Ellerston Asia Growth Fund

Performance Report | February 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net^	0.71%	5.00%	11.34%	14.13%	4.80%	10.97%
Benchmark*	0.81%	3.56%	9.54%	7.85%	2.91%	10.76%
Alpha	-0.10%	1.44%	1.80%	6.28%	1.89%	0.21%

Source: Ellerston Capital

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

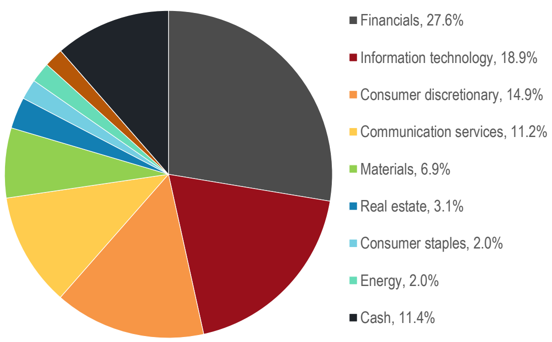
*MSCI Asia ex Japan (non-accumulation) (AUD)

PORTFOLIO CHARACTERISTICS

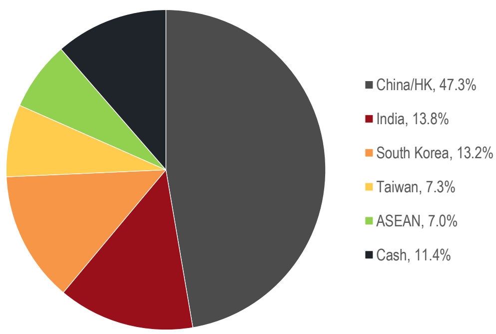
HOLDINGS

Top 10 holdings	Sector	%
Tencent Holdings Ltd	Communication Services	9.2%
Alibaba Group Holding Ltd	Consumer Discretionary	8.1%
Samsung Electronics	Information Technology	7.8%
TSMC	Information Technology	6.1%
China Life Insurance Co. Ltd.	Financials	4.0%
Anhui Conch Cement Company Ltd	Materials	3.2%
Sunac China Holdings Ltd	Real Estate	3.1%
Ping An Insurance	Financials	3.1%
ICICI Bank Ltd	Financials	3.0%
China Merchants Bank Co.	Financials	3.0%

SECTOR ALLOCATION



GEOGRPAHIC 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	$1.1423
Net Asset Value	$1.1395
Redemption Price	$1.1367
Liquidity	Daily
No Stocks	30
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

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COMMENTARY

February was dominated by coronavirus news flow in China and early March has been dominated by the spread of coronavirus globally and the drop in oil prices. Despite the coronavirus outbreak, the Ellerston Asia Growth Fund (EAGF) ended the month of February up 0.7% roughly in line with benchmark (net). As of February 28, 2020, year to date in calendar 2020, EAGF was up 1.76% and had outperformed the benchmark by 0.63% (net).

The current market volatility can be attributed to first order and second order effects. The first order effects are the coronavirus and the drop in the oil price. The second order effects are the policy response to coronavirus and the potential credit impacts of the drop in oil. Below we outline our thoughts on both these primary and secondary drivers and how we are positioned in the current environment.

Coronavirus

More than 9 months ago, Ellerston Asia came to the conclusion that there was going to be some sort of resolution to the trade war and positioned accordingly. Between August 2019 and mid-January 2020, the MSCI Asia ex Japan Index rallied over 18%. Since we were positioned for this rally very early, we began taking profits in the third week of January, prior to the onset of coronavirus. This put us in good stead for subsequent market dislocations.

When coronavirus first hit in Wuhan in late January, we divided the portfolio into 3 buckets: (1) directly negatively impacted by coronavirus; (2) high beta or overbought Asian stocks that were candidates for profit taking in a risk off market; and (3) stocks that would not be impacted or could potentially benefit from coronavirus and the subsequent quarantine conditions.

The Fund only had two stocks in the first category (directly negatively impacted), LG H&H and Wuliangye. We exited both these positions at a gain. Wuliangye in particular had doubled since we initially invested. There were some financial stocks in the second category (high beta, overbought), like China Life, Ping An and ICICI Bank, which we trimmed. In the last category are stocks like JD, Alibaba and Tencent that could benefit from more people being at home shopping and playing online games during quarantine. We maintained or increased positioning in these names.

Note that a large portion of this repositioning occurred prior to the Chinese New Year holidays, when Asian markets were closed for up to 2 weeks in some cases. In hindsight, the closure of Asian markets in the early days of coronavirus was a blessing because it reduced/eliminated opportunities for panic selling and gave both institutional and retail investors time to process and analyse the impacts of the epidemic. When Chinese markets did re-open, the government funds and banks (i.e. the “National Team”) did step in to help stabilize the market. As a result, the CSI 300 and the Shanghai Composite have outperformed most markets globally down 4.2% and 5.7% from their January highs, respectively.

As shown in the table below, countries have responded to the virus with a mixture of fiscal and monetary stimulus. To date, the market has responded more favourably to fiscal stimulus than to monetary stimulus. The threat of most of the developed world reaching the zero lower bound for interest rates is a very real concern and could be one of the lasting negative implications of the pandemic.

In the US, we are particularly concerned that the 50bps emergency cut by the Fed was wasted ammunition and continue to be concerned by President Trump’s apparent reticence to take the coronavirus seriously. Asian countries hurting from the impact of coronavirus may follow suit with sympathy cuts which will be negative for their currencies. India, Malaysia and Korea are most likely to cut in between meetings.

Country	Monetary or Fiscal?	Policy
US	Monetary	50bps cut to the target benchmark rate to 1-1.25%.
China	Monetary & Fiscal	Cut 7-14 day repo rate by 10bps to 2.4%/2.55% respectively. Cut MLF rate by 10bps to 3.15%. Advance allocation of RMB$1.8tn in local government bonds.
Hong Kong	Fiscal	HK$120bn relief package incl. HK10k cash handout to each permanent resident
Singapore	Fiscal	S$20.5bn stimulus package incl. corporate tax cut, job support scheme and assistance to sectors such as aviation and retail.
South Korea	Fiscal	KRW12tn stimulus package to support the healthcare sector and SMEs.
Taiwan	Fiscal	Special budget of NT60bn to support virus affected industries.
Malaysia	Fiscal	MYR20bn to support the tourism industry and increased infra spending.
Indonesia	Fiscal	IDR10.3tn fiscal package focused on tourism, airline and housing sectors.
Thailand	Fiscal	THB400bn stimulus package to support the low income earners, rural households and SMEs.
Australia	Monetary	25bps cut in the cash rate to 0.5%
Italy	Fiscal	EUR3.6bn package incl. tax cuts for the health system and tax credits for struggling companies.
Canada	Monetary	Cut benchmark interest rate by 50bps to 1.25%.
UK	Monetary	50bps cut to the benchmark interest rate to 0.25%.

Communication from Chinese policy makers is that the government will continue to support the economy and will provide fiscal stimulus to aid recovery after the epidemic is deemed under control. This assumed large scale support is one of the reasons why portfolio stocks like Anhui Conch (cement) and SUNAC (property) have held up extraordinarily well in the recent downturn.

We have contacted our portfolio companies in China and all of them are back to work and have capacity back on line, albeit below 100%. The companies confirmed that workers were paid during extended CNY holiday, although not for overtime. As such, demand destruction in China will likely be ephemeral and we expect a bounce back in 2Q20 and 2H20.

On inventory, for the technology supply chain companies we have spoken to, there was on average 2 months of inventory on hand prior to the outbreak of coronavirus. Now supply has been reinstated faster than demand has recovered so the inventory situation, in the tech supply chain at least, is not as dire as some market participants assume.

Oil Price

The second driver of the market sell off is the plunge in the oil price in early March caused by a disagreement and subsequent oil price war between Russia and Saudi Arabia. As our investors know, the Fund has very stringent ESG (Environmental, Social and Governance) criteria and therefore typically has very little exposure to the energy complex. At the time of the oil plunge, we held no extractive industry stocks and no upstream oil producers. We did have a 2% position in Reliance Industries, an Indian conglomerate spanning telecom, retail, petrochemicals and refining, but overall we were significantly underweight the energy sector.

EAGF typically has a large portion of the portfolio in financials, therefore the more pressing issue for our portfolio is the second order effect that the drop in oil prices will have on credit. Within Asia, credit costs at Malaysian banks have by far the highest sensitivity to oil prices but we do not have any investments in Malaysia. Singapore banks are also correlated and are also negatively impacted by lower rates in the US, so we have exited our long held position in DBS. By contrast, Indian financials are uncorrelated with the oil price as India is a net oil importer. As such, a lower oil price is actually a macro positive for India when taken in isolation.

There are a few aspects to consider when determining if the oil price sinks further from the current level. First of all, while oil prices have reacted negatively to the news of a price war, there have not been any actual increases in production yet. The increase in supply is expected to kick in from April 1st when approximately 4m additional barrels of oil will flood the market. Ceteris paribus, we expect prices to go down to ~$20 in this scenario. However, this price level will not sustain as smaller players in the US shale market will shut down capacity and both Saudi and Russia will have to come back to the negotiating table or they risk inflicting major fiscal wounds on their own economies. This could take a few months but we expect the two countries to be back at the negotiating table by the 2H20.

Current Positioning

In this sort of environment, namely one characterized by high volatility and high uncertainty, it pays to be a large cap focused fund like EAGF. We have a very liquid portfolio (average market cap of over $160 billion) and can adjust to major changes in the environment in an efficient manner.

In terms of market contribution, our underweights in Taiwan, Hong Kong and Thailand were the largest contributors to alpha in February while our overweight position in India was the biggest detractor. Consumer discretionary was the largest sector contributor to alpha and financials was the largest detractor. Stock wise, Anhui Conch, SUNAC and Hindustan Unilever were the top contributors to alpha while POSCO and L&T were the largest detractors.

Finally, as you are aware, the Ellerston Asia team spends considerable time on the ground in Asia, typically around 1/3rd of the year. Interestingly, given restrictions on travel, the number of virtual conferences, VC calls and Zoom webcasts with management teams has rapidly replaced face to face meetings. As such, our company contact run-rate year to date in 2020 is actually higher than it has been in previous years. By the end of March we anticipate having had over 120 company contact points versus ~340 for the full year in 2019.

As always, if you have any questions regarding any aspect of EAGF or the portfolio, please feel free to contact us at info@ellerstoncapital.com. On March 17 we are hosting a call for our investors. For more details, please see our website.

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 7701 or info@ellerstoncapital.com

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

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