ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | March 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^	-15.25%	-20.61%	-13.46%	0.81%	-4.03%	-0.10%	4.04%
Benchmark*	0.04%	0.16%	0.35%	0.96%	1.32%	1.51%	1.78%
Alpha	-15.28%	-20.77%	-13.81%	-0.15%	-5.34%	-1.61%	2.27%

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**	23.4%
No. Relative Value positions	34	**Gross Portfolio Exposure**	169.3%
No. Special Situations	21	**Correlation Coefficient (vs ASX 200 Accum)**	49.14%
Beta Adjusted	14.2%	**Net Sharpe Ratio (RFR = RBA Cash)**	0.27

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	21.0%	-15.1%	6.0%
Industrials	40.5%	-7.5%	33.0%
Resources	29.0%	-22.7%	6.3%
Index	0.0%	-21.9%	-21.9%
Total	**90.6%**	**-67.1%**	**23.4%**

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	$0.8956
Net Asset Value	$0.8934
Redemption Price	$0.8912
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 -15.2% in March, an incredibly disappointing result given the Fund's positioning. Relative value contributed -2.5% (gross) with Special Situations -12.7% (gross).

Within Special Situations, a fall in the share price of Village Roadshow (-61.4%) contributed more than half of the underperformance. The increase in volatility led to more activity in Relative Value, but less in Special Situations, although we expect activity in Special Situations to rise with a number of companies expected to recapitalise in the coming months.

Net exposure was +23.4% at the end of March, with a beta-adjusted net of +14.2%. Following on from February, we continued to reduce our gross exposure, which closed the period at 169.3%.

The share price of renewable energy company Infigen Energy (-33.6%) underperformed peers during March, following the sale of the Brookfield Renewable Partners' 9.4% shareholding in February. The only news from the company during the period was positive, with Infigen signing a PPA for 60% of the output from the 227MW Collector Wind Farm in NSW. Along with the recently signed 21MW Toora Wind Farm PPA, this represents approximately 24% of Infigen's growth target. Our shareholding in Infigen is paired with AGL Energy (-10.2%), which continued to buy back shares during the month.

Our paired positions featuring Karoon Energy (-47.3%) continued to give us grief during March, with the company underperforming both Santos (-49.9%) and Woodside Petroleum (-34.8%). The falling oil price seemed to affect Karoon more than peers, despite Karoon not producing any oil and having net cash on balance sheet equal to almost two times the share price.

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The falling oil price also seemed to affect GDI Property (-37.2%), with the Perth-focused REIT's share price falling more than peers Shopping Centres Australasia (-24.6%) and APN Industria (-30.8%) in March. With Perth having more exposure to commodity-based tenants, the office market can be more volatile, and GDI has a relatively short WALE to contend with. The underperformance of GDI detracted from the value of the Fund.

A newly-established paired position between land-developer Peet (-30.2%) and Rural Funds (-0.4%) added to performance, with Peet bouncing 57% from an intra-month low of just $0.56, or 47% of book value. We also added value from a pair within the energy utilities sector, with a long position in Spark Infrastructure (-4.3%) outperforming a short in AusNet Services (+0.9%).

Following the collapse of the Public Storage (-4.1%) takeover bid for National Storage (-29.1%), we moved the National Storage position from Special Situations to Relative Value, hedging the exposure with Abacus Property (-37.1%). The subsequent rebound in National Storage added value to the Fund

As mentioned, the share price of Village Roadshow (-61.4%) fell dramatically during the month with the company's two key assets (cinemas and theme parks) forced to close due to COVID-19. Our holding was originally established within Relative Value, with the exposure hedged with Event Hospitality and Entertainment (-33.6%). Following the receipt of a conditional, non-binding takeover proposal from Pacific Equity Partners (PEP) in December 2019, and another from BGH Capital in January, we moved the holding to Special Situations. We reduced the position modestly following the BGH Capital approach, but liquidity in the name was poor given the time of the year. While there is little chance of either bid progressing while the COVID-19 restrictions are in place, the stock is cheap, trading well below where it traded following the Dreamworld tragedy.

A number of recently established Special Situations also suffered during March, detracting from the Fund's performance. Despite no new news, the share prices of Limeade (-25.8%), Atomos (-46.5%), Uniti Group (-10.0%), New Hope (-3.8%) and Volpara Health Technologies (-22.5%) all fell more than the market.

The share price of National Storage REIT also suffered in March, with the three independent takeover bids withdrawn due to COVID-19. We had established a long position in National Storage in February, with the expectation that Public Storage (the US-based storage company) would be successful with their $2.40 per share bid. Our confidence in the position was galvanised by two other bids being tabled at $2.20 per share, with one of them (GAW Capital Partners), confirming their bid following the conclusion of due diligence. Despite there being no Material Adverse Change clause and no financing conditions to the Public Storage bid, the proposal was eventually withdrawn due to the increasing restrictions on travel and the quarantine regime. Similarly, both other proposals were withdrawn. As previously mentioned, the shareholding was moved into Relative Value, hedged with Abacus Property, and was a net contributor to the strategy in the period.

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

ACTIVITY

Relative Value – Gross Contribution -2.46%

As mentioned, the increase in volatility led to a number of new pairs being established, with many of the spreads narrowing and the positions being unwound before the end of the month. Paired positions between Insurance Australia Group (-2.8%) and Suncorp (-19.5%), Abacus Property and National Storage, and Mirvac (-31.3%) and Stockland (-46.3%) were all established and unwound during March. We also introduced a paired position between service station owners APN Convenience REIT (-21.5%) and Viva Energy REIT (-15.4%). Despite the presence of Charter Hall (-45.0%) on the Viva Energy REIT register, we prefer APN Convenience, which trades at an 10% discount to NTA and has the potential for improvement in tenant quality if the sale of Puma Energy to Chevron Corp (-22.4%) is consummated.

We modestly added to our existing paired position between Infigen Energy and AGL Energy during the month, with Infigen continuing to underperform, despite the fundamentals. At the end of March, Infigen closed with a return-to-consensus price target of +78.8% compared with AGL at +8.8%.

A raid on the register of Centuria Capital (-33.8%) by PE-backed ESR, provided an opportunity to sell stock at a 5.4% premium to last, a rare opportunity in a market that was trading lower. We capitalised on the short-term demand, purchasing property fund manager Primewest Group (-38.7%) as part of the pair.

Special Situations – Gross Contribution -12.68%

We participated in the recapitalisation of oOh!media (-72.0%) during March, with the company issuing shares at 76.8% discount to the share price at the end of February. The raise reduces gearing to 1.4x net debt/EBITDA and together with an amendment to the company's gearing covenant (to 4.0x) provides comfort that the business can get through the COVID-19 restriction period. We believe this is the first of many recapitalisations in Australia and anticipate a significant increase in opportunities for the Fund over the next three months.

We reduced our exposure to New Hope, Village Roadshow and Volpara Health Technologies and completely exited Adairs (-62.8%), Citadel Group (-45.0%), Panoramic Resources (-45.2%), Powerwrap (-32.1%) and Sezzle (-60.3%).

MARKET COMMENTRY

Market Overview

Fear and panic gripped investors in March, as COVID-19 infected and dislocated markets and societies globally. Five weeks ago, it was hard to imagine this type of symmetric shock to the global economy and all asset classes. The scale and speed of the response from central banks and governments have been impressive and extraordinary. We do indeed live in unprecedented times!

Global equity markets and bond yields collapsed in March. The VIX, the so-called "fear index" spiked to near peak volatility levels seen during the GFC. In Australia, the share market had its worst month since October 1987 and the March quarter of was the worst on record. The Australian dollar fell to US$0.61 after touching an intra-month low of US$0.55. Gold, with its safe haven status shining brightly, reached 2013 highs before settling at US$1,609/oz. Oil slumped to a 17 year low as Russia and Saudi Arabia abandoned supply restraint just at a time when global demand was about to collapse.

USA

In March, the S&P 500 fell 12.4%, the Dow Jones was down 13.6% and the NASDAQ Composite fell 10.0%. Extreme volatility featured prominently. The S&P 500 also recorded two of its worst days since 1987 (-12.0% on 16 March and -9.5% on 12 March), but also had two days with gains of over 9.0%. The Dow Jones ended the quarter in bear market territory, with a return of -22.7%. This shocking quarter ended its bull run that started in 2009. From February 19th to March 23rd, the US equity market in fact experienced its quickest meltdown in history, losing 33.9% on the S&P500. The 17.5% rally that followed marked the best 3 day stretch since the 1930s. US bond yields also collapsed, with the 10-year treasury yield down 0.46% to finish 0.68%. It was yielding 1.9% at the start of the quarter!

The economic data and activity indicators were irrelevant given the enormous contraction expected in US GDP. As we write, around 10 million Americans have filed for unemployment support - a number likely to continue to rise, along with the death toll, which is the grim reality of COVID-19. The unprecedented response of the US government and the US Federal Reserve is addressed in later commentary.

Europe

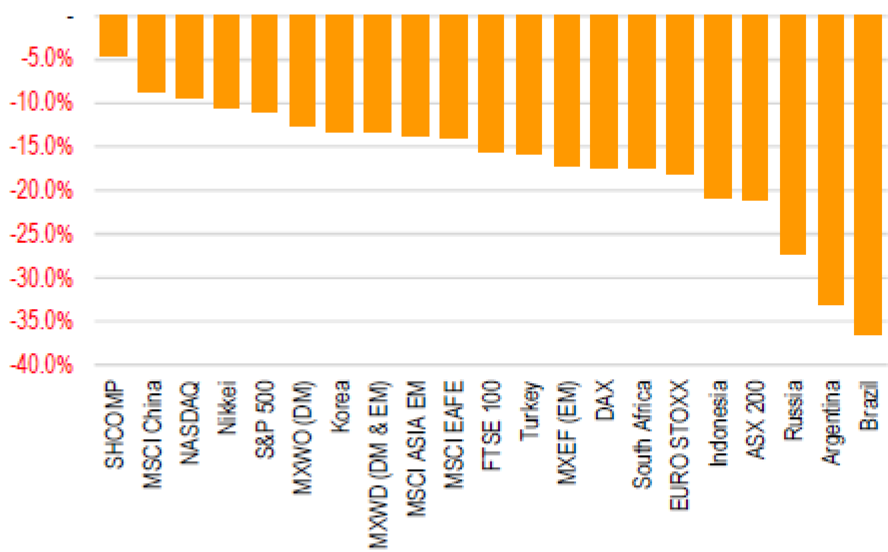
European bourses were also hit hard during the month, with the Euro STOXX 50 closing down 16.2%. Among the major exchanges, the returns were UK's FTSE 100 -13.4%, France's CAC 40 -17.0%, and Germany's DAX -16.4%. These three major markets were in deep bear territory for the quarter, all falling over 25%!

The sheer scale of the major European government's responses to COVID-19 indicates the significant deterioration expected for the wider European economies ahead.

Asia

Asian equities also fell, but outperformed on the downside. China, Korea, Japan and Hong Kong were the earliest to experience COVID-19, so signs that it was being controlled and China "going back to work" helped buffer the declines. The Hang Seng Index was down 9.5%, Japan's Nikkei 225 fell 9.9% and Korea's KOPSI Composite Index finished down 11.7%. The SSE Total Market Index, a broad representative of the Chinese market, proved resilient, only falling by 4.9%. The Indian market was battered, with the BSE Sensex sliding down 22.8%. Investors feared a looming crisis from COVID-19 in an emerging market which lacks key infrastructure and resources to cope with the pandemic.

Global equity markets performance in March 2020

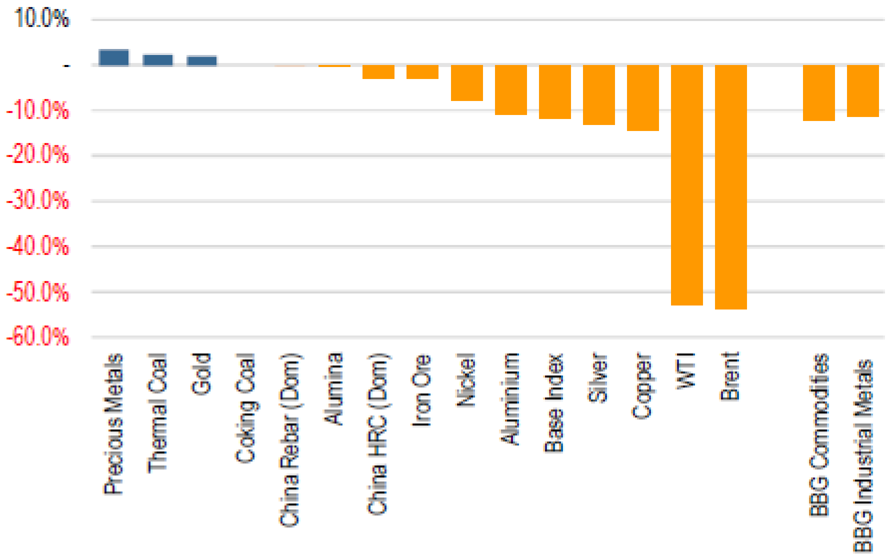


Source: JP Morgan, Bloomberg

Commodities

The BBG commodities index fell 12.1%, mainly driven by the collapse in oil (> 50%). Oil recorded its worst ever quarterly performance, as Russia and Saudi Arabia abandoned supply disciplined at a time when demand was about to collapse as a result of forced isolation policies and the grounding of all non-essential air travel, causing jet fuel demand to fall off a cliff. Please see separate section on oil below.

Global commodity performance in March 2020



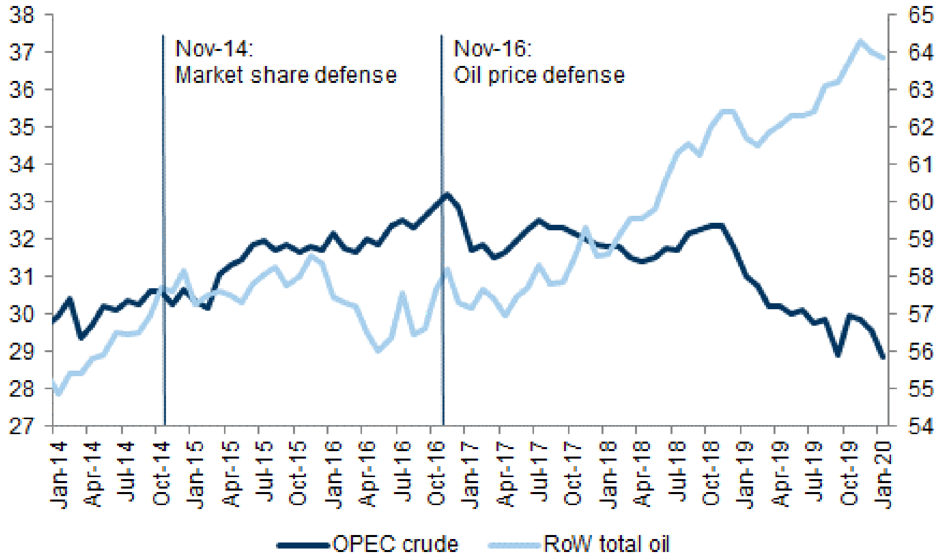
Source: JP Morgan, Bloomberg

Oil Price Collapse

Oil prices have collapsed by over 50% during the month of March with Brent oil down to US$25/bbl. This is the timeline of what happened:

Having traded between US$60-70/bbl for most of calendar 2019, Brent was hovering at US$50/bbl when OPEC+ (which includes 10 non-OPEC countries, the most notable being Russia, Mexico and Kazakhstan) met in Vienna on the 5th of March. Saudi Arabia proposed a further production cut, due to the negative demand impact of COVID-19, of 1.5mbpd (1.5% of global supply) and to extend the previous cut (2.1mbpd) to the end of 2020, which was due to expire at the end of the month. On Friday 6th March, the proposal was rejected by Russia, suggesting it was too soon to make firm determinations on the demand impact of COVID-19 and that it should be US producers who help balance the market. Further, Russia also refused to extend the previous production cut, causing the oil price to fall 10%, given the outcome was a shock to the market. On Saturday 7th March, Saudi Arabia (via Aramco) approached buyers with massive price discounts and vowed to produce more than 11mbpd (later threatening 12.5mbpd), versus its current output of 10mbpd. Russia responded with an additional 0.5mbpd and by Monday the price collapsed to US$33/bbl, a further 27%. Later in the month, with a number on countries in lockdown, it was clear that the negative demand impact of COVID-19 would be significantly more than anyone expected, pushing prices down another 25%.

What occurred leaves one with a feeling of déjà vu. In late 2014, OPEC abandoned their strategy of supporting the market via production cuts and chased market share which had been taken by others and particularly by the US shale producers. Prices collapsed and OPEC's share was reinstated as the high cost producers, especially US shale, curtailed production. Later in 2016, OPEC moved to a price defence strategy and as you can see on the graph below, OPEC's market share (dark line) has declined whilst non-OPEC production (blue line) has increased. This time around, it seems that Russia has been the instigator, however, Saudi Arabia with substantially more additional production capacity appears to be upping the ante to ensure that the burden of supply cuts are appropriately shared.



Source: Goldman Sachs, IEA

Whilst this game of brinkmanship between Saudi Arabia and Russia could possibly be resolved quickly following President Trump's recent intervention in April, it's more likely that it resolves similarly to recent history, whereby supply cuts due to lower prices, rebalance the market and restore prices. Given the high gearing of US shale producers, we believe the market should rebalance quicker than the 12 months it took last time.

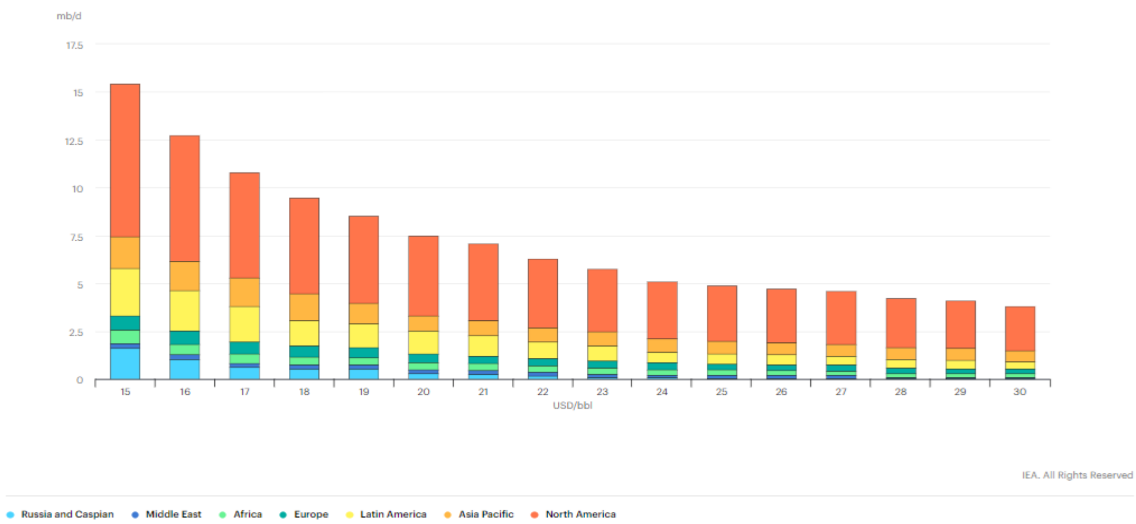
The Bad News:

- Based on the IEA chart below, the current $25/bbl Brent price implies only 5mbpd of production shut-ins. The IEA has forecast a ~20% demand hit of 20mbpd from April. To balance the market, unless OPEC+ go back to the negotiating table to cut a new supply deal, this means we would need a price of < $15/bbl.

The Good News:

- Given storage and other logistical issues, producers (especially in the US) are receiving substantially lower prices than the Brent or WTI benchmarks e.g. Texas Midland crude is at a $10/bbl discount to WTI which is trading at $20/bbl.
- We will run out of storage if the shut-ins don't occur - we have around 3 months of onshore and offshore storage assuming a 20% demand drop. The good news is the US has the bulk of the uneconomic crude (estimated break even at US$48/bbl) which has also been financed by high yield credit.
- China has stated that it wants to increase total oil stockpiles from 85 days of imports which are 10mbpd. They could increase stockpiles by 15 days with existing spare capacity by buying an additional 150mbbls which represents 7 days of the current global surplus. It helps, but it is up to price to drive the shut-ins.
- Chinese stockpiling and any hint of a new OPEC+ deal will help shorten the duration of prices below US20/bbl. If this transpires, the paper markets should rally hard and so will energy stocks, but physical markets always seem to win out and time is what will get them to parity. We may have already seen the low in the oil shares in March if and when OPEC+ shake hands, but the physical oil price could be lower than it has been - its needs to be, in order to rebalance the market. OPEC+ and the markets had universally grossly underestimated the oil demand impact of the COVID-19 pandemic.

IEA's estimate of daily production which cannot cover production costs at various oil prices – Brent basis



Source: IEA

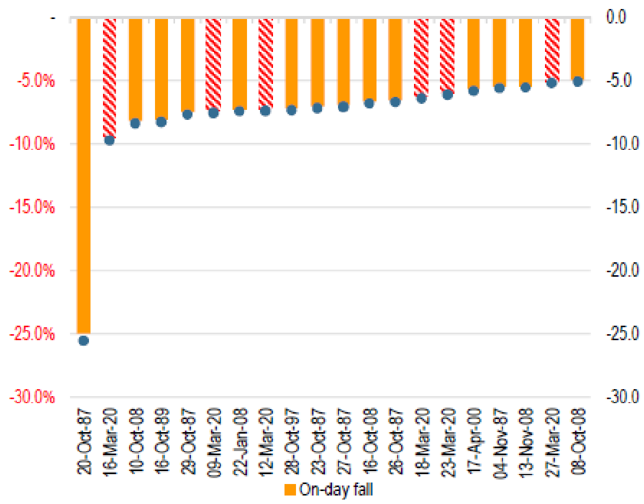
Bonds

Global bond yields collapsed in March due to the announcements and commencement of asset purchases by central banks and considerably lower inflation expectations. The US 10-year bond yield fell 46 basis points to 0.68%, whereas the Australian 10-year bond yield fell modestly, down 6 basis points to 0.76%.

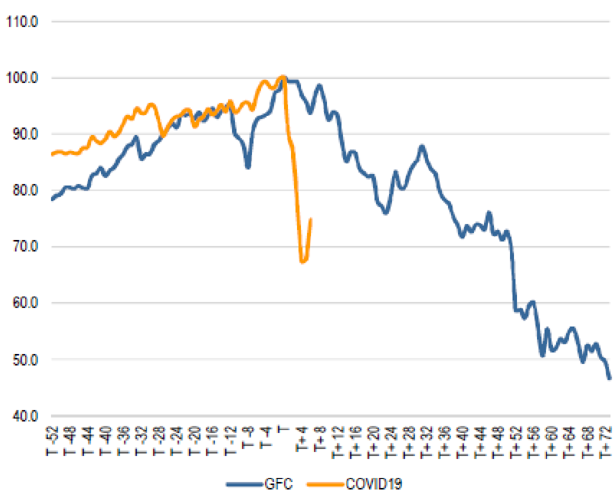
Australia

The S&P/ASX 200 Accumulation Index had a dreadful month, down 20.7% and falling by 23.1% for the March quarter, due to "recessionary" fears brought about by the significant slowdown in global and domestic activity as a result of COVID-19 government mandated shutdowns. The month of March alone has delivered six out of the largest one-day declines in the past 40 years for the All Ordinaries Index, as shown on the first chart. For context, the second chart shows that although the decline in March was shocking, it was less than half of the peak-to-trough decline seen during the GFC (-53.4%).

ASX All Ordinaries – on-day falls



ASX 200: GFC versus Covid-19 (peak rebased to 100)



Source: JP Morgan, Bloomberg

In March, the best performing sector, in terms of its contribution to the index's performance, was Utilities (but still negative), with a contribution of -0.1%. The next two best sectors were Consumer Staples (-0.3% contribution), and Information Technology (-0.4% contribution). Not surprisingly, the bottom three sectors were Financials (-8.4% contribution), Real Estate (-3.2% contribution) and Materials (-1.8% contribution).

The ASX 200 Resources Accumulation Index was the best (of a bad bunch) performing sub-sector, down 17.4%, The Small Ordinaries Accumulation Index also fared worse, down 22.4% and the ASX 200 Industrial Accumulation Index fell 21.4%.

The worst was the ASX 200 A-REIT sector, falling an astounding 35.1% as Australia went into lockdown and tenants refused to pay rents as shopping malls emptied and retail stores and restaurants were shut down.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were in the financials space: Commonwealth Bank of Australia (-197 points), Westpac Banking Corporation (-140 points), National Australia Bank (-136 points), Australia and New Zealand Banking Group (-129 points) and Macquarie Group (-102 points).

Conversely, the top five stocks that made a positive contribution to the index's return were ASX (+8 points, a utility-like company with a strong balance sheet, experiencing record trading volumes), Fortescue Metals Group (+6 points, as iron ore prices remained elevated and the Australian dollar was weaker), a2 Milk Company (+6 points), Fisher & Paykel Healthcare Corporation (+5 points) and Rio Tinto (+5 points, enjoyed the same drivers as Fortescue).

The RBA took drastic measures by cutting rates twice in March to a record low of 0.25%, announced a target for 3-year bond yields of 0.25% and its own quantitative easing program.

The Australian dollar was volatile against the US dollar, collapsing by US$0.10 to US$0.55, before staging a recovery to end the month at US$061.

CONTRIBUTION

Relative Value Gross Contribution -2.46%			
Positive		**Negative**	
RIO TINTO - RIO TINTO	1.19%	AGL ENERGY LTD - INFIGEN ENERGY	-1.55%
ABACUS PROPERTY GROUP - NATIONAL STORAGE REIT	0.88%	KAROON GAS AUSTRALIA LTD - WOODSIDE PETROLEUM	-1.54%
BHP BILLITON - BHP BILLITON	0.72%	KAROON GAS AUSTRALIA LTD - SANTOS	-1.42%
PEET - RURAL FUNDS GROUP	0.45%	GDI PROPERTY GROUP - SHOPPING CENTRES AUSTRALASIA	-0.74%
AUSNET SERVICES - SPARK INFRASTRUCTURE	0.20%	CENTURIA CAPITAL - PRIMEWEST GROUP LTD	-0.46%

Special Situations Gross Contribution -12.68%			
Positive		**Negative**	
PUT SPREAD ON ASX 200	9.02%	VILLAGE ROADSHOW LTD	-6.60%
BENDIGO AND ADELAIDE BANK	0.07%	NATIONAL STORAGE REIT	-2.87%
PEET LTD	0.02%	CARINDALE PROPERTY TRUST	-1.84%
HOTEL PROPERTY INVESTMENTS	0.00%	LIMEADE INC-CDI	-1.76%
NUCHEV PTY LTD	0.00%	ATOMOS LTD	-1.30%

Top 10 Relative Value Positions	
RIO TINTO - RIO TINTO	CENTURIA INDUSTRIAL REIT - GROWTHPOINT PROPERTIES
BHP BILLITON - BHP BILLITON	APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND
AGL ENERGY LTD - INFIGEN ENERGY	KAROON GAS AUSTRALIA LTD - WOODSIDE PETROLEUM
CHARTER HALL RETAIL REIT - SHOPPING CENTRES AUSTRALASIA	KAROON GAS AUSTRALIA LTD - SANTOS
GDI PROPERTY GROUP - SHOPPING CENTRES AUSTRALASIA	RURAL FUNDS GROUP - VITALHARVEST FREEHOLD TRUST

Top 10 Special Situation Positions	
PUT SPREAD ON ASX 200	NEW HOPE CORP LTD
NUFARM HYBRID	VILLAGE ROADSHOW LTD
UNITI WIRELESS LTD	SUNCORP GROUP
LIMEADE INC	VOLPARA HEALTH TECHNOLOGIESS
KALIUM LAKES LTD	CARINDALE PROPERTY TRUST

All holding enquiries should be directed to our registrar, Link Market Services on 1800 992 149 or ellerston@linkmarketservices.com.au

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