

Ellerston Australian Market Neutral Fund

Performance Report | December 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	1.13%	8.15%	19.01%	10.98%	5.67%	5.14%	8.32%
Benchmark [*]	0.01%	0.04%	0.10%	0.32%	0.99%	1.24%	1.62%
Alpha	1.12%	8.11%	18.91%	10.66%	4.68%	3.91%	6.69%

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	68%	Net Equity Exposure	15.6%
No. Relative Value positions	2	Gross Portfolio Exposure	26.0%
No. Special Situations	45	Correlation Coefficient (vs ASX 200 Accum)	52.8%
Beta Adjusted	19.7%	Net Sharpe Ratio (RFR = RBA Cash)	0.72

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	3.1%	-0.2%	2.9%
Industrials	15.3%	-3.3%	12.0%
Resources	2.2%	-1.6%	0.6%
Index	0.0%	0.0%	0.0%
Total	20.7%	-5.1%	15.6%

COMMENTARY

The Fund produced a net return of +1.1% in December, outperforming the benchmark return of 0.01%. Pleasingly, the Fund returned 11.0% net over Calendar Year 2020 compared with the benchmark return of +0.3%. Net exposure was +15.6% at the end of the month, with a beta-adjusted net of +19.7%. Gross exposure closed the period at +26.0%.

ACTIVITY

Relative Value – Gross Contribution -0.71%

Paired positions between the Australian and UK listings of both Rio Tinto (+12.3%) and BHP Group (+11.5%) narrowed in December, and were the largest contributors to performance.

Our paired position between Karoon Energy (+5.0%) and Santos Energy (+1.8%) detracted from performance. This is a disappointing result given Karoon's recently completed final settlement for the Bauna oilfield acquisition. Despite the recent share price performance, Karoon still looks incredibly cheap, trading at an FY22 EV/EBITDA multiple of just 1.2x, compared with Santos on 6.7x.

Our position in HomeCo Daily Needs REIT (-5.0%), hedged with Cromwell Property Group (+3.9%), also detracted from performance in the period. HomeCo Daily Needs invests in metro-located, convenience based assets across sub-sectors of neighbourhood retail, large format retail, and health services. Since the HomeCo \$300m capital raising and an in-specie distribution of HomeCo Daily Needs units to existing HomeCo investors, the stock has fallen by -6.4%.

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

Fund Inception	3 June 2013
Application Price	\$1.1444
Net Asset Value	\$1.1415
Redemption Price	\$1.1386
Liquidity	Daily
Management Fee	1.20%
Performance Fee	20% of outperformance
Buy/Sell Spread	0.25%/0.25%

We attribute this fall to investors who were looking to crystallise recent gains in HomeCo, by selling their recently distributed HomeCo Daily Needs units. We expect this selling pressure to be short lived, and the stock looks increasingly cheap relative to peers.

Special Situations – Gross Contribution 1.68%

We exercised our ImpediMed (-24.2%) unlisted options with the contribution increasing the existing position and adding value to the Fund in December.

We participated in the Initial Public Offering of Nuix (+55.4%), with the company's share price rallying strongly on its first day of trading. Nuix is a provider of analytics and intelligence software used for investigations by governments, regulators, corporations, and professional service providers globally. Its products ingest and process large volumes of structured and unstructured data to extract insights and analysis that support a range of investigatory use-cases. We are attracted to Nuix's exposure to the increasing demand for big data analysis globally and the success management has had generating high and profitable growth to date.

The share price of Kina Securities (+7.1%) reacted positively to the acquisition of Westpac's (-3.8%) Pacific business for A\$420m, which includes operations in Papua New Guinea and Fiji. Following a A\$91m equity raise in September, which was used to increase the overall capital level and to fund growth, the market struggled to digest the EPS dilution from the raise and the share price floundered. However, the acquisition reversed this EPS dilution and the Westpac's business is highly complementary, adding significant scale and reach to Kina's operations, infrastructure, and product offering. The rise in the share price increased the Fund's performance in the period.

MARKET COMMENTARY

Market Overview

Investors ended a wild year by piling into everything from bitcoin to emerging markets, with expectations that a material economic recovery, fuelled by massive government and central bank stimulus and the rollout of the vaccine, will push prices even higher. The performance of global equity markets were mixed, but the Eurozone was the clear laggard.

US government bond yields remain near all-time lows, but squeezed higher towards year end. Crude oil prices were back over US\$50 a barrel after briefly dropping to minus US\$37.00/bbl for the first time ever in April.

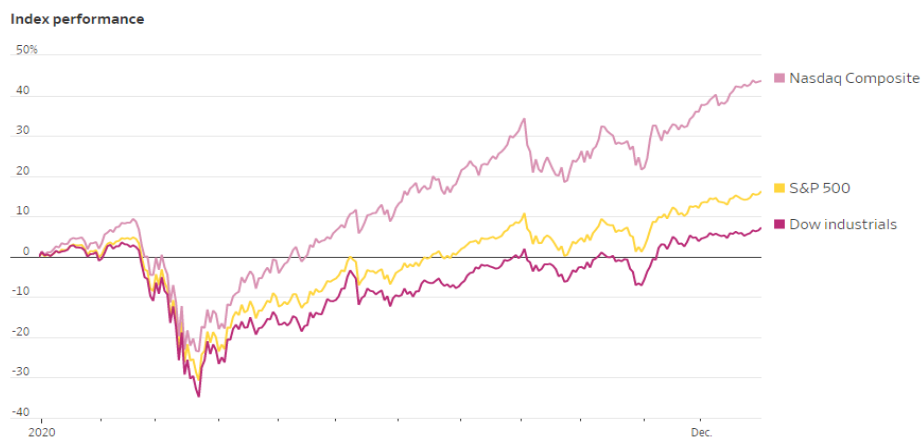
The year ended with investors evaluating the likelihood of further fiscal support from Washington and continuing to buy risk assets, with momentum still the powerful force driving equity prices.

USA

US stocks ended their record-setting run, capping a banner year for everything from gold to bitcoin. After plunging into steep bear market territory as worries about the rapidly spreading coronavirus virtually shut down the globe and smashed investor sentiment, stocks soared in 2020, an unthinkable outcome when markets gapped down in February and March.

The Federal Reserve's massive stimulus, central bank action of a magnitude never seen before and subsequently, news of a vaccine, stoked a powerful rally in markets. The S&P 500 climbed 18.4% for the calendar year to 3,756.1, ending the year at a record level, while the tech-heavy Nasdaq Composite gained 44.9% to 12,888.3, its best year since 2009.

The Dow Jones finished up 9.7% in 2020 to 30,606.5, a far cry from its 23rd of March low of 18,213 points. In the month of December, the S&P 500, Nasdaq Composite and Dow Jones were up 3.8%, 5.7% and 3.4% respectively, fuelled by the distribution of the first COVID-19 vaccines across the country and Congress passing President Trump's signed US\$900 billion stimulus deal four days before the end of the year.



Source: Factset

Under the surface, many individual securities logged even more astonishing returns. More stocks gained at least 400% at their yearly peaks in 2020 than in any year since 2002. Among the names were Tesla (up almost 700%), Peloton Interactive and several biotechnology firms.

Europe

European markets were the worst performers in 2020. The pandemic didn't seem to be under control for any extended period and economies in Europe were severely impacted, as countries went in and out of lockdown. News of the vaccine brought some temporary relief towards the end of the year.

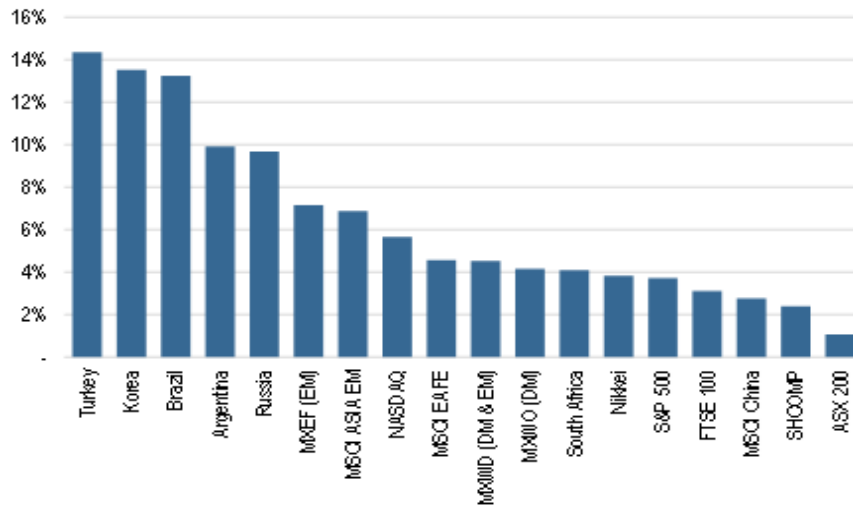
The Euro STOXX 50 Index ended the calendar year down 3.2% (December: +1.8%). Among the major exchanges, the UK's FTSE 100 fared relatively badly, down 11.6% (December: +3.3%), France's CAC 40 returned -5.0% (December: +0.8%) and Germany's DAX's was the only key market which bucked the trend to finish in positive territory for the calendar year with a return of +3.6% (December: +3.2%). Britain became the first Western country to approve the Pfizer vaccine and start mass-vaccinations. At the same time, the European Central Bank boosted its emergency program by 500 billion euros and essentially locked in low interest rates until the pandemic is over. The STOXX50 enjoyed a relief rally in December after the European Union and UK finally reached an agreement on Brexit terms, reaching its highest level since April 2019.

Asia

Despite the economic and humanitarian damage from COVID-19 in 2020, Asian ex-Japan equities ended the year with a gain of 22.5%. The 68% rally from the 23 March bottom (5% gains from this point would match the 2016-18 trough-to-peak rally) which was initially met with extreme scepticism, has increasingly been embraced by investors, especially after the US elections and vaccine progress in November. Unsurprisingly, the strongest performance for the year came from the Healthcare sector (especially in Malaysia and Korea) and other COVID-19 beneficiaries. Strong gains were also seen in the Tech hardware space (5G, laptops and, recently, memory optimism) and the renewables/EV complex (especially after China's carbon neutrality pledge). On the other hand, Property, Energy and Utilities ended the year down. The year also saw record capital raisings and turnover (especially from retail investors) in the region.

The Hang Seng Index was the exception to its major Asian market peers. For the calendar year, it returned a disappointing -0.5% (December: +3.4%), India's BSE SENSEX was up 17.2% (December: +8.2%), Korea's KOSPI rallied 30.8% (December: +10.9%), Japan's Nikkei 225 Index was up 17.8% (December: +3.9%) and the Chinese SSE Composite Index delivered a return of 13.9% (December: +2.4%).

Global equity market performance in December 2020

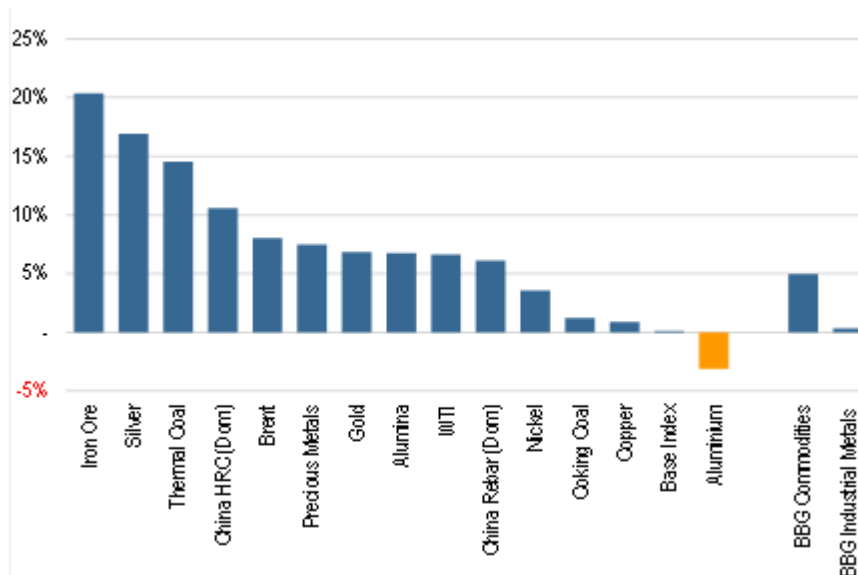


Source: JP Morgan, Bloomberg

Commodities

The CRB commodities index continued its recent strength (up 5% in December). The standout was the 20% rise in the iron ore price, setting all-time highs in Australian dollar terms at over A\$200 per tonne following Vale, Brazil's major iron ore producer, again downgrading its production guidance for CY21. Brent oil rose 8% to US\$51.72/bbl, driven by the OPEC+ decision to limit their previously announced January 2021 supply increase of 2m bpd to a maximum 0.5m bpd and review further increases on a monthly basis. This was premised on the group's concerns over the prospect of reduced demand from new COVID-19 lockdowns. Gold was 7% higher to US\$1898/oz as bond yields rose and the US dollar weakened.

Global commodity performance in December 2020



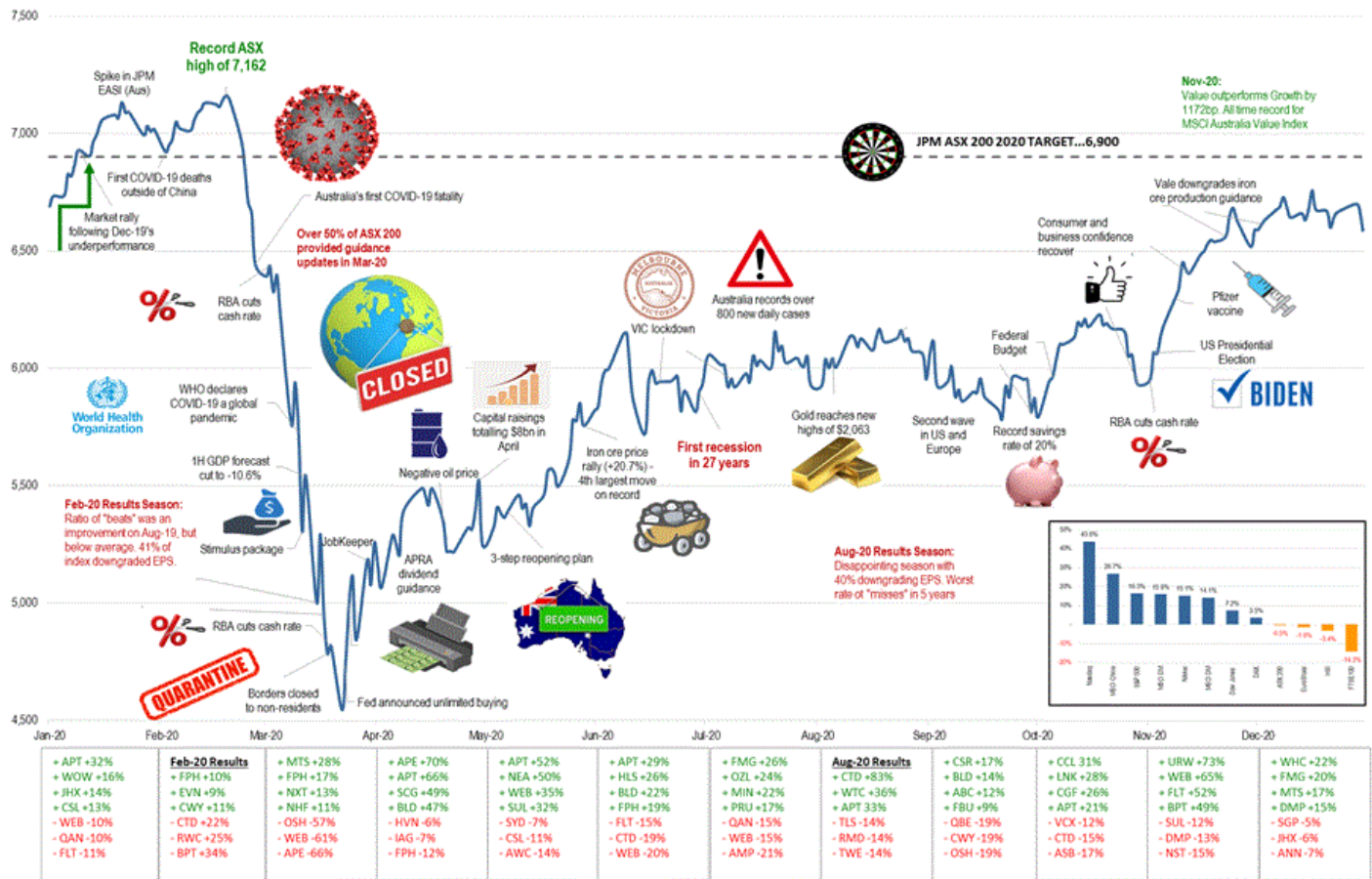
Source: JP Morgan, Bloomberg

Bonds

US 10-year bond yields rose again in December and ended the year at 0.91%, while the Australian 10-year bond yields closed just shy of 1.0%, rising almost 9 basis points. The spread between the US and Australian 10-year has narrowed and expectations of stronger economic growth in the US is likely to push bond yields higher in the US. While official interest rates seemed anchored at historically low levels, it will be interesting to observe just how bond yields fare if the robust forecast global economic recovery eventuates.

Australia

2020 Pictorial Review



Source: JP Morgan

The S&P/ASX 200 Accumulation Index ended the month of December with a return of +1.2% and for the calendar year, up a rather subdued +1.4% to 6,587 points. This is despite key data showing that the economy grew by 3.3% in the September quarter and that it had officially emerged from the recession. The ASX 200 fell 36% peak to trough (and bounced ~50%) as containment measures and social distancing effectively stalled activity. Victoria's second-wave virus experience, marked the inflection of Australia's cycle response and recovery path.

Australia underperformed most global peers in 2020. InfoTech was the clear winner across all major markets.

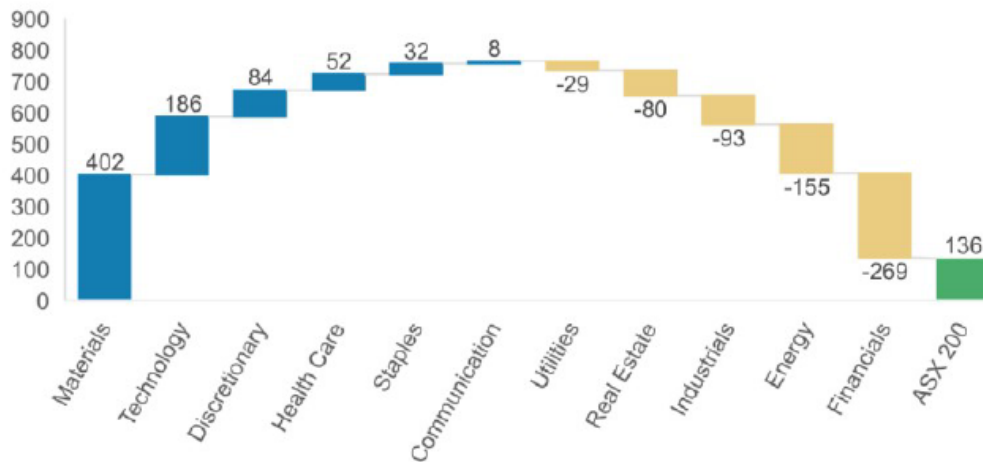
	AUS	ACWI	EM	US	Europe
Index	8.9%	16.8%	18.7%	21.4%	5.9%
Info Tech	67.3%	46.1%	60.9%	46.2%	25.0%
Comms	26.9%	24.1%	27.7%	26.6%	-5.2%
Materials	25.2%	21.5%	25.3%	20.7%	19.9%
Discretionary	19.9%	37.0%	36.8%	50.3%	16.4%
Staples	18.2%	8.8%	11.0%	10.7%	5.7%
Health Care	11.9%	15.4%	52.9%	15.2%	7.6%
Financials	2.8%	-3.2%	-7.8%	-2.0%	-7.5%
Real Estate	2.5%	-5.7%	-16.7%	-2.8%	-3.0%
Industrials	-4.2%	11.8%	5.3%	12.4%	13.5%
Utilities	-12.0%	4.6%	-4.8%	0.2%	22.5%
Energy	-22.7%	-27.7%	-15.0%	-34.0%	-27.4%

Source: MSCI, RIMES, Morgan Stanley Research. Returns showed in US\$ terms

ASX 200 CY2020 Performance Attribution

Fortescue, Afterpay and BHP were the largest contributors to the index return for Calendar 2020

Sector Contribution to Performance (TR)



Source: Bloomberg, Morgan Stanley Research. Performance as at 31/12/2020

The S&P/ASX 200 advanced in December, closing at its highest level since February on December 17th at 6756.7. For the month, the Materials sector was the most significant contributor to the index's performance, adding 1.6%, followed by Information Technology, contributing +0.4% and the Consumer Staples sector contributing +0.1%. Health Care was the worst performer, with a total return of -4.9%, detracting -0.5% from the index's performance.

The best performing sub-index was the ASX 200 Resources Accumulation Index, surging 8.5%, followed by the Small Ordinaries Accumulation Index, +2.8% and the ASX 200 Industrial Accumulation Index, -0.6%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were: CSL (-35 points), Westpac Banking Corporation (-15 points), QBE Insurance Group (-11 points), Cochlear (-11 points) and a2 Milk Company (-9 points).

The top five stocks that made a positive contribution to the index's return were: BHP Group (+69 points), Fortescue Metals Group (+46 points), Commonwealth Bank of Australia (+29 points), Afterpay (+29 points) and Rio Tinto (+25 points).

The AUD was a strong performer in December, rising almost 5% against the USD, and ended the year at 0.77 US cents, helped by the surge in iron ore prices and weakness in the greenback. The AUD, up circa 10% in 2020, recorded its best year in a decade.

Not surprisingly, the RBA left the official cash rate at its historical low level of 0.1% following its meeting in early December.

CONTRIBUTION

Relative Value Gross Contribution -0.71%

Positive		Negative	
BHP BILLITON - BHP BILLITON	0.78%	KAROON GAS AUSTRALIA LTD - SANTOS	-0.77%
RIO TINTO - RIO TINTO	0.36%	CROMWELL PROPERTY GROUP - HOMECO DAILY NEEDS REIT	-0.39%
IOOF - IOOF CALL OPTION	0.29%	AROA BIOSURGERY LTD - POLYNOVO LTD	-0.34%
MERMAID MARINE AUSTRALIA - WORLEYPARSONS	0.13%	SANTOS - SENEX ENERGY LTD	-0.29%
APN INDUSTRIA REIT - PEET	0.05%	INGENIA COMMUNITIES GROUP - LIFESTYLE COMMUNITIES LTD	-0.25%

Special Situations Gross Contribution 1.68%

Positive		Negative	
IMPEDIMED LTD	3.75%	MCPHERSON'S LTD	-1.76%
NUIX LTD	2.72%	SPI FUTURES	-1.10%
KINA SECURITIES LTD	1.03%	LIMEADE INC-CDI	-0.66%
GENUSPLUS GROUP LTD	0.19%	DAMSTRA HOLDINGS LTD	-0.64%
LIBERTY GROUP	0.18%	HARMONEY CORP LTD/NZ	-0.57%

Top 10 Relative Value Positions

KAROON GAS AUSTRALIA LTD - SANTOS
 CHARTER HALL LONG WALE REIT - GROWTHPOINT PROPERTIES
 BHP BILLITON - BHP BILLITON

Top 10 Special Situation Positions

IMPEDIMED LTD	IMDEX LTD
KINA SECURITIES LTD	A2 MILK CO LTD
DAMSTRA HOLDINGS LTD	MONEY3 CORP LTD
BIGTINCAN HLDGS PLACEMENT	ESTIA HEALTH LTD
ATOMOS LTD	AROA BIOSURGERY LTD

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

SYDNEY OFFICE
 Level 11, 179 Elizabeth Street,
 Sydney NSW 2000

Should investors have any questions or queries regarding the Fund,
 please contact our [Investor Relations team](mailto:info@ellerstoncapital.com) on 02 9021 7701 or info@ellerstoncapital.com
 or visit us at <https://ellerstoncapital.com/>

MELBOURNE OFFICE
 Level 4, 75-77 Flinders Lane,
 Melbourne VIC, 3000

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