

Ellerston Low Volatility Income Strategy Fund

Performance Report | January 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year p.a.	Since Inception (p.a.)
Net [^]	4.93%	9.14%	10.99%	-	-	17.04%
Benchmark*	4.98%	6.08%	5.11%	-	-	14.12%
Alpha	-0.06%	3.06%	5.88%	-	-	2.91%

Source: Ellerston Capital

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

* S&P/ASX 200 Accumulation Index

COMMENTARY

The Australian equity market bounced into 2020 delivering a regional best gain of 5.0% for January. The ASX 200 markedly outperformed the MSCI ACWI, which fell 1.2% as escalating coronavirus concerns weighed on global sentiment. The Chinese market was hit particularly hard, falling 2.3%.

The Ellerston Low Volatility Income Strategy Fund (Fund) performed broadly in line with the market in January, rising 4.93% compared to the benchmark increasing 4.98%. Over the 6 month period, the Fund has outperformed the benchmark by 5.88% on a net basis.

For the month, key drivers of relative outperformance were derived from strong sector and stock performance in Healthcare (overweight CSL, Resmed and Sonic Healthcare). These three stocks added 63 bps of relative performance. Key sector / stock performance detraction came from Consumer Staples (overweight Treasury Wines, underweight Woolworths) and Downer EDI. Treasury Wines announced a disappointing downgrade to FY20 earnings guidance on the back of dramatically changing market conditions in the U.S commercial wine market, which saw the share price fall by 26%. It was not a meaningful holding within the portfolio at the time of the downgrade. Downer EDI released a surprising, negative trading update (see below for commentary). Downer EDI and Treasury Wines detracted 80 bps of relative performance.

During the month, we exited our position in Super Retail over concerns that the bushfires/smoke will potentially have a meaningful impact on sales of camping and outdoor equipment over the critical Christmas and January sales period. The stock has performed strongly and is trading above its long term PER valuation average. We also reduced our position in Carsales.com after a very strong performance period, with the stock trading at a PE multiple close to two standard deviations above its long term average versus the market. We still like the company on a longer term basis but feel the valuation has run ahead of fundamentals for now. Finally, we reduced our position in Downer EDI after a very disappointing and surprising trading update which saw the company lower its NPATA guidance by 18%. Negative profit revisions were isolated to the company's Engineering, Construction and Maintenance (EC&M) division, which is their smallest and lowest margin business. We still have a holding in the portfolio based on the expectation that the contract mining business will be sold, with part proceeds used to undertake a share buyback.

There was one new portfolio addition during January. We added ASX Limited following a period of underperformance since July 2019. We expect the upward trend in the cash market business to continue with increases in total trade volumes and values. We are also attracted to its defensive business model at this stage of the business cycle given its little operating and financial leverage. We also increased our position in Centuria Capital Group (CNI) via an \$80m institutional placement at \$2.34 per security to help fund the acquisition of Augusta Capital Group. Augusta Capital Group is one of the largest listed real estate funds management companies in New Zealand and expands CNI's assets under management by 26% to A\$9.2bn. Dividend growth is expected to be 7% in FY20. We also increased our position in Spark New Zealand as part of our deliberate strategy to add to lower beta names as the broader market hits lofty valuations.

The ASX 200 was the best performing major market in local currency terms but in USD terms, the market was flat month on month, in line with the S&P 500. By sector in Australia, Healthcare (+12%), IT (+11%) and Consumer Staples (+8.2%) outperformed whilst Energy (+0.7%) and Materials (+1.8%) all underperformed the market as the spread of coronavirus began to impact cyclical stocks as economic growth forecasts, and therefore profit expectations, began to be cut.

Consequently, Global Bonds rallied strongly in January, with US 10 year bond yields falling 40 bps to 1.52% and Australian 10 year bond yields falling 42 bps to 0.95%.

Similarly, bulk commodity prices moved lower in January, with iron ore declining 7.7% to \$84.94/t. Brent crude declined 13.5% to \$58.16/bbl, the lowest level in over a year on weaker demand prospects. Gold prices rose \$69.45/oz, close to its highest level since 2013.

Investment Objective

The investment objective of the Ellerston Low Volatility Income Strategy Fund ("ELVIS" or "the Fund") is to provide investors with returns and income growth greater than the S&P/ASX 200 Accumulation Index over rolling 3-5 year periods.

Investment Strategy

The Fund is a fundamental, bottom up Australian equity strategy with a clear focus on delivering low volatility, sustainable income for investors through actively blending multiple, distinct dividend yield strategies throughout the market cycle.

Key Information

Strategy Inception	1 May 2019
Portfolio Manager	Chris Hall
Application Price	\$1.1677
Net Asset Value	\$1.1648
Redemption Price	\$1.1619
Liquidity	Monthly
No Stocks	37
Management Fee	0.70%
Performance Fee	10%
Buy/Sell Spread	0.25%/0.25%

On the economic front, the US ISM Manufacturing Index missed, falling modestly to 47.2 (consensus 49.0), while the composite ISM Non-Manufacturing Index lifted to 55.0 (consensus 54.5). December housing starts continued their strong rebound, rising 16.9% on pcp. China economic data was stronger with December industrial production growth of 6.9% (consensus 5.9%) and manufacturing PMI also stronger than expected. In Australia, housing prices (Sydney, Melbourne driven) continued to rebound, with the year on year growth rate rising 4.1%, post a 2.2% rise in December. November retail sales were reported and rose 0.9% month on month, driven by Black Friday spending. While business conditions continued to recover, consumer confidence slumped due to the impact of the bushfires.

The bottom line is we expect the Reserve Bank of Australia to keep interest rates on hold for the foreseeable future until the impact of the bushfires and coronavirus on the Australian economy is clearer.

During the month we meaningfully reduced our exposure to cyclical yield for the first time in 6 months, mainly in the Energy and Materials sectors and increased our weighting to “dividend champions”, those stocks with more sustainable dividend growth rates at this stage of the cycle. The rationale for this is our belief that the cyclical rally we have enjoyed over the past 6 months has seen valuations hit levels which are were no longer attractive in some names that we owned.

We expect Australian economic growth forecasts to see further downward revisions (especially those companies exposed to China) due to the coronavirus impact, which will place pressure on company business fundamentals and valuations.

The beta of the Fund (a measure of volatility) has moved lower as a result of our reduction in cyclical yield exposure. The beta has reduced down to 0.86 from 0.94 and sits comfortably below the market beta of 1.00. The expected FY21 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 4.6% versus 0.5% for the ASX 200 .The expected dividend yield of investee companies held within the portfolio is currently 3.3%.

Regards,

Chris Hall - Portfolio Manager, CIO

PORTFOLIO CHARACTERISTICS

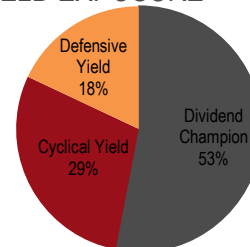
HOLDINGS

Top 10 holdings	Sector	%
CSL Limited	Health Care	9.0%
Macquarie Group Limited	Financials	6.8%
Westpac Banking Corporation	Financial	5.2%
Aristocrat Leisure Limited	Consumer Discretionary	5.1%
Goodman Group	Real Estate	4.7%
Sonic Healthcare Limited	Health Care	4.7%
Rio Tinto Limited	Materials	4.7%
ASX Limited	Financials	4.5%
Resmed Inc	Health Care	4.3%
Woodside Petroleum Limited	Energy	3.0%

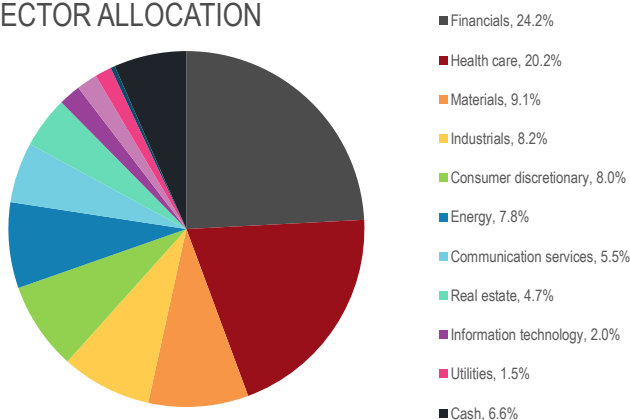
KEY PORTFOLIO METRICS

FY21(e)	Fund	Benchmark
Price/Earnings (x)	20.3	17.9
Dividend Yield (%)	3.3	4.0
Dividend Growth rate (%)	4.6	0.5
Beta	0.86	1.00

PORTFOLIO YIELD EXPOSURE

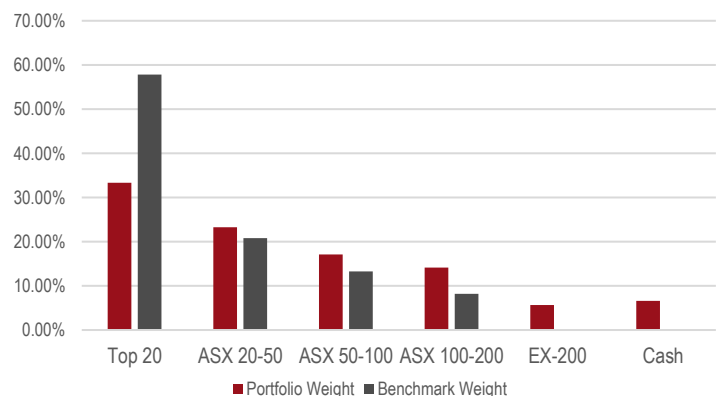


SECTOR ALLOCATION



Source: Ellerston Capital

MARKET CAPITALISATION



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

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Should investors have any questions or queries regarding the fund,

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