

Ellerston Australian Market Neutral Fund

Performance Report | December 19

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	3 Year (p.a.)	5 Year (p.a.)	Since Inception (p.a.)
Net ^A	3.98%	9.00%	15.80%	19.87%	3.66%	5.11%	7.92%
Benchmark [*]	0.07%	0.19%	0.45%	1.16%	1.39%	1.60%	1.82%
Alpha	3.92%	8.81%	15.35%	18.71%	2.27%	3.51%	6.10%

Source: Ellerston Capital

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

^{*}RBA Cash Rate

PORTFOLIO CHARACTERISTICS

KEY PORTFOLIO METRICS

Positive months	67%	Net Equity Exposure	21%
No. Relative Value positions	55	Gross Portfolio Exposure	237%
No. Special Situations	27	Correlation Coefficient (vs ASX 200 Accum)	3.03%
Beta Adjusted	-11.1%	Net Sharpe Ratio (RFR = RBA Cash)	1.09

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	39.3%	-30.2%	9.1%
Industrials	53.2%	-12.3%	41.0%
Resources	31.5%	-27.9%	3.7%
Index	0.0%	-33.2%	-33.2%
Total	124.1%	-103.5%	20.5%

COMMENTARY

The Fund produced a net return of +4.0% in December, outperforming the benchmark return of +0.1% in the period. The majority of the return came from Relative Value with a paired position within the Consumer Discretionary sector the primary contributor. Net exposure was +21% at the end of December, with a beta-adjusted net of -11%. Gross exposure closed the month at 237%.

As mentioned, a paired position within the Consumer Discretionary sector was the main contributor to performance, with Village Roadshow (+17.6%) dramatically outperforming Event Hospitality and Entertainment (+1.7%) in the period. In December, Village announced that it had received a conditional, non-binding proposal from Pacific Equity Partners (PEP) at an indicative price of \$3.90 per share, a 22% premium to the share price at the time. Importantly, it appears that Village's largest shareholder, controlled by the Kirby family and Graeme Burke, is backing the bid, with the group pledging a 19% stake in the company to PEP via a call option structure.

Paired positions within the Energy sector also contributed to performance in December with Carnarvon Petroleum (+12.1%) outperforming Santos (+0.4%) and Karoon (+3.6%) outperforming AGL Energy (+0.6%). Despite the outperformance, we believe that Karoon still represents excellent relative value within the sector, with the acquisition of the Bauna oil field in Brazil yet to settle and potential upside from the Tumbes Basin in Peru. Assuming the settlement of Bauna in March, Karoon trades on an FY21 EV/EBITDA multiple of <2.0x, with a forecast return-to-consensus-price-target of almost +70%.

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	3 June 2013
Portfolio Manager	Paul Drzewucki
Application Price	\$1.1281
Net Asset Value	\$1.1253
Redemption Price	\$1.1225
Liquidity	Daily
Management Fee	1.20%
Performance Fee	20% of outperformance
Buy/Sell Spread	0.25%/0.25%

REIT pairs generally added value during the month with a paired position between Carindale Property Trust (+0.5%) and BWP Trust (-5.9%) the largest contributor. Our buy-write position in Goodman Group (-8.8%) detracted from performance, with the industrial property developer underperforming the broader market in the period.

We participated in the Initial Public Offerings of Nuchev (+38.5%), Tyro Payments (+28.0%) and MoneyMe (+16.0%) during the month, each of which added value to the Fund. A recently-established shareholding in EML Payments (-4.0%) also added modestly to performance.

Nucheve is an Australian-based business, focused on the development and sales of goat infant formula in Australia and China. Goat infant formula is a strongly growing premium formula sub-category, with benefits that include improved digestion, lower incidences of allergic reactions and a strong nutritional profile, compared with other infant formula products. Whilst Nuचेव is a relatively new company, its CEO (and founder) Ben Dingle is very experienced, being the co-founder of New Zealand's Synlait Milk (-3.3%), a NZD1.6b market cap company.

ACTIVITY

Relative Value – Gross Contribution +3.89%

Following the indicative proposal from PEP, we moved the majority of our Village Roadshow position from Relative Value to Special Situations.

A paired position was established between aged-care operators Regis (-17.4%) and Japara Healthcare (-13.2%), with Regis significantly downgrading FY20 earnings in the week before Christmas. Media coverage of the Royal Commission into Aged Care has led to a fall in occupancy rates, resulting in the company reducing their normalised EBITDA guidance over 12%. Regis was the second listed aged-care operator to downgrade in December, with Estia Health (-9.3%) downgrading earlier in the month and its share price suffering accordingly. To date, Japara remains the only stock within the sector not to downgrade and it remains unlikely that they will remain immune to the occupancy issues that have plagued the sector.

A paired position between infrastructure stocks Atlas Arteria (+2.4%) and Sydney Airport (-3.6%) was unwound during December, with Atlas Arteria continuing to re-rate following their acquisition and capital raise in November. We also unwound paired positions between Westpac (-1.2%) and Commonwealth Bank (-1.1%), Scentre (-2.8%) and Vicinity Centres (-4.3%), as well as Kiwi Property (+1.5%) and Precinct Properties (+1.1%).

Special Situations – Gross Contribution +1.13%

The share price of Atomos (-20.0%) traded lower during the month, with investors disappointed by the relatively muted AGM commentary in late November. We believe the company remains undervalued and capitalised on the pullback, adding modestly to our existing position.

In December, Uniti Group (-6.6%) announced the acquisition of 1300 Australia, Australia's market leader in phone words and priority numbers, including '1300', '1800' and '13' phone numbers. The \$78m acquisition was funded with cash and scrip, with the company simultaneously launching an equity placement and entitlement offer to raise \$84.9m. The acquisition is expected to deliver more than 25% EBITDA per share accretion and leaves the company with capacity for another decent acquisition without coming to market. With a forecast return-to-consensus-price-target of +19.3%, we participated in both the placement and entitlement offer, adding to our existing exposure.

A flurry of pre-Christmas block trades and placements led to the Fund establishing positions in EML Payments (-4.0%), Kina Securities (+6.4%), Orthocell (-13.3%) and Zip Co (-5.9%). We reduced our exposure to Superloop (+0.5%) and Infigen Energy (+0.8%) and completely exited our holdings in Bigtincan (+2.2%), NZ-listed EBOS Group (+6.4%) and Rural Funds (+4.1%).

MARKET COMMENTRY

Market Overview

In December, global equities squeezed higher with Australia being the exception. Developed Markets rose 5.2% in local currency terms, outperforming Emerging Markets which rose 2.3%, despite strong gains in Argentina, Brazil and China. Investors were encouraged by positive developments in the discussions between the US and China regarding their ongoing trade war.

USA

The US equities market continued to rally in December, buoyed by positive headlines on the trade war with China and reinforced by solid economic data. The Dow Jones Industrial Average Index was up 1.9%, while the NASDAQ returned an impressive +3.6%. The best performing sectors for the month were Energy and Information Technology.

The S&P 500 had its fourth consecutive month in the black with a return of +3.0%, capping off a very strong calendar year that rewarded investors with a total return of +31.5% and enduring the first decade without a recession. Impressively, 67 of the 68 S&P 1500 Industries (GICSL3) finished in positive territory. The top 5 stocks for 2019 (AAPL, MSFT, FB, GOOGL and AMZN) accounted for 730 basis points of the S&P 500's 31.5% gain, or circa 23% of the performance, very similar to last calendar year's percentage contribution.

The markets finally had some concrete good news on the trade war front towards the end of the year after it was confirmed that the US and China had agreed to a "phase one" trade deal. Also, a stronger non-farm payroll number which showed that payrolls had increased to 266,000 in November against an estimate of 180,000, contributed positively to investor sentiment.

Europe

European equities overall were also in positive territory, with the Euro Stoxx returning +1.2%. The month started with some trepidation with respect to the trade war, but equities rallied with the announcement of the "phase one" deal and the resounding re-election of the Conservative Party in the UK.

The UK's FTSE 100 was up 2.8%, lifted by the convincing victory by the Conservative Party. France's CAC 40 was up 1.3%, while Germany's DAX was only modestly in positive territory, returning +0.1%.

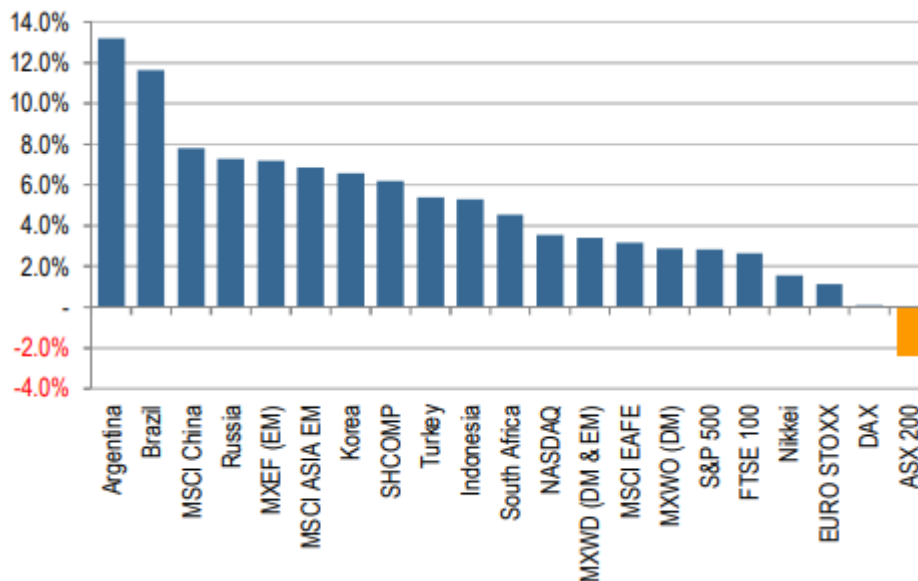
Activity indicators may have bottomed, with flash Eurozone manufacturing PMI for November of 46.9, ahead of consensus of 46.6.

Asia

Asian equities finished December in positive territory after enduring a few months of protests in Hong Kong and trade-war related uncertainty. Markets were stronger after a fresh round of tariffs on Chinese consumer goods were averted following the "phase one" deal on trade.

In Hong Kong, the Hang Seng Index rallied strongly, up 7.0%, China's SSE Total Market Index returned +6.5%, and Korea's KOSPI Composite Index was up 5.3%. Japan and India rose more modestly in comparison: Japan's Nikkei 225 was up 1.7% and India's S&P BSE Sensex was up 1.1%.

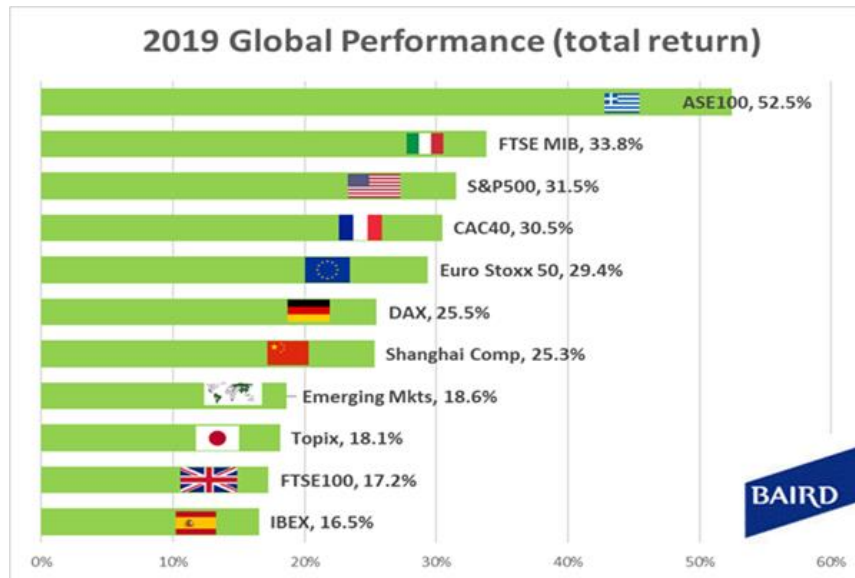
Global Equity Markets' Performance in December 2019



Source: JP Morgan, Bloomberg.

Global equity market returns

Greece leads the way up 52%, with Spain lagging, up 16.5%.

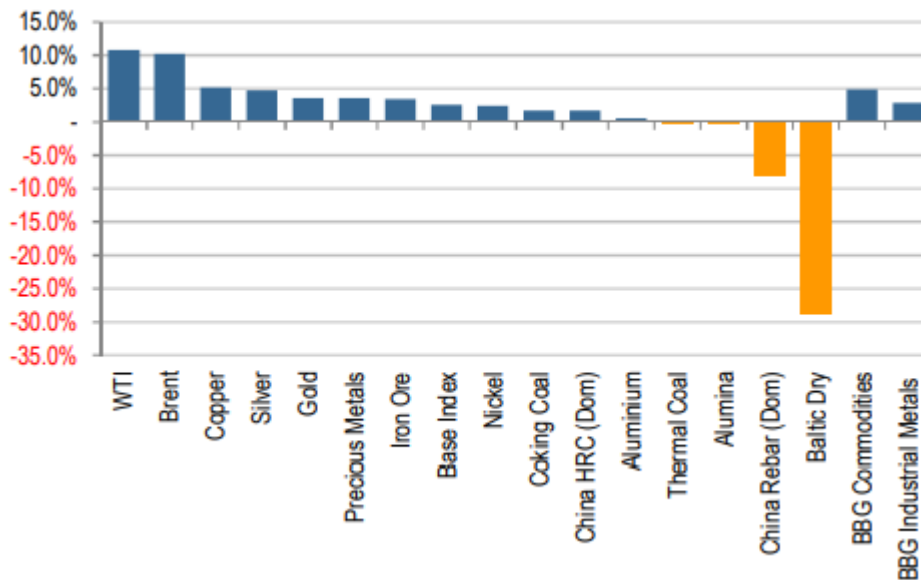


Source: Robert W. Baird Limited, January 2020

Commodities

Bulk commodities were mixed, with iron ore up 3.4% to US\$90.50/t, whilst thermal coal drifted lower. Brent oil rose 10.3% to US\$66/bbl, while gold prices rose to \$1,517/oz. as geopolitical risks rose.

Commodity Performance in December 2019



Source: JP Morgan, Bloomberg.

Bonds

Global bond yields sold off again in December. The US 10-year bond yield rose 14 basis points to 1.92% and the Australian 10-year bond yield rose 34 basis points to 1.37%, the highest level since July 2019.

Australia

The S&P/ASX 200 Accumulation Index bucked the trend and had a poor month, with a return of -2.2%, but was one of the top performing global equity indices in both AUD and USD terms for the year. The domestic market finished the calendar year with a total return of 23.4%, its best performance since 2009 and rising from the ashes of a dreadful end to the previous year, where global equities sold off sharply in December 2018.

In December, the best three performing sectors in terms of their contribution to the index's performance were Materials up 1.6%, with BHP Group (+1.8%), Fortescue Metals Group (+9.9%) and Rio Tinto (+3.6%) being the top three stocks contributing to the ASX 200 index's return, Utilities (+0.8%) and Energy (-1.5%).

Bond proxies came under pressure, buffeted by the headwind of rising treasury yields which posted their largest increase since July. The bottom three sectors were Consumer Staples (-8.1%), (with Woolworths Group (-9.1%) being the single largest detractor from the index's performance), Financials (-1.6%) and Real Estate (-4.8%).

The ASX 200 Resources Accumulation Index, with a return of +1.4% outperformed, followed by the Small Ordinaries Accumulation Index ASX (-0.3%), with the wooden spoon being awarded to the ASX 200 Industrial Accumulation Index which posted a return of -3.0%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Woolworths Group (-26 points), Telstra Corporation (-21 points), National Australia Bank (-20 points), CSL (-19 points) and Goodman Group (-11 points).

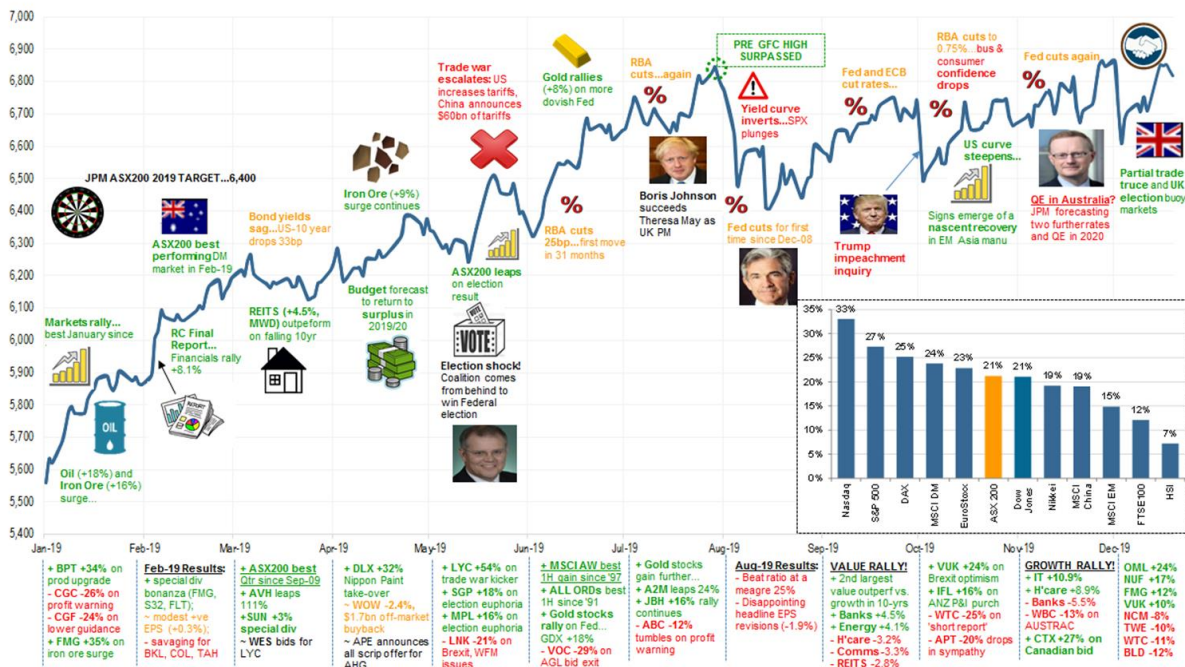
Conversely, the top five stocks that made a positive contribution to the index's return were BHP Group (+11 points), Fortescue Metals Group (+9 points), Rio Tinto (+7 points), Northern Star Resources (+6 points) and Magellan Financial Group (+4 points).

It was a mixed bag on the economics front. NAB business confidence dropped to +0 from +2 previously. October retail sales missed expectations and were flat at 0.0% month-on-month. But employment in November was ahead of expectations, lifting by almost 40,000 against consensus of 15,000.

The RBA left interest rates unchanged at 0.75%, and economic growth, measured by GDP, was in line with expectations at 1.7% year-on-year (in the third quarter of 2019) annualised.

The Australian dollar rose 3.5% against the US dollar, and ended the month at 0.70 cents.

Review of the 2019 calendar year: the pictorial below captures the key events and performance



Source: JP Morgan, Bloomberg.

Following the frightening conclusion to 2018, we commenced 2019 more positively, with the ASX200 rising for seven consecutive months from January. Healthcare dominated yet again, rising an astonishing 45%, led by CSL which was the driver of the sector's outperformance, up 52.6%. This gain equates to an increase in market capitalisation of \$44.2 billion, which, for context, is almost the current market cap of Wesfarmers at \$48 billion! A horrendous year for the Banks dragged Financials into last position on the YTD table, albeit still with a gain of 13.5%

CONTRIBUTION

Relative Value Gross Contribution +3.89%

Positive		Negative	
EVENT HOSPITALITY AND ENTERTAINMENT LTD - VILLAGE ROADSHOW	1.50%	GOODMAN GROUP - GOODMAN GROUP	-0.19%
CARNARVON PETROLEUM LTD - SANTOS	0.31%	ELANOR COMMERCIAL PROPERTY FUND - INGENIA COMMUNITIES GROUP	-0.17%
AGL ENERGY LTD - KAROON GAS AUSTRALIA LTD	0.25%	ECLIPX GROUP LTD - SG FLEET GROUP LTD	-0.13%
BWP TRUST - CARINDALE PROPERTY TRUST	0.23%	MCMILLAN SHAKESPEARE LTD - SMARTGROUP CORP LTD	-0.06%
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	0.22%	ECLIPX GROUP LTD - MCMILLAN SHAKESPEARE LTD	-0.03%

Special Situations Gross Contribution +1.13%

Positive		Negative	
NUCHEV PTY LTD	0.68%	360 CAPITAL DIGITAL INFRA FD	-0.03%
TYRO PAYMENTS LTD	0.18%	ORTHOCELL LTD	-0.03%
EML PAYMENTS LTD	0.15%	MADER GROUP LTD	-0.02%
MONEYME LTD	0.12%	PRIMEWEST GROUP LTD	-0.02%
POWERWRAP LTD	0.11%	MNF GROUP LTD	-0.01%

Top 10 Relative Value Positions

RIO TINTO - RIO TINTO	ELANOR COMMERCIAL PROPERTY FUND - INGENIA COMMUNITIES GROUP
BHP BILLITON - BHP BILLITON	CHARTER HALL LONG WALE REIT - STOCKLAND
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	KAROON GAS AUSTRALIA LTD - SANTOS
AGL ENERGY LTD - INFIGEN ENERGY	GDI PROPERTY GROUP - NATIONAL STORAGE REIT
BWP TRUST - CARINDALE PROPERTY TRUST	CENTURIA METROPOLITAN REIT - NATIONAL STORAGE REIT

Top 10 Special Situation Positions

PUT SPREAD ON ASX 200	KALIUM LAKES LTD
NUFARM FINANCE NZ LTD - NSS	ATOMOS LTD
VILLAGE ROADSHOW LTD	VOLPARA HEALTH TECHNOLOGIESS
LIMEADE INC-CDI	IMPEDIMED LTD
UNITI WIRELESS LTD	SUNCORP GROUP

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