Ellerston Capital

Ellerston Asia Growth Fund

Performance Report | March 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net^	-7.44%	-5.81%	1.96%	2.66%	1.64%	8.08%
Benchmark*	-7.56%	-6.52%	-0.07%	-2.00%	-1.01%	7.83%
Alpha	0.12%	0.71%	2.03%	4.66%	2.65%	0.25%

Source: Ellerston Capital

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

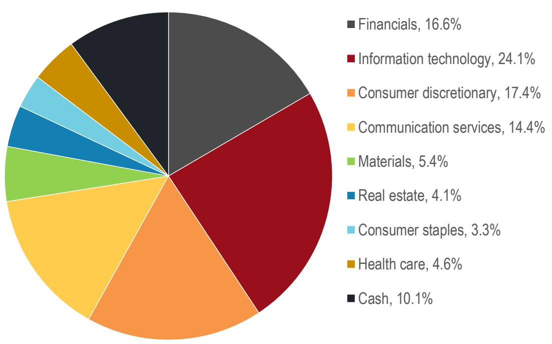
*MSCI Asia ex Japan (non-accumulation) (AUD)

PORTFOLIO CHARACTERISTICS

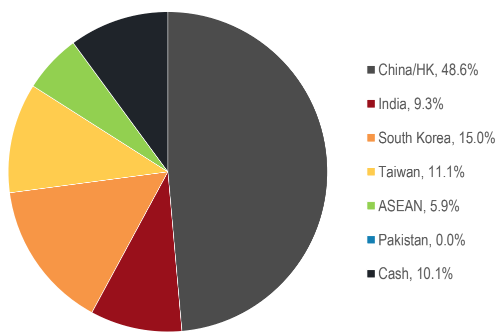
HOLDINGS

Top 10 holdings	Sector	%
TSMC	Information Technology	9.1%
Tencent Holdings Ltd	Communication Services	9.0%
Alibaba Group Holding Ltd	Consumer Discretionary	7.8%
Samsung Electronics	Information Technology	7.8%
Anhui Conch Cement Company Ltd	Materials	4.4%
Sunac China Holdings Ltd	Real Estate	4.1%
SK Hynix Inc	Information Technology	4.1%
JD.com Inc	Consumer Discretionary	3.6%
China Merchants Bank Co.	Financials	3.3%
Ping An Insurance	Financials	3.1%

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	$1.0573
Net Asset Value	$1.0547
Redemption Price	$1.0521
Liquidity	Daily
No Stocks	32
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

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COMMENTARY

March was one of the most volatile months since the GFC. Ellerston Asia Growth Fund (EAGF) ended the month of March down 7.4% and outperformed the benchmark by 0.12% (net). Year to date in calendar 2020, EAGF has outperformed the benchmark by 0.71% (net). In addition to outperforming our Asian benchmark, EAGF's returns CYTD are significantly higher than the returns in the domestic market with the ASX 200 down 21.2% during March and the ASX Small Ords down 22.8%.

EAGF's absolute returns in 2020 have outperformed the returns of the ASX 200 and many other developed markets (DM). This is due to Asian markets as a whole outperforming developed markets and also because EAGF has outperformed our benchmark.

There are a number of key reasons why Asia outperformed most DM markets during March:

(1) **FIFO (First In First Out):** Many Asian countries (China, Korea, Taiwan) were among the first countries to enter the epidemic curve and therefore are the first countries to start to recover and normalize economically. While Chinese markets corrected at the end of January and early February due to COVID-19 risks, global markets, the US in particular, didn't sell off until over a month later.

(2) **Performance Post GFC**: Asian markets had been under pressure from the trade war for about two years prior to the outbreak of COVID-19. As a result, valuations were already very reasonable and there was less far to fall to reach oversold territory.

(3) **Weak AUD:** The fall in the AUD from over $0.70 at the end of 2019 to a low of $0.57 on March 19th provided an FX tailwind for absolute returns in March. The AUD has since recovered to above $0.60 but given the macro situation in Australia and the current stance of the RBI we do not expect the currency to rebound significantly from here.

(4) **Oil**: Asia as a region has very few countries that are net oil exporters (Malaysia) and Energy is less than a ~4% benchmark weigh in MSCI Asia ex Japan. In early March when the oil price fell sharply, countries/regions with lower energy weightings outperformed.

EAGF's outperformance versus our Asian benchmark can be attributed to a few factors:

(1) **High Cash**: At certain times during March we were at 20% cash but this had reduced to 10% by the end of the month as we invested in high quality oversold stocks going into month end.

(2) **Large cap bias**: The MSCI Asia ex Japan Index outperformed the MSCI Asia ex Japan Small Cap Index by over 6% in March alone. As we have stated many times, large cap stock offer better risk reward as they have higher returns and lower liquidity risk. This was definitely true in March 2020 when many smaller cap stocks dropped both due to worsening fundamentals and also due to forced selling and low liquidity.

(3) **Oil:** Due to our strict growth and ESG criteria, EAGF as a fund is generally underweight the Energy sector. We had no upstream energy exposure in March and only held one stock with exposure to the energy complex, Reliance Industries, which is an Indian conglomerate comprising of telecom, retail, petrochemical and oil refining assets. Having zero weight in upstream stocks added to alpha during March.

(4) **Stock Picking**: When I worked at Oaktree Capital, Founder and CIO Howard Marks was fond of saying *"Avoid the losers and the winners will take care of themselves."* This was certainly true in March where a number of our largest single stock contributors to alpha were stocks not owned. These include Axis Bank, Bajaj Finance and CNOOC. Stocks that we do own that contributed to alpha were JD (a potential beneficiary of lock down conditions) and Hindustan Unilever (staples).

While the above explains performance and market movements in March, the question on every investor's mind is whether global markets bottomed in March and when economies will begin to normalize. Our view is that different markets are going to bottom at different times and the path of economic recovery is going to differ significantly across markets.

To help answer these questions and guide our thinking country allocation and cash balance during this volatile time, we have developed a proprietary COVID Market Matrix. The criteria we consider for the matrix includes:

(1) **COVID-19** – Have infections peaked? Have deaths peaked? Is lockdown over or nearing the end?

(2) **Policy response** – Has there been monetary stimulus? Fiscal? What % of GDP is the fiscal stimulus? Is the policy response adequate?

(3) **Valuations** – Are P/B multiples near GFC lows? Are downward EPS revisions adequate?

(4) **Technicals** – Which markets are oversold technically? Which markets are at or near strong technical support levels?

(5) **Flows** – Have retail investors capitulated? Are local governments providing direct market support?

(6) **Oil Price** – Is the country/market a beneficiary of lower oil?

Each country in our universe is given a score on each of these criteria and then countries are ranked, best to worst, based on their total score. Currently China is ranked #1 as it is furthest along the epidemic curve, the policy response is adequate, valuations are attractive, the "national team" has provided market support (particularly for A shares) and China is a net oil importer.

Surprisingly, many ASEAN countries also ranked high in late March because the epidemic is/was not in an exponential growth phase, P/B valuations were at or below GFC lows and technical indicators were showing extreme oversold levels. As such we added to ASEAN in late March and early April, primarily in Thailand and Indonesia.

The country that ranks the worst on our COVID Market Matrix is Malaysia because it is in total lock down despite having a relatively benign epidemic curve, the policy response has been inadequate (fiscal stimulus of 1.2% of GDP), valuations and technicals are not showing extreme levels and Malaysia is the only country in Asia that is a major oil exporter. We have no exposure to Malaysia in the portfolio.

We also rank the major developed countries in the matrix as well and the US and Europe fare worse than most Asian countries. We have long espoused the idea that Emerging Markets in Asia have more policy optionality than Developed Markets and this continues to be the case. Despite most countries in EM Asia lowering interest rates during COVID-19, no country is close to the lower bound. By contrast, the US, Europe, Australia and Japan are already at the lower bound and have to rely to QE and other unconventional stimulatory monetary tools.

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Similarly on the fiscal side, except India (which has very little fiscal room to manoeuvre without risking a credit rating downgrade) most Asian countries have fiscal positions that are relatively strong. Furthermore, unlike the US which remains wedded to a strong dollar policy and has a divided political landscape, Asian countries have currency and industrial policy options.

In late March the matrix was showing attractive buying opportunities in a number of Asian markets. As such, cash has gone from a peak of ~20% during the month to 10% at the end of March 31st, 2020. One area where we added exposure was in India pharma. This sector has been unloved for many years now as the US Food and Drug Administration (FDA) appeared to be on a veritable witch hunt to reduce exports of generic and some branded drugs from India (a less well known aspect of the trade war).

However, in a global pandemic where the US is now at the epicentre, inexpensive and high quality pharma products are suddenly a friend to the US not a foe. President Trump in particular has enthusiastically endorsed hydroxychloroquine as a possible treatment for COVID-19. One stock we bought in late March was Cadila, an Indian pharma company that has the 3rd largest market share of hydroxychloroquine (18%) in the US. Currently, the stock is up 29.2% since we initiated the position a few weeks ago. We also invested in SUN Pharma in late March and that investment is up 25.0% over the same time frame.

One sector where we are proceeding with caution is financials. While consumer facing sectors and technology may recover relatively quickly once economic activity normalizes, the wave of NPLs for banks could take multiple quarters to flow through earnings. We have trimmed exposure to financials and have done extensive model reviews of all our remaining financial holdings to ensure that dividends are sustainable and capital positions are strong. We continue to like China Merchants Bank, OCBC, Ping An and BBCA.

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, Zoom calls and other forms of company engagement has rapidly replaced face to face meetings. As such, since January 2020 we have completed over 160 company contact points which is considerably higher than our company contact run-rate last year.

As always, if you have questions regarding any aspect of EAGF or the portfolio, please feel free to contact us at .info@ellerstoncapital.com. We hosted an update conference call on April 16 for investors in Ellerston Asian Investments (Ellerston's Asia LIC). Both the listed and unlisted Asia funds are managed in the same way, so any EAGF investors who wish to listen to a recording of the call can visit our website for more details. We trust that you and your families are safe and well during this difficult time.

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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