

# Ellerston Low-Vol Income Strategy Fund

Performance Report | December 20

## PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year p.a.	Since Inception (p.a.)
Net <sup>^</sup>	-0.29	7.84	10.11	0.85	-	7.32
Benchmark*	1.21	13.70	13.20	1.40	-	6.02
Alpha	-1.50	-5.86	-3.09	-0.55	-	1.30

Source: Ellerston Capital

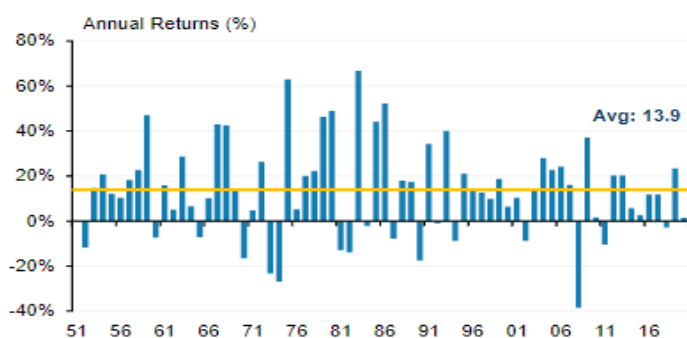
<sup>^</sup> The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

\*S&P/ASX 200 Accumulation Index

## FUND PERFORMANCE & COMMENTARY

CY 2020 will go down as a year dominated by an unprecedented global crisis, followed by an unprecedented global fiscal and monetary response, resulting in a global economy participating in the quickest pace of recession and recovery in history. Markets followed suit with the ASX 200 drawdown of -36% (peak to trough), followed by an even larger recovery of +48%, culminating in a CY20 total return of 1.4%. Over a year of rollercoaster returns from the market, the Fund achieved a 1.9% return on a gross basis vs a 1.4% benchmark return.

**Exhibit 3: A roller-coaster year ended with returns just in positive territory.**



Source: MSCI, RIMES, Morgan Stanley Research

For the month of December, the Fund underperformed its benchmark by 1.5% as the Value rotation into high beta stocks continued. A very strong month for Resources (+8.5%), coupled with a slide in Healthcare (-5.4%) underpinned a third consecutive month of Value outperformance over Growth. The last couple of months of the year were challenging for our low volatility fund strategy.

From a sector perspective, relative underperformance came from our Materials underweight, with no ownership of BHP and Fortescue Metals detracting 1.1% of relative performance. Our underweight in Information Technology (After Pay) also detracted 0.3% of relative performance.

Despite the rally in Value stocks, the PE Ratio differential between Value and Growth stocks is still meaningful. This gap is likely to close further as unprecedented global stimulus and interest rate cuts throughout 2020 leads to more positive company earnings revisions among Value stocks vs Growth stocks. Furthermore, rising long term interest rates will become a far greater headwind for lofty Growth stock valuations in 2021.

### Investment Objective

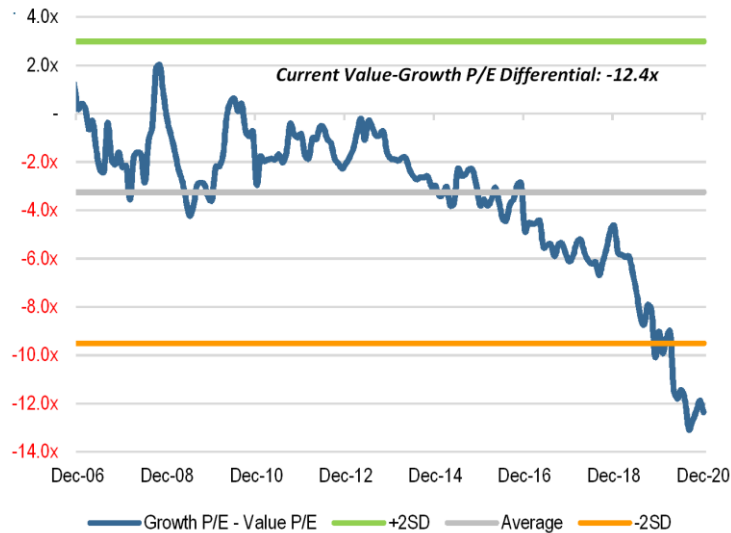
The investment objective of the Ellerston Low Volatility Income Strategy Fund ("ELVIS" or "the Fund") is to provide investors with returns and income growth greater than the S&P/ASX 200 Accumulation Index over rolling 3-5 year periods.

### 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	\$1.1080
Net Asset Value	\$1.1052
Redemption Price	\$1.1024
Liquidity	Monthly
No Stocks	35
Management Fee	0.70%
Performance Fee	10%
Buy/Sell Spread	0.25%/0.25%



Source: JP Morgan

### Portfolio Activity – Major Transactions

During the month, we added Oz Minerals into the portfolio for its high grade copper exposure, highly regarded management team and strong balance sheet. Dividend growth is expected to be in excess of 25% over the next couple of years as strong free cash flow generation has allowed for the funding of ongoing capex whilst keeping company gearing below 5%. It allows the Fund to lift its resource exposure through a high quality company. We also added Liberty Group into the portfolio via an IPO offering. Liberty gives exposure to the rebounding residential property and car market via its provision of consumer loans to customers. The stock was issued at a price of \$6.00 per share on an attractive FY21 pro forma PE multiple of 11.0x and expected dividend yield of 5.1%. The stock is up 30% since listing. We also participated in the Uniti Group placement at \$1.50 per share to fund the acquisition of Telstra’s Velocity business for \$140m. The deal is expected to be highly earnings accretive in FY22.

Finally, we added to our Rio Tinto position based on our view that iron ore prices will remain higher for longer due to supply disruptions from Rio Tinto’s major competitor in Brazil and stronger steel demand out of China.

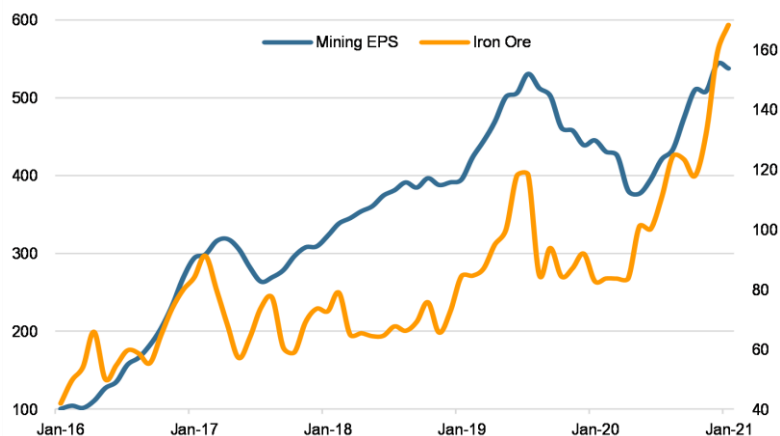
We exited our position in Nine Entertainment following strong gains as the share price approached our valuation and also trimmed our position in Aristocrat Leisure over concerns a rising A\$ will have on earnings growth from their significant US business heading into 2021.

### Markets and Macro News

The US market (S&P 500) ended the year at a record level, rising 18.4%, in response to a) significant fiscal and monetary policy stimulus, b) the near-term roll-out of a vaccine c) improving economic data and corporate profitability and d) the likelihood of a Democrat controlled Senate. US bond yields have bounced off their all-time lows and have just tested the 1.0% level. Congress passed another US\$900bn stimulus deal in late December, but this is likely to be increased to US\$2.0tn under the Biden Presidency.

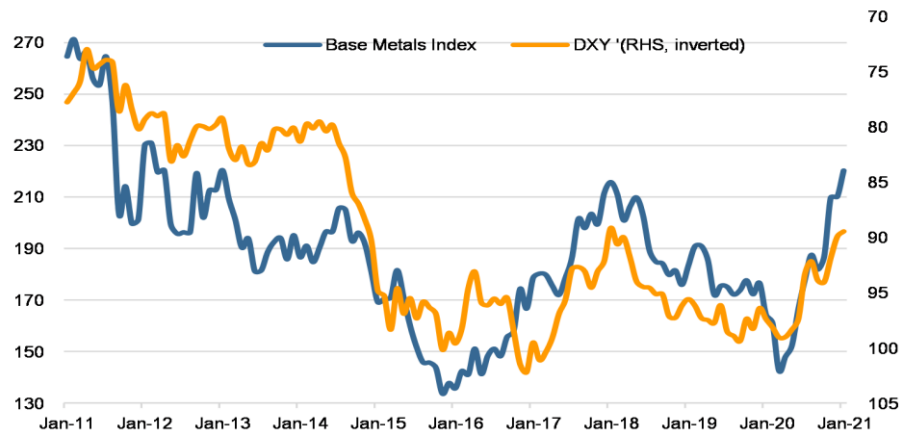
European markets were the laggards in 2020 as the pandemic was never really brought under control, leading to more frequent city and regional shutdowns that crippled the European economy. Conversely, Asia ex Japan markets performed strongly with Korea being the best performing for the year as global manufacturing rebounded strongly.

Commodities continued their recent run with the CRB Commodities Index rising 5% in December. Iron ore was particularly strong, rising 20% to over A\$200 per tonne. This was due to production issues forcing Vale, Brazil’s largest iron ore producer, to cut production guidance for CY21. Oil was also stronger with Brent prices increasing 8% to US\$51.72 per bbl following limited supply increases from OPEC. Finally, gold rose 7% to US\$1,898 per Oz following a rise in US bond yields, now through 1.0%, and further weakening in the USD.

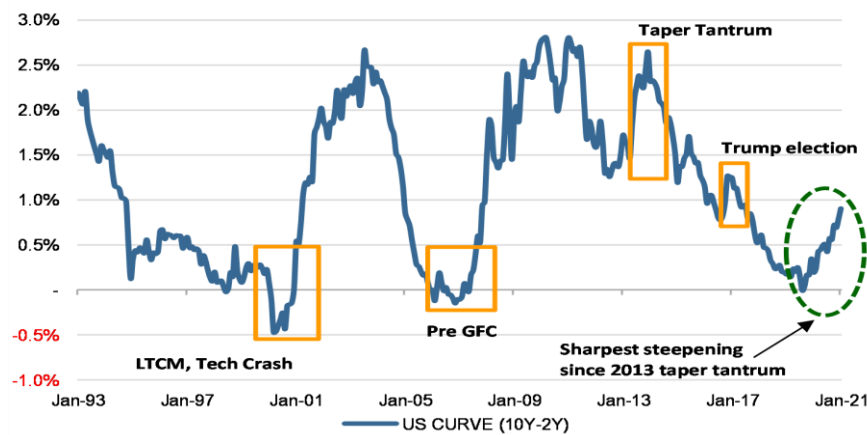


Source: JP Morgan, Bloomberg

Base Metals highly correlated with weakening USD



Source: JP Morgan, Bloomberg



Source: JP Morgan, Bloomberg

In Australia, the Reserve Bank left the official cash rate at 0.1% post its meeting in December. GDP rebounded strongly in September, rising 3.3%, the highest since March quarter 1976. Australian 10 year bond yields rose by 5 basis points to 0.87%. In the US, the bond yield curve continued to steepen, with more expected in H1'21 as the economy continues to recover.

## CONCLUSION

This type of market is the most challenging for the Fund strategy, where high beta, leveraged cyclical stocks have periods of outperformance. The Fund has maintained its Cyclical Yield exposure to its highest level since inception without jeopardising its focus on earnings and dividend quality and growth.

We are still cautious on the market in the near term given a) valuations are looking stretched vs history, b) cash weightings of fund managers are now under historical low levels of 4%, c) global equity offerings of US\$1.1 tn in 2020 were at their highest level since 2009 and d) bond yields continue to rise at a time when the USD continues to weaken.

The beta of the Fund (a measure of volatility) sits at 0.99 vs a market beta of 1.00. The expected FY 21 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 19.8% vs 13.8% respectively. The expected dividend yield of investee companies held within the portfolio is currently 2.9%, 74% franked vs the market dividend yield of 3.0%, 79% franked.

Regards,

Chris Hall - Portfolio Manager, CIO

## PORTFOLIO CHARACTERISTICS

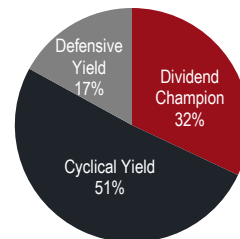
### HOLDINGS

Top 10 holdings	Sector	%
Westpac Banking Corporation	Financials	8.3
CSL Limited	Health Care	5.8
Australia and New Zealand Banking Group	Financials	5.4
Rio Tinto Limited	Materials	5.0
Goodman Group	Real Estate	4.7
Dexus	Real Estate	4.2
Northern Star Resources Ltd	Materials	3.4
Ampol Limited	Energy	3.4
South32 Ltd.	Materials	3.3
QBE Insurance Group Limited	Financials	3.3

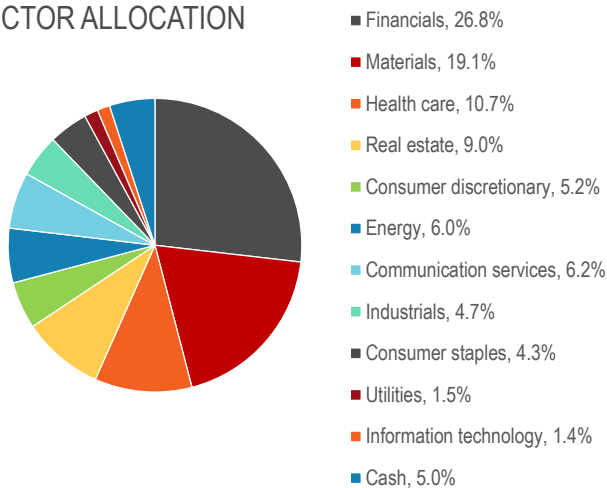
### KEY PORTFOLIO METRICS

FY21(e)	Fund	Benchmark
Price/Earnings (x)	21.8	22.2
Dividend Yield (%)	2.9	3.0
Dividend Growth rate (%)	19.8	13.6
Beta*	0.99	1.00

### PORTFOLIO YIELD EXPOSURE

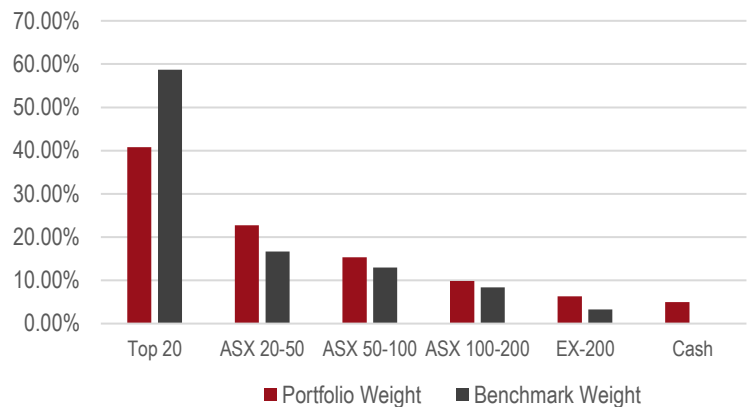


### SECTOR ALLOCATION



Source: Ellerston Capital

### MARKET CAPITALISATION



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

Should investors have any questions or queries regarding the Fund, please contact our **Investor Relations team** on 02 9021 7797 or [info@ellerstoncapital.com](mailto:info@ellerstoncapital.com) or visit us at <https://ellerstoncapital.com/>

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