ELLERSTON CAPITAL

Ellerston India Fund

Performance Report | February 2020

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net^	-3.19%	-2.02%	3.13%	11.65%	8.62%	7.54%
Benchmark*	-3.72%	-2.02%	4.36%	11.31%	7.18%	7.10%
Alpha	0.53%	0.00%	-1.23%	0.34%	1.44%	0.44%

Source: Ellerston Capital

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

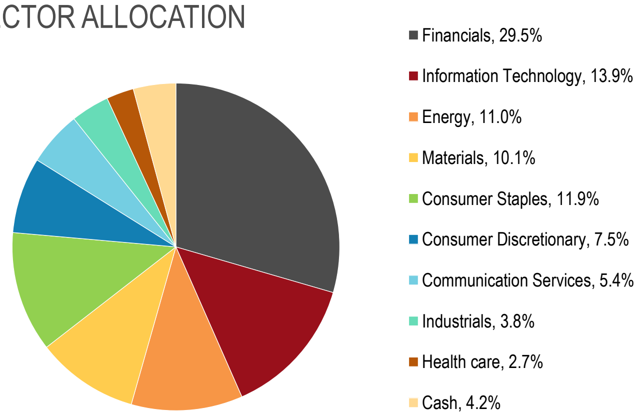
* MSCI India Net Return Index (AUD)

PORTFOLIO CHARACTERISTICS

HOLDINGS

Top 10 holdings	Sector	%
Reliance Industries Ltd	Energy	11.0%
Housing Development Finance Corp Ltd	Financials	10.6%
Infosys Ltd	Information Technology	8.9%
ICICI Bank Ltd	Financials	6.2%
Hindustan Unilever Ltd	Consumer Staples	5.6%
Tata Consultancy Services Ltd	Information Technology	5.0%
Maruti Suzuki India Ltd	Consumer Discretionary	4.5%
Britannia Industries Ltd	Consumer Staples	4.2%
Bajaj Finance Ltd	Financials	4.0%
Larsen & Toubro Ltd	Industrials	3.8%

SECTOR ALLOCATION



Source: Ellerston Capital

Investment Objective

To outperform the MSCI India Net Return Index (AUD) with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio with exposure to Indian Companies using the Manager's high growth, high conviction, benchmark independent investment approach. The Fund has identified a number of core thematics that will drive returns in the Indian market in the medium term. The focus is on investing in Indian Companies that benefit from these fundamental drivers.

Key Information

Strategy Inception	4 May 2017
Portfolio Manager	Mary Manning
Application Price	$1.1316
Net Asset Value	$1.1288
Redemption Price	$1.1260
Liquidity	Daily
No Stocks	28
Management Fee	1.10%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

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COMMENTARY

The Ellerston India Fund (EIF) was down 3.19% in February outperforming the benchmark by 0.53%. Calendar year to date in 2020, EIF is up 0.57% and has outperformed the benchmark by 0.27%.

February was a risk off month for global equity markets and India was no exception. The current market volatility can be attributed to first order and second order causes. The first order causes are the coronavirus and the drop in the oil price. The second order effects are the policy response to coronavirus and the potential credit and macro 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

As at the end of February, there have been 58 countries excluding China with confirmed cases of the virus. India thus far has 50 confirmed cases, with no fatalities. It is important to note that the cases in India have been isolated and none have been human to human transmissions. There are two schools of thought on the way coronavirus will develop in low income countries. On one hand, high population density and less developed health systems suggest that coronavirus would be easier to transmit more difficult to test and contain in countries like India. Yet the lack of community outbreak thus far suggests there are other factors at play. These could include higher general immunity level in developing countries, warmer temperatures in low income countries in the southern hemisphere and lower levels of globalization (i.e. travel, supply chains, etc). The truth is it is too early to tell how the epidemic will play out in India but we continue to monitor very closely given the potential economic and equity market implications if things do get worse.

As shown in the table below, countries have responded to the virus with a mixture of fiscal and monetary stimulus. Since the end of January, a dozen countries including the US, China, Korea, Hong Kong, Singapore, Taiwan and Australia have either cut interest rates or announced fiscal stimulus packages. 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.

We believe India needs to act as well. India is an exporter of commodities, industrial machinery, vehicles and IT services. So a Coronavirus driven slowdown in global economic growth could have a negative impact on an already slowing Indian economy. The latest GDP print for India came in at 4.7% yoy growth for 3QY2020, which marked the seventh consecutive quarterly slowdown and was the lowest growth reading since 2013. Our concern however, is that both the Government and the RBI have limited room to act. India's fiscal deficit is already at the upper limit of the Government target of 3.8% of GDP. Meanwhile, the 135bps of rate cuts delivered by the RBI in 2019 have yet to flow through into the system and headline inflation (+7.6% yoy in January) remains stubbornly high.

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%.

Oil Price

A concurrent market worry to the coronavirus 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, Ellerston India has very stringent ESG (environment, Social and Governance) criteria and therefore typically has very little exposure to the energy complex. At the time of the oil plunge, the only energy stock we held was Reliance Industries, an Indian conglomerate spanning telecom, retail, petrochemicals and refining. We have no exposure to upstream energy stocks.

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 increase 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.

Notably, India is a net oil importer and oil imports is one of the main reasons India has a persistent current account deficit. As such, excluding other factors, a lower oil price is a positive for the macro outlook in India.

YES Bank nationalization and Indian Financials

Another notable event to highlight in India since the start of March was the RBI's decision to take control of Yes Bank due to a serious deterioration in its financial position. A cap on depositor withdrawals was also imposed, whilst the Yes Bank Board was also thrown out and management effectively take over by State Bank of India.

This is an extremely serious move by the RBI but we are disappointed in the RBI's timing. Yes Bank has been in trouble for almost 2 years due to company specific issue (accounting fraud) and mis-management. To effectively nationalize it during one of the most volatile weeks since the GFC and create conditions that could cause a private sector bank run, is misguided at best and irresponsible at worst.

Our view is that Finance Minister Nirmala Sitharaman will be replaced within 6 months. RBI Governor Das will likely stay in his position but with dwindling credibility.

Ellerston India does have a large portion of the portfolio in financials but they are all very high quality, well capitalized private sector banks with good liquidity. As such, we have not altered our financials portfolio significantly in the wake of the YES Bank crisis.

Performance

In terms of portfolio performance, Financials and Energy were the two largest contributors to alpha during the month. While Consumer Discretionary, Materials and Consumer Staples were the largest detractors. The largest contributors to alpha were Au Small Finance Bank, Eicher Motors, Bajaj Finance and Axis Bank. The largest detractors were Britannia, Maruti Suzuki and Tata Steel. Cash at the end of February was 4.2%. Cash as of mid-March is higher as we have taken profits in some high beta names given the global sell off.

As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

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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