ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | January 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	3 Year (p.a.)	5 Year (p.a.)	Since Inception (p.a.)
Net^	-0.98%	4.53%	13.60%	19.80%	3.13%	4.94%	7.66%
Benchmark*	0.06%	0.19%	0.42%	1.10%	1.37%	1.57%	1.81%
Alpha	-1.04%	4.34%	13.18%	18.70%	1.76%	3.37%	5.85%

Source: Ellerston Capital

^Net 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	66%	**Net Equity Exposure**	19%
No. Relative Value positions	35	**Gross Portfolio Exposure**	213%
No. Special Situations	24	**Correlation Coefficient (vs ASX 200 Accum)**	1.29%
Beta Adjusted	-17.0%	**Net Sharpe Ratio (RFR = RBA Cash)**	1.05

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	24.9%	-13.5%	11.4%
Industrials	59.5%	-11.2%	48.3%
Resources	31.3%	-29.6%	1.7%
Index	0.0%	-42.2%	-42.2%
Total	**115.7%**	**-96.5%**	**19.2%**

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	$1.1171
Net Asset Value	$1.1143
Redemption Price	$1.1115
Liquidity	Daily
Management Fee	1.20%
Performance Fee	20% of outperformance
Buy/Sell Spread	0.25%/0.25%

COMMENTARY

The Fund produced a net return of -1.0% in January, underperforming the benchmark return of +0.1% in the period. With no real winners in Relative Value or Special Situations, the Fund's performance generally drifted lower in the month. Net exposure was +19% at the end of January, with a beta-adjusted net of -17%. Gross exposure was lowered during the period, closing the month at 213%.

Our paired positions within the energy sector produced mixed results in the period, with positions featuring AGL Energy (-2.8%) adding value, whilst those featuring Santos (+6.2%) detracted. A long position in Infigen Energy (+21.5%), hedged with AGL, was the largest contributor, with the Infigen share price benefitting from the recent corporate activity in the renewable energy sector.

A newly established pair between Spark Infrastructure (+5.3%) and AusNet Services (+4.1%) added to performance, with the share price of Spark bouncing from its December low. Likewise, a short position in Ingenia Communities (-3.6%), hedged with a long in the newly-listed Elanor Commercial Property Fund (+3.2%) added value, with Ingenia retreating from the all-time high achieved after they were added to the S&P/ASX 200 index in late December.

A real estate pair between GDI Property (+4.7%) and National Storage REIT (+17.2%) detracted from performance following an unexpected approach from HK-based Gaw Capital Partners to acquire all of the outstanding shares in National Storage. Prior to the approach, National Storage was trading at a 29% premium to book value and with a forecast return-to-consensus price target of -16%.

The spread between the Australian and UK listings of both BHP Group (+1.2%) and Rio Tinto (-1.6%) widened during the period, detracting from the performance of the Fund.

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In January, Village Roadshow (+6.1%) received a second unsolicited approach to acquire the company, with the new approach coming from BGH Capital (another Australian PE firm). The second BGH proposal was pitched at a 2.6% premium to the first, with the new interest providing investors with confidence that a deal will be successful. The performance of the Village share price following the new approach added to the Fund's performance.

Our investments within the biotech space generally detracted during January, with both ImpediMed (-21.2%) and Painchek (-26.3%) underperforming in the period. Despite continuing to grow revenue, the market was disappointed with the rate of growth for ImpediMed and marked the share price lower accordingly. We remain excited about the progress made in the heart failure program, with modest revenues now forecast for FY20.

ACTIVITY

Relative Value – Gross Contribution -0.42%

Our paired position between Infigen Energy and AGL Energy was reduced during the month, with the spread between the two stocks narrowing considerably. Ahead of reporting in February, AGL Energy was forced to suspend their on-market buyback, which removed a steady source of demand for their scrip and led to a fall in their share price. Infigen, as previously mentioned, continues to benefit from the increase in corporate activity within the renewable energy sector.

We established a position between Spark Infrastructure and AusNet Services during the month, with a large institutional sell order weighing on the Spark share price. Although Spark has flagged tough regulatory resets for both the SAPN (July 2020) and VPN (July 2021), and a shift to paying corporate tax, we see the valuation as attractive and assign a low probability to further bad news. AusNet on the other hand is trading in line with its 5 year average (EV/CRAB multiple of 1.27x) despite tighter revenue allowance methodology decisions over the past 2 years.

A modest long position was established in Growthpoint Properties (+5.3%), hedged with a short in Shopping Centres Australasia (+8.2%). Growthpoint's real estate portfolio is weighted to the Office (69%) and Industrial (31%) sectors, and we believe demand for these assets will remain robust given the low interest rate environment. Whilst primarily a yield play, Growthpoint has a $350m development pipeline, along with significant debt capacity to fund acquisitions. Shopping Centres Australasia is the owner of sub-regional and neighbourhood shopping centres. Retail landlords in general are currently facing tough market conditions, and we believe that re-leasing spreads for specialty tenants are severely skewed to the downside.

Ahead of reporting season in February, we reduced our Relative Value exposure, unwinding pairs between Insurance Australia (-7.6%) and Suncorp (-0.8%), Sydney Airport (-3.1%) and Transurban (+5.3%), SmartGroup (-2.7%) and McMillan Shakespeare (-1.6%) & Scentre (+0.8%) and Vicinity Centres (+2.0%). We were also stopped out of positions that featured the previously-mentioned National Storage REIT, which received a takeover approach in the period.

Special Situations – Gross Contribution -0.69%

We reduced our position in Imricor Medical Systems (+20.1%), following an announcement from the company it had received CE Mark approval for its revolutionary Ablation Catheter. While the announcement was certainly a positive, we felt the share price move was overdone, especially given the market had expected approval to be granted in CY19.

The share price of junior telco Uniti Group (-2.9%) underperformed the market in January, despite essentially upgrading earnings in their Appendix 4C for the December quarter. We capitalised on the share price weakness, adding to our existing position at about a 7% discount to the December placement price of $1.62 per share.

We also capitalised on the general strength in the share market and reduced our exposure to Atomos (+4.0%), Infigen and Kalium Lakes (+4.1%) and completely exited our position in Elanor Commercial, MoneyMe (+4.1%) and Zip Co (+14.1%) during January.

MARKET COMMENTRY

Market Overview

In January, fears of the negative impact of the Coronavirus on global growth saw global equity markets under pressure, with Developed Markets heavily favoured over Emerging Markets. Australia was the exception, with an impressive return of almost 5% as the market brushed aside concerns that economic growth might be negatively impacted from the bushfires and the virus.

USA

US equities retreated in January, mostly as fears that the Coronavirus would hurt global growth took hold of investor sentiment. The US markets had a strong end to 2019, but were quickly thrown off course by the rapid spread of the virus. Both the S&P 500 and the Dow Jones Indices were modestly in negative territory with returns of -0.0% and -0.9% respectively, however, the tech-heavy NASDAQ composite was again in positive territory and bucked the trend, with a return of +2.0%. Amazon reported its fourth-quarter sales at the end of the month and blew past a previous record, as robust sales and profits from cloud and advertising businesses helped offset higher shipping costs for its one-day Prime program. The stock powered ahead, helping to boost sentiment for tech stocks.

Europe

European stocks were weaker following the global lead, also taking fright from the likely impact of Coronavirus. Stocks had been very strong the previous month and gave up some of those gains. The Euro Stoxx 50 was down 2.7%, with the FTSE 100 being the worst performer, down 3.4% as the euphoria of the previous month faded and the reality of Brexit took hold. Most other major indices were also in negative territory: Germany's DAX was down 2.0% and France's CAC 40 was down 2.7%.

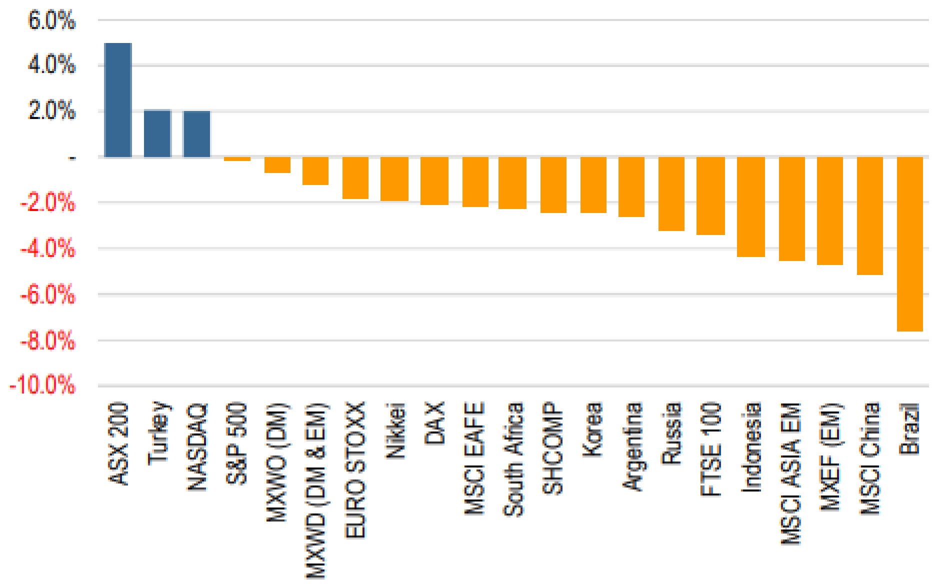
Not surprisingly, the ECB left rates unchanged through January.

Asia

Asian equities were most severely impacted by contagion fears from the virus and the likely resulting hit to economic growth as markets tried to price in the negative impact from travel restrictions, lower consumption and falling demand, especially from China.

In Hong Kong, the Hang Seng Index was down 6.7%, China's SSE Total Market Index returned -2.9%, and Korea's KOSPI Composite Index was down 3.6%.

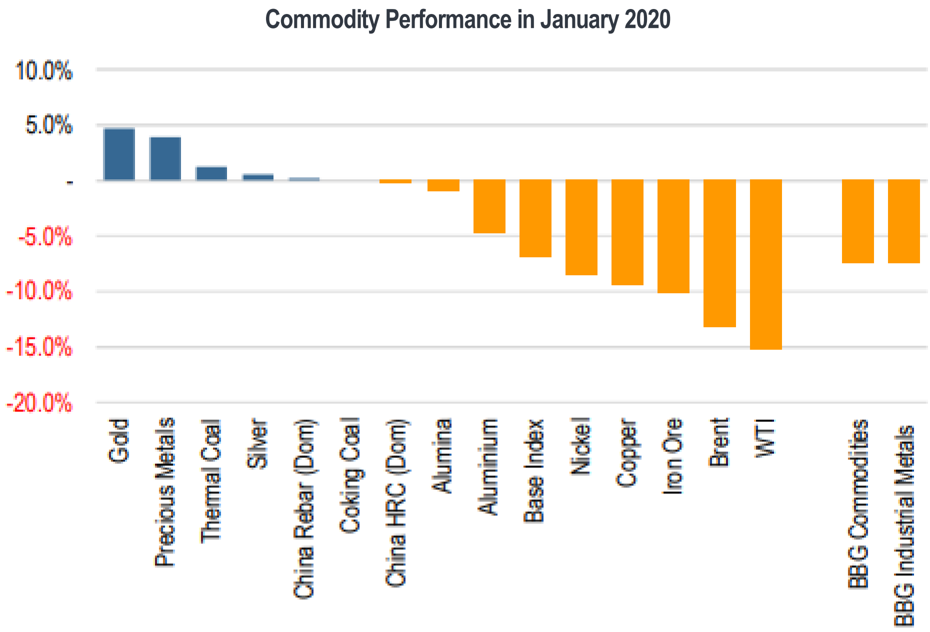
Global Equity Markets' Performance in January 2020



Source: JP Morgan, Bloomberg.

Commodities

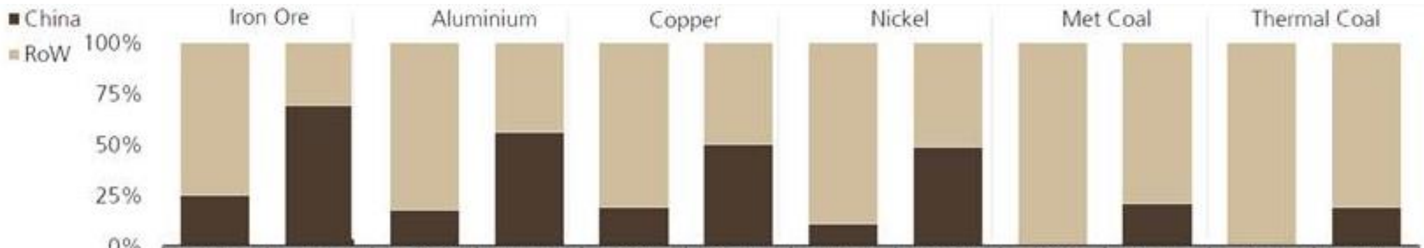
Commodities fell across the month, with bulks the worst performers and base metals (with copper slumping 9.5%), followed closely behind as risk-off mentality took its toll. Precious metals rose given their perceived safe haven status, with Gold and Silver up 4.7% and 0.5% respectively. Iron ore was one of the biggest casualties, down 10.1% to $82.65/t but Brent fell more, down 13.3% to $56.62/bbl.



Source: JP Morgan, Bloomberg

While prices of commodities were weaker in January as fears took hold that the spread of the virus would curtail demand especially from China, it's worth noting the change in commodity demand from China since the last crisis in 2003 - see chart below. The implications for global commodity markets could be far greater if there is a noticeable change in demand for commodities if Chinese economic growth slows.

China Commodity Demand: 2003 (SARS) versus 2020e (Coronavirus)



Mt		Iron Ore 2003	Iron Ore 2020e	Aluminium 2003	Aluminium 2020e	Copper 2003	Copper 2020e	Nickel 2003	Nickel 2020e	Met Coal 2003	Met Coal 2020e	Thermal Coal 2003	Thermal Coal 2020e
	RoW	435	486	22.8	29.5	12.6	12.6	1.1	1.3	191	279	497	830
	China	148	1,096	5.1	38.0	3.0	12.8	0.1	1.2	-	75	-	199

Source: WoodMac, UBS. Note: Seaborne Demand for Bulk Commodities; China was a net exporter of coal in 2003.

Bonds

Global bond yields fell in January as investors took shelter in safe haven fixed income securities. The US 10-year bond yield retraced 36 basis points to 1.56% (just 17 bpts from inversion) and the Australian 10-year bond yield fell 41 basis points to 0.96%, falling below 1%, a level it last breached back in August 2019.

Australia

The S&P/ASX 200 Accumulation Index dismissed the uncertainty surrounding the impact of the bushfire crisis and the Coronavirus outbreak and was one of the strongest performing equity markets in the world, delivering a table-topping gain of +5.0%. In spite of the crisis induced volatility, the ASX 200 reached a new historical high in January at 7,133, with Large Caps preferred over Small Caps.

In January, the best performing sector in terms of its contribution to the index's performance was Financials, contributing 1.4%, with the four majors in the black. Commonwealth Bank of Australia (+6.7%) was the best performing major bank and the second highest contributor to the ASX 200. The next two best contributing sectors were Health Care (1.2%), with CSL up a very impressive 13.2%, making it the largest single contributor to the ASX 200, (Resmed also propelled the Health Care sector with an eye watering +14.4% return), followed by Consumer Staples, contributing +0.5%.

The bottom three sectors were Utilities, contributing +0.0%, Energy (+0.1%) and Industrials at +0.2%.

The ASX 200 Industrial Accumulation Index was the best performing sub-index with a stunning return of +6.1%, followed by the Small Ordinaries Accumulation Index (+3.4), while the ASX 200 Resources Accumulation Index brought up the rear with a return of +0.8%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Treasury Wine Estates (-12 points), Insurance Australia Group (-7 points), Qantas Airways (-6 points), Sydney Airport (-3 points) and Rio Tinto (-3 points).

Conversely, the top five stocks that made a positive contribution to the index's return were CSL (+90 points), Commonwealth Bank of Australia (+52 points), Woolworths Group (+40 points), Wesfarmers (+24 points) and Telstra Corporation (+20 points).

A raft of downgrades featured ahead of the reporting season, with 17 stocks guiding to lower profits in January, resulting in an average on-day share price fall of 16.5%.

The RBA left rates unchanged after its meeting in early February.

The Australian dollar fell 4.0% against the US dollar in January, and ended the month at 0.67 cents.

CONTRIBUTION

RELATIVE VALUE GROSS CONTRIBUTION -0.42%			
Positive		**Negative**	
AGL ENERGY LTD - INFIGEN ENERGY	1.20%	KAROON GAS AUSTRALIA LTD - SANTOS	-0.53%
AGL ENERGY LTD - KAROON GAS AUSTRALIA LTD	0.41%	SANTOS - SENEX ENERGY LTD	-0.40%
AUSNET SERVICES - SPARK INFRASTRUCTURE	0.30%	RIO TINTO - RIO TINTO	-0.40%
ELANOR COMMERCIAL PROPERTY FUND - INGENIA COMMUNITIES GROUP	0.24%	GDI PROPERTY GROUP - NATIONAL STORAGE REIT	-0.38%
ECLIPX GROUP LTD - MCMILLAN SHAKESPEARE LTD	0.21%	BHP BILLITON - BHP BILLITON	-0.38%

SPECIAL SITUATIONS GROSS CONTRIBUTION -0.69%			
Positive		**Negative**	
VILLAGE ROADSHOW LTD	0.49%	IMPEDIMED LTD	-0.48%
NUFARM FINANCE NZ LTD - NSS	0.21%	PAINCHEK LTD	-0.27%
PRIMEWEST GROUP LTD	0.18%	UNITI WIRELESS LTD	-0.15%
KALIUM LAKES LTD	0.18%	SUPERLOOP LTD	-0.10%
IMRICOR MEDICAL SYSTEMS-CDI	0.17%	PANORAMIC RESOURCES LTD	-0.10%

TOP 10 RELATIVE VALUE POSITIONS	
BHP BILLITON - BHP BILLITON	AGL ENERGY LTD - INFIGEN ENERGY
RIO TINTO - RIO TINTO	BWP TRUST - CARINDALE PROPERTY TRUST
KAROON GAS AUSTRALIA LTD - SANTOS	ARENA REIT - CHARTER HALL EDUCATION TRUST
AUSNET SERVICES - SPARK INFRASTRUCTURE	SANTOS - SENEX ENERGY LTD
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	CARNARVON PETROLEUM LTD - SANTOS

TOP 10 SPECIAL SITUATION POSITIONS	
PUTS ON ASX 200	KALIUM LAKES LTD
VILLAGE ROADSHOW LTD	ATOMOS LTD
NUFARM FINANCE NZ LTD - NSS	PRIMEWEST GROUP LTD
UNITI WIRELESS LTD	EVOLUTION MINING LTD
LIMEADE INC-CDI	VOLPARA HEALTH TECHNOLOGIESS

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Should investors have any questions or queries regarding the Fund,

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