

# Ellerston Global Equity Managers Fund (GEMS)

Performance Report | May 19

## PERFORMANCE SUMMARY

Net %	1 Month	3 Months	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	Strategy Since Inception p.a.
GEMS C	1.65	2.61	-14.30	2.52	10.30	9.91

Past performance is not a reliable indicator of future performance.

## 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 KOSPI Composite Index was down 7.3% and the Chinese SEE Total Market Index was down 6.5%.

### Investment Objective

The investment objective is to generate superior returns for Unitholders with a focus on risk and capital preservation.

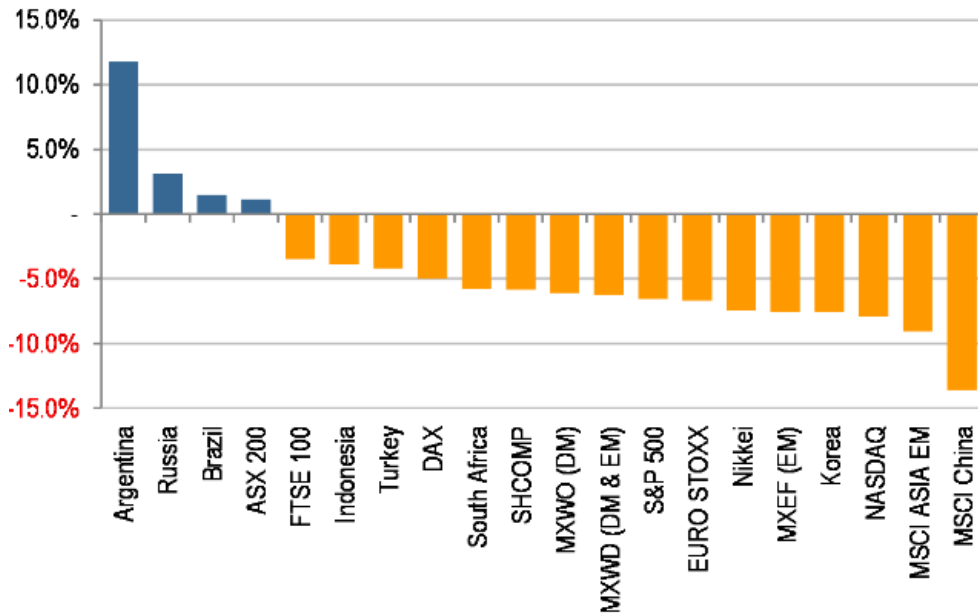
### Investment Strategy

- Global long/short equity
- Overlays fundamental stock selection with macroeconomic outlook
- Bias towards Australia

### Key Information

Strategy Inception Date	1 December 2009
Fund Net Asset Value	A\$156.1M
Liquidity	Monthly
Application Price	A\$ 1.4612
Redemption Price	A\$ 1.4539
No. Stocks	81
Gross Exposure	172%
Net Exposure	3%
Management Fee	1.50% p.a.
Buy/Sell Spread	0.25%
Performance Fee	16.50%
Firm AUM	Over A\$5b

**Global Equity Markets' Performance in May 2019**

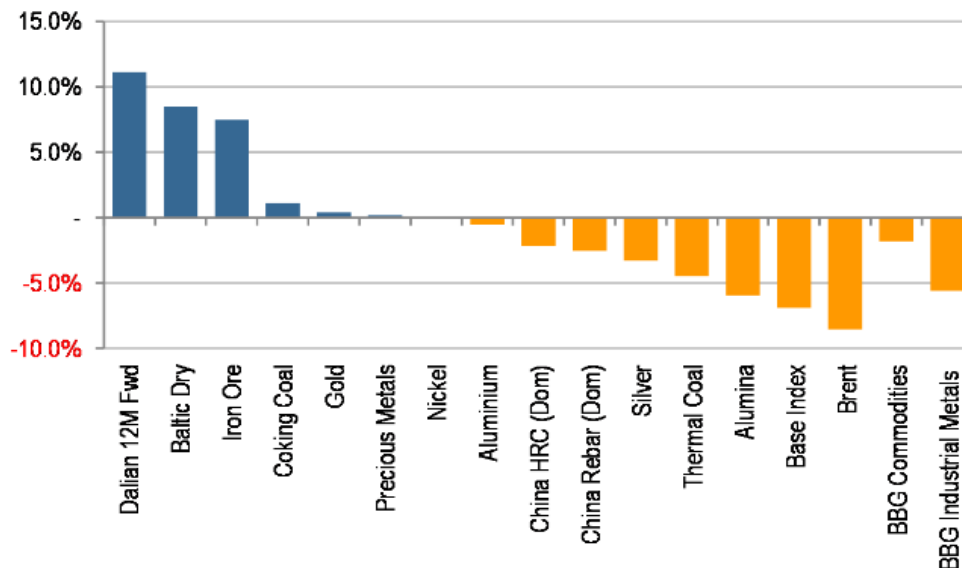


Source: JP Morgan, Bloomberg.

## 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.

**Commodity 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. 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.

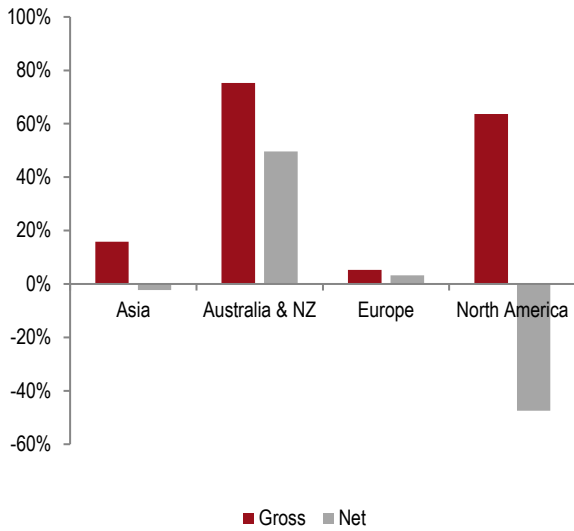
## OUTLOOK AND PORTFOLIO COMMENTARY

The portfolio performed strongly during the month of May in the face of weak global markets which were driven down by escalating trade and geopolitical tensions. An almighty battle is being fought between the bond market which is screaming to the world that recession is looming large and global Central Banks who have flagged willingness to facilitate indefinite ZIRP (Zero Interest Rate Police) and QE outcomes. To date the Central Banks are winning as investors scramble to find returns and try to be anywhere but cash.

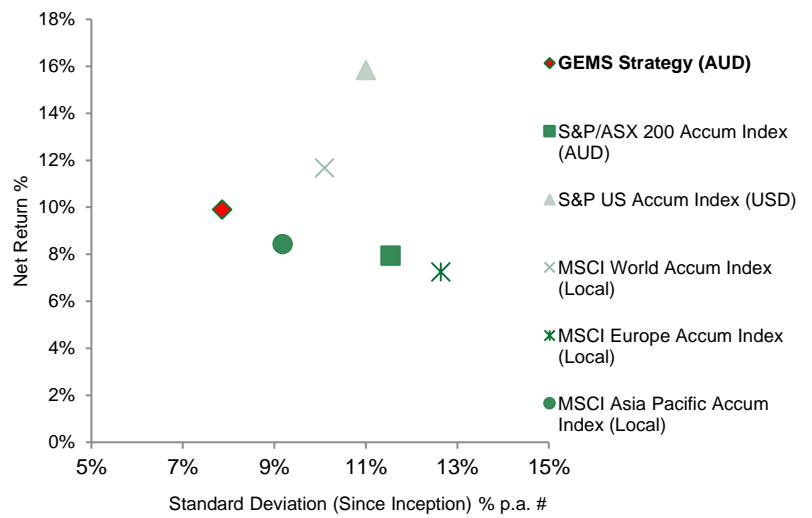
For the month of May the portfolio delivered a net return of 1.65%. The portfolio's long exposure at the end of May was 81.59% while short exposure was 78.42% and has increased materially post the end of the month. During the period contributors to performance included: **Lynas Corp** which benefited greatly from trade tensions as Chinese leaders implied they might withhold supply of rare earths to the US. As the only material non-China based supplier of rare earths, the strategic value of the Lynas assets was strongly highlighted to investors. **Kidman** received a takeover bid from Wesfarmers at a significant premium. We had owned Kidman for its low cost, strategic lithium resource where the company had successfully attracted a strong partner in SQM and put in place supply contracts with Tesla, LG Chem and other significant customers. **Newcrest** continued to perform strongly as gold hovered close to the high end of its seven year trading range and looked set to break out. We have significant gold exposure in the portfolio with Newcrest, Evolution and Gold Roads. This exposure is further enhanced through the ownership of long dated call options on the Gold ETF in the US that tracks the spot gold price.

Detractors included: **GrainCorp** which fell after reporting a drought affected disappointing earnings result. The company continues to execute on its clearly articulated strategy of smoothing the cash flow profile of its grain handling operations and spinning off its malting assets. We believe this will unlock material value for shareholders over the next 6 to 12 months.

### Market Exposure as a % of NAV



### GEMS Strategy Performance & Volatility <sup>^</sup>



### Top Holdings (Alphabetical, Long only)

- BP PLC
- CATAPULT GROUP
- CLOVER CORP
- GRAINCORP
- LYNAS CORPORATION LIMITED
- MONEY3 CORP LIMITED
- NEWCREST MINING
- ORICA LIMITED
- STARS GROUP
- TASFOOD LIMITED

### Key Service Providers

<b>REGISTRY:</b>	LINK MARKET SERVICES LIMITED
<b>AUDITOR:</b>	ERNST & YOUNG
<b>PRIME BROKER:</b>	MORGAN STANLEY INTL & CO PLC & GOLDMAN SACHS INTERNATIONAL
<b>ADMINISTRATOR:</b>	CITCO FUND SERVICES (AUSTRALIA) PTY LTD
<b>CUSTODIAN:</b>	STATE STREET AUSTRALIA LIMITED

Source: Ellerston Capital

### Material Matters

During the month there were no material changes that would impact the Fund in terms of its risk profile, investment strategy or investment staff. There have been no changes to the key service providers described above.

## ABOUT THE ELLERSTON GLOBAL EQUITY MANAGERS 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.

## 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**

### SYDNEY OFFICE

Level 11, 179 Elizabeth Street,  
Sydney NSW 2000

### MELBOURNE OFFICE

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

## DISCLAIMER

<sup>^</sup> Actual performance for your account may vary from that set out in this newsletter and will vary for investments made in different classes, or at different times throughout the year. Some performance data is estimated and preliminary and subject to change.

<sup>^^</sup> For the period 1 January 2002 to 30 April 2006, the CPH Group GEMS Portfolio was not operated within a separate fund structure. The underlying investment assets of the CPH Group GEMS Portfolio were owned during that time within corporate entities of the CPH Group for which audited accounts were prepared on an annual basis. Accordingly, in order to provide relevant historical performance information for the period 1 January 2002 to 30 April 2006 (Historical Returns) net returns were calculated on the basis of the actual dollar returns of the CPH Group GEMS Portfolio adjusted to reflect a fund structure similar to the Fund and including all fees. For GEMS B, GEMS A returns have been used between 1 May 2006 and 2 November 2009. The returns of the Fund and the relevant Indices are net of fees, expenses and taxes and assuming distributions are reinvested.

The returns and risk of the Fund and the relevant Indices are net of taxes, fees and expenses and assuming distributions are reinvested. The performance figures presented are for the Ellerston Global Equity Managers Fund GEMS C Units. The one month return figure may be an estimate and not the final return. This estimate also impacts other performance information provided. Estimated performance figures are preliminary and subject to change. Returns for other classes may differ slightly. Past performance is not indicative of future performance. Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000 is the responsible entity of the Ellerston Global Equity Managers Fund ARSN 118 887 095 (Fund). This newsletter has been prepared by Ellerston Capital Limited without taking account of the objectives, financial situation or needs of investors. Before making an investment decision you should consider your own individual circumstances and obtain a copy of the Product Disclosure Statement for the Fund dated 18 December 2017 which is available by contacting Ellerston Capital. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. To the full extent permitted by law, none of Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this newsletter and disclaims all liability that may arise due to any information contained in this newsletter being inaccurate, unreliable or incomplete.

<sup>#</sup> The standard deviation is often used by investors to measure the risk of an asset. The standard deviation is a measure of volatility: the more an asset's returns vary from the average return, the more volatile the asset. A higher standard deviation means a greater potential for deviation of return from the average return of the asset.