Ellerston Capital

Ellerston India 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^	2.83%	0.60%	1.62%	15.22%	12.48%	8.77%
Benchmark*	2.97%	-1.32%	0.40%	12.36%	10.99%	7.77%
Alpha	-0.14%	1.92%	1.22%	2.86%	1.49%	1.00%

Source: Ellerston Capital

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

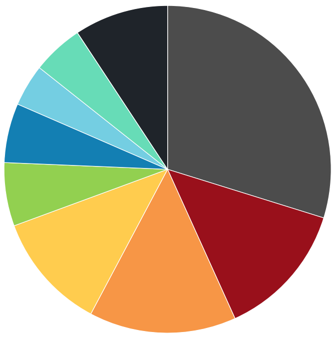
* MSCI India Net Return Index (AUD)

PORTFOLIO CHARACTERISTICS

HOLDINGS

Top 10 holdings	Sector	%
Reliance Industries Limited	Energy	14.4%
Housing Development Finance Corp Ltd	Financials	7.9%
Infosys Limited	Information Technology	7.1%
Hindustan Unilever Limited	Consumer Staples	6.4%
Axis Bank Limited	Financials	5.6%
HDFC Bank Limited	Financials	5.5%
ICICI Bank Limited	Financials	5.3%
Tata Consultancy Services Limited	Information Technology	4.6%
Larsen & Toubro Ltd.	Industrials	4.1%
Bajaj Finance Limited	Financials	3.6%

SECTOR ALLOCATION



Source: Ellerston Capital

Investment Objective

To outperform the MSCI India Net Return Index (AUD) with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio with exposure to Indian Companies using the Manager's high growth, high conviction, benchmark independent investment approach. The Fund has identified a number of core thematics that will drive returns in the Indian market in the medium term. The focus is on investing in Indian Companies that benefit from these fundamental drivers.

Key Information

Strategy Inception	4 May 2017
Portfolio Manager	Mary Manning
Application Price	$1.1433
Net Asset Value	$1.1404
Redemption Price	$1.1375
Liquidity	Daily
No Stocks	24
Management Fee	1.10%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

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ELLERSTON CAPITAL

COMMENTARY

The Ellerston India Fund (EIF) was up 2.83% in September versus the benchmark which was up 2.97%. Calendar year to date in 2019 the Fund is up 9.05%, outperforming the benchmark by 2.43%.

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 17th. 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 20th, 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 a 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 the 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.

Furthermore, RBI Governor Das appears too tentative on interest rate cuts. Inflation in India is very low and stable by historical standards and interest rates remain high relative to other countries at 5.15%. In our view, fiscal policy should be focused on reviving demand and monetary policy should be aggressively dovish.

In the last few weeks, other investors have clearly come around to this view as the NIFTY50 Index has given up over 2% of the gains made immediately post the tax announcement. We remain positioned in high quality, structural growth stocks with strong earnings visibility. We have exited positions where the demand slow down threatens to meaningfully and negatively impact 2Q earnings. These include Marico and Titan, both consumer companies.

From a sector perspective, Financials and Health Care contributed the most alpha in September while Energy was the largest detractor. Stock wise, HDFC Bank and Bajaj Finance were the largest contributors to alpha while not owning Bharat Petroleum was the largest detractor. Cash at the end of September was 9.2%.

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.

Kind regards,

Mary Manning - Portfolio Manager

All holding enquiries should be directed to our registrar, Link Market Services on 1800 992 149 or 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

or visit us at https://ellerstoncapital.com/

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