

# Ellerston Australian Market Neutral Fund

Performance Report | August 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	1.71	8.81	8.04	-1.81	-0.25	3.20	6.29
RBA Cash Rate	0.08	0.27	0.65	1.39	1.46	1.71	1.88
Alpha	1.63	8.54	7.39	-3.20	-1.71	1.49	4.41

Source: Ellerston Capital Limited

%	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2019	-0.92	-0.72	-4.03	3.28	0.17	5.98	0.94	1.71					6.29
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	<b>65%</b>	Net Equity Exposure	<b>+24.0%</b>
No. Relative Value positions	<b>91</b>	Gross Portfolio Exposure	<b>191.3%</b>
No. Special Situations	<b>36</b>	Correlation Coefficient (vs ASX 200 Accum)	<b>5.49%</b>
Beta Adjusted	<b>7.8%</b>	Net Sharpe Ratio ( RFR = RBA Cash)	<b>0.83</b>

## PERFORMANCE

The Fund returned +1.7% in August, outperforming the benchmark return of +0.1%. The positive return saw strong contributions from both Special Situations (+1.1% gross) and Relative Value (+0.7% gross). August captured most of the FY19 reporting season, and volumes across the market were light as anticipated. Net exposure was +24%, with a beta-adjusted net of 7.8%. Gross exposure closed the month at 191%.

The spread between the Australian and UK listings of BHP Group (-11.0%) narrowed during the month, assisted by the stronger GBP/AUD cross rate and contributing positively to performance.

### 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** \$191.5M

**Liquidity** Daily

**Application Price** \$1.0025

**Redemption Price** \$0.9975

**Management Fee** 1.20%

**Buy/Sell Spread** 0.25%

**Performance Fee** 20% of outperformance

**Firm AUM** Over \$5 billion

Carindale Property Trust (-2.6%) announced in their FY19 results that Kmart would lease the 2nd level floor space being vacated by David Jones, who are shrinking their store foot print at the Brisbane-based Carindale shopping centre. Although this removes leasing risk for the trust, it locks in a rent below the markets expectations and resulted in slight broker valuation downgrades. Long positions in Carindale hedged with BWP Trust (+3.7%) and Aventus Group (+6.1%) detracted from the performance of the Fund. Despite Carindale's gearing increasing marginally to 30%, the firming of the asset's cap rate by 25bps to 4.75% is a positive for the REIT.

Activist short seller Bonitas Research issued a scathing report on Rural Funds Group (-6.9%) in the month, alleging financial impropriety and highlighting irregularities in their prior financial reports. The market reacted quickly, and before being placed into a trading halt, the stock had fallen 42%. In defence of the allegations, Rural Funds provided a line-by-line rebuttal and engaged Ernst & Young to conduct an independent investigation into the matter. The market appeared satisfied with management's response, and the stock rallied strongly into month's end. The Fund closed its pair with VitalHarvest (+0.6%), with the paired position contributing positively to performance.

It was a busy month in the media space, with M&A, capital raisings, and downgrades impacting a number of our pairs. Outdoor advertising company oOh!media (-30.5%) revised down its earnings expectations as a result of a significant decline in advertising spend. Management cut FY20 guidance ~17% and the market reacted swiftly with the stock closing down 27% on the day. Our paired position with QMS Media Ltd (-12.6%) contributed positively to performance in the month. Further, QMS raised \$12m via an institutional placement @ 84c per share (a 6.1% discount to the last close) for the acquisition of the Australian assets of TLA Worldwide. QMS is also paired with a short in Nine Entertainment (-1.5%), however this pair detracted from performance in the month.

Our paired position between Event Hospitality and Entertainment (+3.4%) and Village Roadshow (+4.9%) also added to performance during the month following a strong set of number from Village showing a return to profitability in FY19 and increased cash generation.

Charter Hall Long Wale REIT (+14.0%) undertook a \$261m equity raise to fund its share of the Telstra exchanges portfolio, comprising a \$130m placement and a \$131m rights issue. In addition to the raise, rumours of the stock being added to the widely followed FTSE EPRA NAREIT Index helped push the stock to all-time highs, and our paired position against Centuria Industrial REIT (+5.7%) detracted from performance. The Fund used the share price strength in Charter Hall Long Wale REIT to establish paired positions with Mirvac Group (-0.9%) and VitalHarvest.

Infigen Energy (+24.2%) contributed positively to performance after global energy giant Shell launched a \$617m all-cash takeover bid for local electricity retailer ERM Power (+34.4%). The deal price implies a 38.4% premium to the one-month volume weighted average price and highlights the interest in Australian energy generation assets. Despite the recent rally, Infigen continues to trade at a significant discount to our DCF valuation, which was upgraded post their recent FY19 result (and which reflects the upside of their C&I contracting strategy).

Kalium Lakes (-11.6%) was a negative performer for the Fund in August, following a positive reaction to the capital raise in July. The stock traded back to the deal price on light volume, as the market digested the additional shares on issue.

Aveo Group (+3.4%) informed investors it had entered a scheme of implementation with Brookfield for a cash price of \$2.195 per share, which includes a pre-announced 4.5 cent per share distribution. The Aveo board concluded that in light of Aveo's short-to-medium term outlook, the Brookfield transaction was in the best interests of security holders. Malaysian based Mulpha Group (which is Aveo's largest shareholder with a 24% holding) confirmed it would support the transaction. Following the announcement, the Fund exited its holding entirely, contributing positively to performance.

A 6% fall in the WTI oil price weighted down oil explorer Carnarvon Petroleum (-11.0%), which contributed negatively to the Fund in August. Carnarvon's resource is located on Australia's North West Shelf, and recently drilled wells are currently being appraised. We expect the stock to remain correlated to the oil price until the results are released to the market.

Imricor Medical Systems (+74.7%) contributed positively to the month's performance after a strong debut on the ASX. We participated in the IPO, which raised \$12m at 83 cents per share. Imricor develops MRI-compatible products for procedures to treat abnormal heart rhythms, and is working through regulatory approvals in Europe and Australia.

The Fund also participated in the IPO of Irish software company Fineos Corporation (+24.0%), which provides software used by life, accident and health insurance clients. The company earns 53% of its revenue in the Asia Pacific region with clients including AMP, CBA's CommInsure, NSW Workers Compensation Scheme, iCare and WorkSafe. The IPO raised \$211m in equity, which places a value on the company of \$712m.

After a weak August on the back of a failed transaction, Superloop's (-6.1%) share-price stabilised on lighter volumes towards the end of the month. Despite some recent challenges and a geared balance sheet, the company is well positioned to deliver positive results in the medium term. The company has a new fibre network that took 5 years to build, and we expect free cash generation to improve substantially given the capital investment phase is now complete.

## ACTIVITY

### Relative Value – Gross Contribution +0.74%

The reporting season offered a number of opportunities for the Fund to close existing and establish new pairs as information was released to the market. Convergence in the share prices of Insurance Australia Group (-4.2%) and Suncorp Group (+5.6%) allowed the Fund to close down the existing position. Despite both companies issuing lacklustre FY20 guidance, the valuation differential appeared unjustified and the market adjusted accordingly.

We also established a long in Mirvac, hedging the exposure with GPT (+2.9%). Mirvac reported an in-line result and issued guidance of 3-4% EPS growth for FY20. Despite the slight EPS dilution of the recent capital raise, Mirvac's earning growth outlook is underpinned by 3 major apartment projects and its highly profitable 470 Collins Street office development. GPT on the other hand reiterated 2.5% EPS growth guidance for FY20, and the market focused on the poor operating metrics for the retail division (which were below expectations).

A placement by Transurban Group (-3.9%) provided an opportunity to establish a long position which was hedged with Sydney Airport (+0.8%). Transurban raised \$500m to take full ownership of the M5 West toll road in Sydney, acquiring the 35% it did not already own.

Volatile intra-month moves in the share price of Charter Hall Retail REIT (-3.5%) and Shopping Centres Australasia (+7.8) allowed the Fund to unwind an existing pair, and then re-establish a new pair towards month end. Both stocks reported in-line results, and we believe that current guidance for both appears conservative with potential upgrades coming from better than expected comp NOI growth.

Following continued share-price strength in Ingenia Communities Group (+15.5%), we reduced our exposure by partially unwinding the paired position with Aventus Retail Property (+6.1%).

### Special Situations – Gross Contribution +1.08%

Global equities manager Magellan Financial Group (-16.2%) raised \$275m at \$55.20 per share for a new ASX-listed investment trust. The Fund participated in the raise despite the share price more than doubling this year on the back of strong growth in assets under management.

The ACCC gave the green light for Canadian fertiliser giant Nutrien's \$469m takeover of Ruralco (+3.3%) despite concerns regarding its market dominance in a handful of locations. The approval, which comes almost six months after Nutrien lodged its takeover bid in February, will result in the soon to be merged Landmark/Ruralco being the dominant farm services player in Australia.

The Fund participated in a block trade of mining services company Ausdrill (+1.0%). The stake was held by Gresham Private Equity, which it received when Ausdrill bought Gresham-backed Barmenco in a scrip-based deal in 2018. The trade was for a block of 48 million shares worth 8% of the company, and was sold at the previous close of \$1.88. The block was well anticipated by the market and traded accordingly, closing up +6% the following day.

## SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Banks	0.0%	0.0%	0.0%
Div Financials	0.7%	0.0%	0.7%
Insurance	0.0%	0.0%	0.0%
Regional Banks	0.0%	0.0%	0.0%
REITs	40.6%	-44.0%	-3.4%
<b>Financials</b>	<b>41.3%</b>	<b>-44.0%</b>	<b>-2.7%</b>
Builders	0.0%	0.0%	0.0%
Consumer Disc	7.6%	-2.2%	5.4%
Consumer Staples	2.1%	0.0%	2.1%
Contractors	0.0%	0.0%	0.0%
Gaming	0.0%	0.0%	0.0%
General Industrials	6.2%	-1.0%	5.2%
Health Care	4.7%	0.0%	4.7%
Information Technology	0.0%	0.0%	0.0%
Infrastructure	2.5%	-2.5%	0.0%
Materials	4.0%	0.0%	4.0%
Media	6.0%	-2.8%	3.2%
Telcos	1.7%	0.0%	1.7%
Utilities	5.4%	0.0%	5.4%
<b>Industrials</b>	<b>36.3%</b>	<b>-8.6%</b>	<b>27.7%</b>
Bulk Metals	17.7%	-17.7%	0.0%
Energy	1.4%	0.0%	1.4%
Gold	0.0%	0.0%	0.0%
<b>Resources</b>	<b>23.0%</b>	<b>-17.7%</b>	<b>5.3%</b>
Hedge	7.0%	-13.4%	-6.4%
<b>Index</b>	<b>7.0%</b>	<b>-13.4%</b>	<b>-6.4%</b>
<b>Total</b>	<b>107.6%</b>	<b>-83.7%</b>	<b>24.0%</b>

Source: Ellerston Capital Limited

## MARKET COMMENTARY

### Market Overview

Global equity markets were unsettled by renewed tensions over trade between the US and China and fears over slowing global growth. Equities delivered negative returns overall, but most of the pain was felt in Emerging Markets, down 5.1%. A surging US dollar and the collapse of Argentina's equity market (-51%) following the shock defeat of that country's President in their elections, sparked fears of contagion, weighing heavily on Emerging Markets. Developed Markets fell 2.2%, impacted by weakness in technology shares and the sharp fall in the FTSE 100 on "no deal" Brexit fears.

### USA

The S&P 500 Index and the Dow Jones Industrial Average Index were in negative territory in August, returning -1.6% and -1.3% respectively. The NASDAQ was also weaker, with a return of -2.5% as tech stocks were caught up in trade war concerns. President Trump escalated all-out trade war fears by announcing a 10% tariff on the remaining \$300 billion of Chinese exports to take effect on 1 September. But the US then delayed some tariffs until 15 December, seemingly to allow for Christmas purchases by US consumers. China retaliated with plans to impose tariffs on \$75 billion of US goods. The trade war ping-pong has resumed.

In the meantime, the Fed kept rates on hold, July ISM Manufacturing came in below expectations at 51.2 and US 2Q GDP came in flat for the June Quarter at 2%.

## Europe

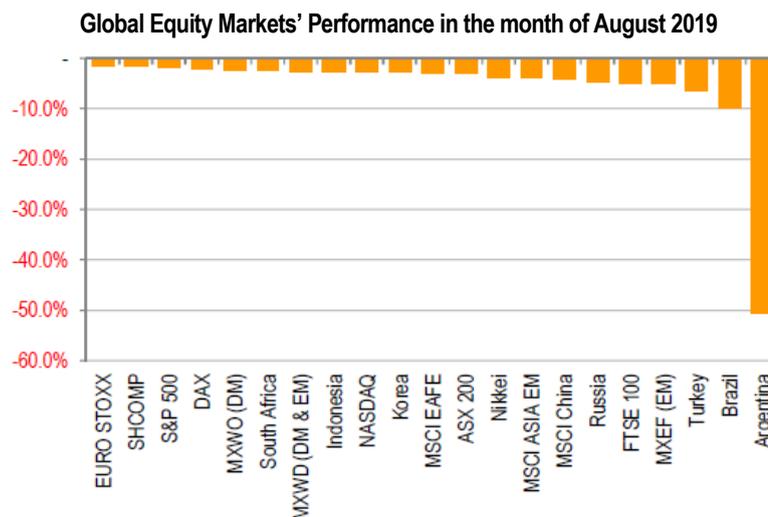
European equities were weaker across the board, with the Euro Stoxx returning -1.1%. Brexit, global trade fears and slowing growth pressured markets.

The UK's FTSE 100 was the worst performer falling 4.1%, as a "no deal" Brexit looked increasingly likely after new PM Johnson's strong push towards a hard Brexit. France's CAC 40 returned -0.7% and Germany's DAX returned -2.1%, impacted by weak economic data confirming that the German economy was slowing, with the Banks and Insurance sectors weighing on the market.

## Asia

Asian equities finished the month in the red, as the trade war rhetoric heated up, the USD strengthened and ongoing protests in Hong Kong which showed no signs of de-escalation, depressed investors' appetites.

Japan's Nikkei 225 was a poor performer with a return of -3.7%, but Hong Kong's Hang Seng (-7.1%) was the worst performer in the region, as civil unrest continued unabated. Other markets suffered, as the US and China traded blows on tariffs, with Korea's KOSPI Composite Index finishing down almost 3%, and the Chinese SEE Total Market Index recording a 1.1% decline, not helped by the Industrial Production print which surprised to the downside by falling to 4.8% vs 6% expected in July.

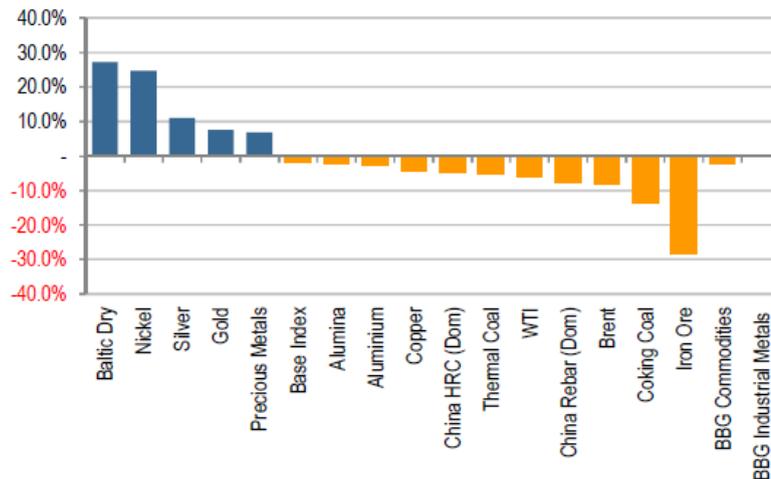


Source: JP Morgan, Bloomberg.

## Commodities

The commodities index slipped again in August, impacted by concerns over slower growth and trade war tensions. Iron Ore prices which spiked to US\$122/t only recently, tumbled spectacularly in August, falling 28.3% to US\$84.80/t. This broke the eight consecutive month positive run! Other bulks were also in negative territory with Coking Coal dropping 13.8% and Thermal Coal down 5.3%. In base metals, Nickel was the standout outperformer (+24.6%) on supply side concerns, but unsurprisingly, Copper (-4.2%), Aluminium (-2.8%) and Alumina (-2.2%) were all weaker, closely tied to slowing global Industrial Production. Brent also was lower too and ended the month down 8.2% to \$59.25/bbl. In August's risk-off environment, precious metals were stronger, with Gold and Silver gaining 7.5% and 10.9% respectively.

### Commodity Performance in August 2019



Source: JP Morgan, Bloomberg.

## Bonds

Continued worries over global growth saw bond yields drop even further in August. US 10-year bond yields closed the month at 1.5%, falling by over 50 basis points. The sharp fall in the long end of the US yield curve saw the curve invert once again, sparking fears of a pending recession down the track. The Australian 10-year bond yield fell to a new all-time low of 0.89% in August.

## Australia

**The S&P/ASX 200 Accumulation Index ended the month down 2.4%, breaking its run of 7 consecutive months of gains, with the results season delivering weak aggregate EPS growth and subdued outlooks. The index is however, still +20.3% for the calendar year to date.**

In August, the best three performing sectors in terms of their contribution to the index's performance were Health Care (+3.6%), Real Estate (+2.3%) and Consumer Discretionary (+0.2%). The bottom three sectors were Materials (-7.3%), Financials (-2.6%) and Energy (-5.6%).

The ASX 200 Industrials Accumulation Index was the best performer with a return of -1.0%. The Small Ordinaries Accumulation Index returned -3.9%, while the ASX 200 Resources Accumulation Index fell 7.5%. The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were BHP Group (-74 points), Australia and New Zealand Banking Group (-19 points), National Australia Bank (-18 points), Rio Tinto (-17 points) and Brambles (-17 points). The worst performing stock in the Index was Speedcast International which fell 58.9% in the month, after reporting that its 1H19 NPAT had fallen 30%.

The top five stocks that added to the positive index return were CSL (+30 points) taking the top spot for the second month in a row, Woolworths Group (+17 points), Lend Lease Group (+10 points), Newcrest Mining (+7 points) and James Hardie Industries (+7 points).

After two rate cuts in as many months and the expected lag in economic activity, the RBA left the cash rate on hold, with minutes suggesting that it was likely to keep rates steady for a period. The RBA was looking for domestic activity to deteriorate materially before more rate cuts would be forthcoming. The NAB business survey in July was disappointing – confidence improved from +2 to +4 but conditions eased to +2 from +4, and employment intentions were well down. Conditions in the retail sector were tough, with weaker house prices and no real wage growth depressing the demand for goods.

The Australian dollar ended the month 1.6% lower against the US dollar at 0.67 cents.

## CONTRIBUTION

### Relative Value Gross Contribution +0.74%

Positive		Negative	
RURAL FUNDS GROUP - VITALHARVEST FREEHOLD TRUST	0.49%	NINE ENTERTAINMENT CO HOLDIN - QMS MEDIA	-0.50%
OOH!MEDIA - QMS MEDIA	0.44%	BWP TRUST - CARINDALE PROPERTY TRUST	-0.29%
EVENT HOSPITALITY AND ENTERTAINMENT LTD - VILLAGE ROADSHOW	0.42%	AVENTUS RETAIL PROPERTY FUND - CARINDALE PROPERTY TRUST	-0.25%
AGL ENERGY LTD - INFIGEN ENERGY	0.33%	CENTURIA INDUSTRIAL REIT - CHARTER HALL LONG WALE REIT	-0.24%
BHP BILLITON - BHP BILLITON	0.22%	ABACUS PROPERTY GROUP - BWP TRUST	-0.19%

### Special Situations Gross Contribution +1.08%

Positive		Negative	
INFIGEN ENERGY	0.90%	KALIUM LAKES LTD	-0.39%
AVEO GROUP	0.40%	SUPERLOOP LTD	-0.21%
IMRICOR MEDICAL SYSTEMS	0.28%	IMPEDIMED LTD	-0.13%
FINEOS CORP HOLDINGS PLC	0.20%	CARNARVON PETROLEUM LTD	-0.11%
PARADIGM BIOPHARMACEUTICALS	0.13%	VOLPARA HEALTH TECHNOLOGIESS	-0.11%

Source: Ellerston Capital Limited

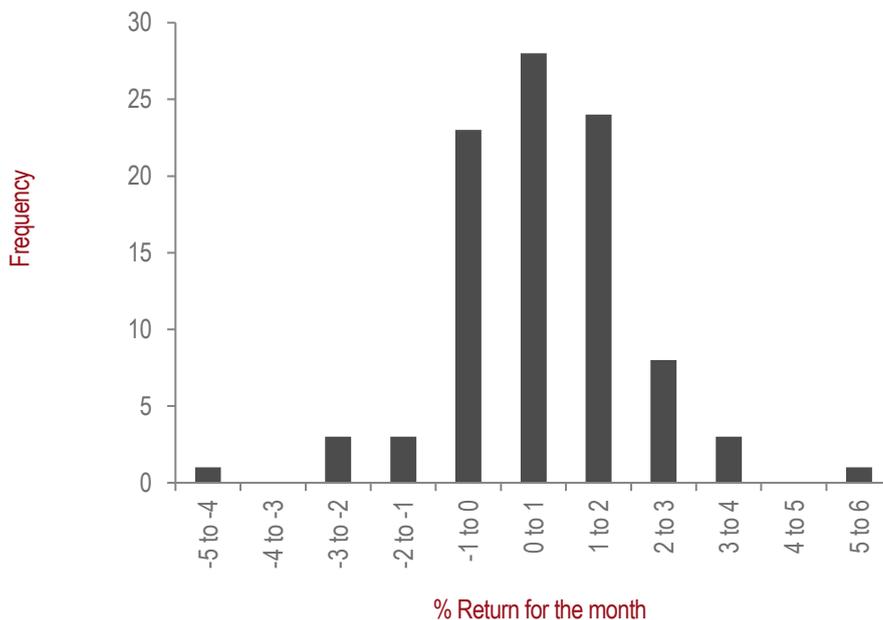
## TOP 10 RELATIVE VALUE POSITIONS

- BHP BILLITON - BHP BILLITON
- RIO TINTO - RIO TINTO
- EVENT HOSPITALITY AND ENTERTAINMENT LTD - VILLAGE ROADSHOW
- NINE ENTERTAINMENT CO HOLDIN - QMS MEDIA
- APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND
- AVENTUS RETAIL PROPERTY FUND - CARINDALE PROPERTY TRUST
- GPT GROUP - MIRVAC GROUP
- BWP TRUST - CARINDALE PROPERTY TRUST
- ABACUS PROPERTY GROUP - GROWTHPOINT PROPERTIES
- CENTURIA INDUSTRIAL REIT - CHARTER HALL LONG WALE REIT

## TOP 10 SPECIAL SITUATION POSITIONS

- PUT SPREADS ON AS51
- NUFARM FINANCE NZ LTD
- INFIGEN ENERGY
- KALIUM LAKES LTD
- SUPERLOOP LTD
- APN INDUSTRIA REIT
- SUNCORP GROUP NOTE
- RURALCO HOLDINGS LTD
- IMPEDIMED LTD
- UNITI WIRELESS LTD

### 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

**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.

## CONTACT US

All holding enquiries should be directed to our registrar, **Link Market Services** on **1800 992 149** or [ellerston@linkmarketservices.com.au](mailto:ellerston@linkmarketservices.com.au)

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

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