

Ellerston Australian Market Neutral Fund

Performance Report | October 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 ^a	0.37%	4.23%	19.56%	8.72%	3.73%	4.10%	7.43%
Benchmark [*]	0.02%	0.06%	0.12%	0.42%	1.07%	1.30%	1.66%
Alpha	0.35%	4.17%	19.44%	8.30%	2.66%	2.79%	5.77%

Source: Ellerston Capital

^aNet 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	24.0%
No. Relative Value positions	66	Gross Portfolio Exposure	197.6%
No. Special Situations	24	Correlation Coefficient (vs ASX 200 Accum)	50.0%
Beta Adjusted	23.9%	Net Sharpe Ratio (RFR = RBA Cash)	0.63

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	29.3%	-20.7%	8.6%
Industrials	43.6%	-5.4%	38.2%
Resources	27.4%	-17.5%	9.9%
Index	7.7%	-40.4%	-32.7%
Total	108.0%	-84.0%	24.0%

COMMENTARY

The Fund produced a net return of +0.37% in October, outperforming the benchmark return of +0.02%. Net exposure was +24.0% at the end of the month, with a beta-adjusted net of +23.9%. Gross exposure closed the period at +197.6%.

A paired position featuring medical equipment companies CleanSpace (+56.5%) and EBOS Group (+7.0%) was the largest contributor to the Fund's performance during the month. CleanSpace is a recently-listed company that sells low profile, high protection, reusable respirators that protect industrial and healthcare workers. The company has been a major beneficiary of COVID-19, with a significant increase in demand, amid a worldwide shortage of conventional masks and respirators.

With Karoon Energy (+0.6%) continuing to inch towards settlement of the Bauna oilfield acquisition, our paired position between Karoon and Santos Energy (-3.1%) once again added to performance. At the end of October, both ANP approval and the FPSO charter assignment had been achieved, with settlement re-scheduled to occur in the first week of November. Despite a narrowing in the spread we still like the pair, with Karoon trading on an FY21 EV/EBITDA ratio of just 1.2x, compared with Santos on 5x.

Uniti Group (-16.8%) was once again forced to increase their bid for OptiComm (+11.1%), with the First State Superannuation Scheme (now called Aware Super) increasing their cash bid to \$6.50 per share. The market is starting to get concerned that Uniti will overpay and/or end up overgeared and marked the share price down accordingly. A paired position featuring Uniti, hedged with TPG Telecom (-1.6%) detracted from the performance of the Fund. We suspect the revised bid from Uniti will be successful, and the merged company will trade higher than the current multiple of just 6.5x FY21 EV/EBITDA.

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	\$1.0620
Net Asset Value	\$1.0594
Redemption Price	\$1.0568
Liquidity	Daily
Management Fee	1.20%
Performance Fee	20% of outperformance
Buy/Sell Spread	0.25%/0.25%

Our paired position between Buy-Now-Pay-Later (BNPL) companies Afterpay (+20.9%) and Flexigroup (-11.7%) also detracted from performance, with the share price of Flexigroup continuing to underperform its high-flying peer. Following the capital raise in August, Flexigroup is expected to re-brand as “hummm”, the BNPL brand under which it operates.

The spread between the Australian and UK listings of both Rio Tinto (-2.0%) and BHP Group (-5.1%) widened during October, detracting value from the Fund.

The merger of Damstra (-2.5%) and Vault Intelligence (+14.2%) was completed during October, with our shareholding in Vault converted to Damstra shares. The merger resulted in an increase in the value of our position, adding to the performance of the Fund in the period.

Impedimed (+23.5%) announced the publication of a sub-analysis of the PREVENT study that clearly demonstrated the benefit of bioimpedance spectroscopy (BIS) when compared with tape measurement. The study adds to the growing body of evidence that supports the use of BIS in detecting subclinical breast cancer-related lymphoedema. The company also released its FY21 first quarter results, which were better than expected.

The share price of Kina Securities (-6.9%) continued to flounder in October, with the market struggling to digest the recent capital raise. In September, Kina completed an equity raise of \$91m to increase their total capital ratio to above 20%, and also to fund an increase in the single borrower limit. The fall in the share price reduced the Fund's performance in the period.

The stronger equity market in October led to the derivative position detracting from the Fund's value.

ACTIVITY

Relative Value – Gross Contribution -1.11%

It was another incredibly busy month for Relative Value in October, with the Fund very active in a number of sectors.

We unwound our paired position between Fletcher Building (+8.7%) and Boral (+0.0%) following a narrowing in the spread. During October, Boral announced the sale of its stake in the plasterboard business, USG Boral, to Knauf for USD1.01b, with the proceeds used to reduced debt. We also unwound paired positions featuring Select Harvests (+10.6%) and Elders (+3.3%), and QANTM Intellectual Property (-0.5%) and IPH (-8.2%).

A paired position was established between Spark Infrastructure (-3.2%) and AusNet Services (+6.4%), following a period of underperformance from Spark. The underperformance was due primarily to a large sell campaign that weighed heavily on the company's share price. At current prices we prefer Spark, with a return-to-consensus-price-target of +13.5% vs AusNet at -4.8%.

We participated in the sell down of Westpac Banking Corp's (+6.4%) shareholding in Zip Co (-7.3%) which was completed at a 6.1% discount to the prevailing share price. The position was hedged with Afterpay which trades at an FY21 EV/Revenue of 30x, compared with Zip at 12x.

Also during the month, we reduced our exposure to pairs that featured Abacus Property (-4.8%) with the REIT underperforming both Centuria Industrial (-1.3%) and National Storage (-0.6%). We reduced our exposure to the pair between childcare landlords Arena (-2.9%) and Charter Hall Social Infrastructure (+2.5%).

Special Situations – Gross Contribution 1.68%

It was a relatively quiet month within Special Situations, although we did participate in a number of equity placements including Dubber Corporation (+17.3%), Frontier Digital Ventures (-2.2%) and the Vital Healthcare Property Trust (-2.0%). We also established a position in MyDeal.com.au (+24.5%), an online marketplace for household goods.

We reduced our exposure to Atomos (+1.5%), Electro Optic Systems (+0.9%), Kalium Lakes (+32.1%) and Mader Group (+11.8%) in October and completely exited our position in Village Roadshow (+2.8%). Our position in the Nufarm hybrid securities (-5.1%) was also trimmed.

MARKET COMMENTARY

Market Overview

In October, equity markets were mostly weaker as a spike in COVID-19 infections globally, the absence of any agreement on fresh fiscal stimulus in the US and in-line earnings from the tech giants dampened investor enthusiasm. In Australia the ASX 200 markedly outperformed the MSCI Developed Market's benchmark by ~5%, as a highly stimulatory budget was well received. The AUD fell on more dovish comments from the RBA governor about further rate cuts and the prospect of QE, and general 'risk-off' sentiment. Global bond yields rose modestly, but inflation expectations continued to fall, due to softer oil prices driven by anticipated weaker demand for transport fuels from new shutdowns.

USA

US equities finished lower for the second month in a row, as COVID-19 cases surged to record levels and a consensus on a new two trillion dollar fiscal stimulus package was unable to be achieved. Additionally, the prospects of a messy Presidential election outcome weighed on investor sentiment. The Federal Reserve chairman, Jerome Powell, reiterated his warning that the recovery would stutter without further stimulus.

The NASDAQ Composite finished the month in negative territory with a return of -2.3%, but remains strongly in the black for the calendar year to date. The S&P 500 posted a -2.7% return and the Dow Jones was down 4.5%.

Activity indicators remain mixed. The manufacturing ISM retraced to 55.4 (consensus: 56.5, previous: 56.0), however, the composite services ISM was better than expected, rising to 57.8 (consensus: 56.2, previous: 56.9).

The US printed a record snapback in economic activity in 3Q (+7.4% quarter-on-quarter GDP growth and +33.1% quarter-on-quarter annualised), with strength apparent in personal consumption, residential investment and equipment investment.

Europe

European markets were particularly badly hit. Fears of a severe second coronavirus wave were realised with fresh lockdowns announced in the major economies of the UK and France. The markets were also impacted by the uncertainty around further fiscal stimulus in the US and Brexit risks.

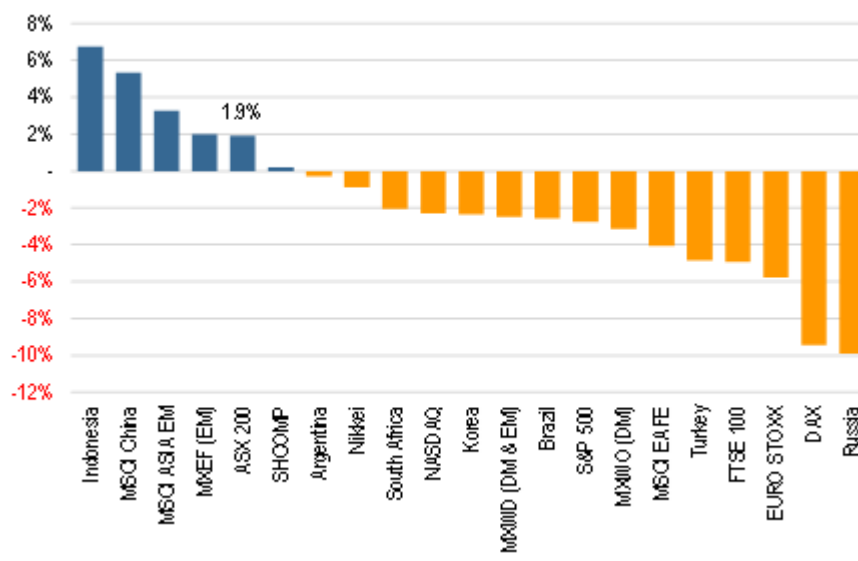
The Euro STOXX 50 Index was crunched, falling 7.3%. Among the major exchanges, Germany's DAX's fared the worst, with a return of -9.4%, followed by the UK's FTSE 100, -4.8% and France's CAC 40, -4.4%.

Activity indicators in Europe were again mixed. The flash Eurozone manufacturing PMI for October was ahead of expectations, rising to 54.4 (consensus: 53.0, previous: 53.7), whilst the composite PMI fell to 49.4 (consensus: 49.2, previous: 50.4).

Asia

Unlike US and European markets, Asian markets bucked the trend and were broadly stronger in October. The economic data out of China was below expectations but still strong, with 3Q GDP rebounding to +4.9% year-on-year. The Hang Seng Composite Index returned +2.8%, the Chinese SSE Composite Index, +0.5%, and India's BSE SENSEX was up 4.3%, but Japan's Nikkei 225 Index was down 0.9% and Korea's KOSPI was down 2.6%.

Global markets performance in October 2020

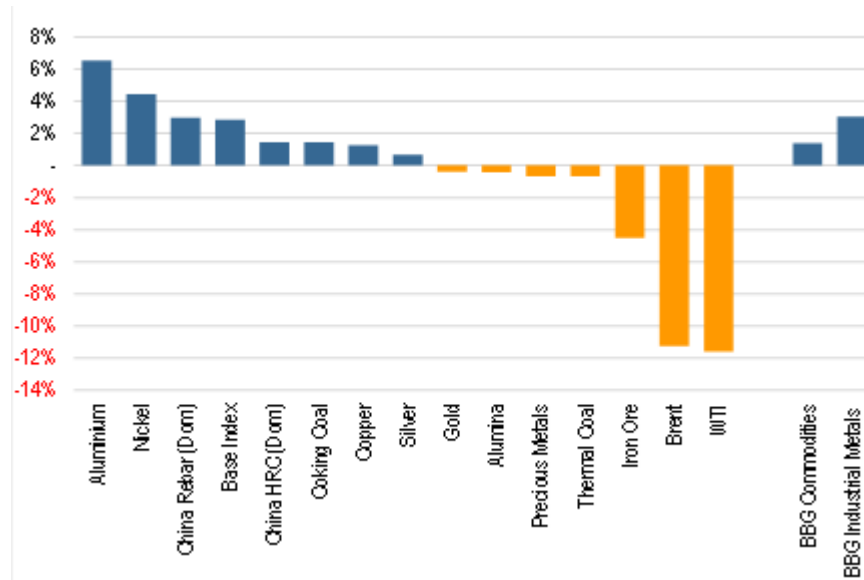


Source: JP Morgan, Bloomberg

Commodities

Commodity prices were mixed in October. Fears of another lock-down hit oil prices with Brent oil down 11%. Iron ore prices also fell as Chinese inventories continued to rise from increased supply by Brazil, but remain at elevated levels. Despite a broadly 'risk-off' environment, gold prices declined slightly to US\$1,882/oz.

Global commodity performance in October 2020



Source: JP Morgan, Bloomberg

Bonds

Bond yields rose in October with the US 10-year government bond yield rising sharply by 17 basis points to 0.85%, perhaps taking a view on the upcoming election, whilst the Australian 10-year bond yield rose more modestly, up 4 basis points to 0.83%.

Australia

The S&P/ASX 200 Accumulation Index was up 1.9% in October and proved to be one of the few global markets to deliver a positive return. It was a rather volatile month in Australia also, as the domestic market was buffeted by negative international sentiment but offset by the highly expansionary government budget and soaring consumer confidence.

The Financials sector was the most significant contributor to the index's performance, adding 1.6%, followed by Information Technology (+0.3% contribution) and Consumer Staples (+0.3% contribution).

The ASX 200 Industrial Accumulation Index was the top performing sub-index, with a return of +2.8%, followed by the Small Ordinaries Accumulation Index, +0.5% and then the ASX 200 Resources Accumulation Index which was down 1.3%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were: BHP Group (-31 points), Transurban Group (-10 points), Newcrest Mining (-10 points), Brambles (-8 points) and Telstra Corporation (-7 points).

The top five stocks that made a positive contribution to the index's return were: Commonwealth Bank of Australia (+58 points), Australia and New Zealand Banking Group (+ 26 points), Westpac Banking Corporation (+ 23 points), Afterpay (+22 points) and National Australia Bank (+17 points).

As expected, immediately post month end on Melbourne Cup day, the RBA cut official cash rates to 0.1% from 0.25% and embraced quantitative easing, with a \$100 billion bond buying program at maturities of around 5 to 10 years over the next six months, in an effort to keep a lid on longer-term interest rates.

CONTRIBUTION

Relative Value Gross Contribution -1.11%

Positive		Negative	
CLEANSPACE HOLDINGS LTD - EBOS GROUP LTD	0.87%	TPG TELECOM LTD - UNITI WIRELESS LTD	-1.20%
KAROON GAS AUSTRALIA LTD - SANTOS	0.31%	AFTERPAY TOUCH GROUP LTD - FLEXIGROUP	-0.85%
IOOF – IOOF CALL OPTION	0.27%	BHP BILLITON - BHP BILLITON	-0.24%
ELDERS - SELECT HARVESTS LIMITED	0.19%	MALI LITHIUM LTD - SARACEN MINERAL HOLDINGS LTD	-0.24%
TPG TELECOM LTD - TUAS LTD	0.16%	SCENTRE GROUP - VICINITY CENTRES	-0.23%

Special Situations Gross Contribution 1.68%

Positive		Negative	
DAMSTRA HOLDINGS LTD	0.67%	PUT SPREAD ON ASX 200	-0.55%
IMPEDIMEDD LTD	0.55%	VAULT INTELLIGENCE LTD	-0.42%
LIMEADE INC-CDI	0.50%	INVEX THERAPEUTICS LLTD	-0.28%
KALIUM LAKES LTD	0.41%	KINA SECURITIES LTD	-0.25%
MYDEAL.COM.AU LTD	0.30%	ADORE BEAUTY GROUP LTD	-0.12%

Top 10 Relative Value Positions

BHP BILLITON - BHP BILLITON	APN INDUSTRIA REIT - GDI PROPERTY GROUP
KAROON GAS AUSTRALIA LTD - SANTOS	AUSNET SERVICES - SPARK INFRASTRUCTURE
SCENTRE GROUP - VICINITY CENTRES	ARENA REIT - CHARTER HALL EDUCATION TRUST
RIO TINTO - RIO TINTO	AFTERPAY TOUCH GROUP LTD - FLEXIGROUP
TPG TELECOM LTD - UNITI WIRELESS LTD	INGENIA COMMUNITIES GROUP - LIFESTYLE COMMUNITIES LTD

Top 10 Special Situation Positions

PUT SPREAD ON ASX 200	IMPEDIMEDD LTD
VOLPARA HEALTH TECHNOLOGIESS	SUNCORP GROUP NOTE
NUFARM HYBRID	ACCESS INNOVATION HOLDINGS
KINA SECURITIES LTD	INVEX THERAPEUTICS LTD
ATOMOS LTD	LIMEADE INC-CDI

All holding enquiries should be directed to our registrar, [Link Market Services](https://linkmarketservices.com.au) on 1800 992 149 or ellerston@linkmarketservices.com.au

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