ELLERSTON CAPITAL

Ellerston India Fund

Performance Report | March 2020

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net^	-19.29%	-18.83%	-19.05%	-17.74%	-1.64%	-0.28%
Benchmark*	-21.13%	-20.90%	-20.07%	-19.75%	-3.82%	-1.47%
Alpha	1.84%	2.07%	1.02%	2.01%	2.18%	1.19%

Source: Ellerston Capital

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

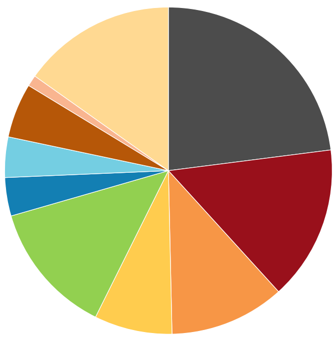
* MSCI India Net Return Index (AUD)

PORTFOLIO CHARACTERISTICS

HOLDINGS

Top 10 holdings	Sector	%
Reliance Industries Ltd	Energy	11.4%
Housing Development Finance Corp Ltd	Financials	9.8%
Infosys Ltd	Information Technology	9.7%
Hindustan Unilever Ltd	Consumer Staples	7.4%
Tata Consultancy Services Ltd	Information Technology	5.6%
ICICI Bank Ltd	Financials	5.0%
Britannia Industries Ltd	Consumer Staples	4.7%
Asian Paints Ltd	Materials	4.5%
Sun Pharmaceutical Industries Ltd	Health Care	4.4%
Bharti Airtel Ltd	Communication Services	4.0%

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	$0.9134
Net Asset Value	$0.9111
Redemption Price	$0.9088
Liquidity	Daily
No Stocks	21
Management Fee	1.10%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

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COMMENTARY

March was another turbulent month for financial markets globally driven by the continued spread of the coronavirus and the sharp drop in oil prices. India was not spared, with the MSCI India benchmark falling 21.1% during the month. The Ellerston India Fund (EIF) ended March down 19.3%, significantly outperformed the benchmark by 1.8%. Year to date in calendar 2020, EIF is down 18.8%, but has outperformed the benchmark by 2.1%.

EIF's outperformance during the month and CYTD in 2020 is a function of a few factors:

Active Cash Management: At certain times during March we were at the 20% cash maximum but this had reduced to 15.2% by the end of the month as we invested in high quality oversold stocks going into month end.

Large cap bias: The NIFTY 50 Index outperformed the NIFTY Small Cap 100 Index by over 13% in March alone. As we have stated many times, large cap stocks in India offer better risk reward as they have higher returns and lower liquidity risk. This was definitely true in March when many smaller cap stocks dropped both due to worsening fundamentals and also due to forced selling and low liquidity.

Oil: Due to our strict growth and ESG criteria, EIF 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. Our zero weight in upstream oil stocks added to alpha during March.

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 not owned.

Since our last monthly update, the coronavirus situation in India has unfortunately escalated and this was the primary reason driving the selloff in the Indian markets. The total number of cases currently stands at over 10,000 up from only 50 last month. There have been 358 reported deaths so far compared to zero fatalities in February. The following outlines what we are hearing on the ground about the spread and economic impact of COVID-19 and how we are positioned for this environment.

Coronavirus Update and Policy Response

The epidemiological and economic outcomes of the coronavirus in India are yet to be determined and will ultimately depend on the effectiveness of the measures undertaken by the Indian Government. The most significant measure that the Indian Government has undertaken was to impose a 3-week strict lock down starting from March 25 across the entire country. While we believe this was a necessary step to control the spread of the virus in a country as densely populated as India, we also note that the decision blindsided both citizens and corporates and brought the country to an abrupt standstill.

In mid-April, the Indian Government has announced an extension of the lockdown for another three weeks, up to May 3. The Government plans to release detailed guidelines on the transition from lockdown to resumption of economic activity soon. Our conversations with people on the ground suggests that the Indian Government will lift lockdown provisions in a staggered manner from April 20, with certain virus hot spots across the country remaining under lockdown until the number of cases in those areas start trending downwards.

The Government has plans to demarcate the country into red, orange and green zones which will determine the level of people movement and economic activity that is allowed. We note that the lockdown has coincided with a ramp up of testing across the country and there are plans to roll out antibody testing on a mass scale (over 5 million tests) which could help identify virus clusters at a much faster rate. We are hopeful these measures are effective in containing the spread of the virus and to limit the impact to the economy. At this stage, the Indian economy looks set to contract in 1QFY21 by as much as 10%, with FY21 GDP growth potentially coming in at only ~3%.

In conjunction with the lockdown imposed, the Government announced a stimulus package of INR1.7tn to support low income earners. Meanwhile, the RBI announced a 75bps cut to the cash rate to 4.4%. We believe both measures, whilst necessary, are underwhelming and insufficient to offset the full economic impact of the lockdown. The fiscal package equates to just 0.7% of India's GDP and falls well short of the policy response of other countries globally (see table below). As such, we believe the Government will most likely announce a second stimulus package in the coming weeks if not days, especially if containment of the coronavirus takes longer than expected. On monetary policy, our concern remains the time lag it takes for rate cuts to work its way into the economy.

While in most countries, our preference is for fiscal policy to do more of the heavy lifting in supporting the economy during and after this difficult period, India does not have much fiscal room to manoeuvre without risking a sovereign downgrade and/or significant downward currency pressure. The lower oil price environment should benefit oil importers like India and give the Government some fiscal headroom to help coronavirus-affected industries and businesses and to fund labour intensive infrastructure projects.

Country	Monetary or Fiscal?	Policy	Fiscal stimulus as % of GDP
UK	Monetary & Fiscal	50bps cut to the benchmark interest rate to 0.25% and GBP200bn QE program. GBP330bn in government backed loans for businesses.	14.0%
Singapore	Fiscal	S$48bn stimulus package incl. corporate tax cut, job support scheme, wage offsets and assistance to sectors such as aviation and retail.	10.7%
US	Monetary & Fiscal	150bps cut to the target benchmark rate to 0-0.25% and announced a further unlimited asset buying program. $2tn stimulus package for financial aid, hospitals and industries affected by the coronavirus.	10.3%
Australia	Monetary & Fiscal	50bps cut in the cash rate to 0.25% and asset purchase program. A$17.6bn stimulus package to support SMEs and pensioners and disadvantaged households (A$750 cash handout). Another A$66bn package for financial aid. Third stimulus package of $130bn for wage, loan and rent support.	9.6%
Hong Kong	Fiscal	HK$120bn relief package incl. HK10k cash handout to each permanent resident. Additional HK$138bn of stimulus incl. wage subsidies and financial aid to affected industries.	8.9%
South Korea	Monetary & Fiscal	Cut benchmark interest rate by 50bps to 0.75%. KRW12tn supplementary budget to support the healthcare sector and SMEs. KRW16tn of stimulus to support businesses and individuals. Another KRW100tn for financial aid and to support the bond and equity markets. Further KRW54tn to boost the economy.	8.9%
Taiwan	Monetary & Fiscal	Cut to the benchmark rate by 25bps to 1.125%. Special budget of NT60bn to support virus affected industries. Additional NT$1tn in financial aid to SMEs and households.	6.0%
New Zealand	Monetary & Fiscal	Cut benchmark interest rate by 75bps to 0.25%. NZ$12bn stimulus package for health services, income support and wage subsidies.	3.3%
Thailand	Fiscal	THB400bn stimulus package to support the low income earners, rural households and SMEs.	2.3%
China	Monetary & Fiscal	Cut 7 day repo rate by 30bps to 2.2%. Cut MLF rate by 10bps to 3.15%. Cut RRR by 50-100bps. Advance allocation of RMB$1.8tn in local government bonds.	1.8%
Malaysia	Monetary & Fiscal	Cut benchmark interest rate by 25bps to 2.50%. MYR20bn to support the tourism industry and increased infra spending.	1.2%
India	Monetary & Fiscal	Cut repo rate by 75bps to 4.40%. INR1.7tn rescue package which cash transfers, food distribution and support for organized workers.	0.7%

Positioning and Performance

We proactively trimmed the portfolio in early March in response to the early warning signs regarding the spread and economic impact of the virus. As such, cash as at the end of March was 15.2% compared to 4.1% in February. Prior to the infection numbers taking off in late March, we divided the portfolio into 3 buckets: (1) companies that were directly negatively impacted by the coronavirus; (2) high beta stocks that were candidates for profit taking in a risk off market; and (3) stocks that would not be impacted or could potentially benefit from coronavirus and the subsequent quarantine conditions. The stocks we sold during March fell primarily in the first two buckets such as Mahindra and Mahindra, Tata Motors, PVR, Hindalco, Tata Steel and MMFS. We also added or increased position sizes in stocks in the last category namely Hindustan Unilever (staples) and pharma (Sun Pharma, Cadila, Dr. Lal).

The Ellerston India Fund has generally been underweight Indian pharma since inception. The sector has been unloved for many years 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 have recently bought is Cadila, an Indian pharma company that has the 3rd largest market share of hydroxychloroquine (18%) in the US. We also invested in SUN Pharma in late March and that investment is up 25.0% over the same time frame. We also initiated a position in Dr Lal Pathlabs, a company that operates clinical laboratories and offers services including medical diagnostics and blood testing.

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 hold the large cap, high quality, private sector financials like HDFC, HDFC Bank and ICICI Bank.

Turning to portfolio performance, Industrials, Communication Services and Materials were the largest sector contributors to alpha during the month. While Consumer Staples and Financials were the biggest detractors. At a stock level, Axis Bank (underweight) and not owning Bajaj Finserv and State Bank of India contributed the most to alpha. Conversely, AU Small Finance Bank, Bajaj Finance and Maruti Suzuki were the biggest detractors from alpha. We have exited the position in AU Small Finance Bank.

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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