ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | February 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^	-5.40%	-2.60%	5.65%	14.15%	1.58%	3.55%	6.68%
Benchmark*	0.06%	0.19%	0.39%	1.04%	1.35%	1.55%	1.80%
Alpha	-5.46%	-2.78%	5.26%	13.11%	0.23%	2.01%	4.88%

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	65%	**Net Equity Exposure**	22.4%
No. Relative Value positions	29	**Gross Portfolio Exposure**	181.5%
No. Special Situations	30	**Correlation Coefficient (vs ASX 200 Accum)**	12.43%
Beta Adjusted	13.7%	**Net Sharpe Ratio (RFR = RBA Cash)**	0.81

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	22.8%	-11.9%	10.9%
Industrials	43.5%	-5.1%	38.4%
Resources	30.5%	-21.8%	8.7%
Index	0.0%	-35.7%	-35.7%
Total	**96.8%**	**-74.5%**	**22.4%**

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	$1.0567
Net Asset Value	$1.0541
Redemption Price	$1.0515
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 -5.4% in February, with most of the loss coming in the last week of February. Despite many of our positions having little direct impact from COVID-19, a number of our holdings were sold down aggressively, with no apparent rhyme or reason. The return was particularly disappointing because we have been cautious on equity markets and have accordingly been maintaining extra protection via derivatives.

Net exposure was +22% at the end of February, with a beta-adjusted net of +13.7%. Gross exposure was further lowered during the period, closing the month at 181%.

Our paired positions within the energy sector detracted from performance in the period, with Karoon Energy (-27.2%) underperforming both Santos (-20.6%) and Woodside Petroleum (-17.5%). Karoon remains on track to settle the acquisition of the Bauna oil field in Brazil in early April, with the final acquisition price reduced by the net cash flow received on production from the field during FY20 (approximately 9 months). The company has also previously announced that there is a need to refresh the composition of the Board, with a number of new independent directors scheduled to replace the existing non-executives. Despite the share price fall, Karoon remains one of our most high conviction positions, trading on an FY21 EV/EBITDA multiple of less than 2x and with an expected return-to-consensus price target of +142%.

After adding considerable value to the Fund over the past few months, the share price of Infigen Energy (-19.0%) traded lower, in part due to the large block sale of the Brookfield Renewable Partners' shareholding. The position was paired with AGL Energy (-1.8%), whose share price also suffered during the period, however not enough to compensate for the fall in Infigen.

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Our paired position between Eclipx Group (-9.4%) and McMillan Shakespeare (-16.0%) added value in the month, with increased speculation that McMillan may make a second bid for Eclipx, leading to a narrowing in the spread.

The spread between the Australian and UK listings of both BHP Group (-14.7%) and Rio Tinto (-11.6%) widened during the period, detracting from the performance of the Fund.

The share price of Village Roadshow (-12.9%) underperformed during the month, despite both potential Private Equity suiters remaining in due diligence. During February, the company announced its 1H20 result, with a weaker contribution from Film Distribution leading to a modest reduction in FY20 and FY21 earnings forecasts. The company also identified up to $3m of EBITDA was at risk due to COVID-19, a relatively modest impact on a FY20 figure that we expect to be approximately $120m. We remain comfortable with our position, with the stock closing the month at a 12.2% discount to the higher of the two takeover proposals.

Our shareholding in Atomos (-40.8%) significantly detracted from performance in the month, with the share price knocked lower on fears around their Chinese supply chain due to COVID-19. Recall that Atomos designs and manufactures monitor-recorders, which can be added to existing video equipment to improve the image quality and most of their products are manufactured in China. With the 1H20 results announcement, the company disclosed a further three month delay in the release of a new product, Neon, which led analysts to downgrade the forecast contribution in 2H20.

Despite an earnings upgrade from Uniti Group (-15.0%) in the period, the company's share price came under pressure, detracting significant value from the Fund. Ahead of its earnings release in late February, the company upgraded FY20 EBITDA by 12.5%, based on better than expected organic growth and higher synergies realised in integrating 1300 Australia into the Specialty Services business unit.

Our index derivative position was the largest positive contributor to performance during the month

ACTIVITY

Relative Value – Gross Contribution -2.16%

We added to our existing paired position between Infigen Energy and AGL Energy during the month, capitalising on the block sale of Brookfield's 9% stake in Infigen. Infigen also released their 1H20 results during the month, meeting the market's expectations and resulting in modest forecast earnings upgrades. The AGL Energy buyback was recommenced following their 1H20 results release and at the end of February was about 2/3 complete.

The spread between Spark Infrastructure (-4.1%) and AusNet Services (-4.2%) narrowed during the month, causing the position to be unwound. We also unwound existing paired positions between Arena REIT (-2.9%) and Charter Hall Social Infrastructure REIT (-1.1%), Eclipx Group and McMillan Shakespeare, and Carindale Property (-5.0%) and BWP Trust (-7.8%).

During the month, Viva Energy (+2.3%) sold its 35.5% stake in Viva Energy REIT (-1.8%), the vehicle that was established to hold their portfolio of service station assets. The sell-down was particularly interesting, in that 5% of the REIT was sold to both Charter Hall Group (-3.0%) and Charter Hall Long WALE REIT (-2.1%), with the balance sold to investors. Charter Hall is not known for holding passive stakes in REITs that are not under their management and the market is already speculating on their ultimate intention. We participated in the liquidity event, creating new paired positions that included Charter Hall Long WALE, GPT Group (-3.7%) and Shopping Centres Australasia (+4.2%).

Special Situations – Gross Contribution -3.84%

After selling out of Imricor Medical Systems (+18.1%) in January, we re-established a position in February, participating in a $20m equity raise. The new funds will be used to grow the installed base, expand the product line, expand the geographies in which those products are approved and broaden their indications for use.

We also established a long position in National Storage (+3.7%) following the withdrawal of both Gaw Capital Partners and Warbug Pincus from the takeover process. Gaw Capital completed its due diligence but advised National Storage that it was unable to make an offer of $2.40 per share or greater and was therefore unable to match the offer made by US-listed Public Storage (-6.5%). Following the Public Storage bid, Warburg Pincus advised National Storage that it had decided not to pursue an offer for the REIT. We expect the Public Storage bid of $2.40 per share will be successful, with the transaction closing and proceeds received before the end of FY20.

A short position in domestic coal-miner New Hope Corp (-22.9%) was covered and we went long as part of a block sale of Mitsubishi's 11.2% stake, held for over 30 years. Whilst we appreciate the increasing stigma around coal mining, investors are certainly getting compensated - New Hope trades on a FY20 EV/EBITDA multiple of around 4x and a fully-franked dividend yield of over 15%.

We sold our remaining holdings in Superloop (-12.5%), MNF Group (-17.9%) and Bendigo and Adelaide Bank (-11.7%). We also bought back a short position in gold-producer Evolution Mining (+10.6%).

MARKET COMMENTRY

Market Overview

As COVID-19 spread around the world, alarm over its negative impact on global growth and ongoing supply-chain disruption saw equity markets sell off rapidly and bond yields collapse to record lows in February. The sharp falls in equity markets in the last week of the month were reminiscent of the panic during the throes of the Global Financial Crisis (GFC). The collapse marked the swiftest 10% correction from an all-time high on record. Surprisingly, Emerging Markets outperformed Developed Markets by 3.2%. Gold rose to the highest level since 2013 given its safe haven status, while Brent crude oil prices fell to 2018 lows.

USA

The economic fallout from the spread of COVID-19 rattled investors, causing US stocks to tumble in late February. The final week of the month was the worst since the GFC, with equity indices down 11%, while treasury yields plummeted to all-time lows. For the month, the S&P 500 was down 8.2% (-8.3% calendar year-to-date) and the Dow Jones Industrial Average was down 9.8% (-10.6% calendar year-to-date). The Dow fell 3,583 points, the largest weekly point loss ever and 14.1% from its intraday zenith recorded on February 12th. The NASDAQ Composite was also in negative territory but fared slightly better, with a return of -6.3% in the period (-4.4% calendar year-to-date.)

Despite the turmoil in the financial markets, US February activity indicators remained resilient. The manufacturing ISM rose more than expected to 50.9 (consensus: 48.5; previous: 47.8), with the composite non-manufacturing ISM also increasing to 55.5 (consensus: 55.1; previous: 54.9). Non-farm payrolls beat expectations, rising 225,000 in January and average hourly earnings ticked up 3.1% year-on-year. Of course these are backward looking, but nonetheless point to a stronger underlying economy. The markets are concerned about the dampening effect on the economy looking forward. However, in early March, the markets initially rebounded sharply - the Dow recording it largest one-day point increase of 1,294 points (5.0%) - in anticipation of co-ordinated central bank stimulatory action to combat any negative economic impact from COVID-19. The central bankers have started to oblige, with rate cuts from the RBA and the Fed in early March.

On the 3rd of March, the Fed delivered an inter-meeting cut of 50 basis points, bringing rates to a range of 1 - 1.25%. It was the first emergency action since October 2008, which was during the heart of the GFC. The rate cut was followed by a press conference from Fed Chair Powell, where he noted that the Fed will use tools and act appropriately depending on the flow of events. In other words, additional cuts are on the table. The Dow Jones fell 785 points (2.94%) in response to Powell's misfired commentary that afternoon. We would expect ongoing volatility in markets.

Europe

European stocks were also much weaker as fears of a pandemic spread, with a sudden outbreak in Italy and numerous cases reported across Europe. Stocks had been weak the previous month, but collapsed in February. The Euro Stoxx 50 was down 8.5%, with all major markets in the red: the FTSE 100 returned -9.0%, France's CAC 40 -8.6% and Germany's DAX -8.4%. At the end of February, the FTSE 100, CAC 40 and the DAX registered returns below 10% in the calendar year-to-date - officially in "correction" territory.

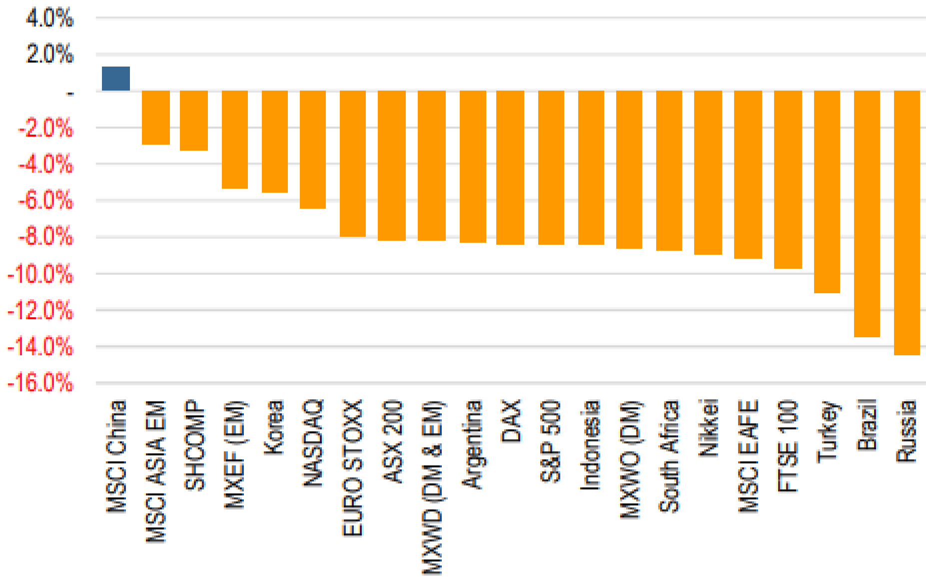
Activity indicators in Europe moderated, with the flash Eurozone manufacturing PMI for February beating, but still only at 49.1. January inflation data came in at 1.4% year-on-year, as expected.

Asia

Asian equities were also dragged down in the global sell-off, with Japan's Nikkei 225 and Korea's KOSPI Composite the worst performers, down 8.8% and 6.2% respectively. The Hang Seng was a comparatively good performer, being down only 0.4% and the broader Chinese market, represented by the SSE Total Market Index, was down 2.7%.

It was widely expected that the spread of COVID-19 and measures imposed to contain it would severely impact Chinese economic growth. Manufacturing activity data released in early March showed that Chinese factories were reeling, with China's manufacturing purchasing managers' index sinking far worse than expected to 35.7 in February - the lowest reading since the survey began in 2004 - and down from 51.1 in January.

Global Equity Markets' Performance in February 2020

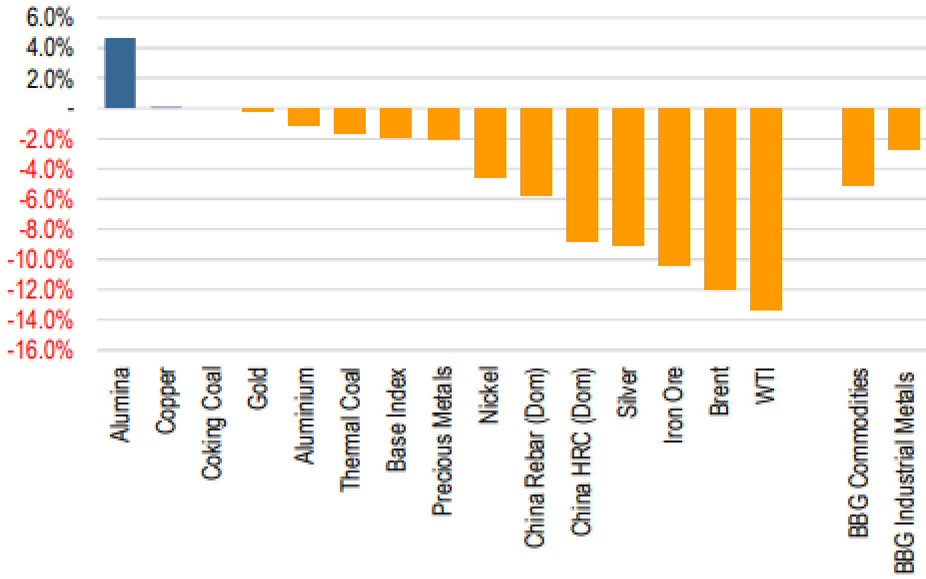


Source: JP Morgan, Bloomberg.

Commodities

The BBG commodities index fell 5.2% in the month. Iron Ore was down 10.4%, as China-related demand unease saw iron ore prices close at US$86/t and Brent dropped 12% as fears that COVID-19 would negatively impact global growth took hold. Base metals were also weaker and precious metals weren't spared either. Alumina was the best performer, up 4.7%%.

Global Commodity Performance in February 2020



Source: JP Morgan, Bloomberg

Bonds

Global bond yields fell again in February, hitting new record lows as investors clamoured for the safety of government paper and safe haven assets. The US 10-year bond yield ended the month at 1.15% (and has continued to fall in early March) and the Australian 10-year bond yield remained below 1%, closing the month at 0.82%.

Australia

The S&P/ASX 200 Accumulation Index had a shocking February, ending the month at 6,441.2, down 7.7% (-3.1% calendar year-to-date), as the first-half earnings season was quickly brushed aside. Investor confidence that saw the market achieve a record high of 7,197.2 intra month and outperform the previous month, dissipated rapidly as COVID-19 spread globally, dominating news headlines. The battering represented a 10.5% decline and the fastest correction from its recent high on record, with every GICS in the red in the month of February.

The month featured the semi-annual reporting season which is now over, with more misses than beats. ASX 200 Industrial firms delivered their weakest profit growth since the GFC. EPS fell 8% year-on-year and 43% of firms missed EPS forecasts (according to data compiled by Goldman Sachs). It is estimated that 49% of ASX 100 companies saw downward EPS revisions to FY20 EPS of greater than 2%, against just 14% of stocks seeing 2% plus upward revisions. While consensus downgrades were much larger than average, downgrades are expected to accelerate in Q3, as few companies were yet at a point where they could quantify the potential revenue impacts from a slowing economy, let alone issues with their supply chain disruptions. This reporting season was also the first half in a decade where the average company did not grow its dividend.

In February, the best performing sector in terms of its contribution to the index's performance was Utilities (but still negative), returning -0.1%. The next two best sectors were Communications Services (-0.3%), and Real Estate (contribution -0.4%). The bottom three sectors were Materials, Financials and Energy.

Large Caps were preferred over Mid and Small Cap counterparts. The ASX 200 Resources Accumulation Index was the worst performing sub-sector, down 13.3%, with slowing global growth fears manifested most clearly in the demand for commodities. The Small Ordinaries Accumulation Index also fared badly -8.7% with the ASX 200 Industrial Accumulation Index fell 6.3%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were BHP Group (-88 points), Woodside Petroleum (-29 points), Westpac Banking Corporation (-28 points), Wesfarmers (-23 points) and Rio Tinto (-22 points).

Conversely, the top five stocks that made a positive contribution to the index's return were a2 Milk Company (+3 points), Evolution Mining (+2 points), Northern Star Resources (+2 points), Cleanaway Waste Management (+2 points) and IDP Education (+2 points).

In a move widely expected, the RBA left rates unchanged after its meeting in early February but immediately cut rates by 25 basis points to their lowest level in Australian history following its meeting in early March. The move follows three rate cuts last year. The RBA's statement said: "The Board took this decision to support the economy as it responds to the global COVID-19 outbreak." The four major banks passed on the rate cut in full. It is expected that the government will announce a fiscal stimulus package ahead of the budget, but details remain scarce.

The Australian dollar fell 2.6% against the US dollar in February, ending the month at 0.65 cents.

CONTRIBUTION

Relative Value Gross Contribution -2.16%			
Positive		**Negative**	
ECLIPX GROUP LTD - MCMILLAN SHAKESPEARE LTD	0.25%	KAROON GAS AUSTRALIA LTD - SANTOS	-0.95%
SHOPPING CENTRES AUSTRALASIA - VIVA ENERGY REIT	0.18%	AGL ENERGY LTD - INFIGEN ENERGY	-0.69%
CHARTER HALL LONG WALE REIT - VIVA ENERGY REIT	0.08%	KAROON GAS AUSTRALIA LTD - WOODSIDE PETROLEUM	-0.55%
APN CONVENIENCE RETAIL REIT - VIVA ENERGY REIT	0.08%	CARNARVON PETROLEUM LTD - SANTOS	-0.34%
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	0.06%	GROWTHPOINT PROPERTIES - SHOPPING CENTRES AUSTRALASIA	-0.13%

Special Situations Gross Contribution -3.84%			
Positive		**Negative**	
PUT SPREAD ON ASX 200	3.80%	ATOMOS LTD	-1.43%
SUNCORP GROUP	0.09%	VILLAGE ROADSHOW LTD	-1.30%
BENDIGO AND ADELAIDE BANK	0.09%	VOLPARA HEALTH TECHNOLOGIESS	-0.95%
VITALHARVEST FREEHOLD TRUST	0.04%	UNITI WIRELESS LTD	-0.83%
IMRICOR MEDICAL SYSTEMS-CDI	0.01%	IMPEDIMED LTD	-0.73%

Top 10 Relative Value Positions	
BHP BILLITON - BHP BILLITON	KAROON GAS AUSTRALIA LTD - SANTOS
RIO TINTO - RIO TINTO	SHOPPING CENTRES AUSTRALASIA - VIVA ENERGY REIT
AGL ENERGY LTD - INFIGEN ENERGY	BWP TRUST - CARINDALE PROPERTY TRUST
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	SANTOS - SENEX ENERGY LTD
KAROON GAS AUSTRALIA LTD - WOODSIDE PETROLEUM	GROWTHPOINT PROPERTIES - GPT GROUP

Top 10 Special Situation Positions	
PUT SPREAD ON ASX 200	VILLAGE ROADSHOW LTD
NUFARM FINANCE NZ LTD - NSS	KALIUM LAKES LTD
UNITI WIRELESS LTD	VOLPARA HEALTH TECHNOLOGIESS
LIMEADE INC-CDI	ATOMOS LTD
NEW HOPE CORP LTD	PRIMEWEST GROUP LTD

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

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