

# Ellerston Asia Growth Fund

Performance Report | September 19

## PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net <sup>^</sup>	1.07%	-0.26%	0.69%	5.34%	6.17%	8.84%
Benchmark*	1.33%	-1.51%	-1.93%	1.13%	4.28%	9.34%
Alpha	-0.26%	1.25%	2.62%	4.21%	1.89%	-0.50%

Source: Ellerston Capital

<sup>^</sup> The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

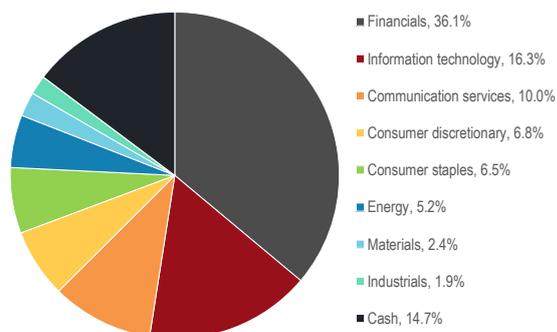
\*MSCI Asia ex Japan (non-accumulation) (AUD)

## PORTFOLIO CHARACTERISTICS

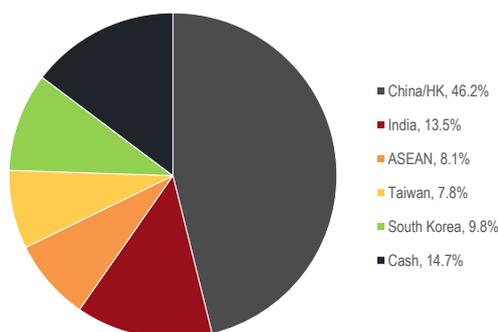
### HOLDINGS

Top 10 holdings	Sector	%
Tencent Holdings Ltd	Communication Services	8.7%
TSMC	Information Technology	6.6%
Samsung Electronics	Information Technology	6.5%
Alibaba Group Holding Ltd	Consumer Discretionary	5.9%
Ping An Insurance	Financials	5.1%
China Construction Bank Corp	Financials	5.0%
ICICI Bank Limited	Financials	4.5%
DBS Group Holdings Ltd	Financials	4.0%
Hong Kong Exchanges & Clearing Ltd	Financials	3.7%
CNOOC Limited	Energy	3.1%

### SECTOR ALLOCATION



### GEOGRAPHIC EXPOSURE



Source: Ellerston Capital

### Investment Objective

To outperform the MSCI Asia Ex Japan (non-accumulation) (AUD) benchmark on a net of fees basis, with a focus on capital growth and downside protection.

### Investment Strategy

The Fund's investment strategy is to provide access to a high quality portfolio of primarily large cap Asian Companies using the Manager's distinctively high growth, high conviction and benchmark-independent investment approach. The Manager believes that the trade-off between risk and potential returns at the portfolio level is improved by implementing highest conviction ideas from a filtered universe of securities that offer the best risk/reward.

### Key Information

Strategy Inception	4 January 2017
Portfolio Manager	Mary Manning
Application Price	\$1.0492
Net Asset Value	\$1.0466
Redemption Price	\$1.0440
Liquidity	Daily
No Stocks	27
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

## COMMENTARY

The Ellerston Asia Growth Fund (EAGF) was up 1.07% during the month of September performing roughly in line with the benchmark (gross). Calendar year to date in 2019, the Fund is up 13.80% and has outperformed the benchmark by 5.72% (gross).

There were 3 main factors that drove returns in September: (1) the trade negotiations; (2) Hong Kong protests; and (3) corporate tax cuts in India.

On the trade negotiations, the 13th round of talks between China and the US took place in early October in the US. These meetings resulted in a "Phase 1" agreement whereby China will increase agricultural purchases and in return, the US will delay the application of new tariffs. Presidents Trump and Xi are slated to meet at the APEC Summit in Chile in November where a more meaningful deal could be tabled and signed.

In Hong Kong, Carrie Lam's concession to protestors on the formal withdrawal of the extradition bill has done little to quell the protests. While the absolute number of protestors has reduced, the violence of the protests and the severity of the police response has actually increased. We remain underweight Hong Kong and have further reduced our AIA position as the economic impacts of the protests continue to weigh on the outlook for stocks.

September was a tale of two halves for India. The first half of the month was characterized by a very weak GDP print (only 5% growth) and concerns that the drone attack on Saudi Arabia would lead to higher oil prices (a negative for India). The NIFTY50 Index sold off almost 4% in AUD terms between the end of August and September 17<sup>th</sup>. Foreigners sold, locals moved to cash and some hedge funds shorted the Indian market on the higher oil price thematic.

The second half of the month however, was very different. On September 20<sup>th</sup>, Finance Minister Nirmala Sitharaman cut corporate taxes in India from over 30% to 22% which drove the NIFTY up 5.3% in one day - the biggest move in 10 years. This was primarily short squeeze but was followed by another 2% move higher the following trading day as long only money flowed into tax cut beneficiaries.

There were a few reasons for this sharp positive reaction. First of all, mathematically the tax cut results in positive EPS revisions for FY20 as tax change takes effect in the current financial year. Secondly, the tax cut is positive for India's ability to attract foreign investment as Indian corporate tax rate is now among the lowest in Asia (only HK, Singapore and Thailand are lower).

Thirdly, the policy move also sent a strong signal that the government will not tolerate 5% GDP growth. And finally, the tax change increased expectations that Reserve Bank of India (RBI) will follow suit with more rate cuts so there is co-ordinated loosening. This indeed occurred with the RBI cutting rates by 25bps in early October.

While the positive market reaction boosted both absolute and relative returns in September, our view is that the tax cut is actually a very poor economic policy. The macro economic slowdown in India is primarily demand driven, and cutting corporate taxes will not directly boost demand unless companies pass the tax cut along in the form of lower prices (unlikely). Note there was no reduction in the personal tax rate or other measures that would boost consumer confidence or consumer spending.

Secondly, the policy reduces tax revenues at a time when GST collection is still behind expectations giving rise to concerns about the re-emergence of the twin deficits problem that has plagued India in the past. Tax changes are expected to increase the fiscal deficit from 3.3% of GDP to ~4%. This is disappointing because the fiscal deficit has blown out with no new jobs created or infrastructure built. If the government wants to do additional fiscal stimulus, the deficit will be at unacceptably high levels.

In sum, while we welcome the government's desire to do something to address the macro slowdown, we are concerned that fiscal policy based on corporate tax cuts will not be sufficiently stimulative to return India to the 7%+ growth trajectory in the near term. We have reduced our India overweight until the macroeconomic situation improves and there is more earnings certainty for domestic demand driven stocks.

With respect to performance, Samsung Electronics and Larsen & Toubro were the largest contributors to alpha in September while Hong Kong Exchange was the largest detractor. Hong Kong Exchange made a bid for the London Stock Exchange during September which caused the stock to sell off sharply. The bid was rebuffed by the LSE and the transaction has been abandoned. Cash at the end of September was 14.7%.

As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at [info@ellerstoncapital.com](mailto:info@ellerstoncapital.com).

Kind regards,

Mary Manning - Portfolio Manager

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

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