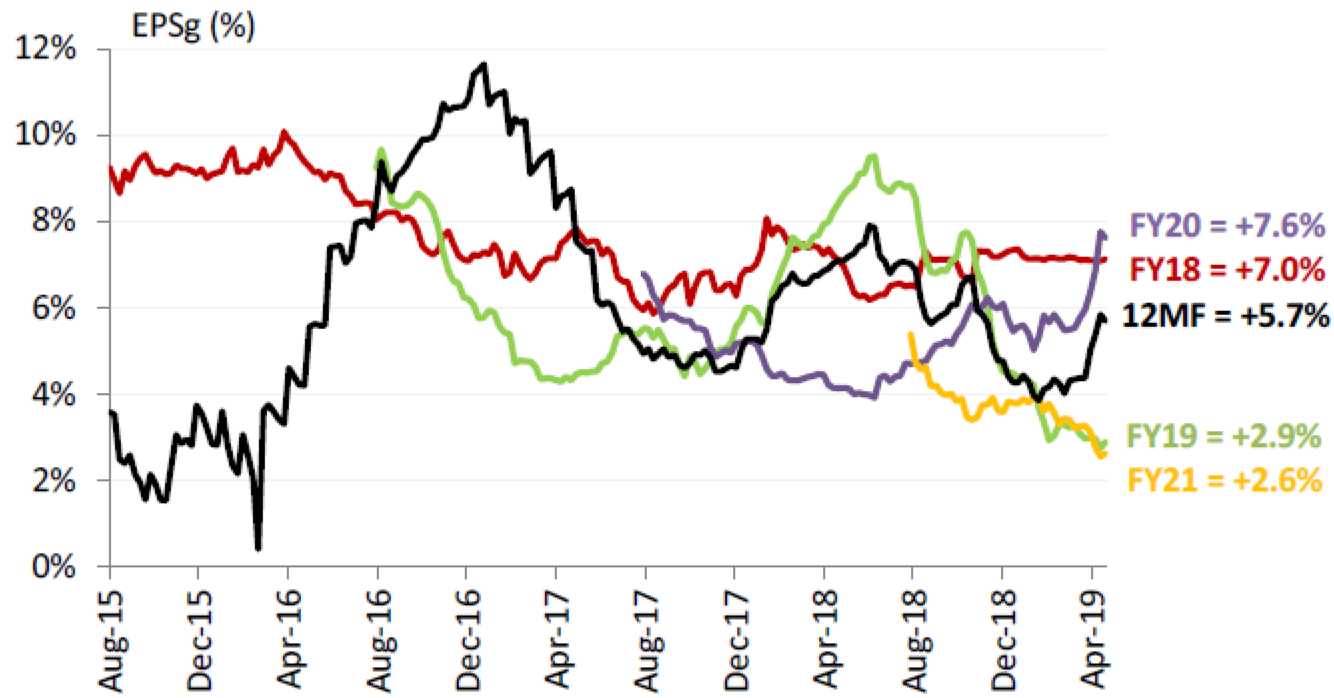
FY19 consensus EPS revision trends by sector



Source: RIMES, Morgan Stanley Research.

So, the uptick in EPS expectations for FY20 (relative to March) has been narrowly driven by the Materials sector. Aggregate consensus EPS growth for FY19 has moved down even further in March, now sitting at +2.9%.

EPS expectations revised down again – FY19 at only +2.9%



Source: RIMES, IBES, Morgan Stanley Research.

Investment risks to the market remain, despite central banks moving to a more accommodative stance. The ebb and flow of the trade war between the US and China is an ever constant presence. As I write, President Trump tweeted about his frustration over the pace of negotiations and alluded that another $325 billion of goods would incur tariffs of 25%, causing markets to take fright. Our concerns once again are: the negative effects of a trade war, and slowing global growth including growing fears of a European slow down. 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 the uncertainty created by a pending Federal election this year.

It makes for a volatile investment environment in 2019 to continue. 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, especially from overseas players if the AUD weakens further.

Warm Regards,

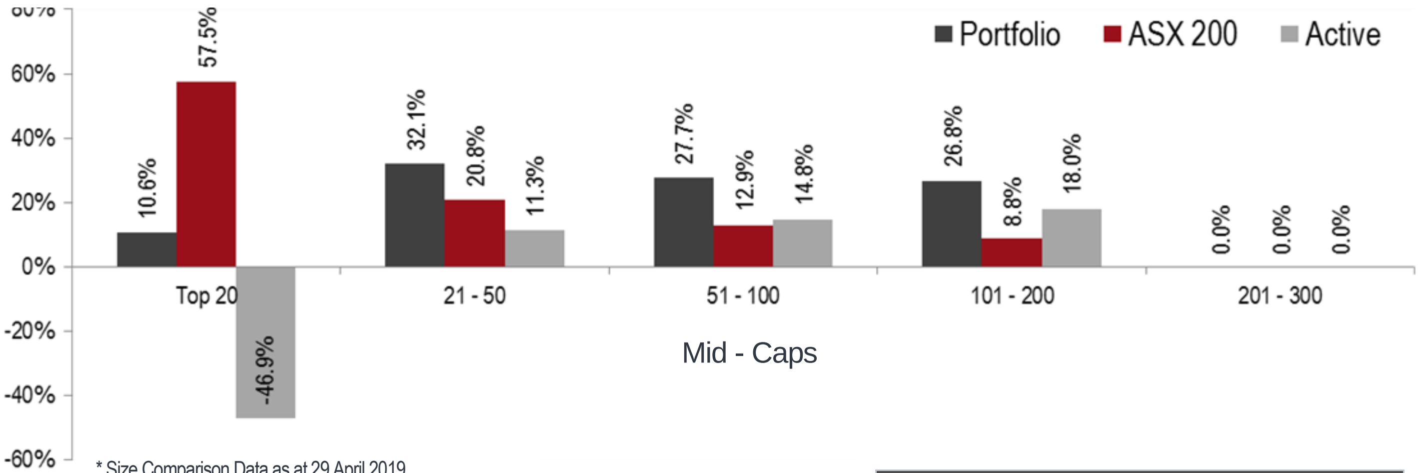
Chris Kourtis

Portfolio Manager

ELLERSTON CAPITAL

PORTFOLIO FEATURES

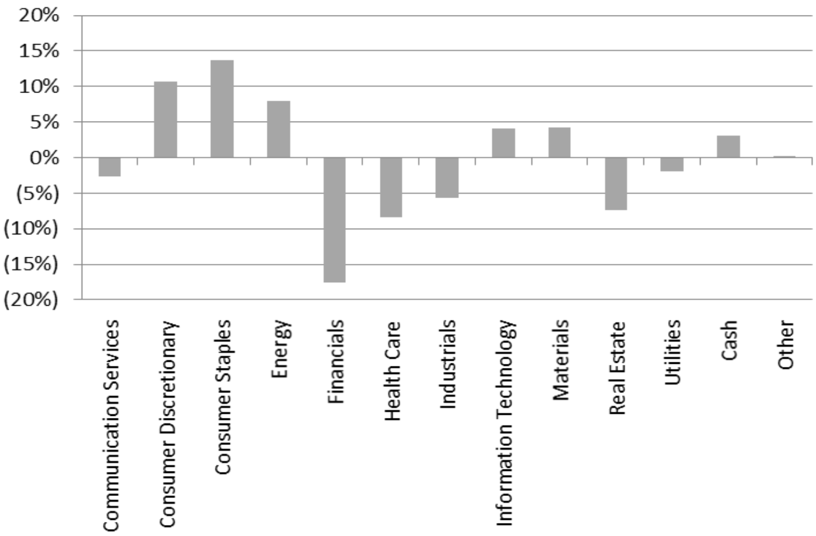
Size comparison Chart vs ASX 200



* Size Comparison Data as at 29 April 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 PETROLEUM

ASSET CLASS EXPOSURES	
EXPOSURE (% OF NAV)	Net
EQUITY	96.97
LONG OPTION	0.0
SHORT OPTION	(0.90)
EFFECTIVE CASH	3.93
GRAND TOTAL	100%

* 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.

ELLERSTON CAPITAL

ABOUT THE ELLERSTON OVERLAY ASF

The Fund aims to achieve its performance objectives by adopting a fundamental "bottom-up" investment approach to stock selection whilst delivering additional income where possible, through option strategies.

Because of the nature of the strategy, at least 75% of the Fund's exposure is aligned to the portfolio of the Ellerston Australian Share Fund.

The 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.

FUND FACTS

STRATEGY FUNDS UNDER MANAGEMENT	$223 MILLION
FUNDS UNDER MANAGEMENT –UNIT TRUST	$16 MILLION
APPLICATION PRICE	$1.1034
REDEMPTION PRICE	$1.0978
NUMBER OF STOCKS	20
INCEPTION DATE	4 January 2012

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