Ellerston Capital

Ellerston Low-Vol Income Strategy 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^	-7.40%	-4.02%	2.16%	-	-	8.38%
Benchmark*	-7.69%	-5.18%	-0.63%	-	-	5.35%
Alpha	0.29%	1.16%	2.79%	-	-	3.03%

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 spread of COVID-19 around the globe was the catalyst for a meaningful sell-off in global equity markets, as fear of significant supply chain disruption and the subsequent impact on global economic growth and company profits saw investor behaviour reminiscent of the GFC. Furthermore, bond yields continued to collapse globally as investors moved out of equity markets to the "safer" investment environment of bonds. The sell-off in equity markets was the quickest 10% correction period on record. In Australia, we saw the S&P/ASX 200 Accumulation Index decline 7.7% as a result of the above, coupled with a very ordinary company reporting season.

The Fund outperformed the market in February, falling 7.40% on a net basis compared to the benchmark's decline of 7.69%. Since inception in May, 2019, the fund has outperformed the index by 3.00% 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 Goodman Group. These two stocks added 60bps of relative performance. Also, not owning BHP Group added 50 bps of relative performance. Key sector / stock performance detraction came from ASX Limited, QUB Holdings and Pendal Group, which collectively lost 60 bps of relative performance. Also, not owning much of the retail banks (Commonwealth Bank, National Bank, ANZ Bank) detracted 90 bps of relative performance.

During the month we exited our position in MNF Group following a disappointing interim result and a lowering of FY20 earnings guidance due to higher costs, thereby impacting gross margins across all three divisions. The stock has declined 20% since sale date so we will look for the right re-entry point given it is a quality business with only short-term headwinds. We also exited our position in Service Stream after a very strong performance period, with the stock trading at a PE multiple 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 Centuria Capital following strong performance post the placement undertaken in January 2020. This was justified on valuation grounds and a requirement to better deploy funds elsewhere. We still like the longer term fundamentals and hold a reasonable position in the stock.

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	$1.0813
Net Asset Value	$1.0786
Redemption Price	$1.0759
Liquidity	Monthly
No Stocks	37
Management Fee	0.70%
Performance Fee	10%
Buy/Sell Spread	0.25%/0.25%

There were two new portfolio additions during February. We added Baby Bunting on the expectation that gross margins will continue to trend higher than market expectations, with their private label brand generating strong sales growth. We also added a position in Breville Group due to its strong product growth potential in Europe and the UK and its minimal manufacturing exposure to COVID-19. Breville is a quality company with an outstanding management team capitalising on strong revenue and earnings growth via new product launches and increased market penetration rates. Dividend growth rate is greater than 10.0% p.a. Finally, we added to our existing position in James Hardie Industries as the share price retraced in the broader market sell-off. US housing still looks attractive and fibre cement continues to gain market share as a product class. The stock continues to be a successful dividend compounder with a reliable earnings growth profile.

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 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 the US, 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.

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%.

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%.

During the month we continued to reduce our exposure to cyclical yield, following a meaningful decrease in January, and increase our exposure to defensive yield. The rationale for this is our belief that the cyclical rally will continue to stall as COVID-19 supply chain disruptions place meaningful pressure on global economic growth and company earnings for the foreseeable future. Valuations for the market, as a whole, still look lofty and require some adjustment to better reflect the economic environment and corporate earnings cycle likely to play out from here over the following 12 months.

We still 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 continued to move lower as a result of our reduction in cyclical yield exposure. The beta of the portfolio is sitting comfortably at 0.90, below the market beta of 1.00. The expected FY 21 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 5.2% vs 0.9% for the ASX 200 .The expected dividend yield of investee companies held within the portfolio is currently 4.1%.

Regards,

Chris Hall - Portfolio Manager, CIO

PORTFOLIO CHARACTERISTICS

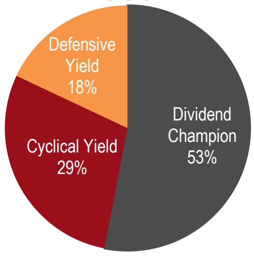
HOLDINGS

Top 10 holdings	Sector	%
CSL Limited	Health Care	9.6%
Macquarie Group Limited	Financials	6.8%
Westpac Banking Corporation	Financials	5.3%
Goodman Group	Real Estate	5.1%
Aristocrat Leisure Limited	Consumer Discretionary	5.1%
Sonic Healthcare Limited	Health Care	4.6%
Resmed Inc	Health Care	4.5%
Rio Tinto Limited	Materials	4.5%
James Hardie Industries	Materials	4.3%
ASX Limited	Financials	4.2%

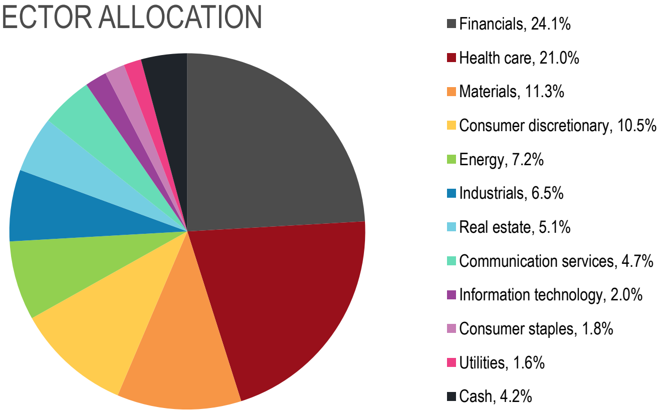
KEY PORTFOLIO METRICS

FY21(e)	Fund	Benchmark
Price/Earnings (x)	16.3	14.4
Dividend Yield (%)	4.1	5.0
Dividend Growth rate (%)	5.2	0.9
Beta*	0.90	1.00

PORTFOLIO YIELD EXPOSURE

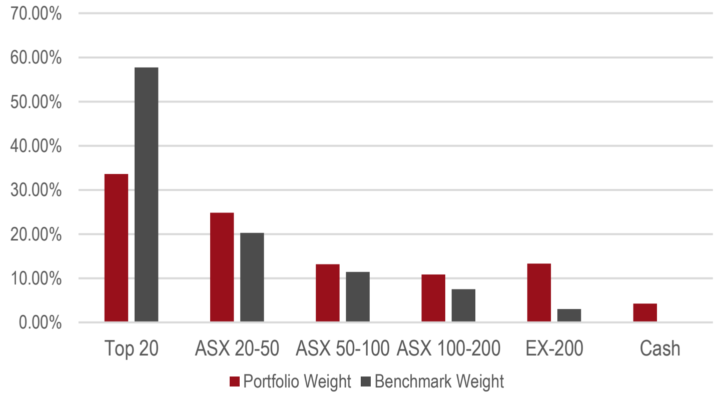


SECTOR ALLOCATION



Source: Ellerston Capital

MARKET CAPITALISATION



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,

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