ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | August 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^	0.44%	8.86%	5.96%	11.95%	2.87%	3.63%	7.05%
Benchmark*	0.02%	0.06%	0.14%	0.53%	1.14%	1.36%	1.69%
Alpha	0.42%	8.80%	5.82%	11.42%	1.73%	2.27%	5.36%

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	67%	**Net Equity Exposure**	21%
No. Relative Value positions	46	**Gross Portfolio Exposure**	232.0%
No. Special Situations	24	**Correlation Coefficient (vs ASX 200 Accum)**	52.03%
Beta Adjusted	20.9%	**Net Sharpe Ratio (RFR = RBA Cash)**	0.58

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	26.4%	-14.3%	12.1%
Industrials	55.6%	-10.3%	45.3%
Resources	32.0%	-24.7%	7.3%
Index	8.3%	-51.7%	-43.5%
Total	**122.3%**	**-101.0%**	**21.3%**

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	$1.0235
Net Asset Value	$1.0209
Redemption Price	$1.0183
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 +0.44% in August, compared with the benchmark return of +0.02% in the period. Despite the outperformance, we were disappointed with the result, as the contribution from a number of key positions was diluted by a few short positions that rallied strongly. Net exposure was +21.3% at the end of August, with a beta-adjusted net of +20.9%. We harvested a number of positions during the month and gross exposure reduced accordingly, closing the period at +232.0%.

A paired position between Cromwell Property (+1.7%) and Peet (+19.9%) added to performance, with corporate activity in both names leading to a narrowing in the spread. Firstly in Cromwell, substantial shareholder ARA Asset Management added to their existing stake with the purchase of 2.6% of the outstanding shares at a small premium to market. Two days later, former substantial shareholder Redefine Properties sold their remaining shareholding at a modest discount to market. Meanwhile, the Tony Pitt-led 360 Capital (-8.7%) made an audacious raid on the share register of Peet, purchasing a little over 5% of the company at an approximate 10% premium to the prevailing share price at the time. Another position that also featured Cromwell, this time hedged with the Charter Hall Social Infrastructure REIT (+12.3%) also added value in the month.

Karoon Energy (+10.5%) continued to outperform during August, with our pair featuring Karoon and Santos (+8.1%) adding to performance. Following the announcement last month of the revised Bauna transaction, Karoon reported that it had been issued with new environmental operational licenses by the Brazilian environmental agency, IBAMA. Only two conditions to the transaction remain, being ANP approval and FPSO charter assignment, both of which we expect will be satisfied by the end of September.

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The biggest detractor to performance in the month was our paired position between Mirvac (+1.0%) and Stockland (+24.1%), two diversified property companies. The share price of Mirvac barely moved during the month, despite a credible 2H result in what was incredibly difficult times. The share price of Stockland on the other hand, was incredibly strong, with the market seemingly ignoring the write downs to the value of Retirement and Retail assets and focussing only on the HomeBuilder-fueled increase in residential sales.

After adding value in July, the position between telecommunication companies Uniti Group (-9.0%) and TPG Telecom (+2.4%) detracted from performance, with Uniti falling and TPG rallying during August. Both companies reported in the period, and the market seemed to focus on the regulatory risks for Uniti - in particular, the potential for the NBN Co to charge a lower price per connection, thus reducing margins. The Telecommunications In New Developments (TIND) policy was released in early September and whilst it allowed the NBN Co to charge lower price, it needs to be justified as a commercially-viable decision, one which would be difficult with their current cash burn rate.

The spread between the Australian and UK listings of Rio Tinto (-2.0%) narrowed in the period, adding to the performance of the Fund.

The initial public offering of 4D Medical (+103.4%) was a success, with the stock rocketing higher on the first day of trade. 4D Medical is an Australian-based medical software company that converts X-ray scans into a 4-dimensional image (the 4th dimension being time). The company is in the very early stage of commercialisation and the global market for its product is huge. Our modest position within Special Situations was a significant positive contributor to performance.

After increasing our shareholding in Atomos (+10.5%) last month, the company reported 2H FY21 earnings in August, with the result heavily impacted by COVID-19, as expected. More importantly, the company has used the crisis to reset its cost base to move forward more profitably. The company also provided colour on the FY21 year, reporting that July and August were running at 50-60% more than the 2H FY20 run rate. The share price reacted positively, with our long position adding value accordingly.

We typically use index derivatives to hedge the equity exposure that emanates from the Special Situations strategy. The stronger equity market in August led to the derivative position detracting from the Fund's performance.

ACTIVITY

Relative Value – Gross Contribution 0.13%

In early August, the Centuria Industrial REIT (-4.2%) announced the acquisition of the Telstra Data Centre in Clayton, together with two other industrial assets in NSW and Victoria. To fund the purchases, the REIT conducted a $341m equity raise, issuing shares at a 4.8% discount to the prevailing market price. We participated in the placement, unwinding a number of existing pairs and establishing a new one – this time between Centuria Industrial and Growthpoint Properties (+4.4%).

We continued to add to our building materials pair during the month, with Fletcher Building (+4.2%) continuing to trade within a few percent of book value. As expected, Fletcher Building and Boral (+11.7%) reported during the period, with FY20 earnings for both companies suffering due to the COVID-19 environment. Boral also announced a review of all its businesses, with the outcome scheduled to be released in late October. Despite the review and the new CEO at Boral, we prefer Fletcher Building, which has a return to consensus price target of +11.7% compared with Boral's +5.7%.

Our paired position between the Charter Hall Long Wale REIT (+6.9%) and the Charter Hall Social Infrastructure REIT (+12.3%) was unwound following a narrowing in the spread. Despite the rally, Charter Hall Social Infrastructure continues to trade below NTA and we continue to hold a significant position that is hedged with Cromwell Property (+1.7%).

We were stopped out of our paired position between Mirvac and Stockland following a widening in the spread. We also unwound paired positions between AusNet Services (+2.5%) and Spark Infrastructure (-1.3%), Breville (+4.6%) and Premier Investments (+12.9%), Commonwealth Bank (-2.8%) and Westpac Banking Corp (+2.6%) and Insurance Australia (-6.3%) and Suncorp (+9.9%).

Special Situations – Gross Contribution 0.44%

A new position was established in FlexiGroup (-1.0%) during August, with the Fund participating in a $140m equity raise to strengthen the balance sheet. The company also announced a strategic focus on their Buy-Now-Pay-Later (BNPL) product, Humm, together with the intention to divest its commercial leasing operation. Whilst the company has a way to go before it can be considered a pure BNPL business, we like the pivot and have established a modest position accordingly.

The Fund invested in a number of IPOs that are scheduled to list in the coming months – in particular, Laybuy Group, AI Media and CleanSpace. We also participated in the recapitalisation of gold-producer Gascoyne Resources, which is due to list in mid-September.

Our remaining holding in Damstra (+4.1%) was switched into Vault Intelligence (+8.7%), with Vault continuing to trade at a circa 15% discount to the implied bid price. We also added to our exposure to Opticomm, ahead of the Scheme Meeting on 10 September.

Our exposure to Kalium Lakes (+10.3%), Sky Network Television (+6.2%) and Panoramic Resources (+7.4%) was reduced and we completely exited our positions in Electro Optic Systems (+0.5%) and Retail Food Group (+6.3%).

MARKET COMMENTRY

Market Overview

In August, fresh hopes of a vaccine for COVID-19 and a rally in US technology stocks drove global markets higher. In Developed Markets, the Consumer Discretionary and Technology sectors outperformed, while the more defensive sectors like Utilities and REITs underperformed. Key features of the month included the continued rise in the price of iron ore as Chinese industrial production rebounded and the strength of the Australian dollar (on US dollar weakness). Modestly rising inflationary expectations also saw global bond yields increase slightly. The US Federal Reserve announced a major pivot in policy, essentially allowing inflation and unemployment to move higher, while keeping interest rates at the short end at their current historically low levels.

USA

The US markets continued to break records, rallying past the levels last seen in February, as resilient corporate earnings fuelled investor enthusiasm. Towards the end of the month, the Federal Reserve announced a major shift in its approach to monetary policy which would see interest rates kept low, while allowing the Average Inflation Target to tick upwards. Additionally, there was renewed hope that lawmakers would reach a deal on more government assistance, Trump would sign an executive order on enhanced unemployment benefits and encouraging news on the vaccine front that also pushed share prices higher. But it was really a surge in technology stocks that had people scratching their heads.

The NASDAQ Composite was up an impressive +9.7% in August, leaving the index up +32.1% for the calendar year. The S&P 500 +7.2% and the Dow Jones +7.9%, also posted strong gains for the month.

Activity indicators showed further signs of strength. The manufacturing ISM lifted to 54.2 (consensus: 53.6, previous: 52.6) and the composite non-manufacturing ISM also beat expectations, lifting to 58.1 (consensus: 55.0). The unemployment rate fell to 10.2% from 11.1% previously.

Europe

European markets were buoyed by optimism of a new vaccine and national governments ruling out further lockdowns. As manufacturing expanded, equity markets started the month strongly. But it was a choppy month as external events, including renewed US and China tensions following Trump banning WeChat in the US and selected lockdowns within the UK, negatively affected investor sentiment.

The Euro STOXX 50 Index closed the month up 3.2%. Among the major exchanges, Germany's DAX was the best performer up +5.1%, followed by France's CAC 40, with a return of +3.4% and the UK's FTSE 100, +1.8%.

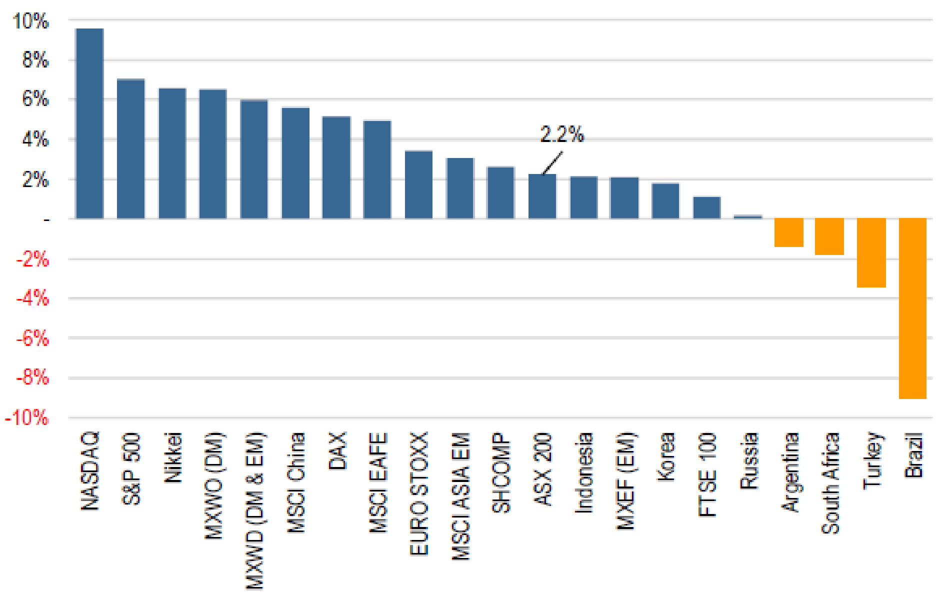
Activity indicators in Europe were also ahead of expectations. The flash Eurozone manufacturing PMI for July was up to 51.8 from 47.4 previously, and the composite PMI also lifted to 54.9 (consensus: 54.8) from 48.5.

Asia

The rise in Asian equities during the month was driven by similar optimism that drove other key markets, including hopes of a vaccine and activity levels progressively approaching pre-COVID-19 growth rates. Some markets were more volatile, as US-China tensions weighed on sentiment. Investors in Japan were totally surprised by the resignation of long standing Prime Minister Abe, who stepped down due to health issues. However, in the Asian region, stronger Chinese economic data was viewed very positively, such as the Chinese trade surplus of $62.3 billion which was way ahead of expectations of $42.6 billion (previous: $46.4 billion).

The Hang Seng Composite Index returned +2.5%, the Chinese SSE Composite Index was up 3.2% (up an astonishing 26.4% over the past 3 months) and Japan's Nikkei 225 Index closed up 6.6% despite coming off the boil on news of Prime Minister Abe's resignation.

Global markets performance in August 2020

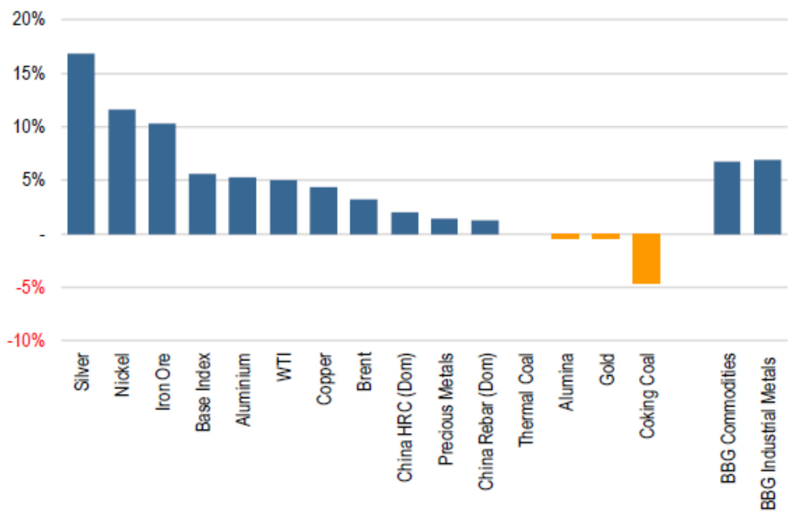


Source: JP Morgan, Bloomberg

Commodities

Commodities rallied in August on a weaker US dollar and signs that the global economy was recovering. One of the standouts was Iron Ore, up over 10%, on the back of strong steel demand in China, with Chinese production continuing to accelerate, constrained shipments out of Brazil and a weaker US dollar. Oil prices also squeezed higher, with WTI closing at US$43/bbl (up 20% over the past 3 months), driven by the same dynamic of recovering global growth. Conversely, gold prices decreased slightly from record highs to finish the month at US$1,967/oz. However, the best performing commodity was silver, which delivered another very strong month of gains (up 15%), closing at US$28/oz and up over 57% in the last 3 months.

Global commodity performance in August 2020



Source: JP Morgan, Bloomberg

Bonds

Global bond yields backed up sharply in August, with the US 10-year government bond yield rising 17 basis points to 0.7%. The Australian 10-year government bond yield also rose 17 basis points, to 0.98%. The rise in yields was driven by higher inflation expectations and a change in the US Fed's policy.

Australia

The S&P/ASX 200 Accumulation Index posted solid gains in August with a return of +2.8%, notching up its 5th consecutive month in the green. The Australian market responded well to a mixed reporting season (see further detail on the results season in the strategy section), mostly buoyed by hopes of a vaccine and green shoots of global growth.

The Consumer Discretionary sector was the best performer in terms of contribution to the index's performance, with a contribution of +0.6%. Information Technology was next (with a contribution of +0.5%), followed closely by Real Estate (+0.5%). Conversely, the bottom three sectors, were Communication Services (-0.2%), Utilities (-0.1%) and Consumer Staples (-0.0%).

The Small Ordinaries Accumulation Index was the best performing sub-index, with a return of +7.2%, followed by the ASX 200 Industrial Accumulation Index, returning +3.4% and the ASX 200 Resources Accumulation Index, +0.9%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were: Telstra Corporation (-27 points), Commonwealth Bank of Australia (-20 points), Newcrest Mining (-14 points), a2 Milk Company (-10 points) and Resmed (-8 points).

The top five stocks that made a positive contribution to the index's return were CSL (+44 points), Afterpay (+31 points), with the stellar run of the Buy-Now-Pay-Later sector continuing in August, BHP Group (+23 points), Goodman Group (+14 points) and Wesfarmers (+13 points).

Not surprisingly, the RBA left rates unchanged in August. The Australian dollar had another strong month. It gained 3.2% against the US dollar, with expectations of further strength, and finished the month at 0.74US cents.

CONTRIBUTION

Relative Value Gross Contribution 0.13%

Positive		Negative	
CROMWELL PROPERTY GROUP - PEET	0.78%	MIRVAC GROUP - STOCKLAND	-1.30%
KAROON GAS AUSTRALIA LTD - SANTOS	0.70%	CORPORATE TRAVEL MANAGEMENT - HELLOWORLD TRAVEL LTD	-0.70%
CROMWELL PROPERTY GROUP - CHARTER HALL EDUCATION TRUST	0.40%	TPG TELECOM LTD - UNITI WIRELESS LTD	-0.53%
RIO TINTO - RIO TINTO	0.33%	CARINDALE PROPERTY TRUST - INGENIA COMMUNITIES GROUP	-0.22%
DOWNER EDI - MONADELPHOUS GROUP LTD	0.30%	AROA BIOSURGERY LTD - POLYNOVO LTD	-0.20%

Special Situations Gross Contribution 0.44%

Positive		Negative	
4D MEDICAL PTY LTD	0.87%	PUT SPREAD ON ASX 200	-1.58%
ATOMOS LTD	0.34%	IMRICOR MEDICAL SYSTEMS	-0.26%
NUFARM HYBRID	0.32%	IMPEDIMEDD LTD D	-0.21%
KALIUM LAKES LTD	0.22%	OPTICOMM LTD	-0.11%
VOLPARA HEALTH TECHNOLOGIESS	0.18%	US MASTERS RESIDENTIAL PROPE	-0.07%

Top 10 Relative Value Positions

BHP BILLITON - BHP BILLITON	BORAL - FLETCHER BUILDING
RIO TINTO - RIO TINTO	APN INDUSTRIA REIT - GDI PROPERTY GROUP
KAROON GAS AUSTRALIA LTD - SANTOS	PRIMEWEST GROUP LTD - RURAL FUNDS GROUP
CROMWELL PROPERTY GROUP - CHARTER HALL EDUCATION TRUST	APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND
TPG TELECOM LTD - UNITI WIRELESS LTD	CORPORATE TRAVEL MANAGEMENT - HELLOWORLD TRAVEL LTD

Top 10 Special Situation Positions

PUT SPREAD ON ASX 200	VILLAGE ROADSHOW LTD
OPTICOMM LTD	LIMEADE INC
VOLPARA HEALTH TECHNOLOGIESS	SUNCORP GROUP NOTE
NUFARM HYBRID	INVEX THERAPEUTICS LLTD
ATOMOS LTD	IMPEDIMEDD LTD D

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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