

Ellerston Global Equity Managers Fund (GEMS)

Performance Report | October 2020

PERFORMANCE SUMMARY

Performance*	FYTD	CYTD	1 Year	3 Year (p.a.)	5 Yr (p.a.)	Since Inception (p.a.)**
GEMS C	9.38%	17.02%	24.04%	7.24%	9.32%	11.18%

Source: Ellerston Capital

*Net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

PORTFOLIO COMMENTARY & MARKET OUTLOOK

Performance:

Fiscal Year to Date from July 1 to October 31, 2020, the Australian ASX 200 is up +1.5%, and the US S&P500 is up +6.0%. **The Fund is up net after fees +9.4%.**

Calendar Year to Date from January 1 to October 31, the Australian ASX 200 is down -9.1%, and the US S&P500 is up +2.8%. **The Fund is up net after fees +17.0%.**

For the **Month of October 2020**, the Australian ASX 200 was up +1.9%, and the US S&P500 was down -2.7%. **The Fund was up net after fees +0.6%.**

The portfolio performed solidly against a mixed backdrop for global markets during the month of October, generating positive performance despite the US and European markets having a meaningful down month.

As of November 27, the portfolio had a net exposure of circa 70%, plus an exposure to gold and silver of circa 8%, uranium of circa 6%, and had minimal foreign currency exposure.

The Fund has performed very strongly in the month to date for November and is on course to achieve its best ever month.

Portfolio:

Investments – We continue to identify and invest in new opportunities that excite us and fit our asymmetric risk reward profile requirements. The portfolio is eclectic and provides exposure to growth, recovery, themes, juggernauts, hidden gems and stock specific opportunities across a range of sectors. Some examples of this include Celsius (US), a growing force in energy drinks with a fitness focus. Bed, Bath & Beyond (US) is a US centric omni channel retailer focussed on the home, baby, wellness and beauty markets that is undergoing a powerful transformation under a relatively new A grade management team. Soitec (France) is a mission critical enabler of 5G connectivity. BetMakers provides the platforms and tools that enable the provision of fixed odds betting for horse racing, and are best positioned to capitalise on the pending introduction of fixed odds betting on horse racing in the US. Madison Square Garden (US) owns Madison Square Garden in NYC and is developing the Sphere in Las Vegas which promises to be an E Sports mecca and will be benefit greatly post COVID-19. Cameco and Kazatomprom are the leading Tier one, lowest cost uranium producers. We have outlined our thesis on the uranium sector below.

Hedging - We remain heavily hedged with portfolio protection through futures, put options, rotation hedges and individual stock shorts. Options hedging includes both at the money and deep out of the money put options. Driven by the magnitude and velocity of any market decline, the delta of the options should expand materially and magnify the value of the options, particularly the deep out of the money options. The nature of our protection is such that we are protecting against material market falls as opposed to sub 4% market pullbacks

Market Commentary:

Financial Asset hyperinflation beckons.

Many commentators would agree the present bull market in equities began in the late 70s when Fed Chairman Volcker hiked interest rates to break the back of inflation. Once the markets digested stupendously high interest rates, US30yr at 16%, the markets started a long, long bull run interrupted by several business cycles along the way. Many investors made extraordinary fortunes by riding the rate cycle through property and the equity markets being rerated by the discount rate moving down relentlessly.

Investment Objective

The investment objective is to generate superior returns for Unitholders with a focus on risk and capital preservation.

Investment Strategy

The Fund provides investors with exposure to global markets through a long short equity strategy. The strategy overlays fundamental bottom-up stock selection with global macroeconomic and market outlook.

Key Information

**Class Inception Date 1 December 2009

Co Portfolio Managers	Ashok Jacob & Arik Star
Application Price	\$ 1.6045
Net Asset Value	\$1.6005
Redemption Price	\$ 1.5965
Liquidity	Monthly
No Stocks	97
Gross Exposure	208.63%
Net Exposure	63.69%
Management Fee	1.50%
Performance Fee	16.50%
Buy/Sell Spread	0.25%/0.25%

This all ended with the GFC, with rates already on the low side and governments already carrying too much debt. Central Banks, led by one B. Bernanke, changed course. Reserve Bank balance sheets were expanded exponentially to keep rates artificially low (financial suppression) and to provide liquidity to the financial system. When this approach was taken, the business cycle ebb and flow was artificially destroyed and the new game in town became low, extremely low and zero rates. The fear at the time, which proved unfounded, was that this would lead to inflation down the line. It clearly did not. But the new paradigm of investing became zero rates causes high growth to become the most precious asset in the investment universe. The asset to ride became growth and high growth equities.

Then came COVID-19. By itself it was simply a pandemic. Coupled with zero rates it lit a fuse under an already elevated historical valuation for growth equities. On top of that, the massive liquidity injection created a monster bull market in equities.

Consequently, and completely reasonably, in November we are seeing the beginning of financial asset inflation. In some cases, hyperinflation. Many Investors are experiencing their biggest ever monthly return in November.

However, a word of caution, excess liquidity has unhinged the relationship between risk and return.

More vaccine news, a powerful V shaped economic recovery, and new stimulus packages around the world look set to favour the risk on, all in investor through 2021. A wobble is due, but the outlook is positive.

Although we are fully invested, we carry significant protection and insurance at between 2-10% below current market levels.

Uranium – Tremendous asymmetric risk/reward opportunity:

From a peak of circa US\$140/lb in 2007, the spot uranium price has trended downwards and currently sits at circa US\$29/lb, a decline of circa 79%. Over the same period, capital expenditure in the sector has been decimated and significant primary production has been eliminated. Meanwhile, there is a strong development pipeline for the construction of Nuclear power reactors, which will ensure robust demand and demand growth for uranium going forward. As a result, **uranium is currently in the eye of the storm of an unsustainable primary source supply/demand disequilibrium.**

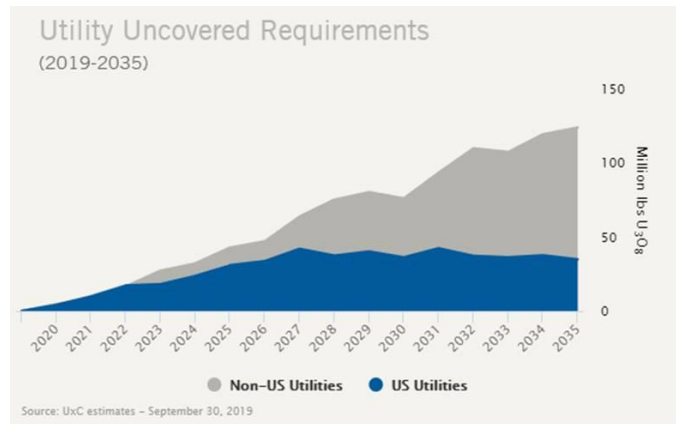
Uranium - Virtually all the uranium produced globally is used in nuclear reactors that provide baseload power supply. Nuclear energy is one of the cleanest sources of energy, emitting no greenhouse gases when generating electricity. It is the only carbon-free energy source that operates around the clock.

In recent years, a low uranium price has caused Significant primary production disruptions....

.... Resulting in utilities developing dangerous reliance on uncontracted sources from opaque secondary supply channels.



Source: (1) UxC LLC

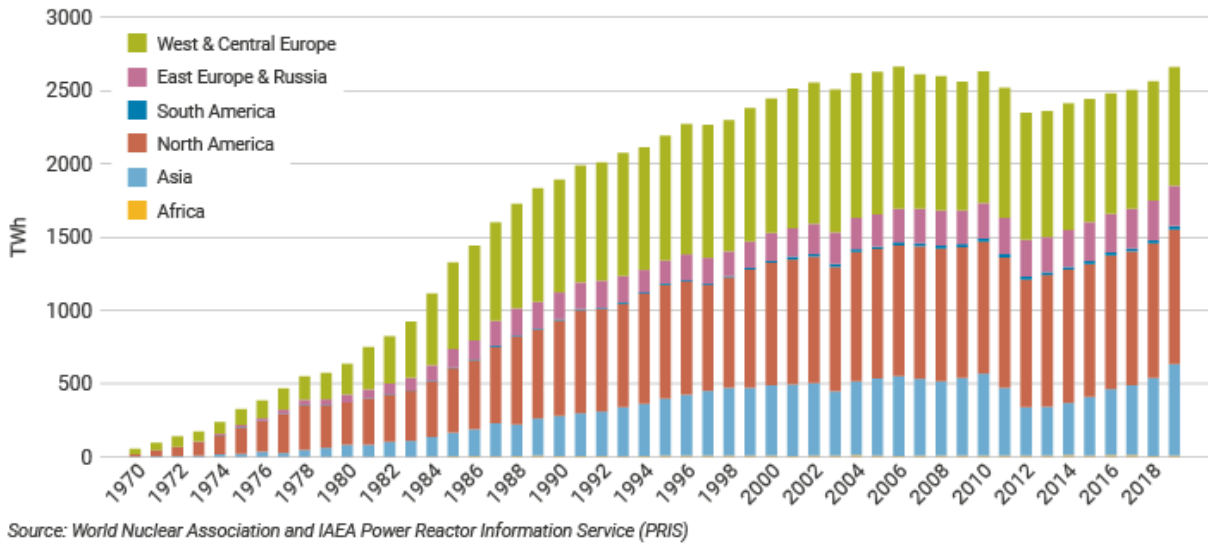


Source: (1) UxC LLC

Demand - The whole Uranium industry was impacted by the well-known Fukushima accident in March 2011, as dozens of reactors worldwide were shut down in response. This caused a drop of more than 10% in total global uranium demand. Nearly a decade later, demand is back around pre-Fukushima levels and the number of reactors is growing again with a strong pipeline of newbuilds.

The World Nuclear Association estimates a total of **177 million pounds of uranium is required to power today's fleet of 441 operating reactors.** A further 53 reactors are currently under construction, 100 planned and 326 proposed.

Global Nuclear Energy Production



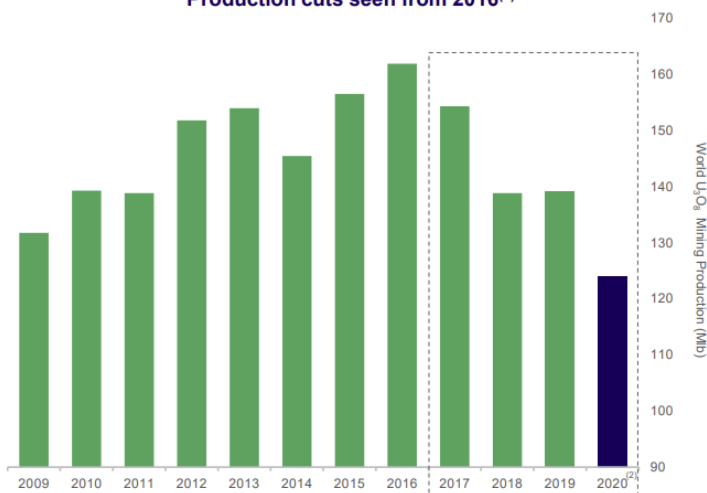
Supply - Producers have been navigating a 10-year bear market for the uranium price that has seen capital expenditure and the number of companies producing, developing and exploring for uranium get decimated.

Primary supply, provided from annual uranium production, peaked in 2016 at 162 million pounds with **production having decreased by circa 25% to about a 120 million pounds per annum run rate currently**. Utilities have become increasingly reliant on the opaque secondary market, which is comprised of stockpiles held by utilities, governments and suppliers, traders and financials. Security of uranium supply is critical for a nuclear power utility, and arguably the secondary supply market does not provide that. Long term contracts with producers do. With uranium prices trading at below the all-in cost of marginal production for many years, existing long term contracts starting to roll off, most uranium producers, developers and explorers have clearly indicated that any material long term contracts would need to be at circa US\$50 a pound, well above the current spot price. In terms of actual production, any mines that are in a care and maintenance state will typically take 12 to 24 months to bring back into production and then ramp up to capacity, while any greenfield deposits being developed would take typically 5 to 10 years to reach production.

Producers have been taking self-help measures.

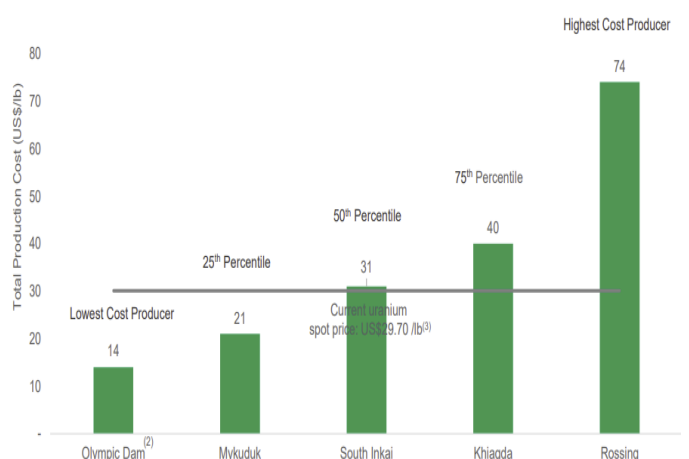
Significant portion of supply loss making at current spot price, exacerbated by COVID-19.

Production cuts seen from 2016⁽¹⁾



Source: (1) UxC LLC

2018 Estimated Total Production Costs⁽¹⁾ (US\$/lb)



Source: (1) UxC LLC

Thesis - There is a structural under-supply issue that exists in uranium production for the years and decades ahead, and a disequilibrium between the spot price and marginal all in cost of production. This is not sustainable medium term, and prices must increase to incentivise uranium miners to fill the deficit. COVID-19 further impacted this structural imbalance and induced the temporary shutdown of some Tier 1 mines. In conjunction with several primary production natural retirements scheduled for 2021, this has served to accelerate the outcome of the current price disequilibrium position.

Interestingly the medium-term uranium supply/demand outlook is much worse today than it was 2007 when spot prices hit US\$137.

While the timing of an outcome here is unclear, the risk/reward dynamic is outstanding, and we will be paid handsomely to be patient. GEMS currently has exposure to the uranium sector through direct equity investments and long dated call options on equities. Investments include Kazatomprom and Cameco (Leading Tier 1 producing assets), Paladin (Mine on care & maintenance), NexGen Energy (Scale undeveloped deposit), and Yellow Cake (Owner of physical uranium).

“By 2030, the market will need production equivalent to two equivalent Kazatomproms to fill the expected gap between supply and demand. Hence, the fundamentals of uranium look certainly bullish.”

Askar Batyrbayev, Managing Director of Marketing & Sales, Kazatomprom (**Kazatomprom - largest producer in the world**).

PORTFOLIO CHARACTERISTICS

Market Exposure as a % of NAV



Source: Ellerston Capital

Top 10 Holdings (Alphabetical, Long Only)

- ADAIRS LTD
- AMPOL LTD
- CELSIUS HOLDINGS INC
- FACEBOOK.COM
- GRAINCORP LTD
- NEXTDC LTD
- OPEN LENDING CORP
- S.O.I.T.E.C.
- SCIENTIFIC GAMES CORP
- SKY CITY ENTERTAINMENT GROUP

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

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Should investors have any questions or queries regarding the Fund,

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DISCLAIMER

[^] Actual performance for your account may vary from that set out in this newsletter and will vary for investments made in different classes, or at different times throughout the year. Some performance data is estimated and preliminary and subject to change.

^{^^} For the period 1 January 2002 to 30 April 2006, the CPH Group GEMS Portfolio was not operated within a separate fund structure. The underlying investment assets of the CPH Group GEMS Portfolio were owned during that time within corporate entities of the CPH Group for which audited accounts were prepared on an annual basis. Accordingly, in order to provide relevant historical performance information for the period 1 January 2002 to 30 April 2006 (Historical Returns) net returns were calculated on the basis of the actual dollar returns of the CPH Group GEMS Portfolio adjusted to reflect a fund structure similar to the Fund and including all fees. For GEMS B, GEMS A returns have been used between 1 May 2006 and 2 November 2009. The returns of the Fund and the relevant Indices are net of fees, expenses and taxes and assuming distributions are reinvested.

[#] The standard deviation is often used by investors to measure the risk of an asset. The standard deviation is a measure of volatility: the more an asset's returns vary from the average return, the more volatile the asset. A higher standard deviation means a greater potential for deviation of return from the average return of the asset.

The returns and risk of the Fund and the relevant Indices are net of taxes, fees and expenses and assuming distributions are reinvested. The performance figures presented are for the Ellerston Global Equity Managers Fund GEMS C Units. The one month return figure may be an estimate and not the final return. This estimate also impacts other performance information provided. Estimated performance figures are preliminary and subject to change. Returns for other classes may differ slightly. Past performance is not indicative of future performance. Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000 is the responsible entity of the Ellerston Global Equity Managers Fund ARSN 118 887 095 (Fund). This newsletter has been prepared by Ellerston Capital Limited without taking account of the objectives, financial situation or needs of investors. Before making an investment decision you should consider your own individual circumstances and obtain a copy of the Product Disclosure Statement for the Fund which is available by contacting Ellerston Capital. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. To the full extent permitted by law, none of Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this newsletter and disclaims all liability that may arise due to any information contained in this newsletter being inaccurate, unreliable or incomplete.

5 Ellerston Global Equity Managers Fund (GEMS)

GEMS Strategy Performance & Volatility[^]

