Ellerston Capital

Ellerston Low Volatility Income Strategy Fund

Performance Report | May 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	FYTD	Since Inception (p.a.)
Net^	5.98	-7.36	-11.08	1.22	-1.73	0.37
Benchmark*	4.36	-9.92	-14.59	-6.70	-10.03	-4.72
Alpha	1.62	2.56	3.51	7.91	8.30	5.08

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

Despite persistent fears of a deep and drawn out economic downturn, equity markets gained further in May, with the MSCI ACWI rising 4.1% and the S&P/ASX 200 Accumulation Index gaining 4.4%. The unprecedented levels of global stimulus, including a US$2.5 trillion increase in US money supply in the past three months, has been a big reason for the liquidity driven market rally. This factor, along with renewed optimism surrounding the re-opening of the world economy, should continue to support equities in the short-term. The sustainability of the rally will ultimately come down to fundamentals, specifically company earnings recovery. This will determine whether the market behaviour to look through the economic impact of COVID-19 has been the correct course of action or has become too euphoric.

The Ellerston Low-Volatility Income Strategy Fund outperformed the market in May, rising 6.0% on a net basis compared to the benchmark's increase of 4.4%. The Fund therefore outperformed its benchmark by 1.6%. It was a tale of two halves, with the Funds' more defensive positioning in quality stocks driving meaningful outperformance over the first 2.5 weeks, but the market rotation into value stocks subtracted some of the outperformance in the last 1.5 weeks of the month. Since inception in May 2019, the Fund has outperformed the index by 5.1% on a net basis. FYTD, the Fund has outperformed by 8.3% on a net basis.

Outperformance in May occurred due to positive stock selection in Healthcare (Ansell, Ramsay Healthcare, CSL), Materials (James Hardie, Northern Star Resources), Industrials (Qube Logistics) and Consumer Discretionary (Super Retail) whilst Communication Services (Spark New Zealand) was a detractor.

PORTFOLIO ACTIVITY – MAJOR TRANSACTIONS

During the month we reduced our position in CSL Limited over concerns regarding the slowing rate of plasma collection due to COVID-19 and subsequent high chance of earnings downgrades. For the first time since the Fund inception, we are underweight CSL. A 20% decline in plasma in Q4 would result in a US$250m decline in EBIT.

There were a number of new additions to the Fund in order to add back some cyclicality to the portfolio as world and Australian economies open up. We added Macquarie Group back into the portfolio as we see a recovery occurring in the market facing businesses (30% of earnings) and continued stabilisation in the annuity style businesses (70% of earnings). The stock was trading on a FY21 yield of 3.7% at the time of purchase. We also added back our position in Super Retail Group on valuation grounds after selling it at much higher levels pre COVID-19. We expect earnings to rebound as domestic tourism activity rapidly accelerates post COVID-19 and school / adult sports begin to return, thereby driving demand for their outdoor leisure and sporting products. The stock was trading on a FY21 PER of 10.0x, representing good value.

We also participated in a number of equity placements pertaining to our existing holdings during the month. Specifically, these were in Breville Group, Atlas Arteria, Qube Holdings and United Malt Group. Pleasingly, all placement stock for each company is trading materially higher today than their issue price.

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	$1.0017
Net Asset Value	$0.9992
Redemption Price	$0.9967
Liquidity	Monthly
No Stocks	36
Management Fee	0.70%
Performance Fee	10%
Buy/Sell Spread	0.25%/0.25%

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MARKETS AND MACRO NEWS

The S&P/ASX 200 Accumulation Index has now rallied over 30% from its trough in late March and has continued to rally into June. The MSCI AC World Index is currently trading on a 12m forward PE of 20.0x, with the US market trading on 22.0x. World earnings per share growth is expected to decline 19% in FY20, followed by a 26% rebound in FY21. Earnings downgrade momentum is slowing, with April seeing global negative earnings revisions of 15%, followed by a further 4% reduction in May.

The month of May will likely be remembered as the month in which the world economy re-opened for business. After reaching an all-time low in April, the JP Morgan Global Manufacturing PMI rose 6.7 points in May. At the sector level, consumer goods manufacturing output registered the largest increase, rising to 41.4. US and Australian 10 year yields were largely unchanged in May, at 0.65% and 0.88%, respectively. The Australian dollar (AUD) continued its strong rebound as global growth expectations rebounded. The AUD is now up 20% from mid-March, predominantly driven by the strong iron ore price. Finally, with the exception of thermal coal, every major commodity rose in May. WTI Oil rose a staggering 62% whilst iron ore broke through $100/t following a 21% rise during the month.

Turning to Australia, consumer confidence improved for the eighth consecutive week, rising to 92.7 at May-end following a March-end trough reading of 65.3. Business confidence also saw a pick up according to the NAB survey, but confidence still remains fragile and capacity utilisation is yet to show any meaningful rebound. Concerns are growing over Australia's relationship with China following our strong advocacy for an independent investigation into the origins and handling of the COVID-19 outbreak in China. China's decision to slap an 80% tariff on Australian barley exports (China is the largest export market for Australian barley), followed by strong discouragement from China's Education and Tourism ministry's to study / travel to our country signals a further escalation in tensions between the two trading partners.

CONCLUSION

During the month we added back to our cyclical yield positioning, following a meaningful decrease since January. The adjustment in our view came from a significant and surprising downward revision in the Job Keeper wage subsidy program from $130bn to $70 billion, indicating stronger resilience being shown by the Australian economy. This factor, coupled with a faster, global re-opening of global economies justified a refinement in our portfolio positioning. The beta of the Fund (a measure of volatility) consequently moved higher as a result of our increase in cyclical yield exposure. The beta of the portfolio is sitting comfortably at 0.92, below the market beta of 1.00. The expected FY21 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 4.2% vs -2.7% for the ASX 200 .The expected dividend yield of investee companies held within the portfolio is currently 3.0%.

Regards,

Chris Hall - Portfolio Manager, CIO

PORTFOLIO CHARACTERISTICS

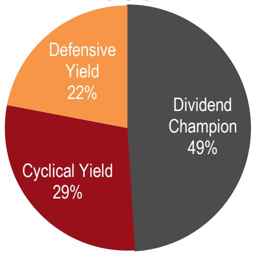
HOLDINGS

Top 10 holdings	Sector	%
CSL Limited	Health Care	6.1%
Goodman Group	Real Estate	5.2%
Rio Tinto Limited	Materials	5.1%
ASX Limited	Financials	5.0%
Westpac Banking Corporation	Financials	5.0%
James Hardie Industries	Materials	4.8%
Ramsay Health Care Limited	Health Care	4.0%
Macquarie Group Limited	Financials	3.9%
Spark New Zealand Limited	Communication Services	3.6%
Resmed Inc	Health Care	3.5%

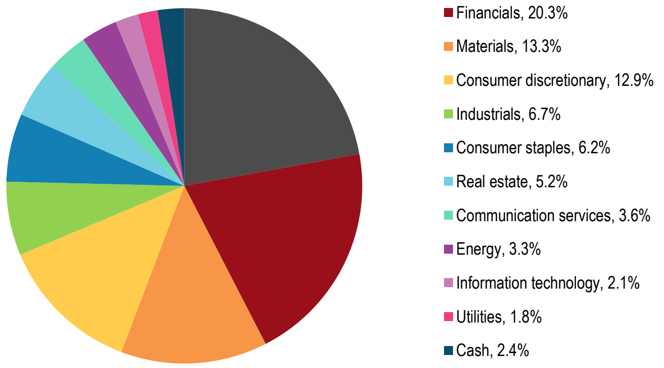
KEY PORTFOLIO METRICS

FY21(e)	Fund	Benchmark
Price/Earnings (x)	22.1	20.6
Dividend Yield (%)	3	3.2
Dividend Growth rate (%)	4.3	-2.7
Beta*	0.92	1.00

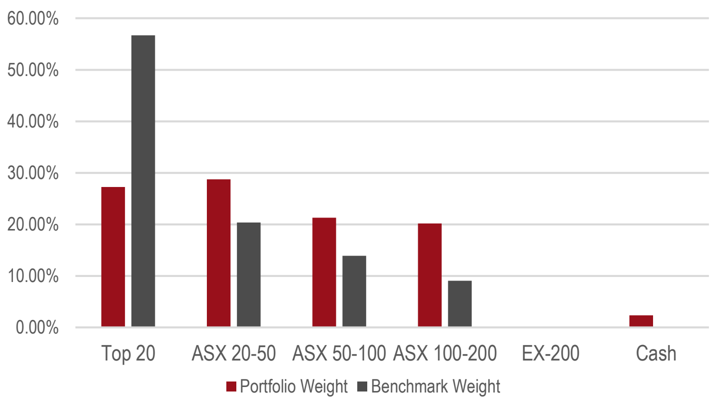
PORTFOLIO YIELD EXPOSURE



SECTOR ALLOCATION



MARKET CAPITALISATION



Source: Ellerston Capital

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

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