Ellerston Capital

Ellerston Low-Vol Income Strategy Fund

Performance Report | January 21

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year p.a.	Since Inception (p.a.)
Net^	0.18	6.79	8.18	-3.71	-	7.07
Benchmark*	0.31	11.89	12.99	-3.11	-	5.91
Alpha	-0.13	-5.10	-4.81	-0.60	-	1.16

Source: Ellerston Capital

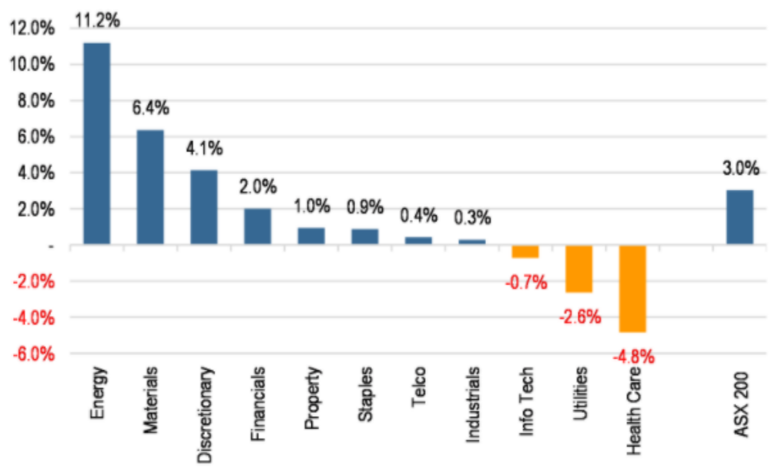
^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

*S&P/ASX 200 Accumulation Index

FUND PERFORMANCE & COMMENTARY

Over the past month we saw a very strong upswing in global earnings expectations, with one year forward consensus earnings for the MSCI All Countries World Index rising 4.1%. Australia is heading into its February reporting season and our expectation is for a strong earnings reporting season highly likely to exceed market expectations. We see Materials and Consumer Discretionary as offering the biggest positive sector earnings surprise. Dividend expectations from corporate Australia also continue to rise due to the ongoing improvement in company balance sheets and strong free cash flow rebound. This has been generated from stronger, recovering economic activity due to very meaningful global and domestic stimulus programs.

Figure 26: ASX 200 GICS DPS Revisions | 1-month ∆



Source: J.P Morgan calculations, Bloomberg Finance L.P.

The Australian market was volatile in January as investors weighed up the hiccups of the vaccine rollout, delays in the US fiscal stimulus, elevated valuations and rising bond yields. For the month of January, the fund performed broadly in line with its benchmark, with a relative performance differentiation of 13 basis points. The ASX 200 (benchmark) rose 31 bps whilst the Fund rose 18 bps, with value stocks continuing their outperformance.

From a sector perspective, relative outperformance came from Healthcare (overweight Sonic Healthcare, underweight CSL), and Industrials (not owning Transurban or Sydney Airport). Sector performance detraction came from Consumer Discretionary.

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

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.

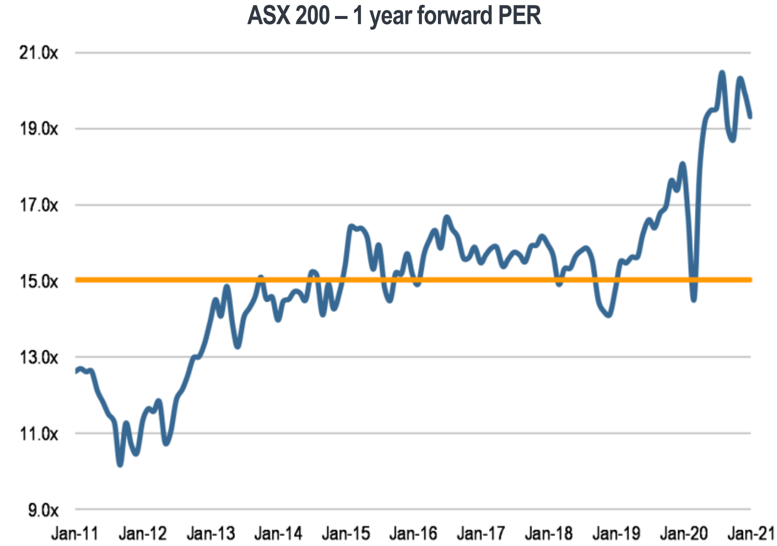
Investment Strategy

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	$1.1101
Net Asset Value	$1.1073
Redemption Price	$1.1045
Liquidity	Monthly
No Stocks	33
Management Fee	0.70%
Performance Fee	10%
Buy/Sell Spread	0.25%/0.25%

interest rates will become a far greater headwind for lofty Growth stock valuations in 2021. One note of caution is that the ASX 200 is trading at a 28% premium to its 10 year average on a 1 year forward PE multiple.



Source: JP Morgan

Portfolio Activity – Major Transactions

During the month, we added ANZ Banking Group and National Bank as it became more apparent that the provisioning for bad and doubtful debts is likely to be extremely excessive, hence supporting future write-backs and a quicker return to paying a more normalised dividend stream. Furthermore, housing loan growth is likely to exceed expectations as house prices recover. Valuations still look undemanding given the earnings upgrade cycle we are expected to see. We also added Sealink Travel to the portfolio on further likely bus contract wins and continued earnings recovery from its ferry businesses as the economies open up.

To fund these purchases we exited Medibank Private as the stock approached our valuation target plus claims inflation indicators are starting to look threatening. We also trimmed our positions in Goodman Group and James Hardie on valuation grounds and further trimmed our position in CSL.

Markets and Macro News

US stocks were weaker in a roller-coaster January. A feature of the month was the trading frenzy and short squeeze in specific stocks coordinated by smaller retail investors on popular platforms like Robinhood and Reddit. Stocks at the centre of social media forums were driven by investors exchanging trading ideas online, resulting in the meteoric rise of previously lesser known small-cap stocks like GameStop and AMC Entertainment. Retail investors relentlessly squeezed hedge fund shorts, causing significant losses in some high profile hedge funds. Time will tell how this battle between professional short sellers and marauding retail speculators plays out, but ultimately, the music must stop.

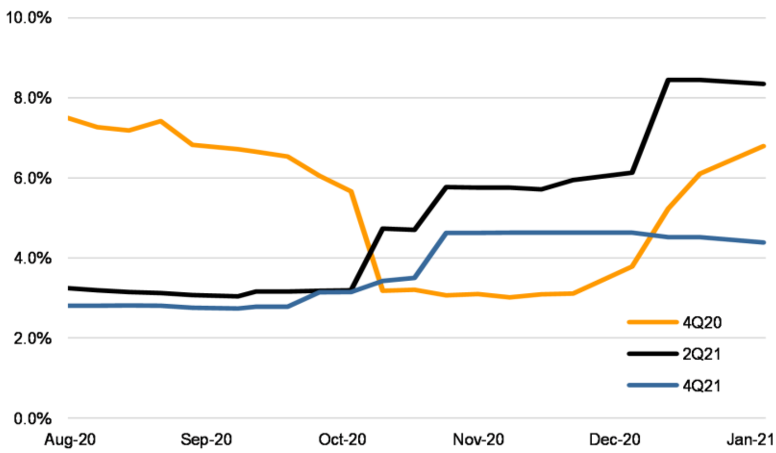
Joe Biden was sworn in as the 46th President of the United States on 20th January and hours later, signed an executive order to reinstate the US to the Paris Agreement on climate change, to which the renewable energy sector reacted positively. The dispute on the size of the US stimulus continued with no agreement reached - Biden pushing for his US$1.9 trillion package without Republican support. On the economic front, overall key US data points improved, with the US manufacturing ISM rising to 60.7 (consensus: 56.8; previous: 57.5) and the US composite services ISM ahead of expectations rising to 57.2 (previous: 56.8).

The Dow Jones ended the month down almost 2%, the S&P 500 was down 1.0% (despite having hit several new record highs), but the Nasdaq Composite Index delivered a positive return of +1.4%. Style performance was undifferentiated and sector leadership revealed no obvious pro or counter-cyclical pattern for the month, but Small caps were the clear outperformer.

Global bond yields moved higher, with the US10 year treasury yield rising 17 bps to 1.09%. The yield curve is at its steepest in 20 years as inflationary expectations continue to move higher. On the commodities front, Brent Oil rose 8% to US$56 per barrel, driven by the Saudi oil supply cut. Iron ore prices had a volatile month, eventually settling at US$158 per tonne. Gold fell 2% to US$1,850 per ounce as the USD moved higher.

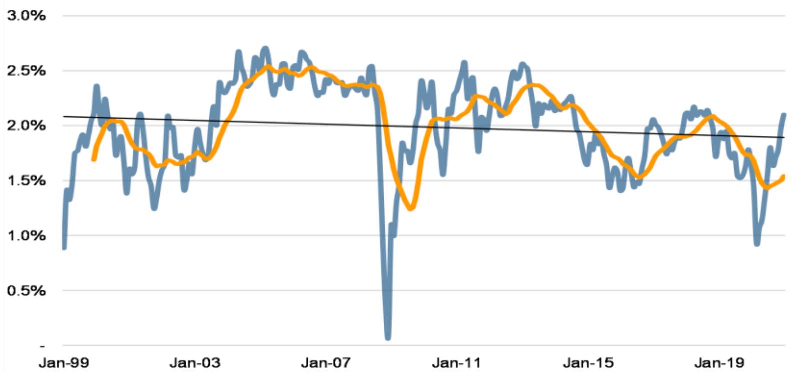
Putting all this together, we expect the acceleration recently seen in global economic growth to begin to normalise as we move through 2021/2022. Earnings growth in the US will moderate off a very high base following a very strong earnings recovery in 2020. We expect inflation expectations to gather momentum as we move through the year. Inflation is initially normally positive for the equity market until an inflection point is reached where interest rates begin to move up faster than expected, thereby slowing economic growth and placing pressure on company valuations.

Global GDP profile – anticipating a bounce in 2Q21



Source: JP Morgan

US 10 Yr Break-evens: Inflation expectations are on the rise. (Orange line is 12m moving average).



Source: JP Morgan, Bloomberg

In Australia, all eyes will be focused on the interim reporting season, which is expected to be relatively strong following significant stimulus programs undertaken globally in 2020. We are expecting earnings upgrades to continue in the short-term (next 3 months). One key focus point will be on company profit margins, particularly around supply chain disruption comments and the trend in cost structures given the rapid rise in commodity (base metals, oil) and freight prices (up 100% in 3 months).

CONCLUSION

The upcoming reporting season in Australia is expected to be very robust, following the recent Q4 US reporting season which saw 65% of companies meaningfully beat market consensus earnings expectations, resulting in 9 of their 11 sectors seeing earnings expectations revised higher. The trend is highly likely to be replicated here, especially in the cyclical part of the market.

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) US junk bond yields are below 4% for the first time in history indicating maximum bullishness and d) Government bond yields continue to rise at a time when the USD continues to weaken.

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 anticipate that bond yields will continue to move higher at a faster rate than being anticipated by the market.

The beta of the fund (a measure of volatility) sits at 0.95 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 27.2% vs 20.8% respectively. The expected dividend yield of investee companies held within the portfolio is currently 3.1%, 74% franked vs the market dividend yield of 3.2%, 78% franked.

Regards,

Chris Hall - Portfolio Manager, CIO

PORTFOLIO CHARACTERISTICS

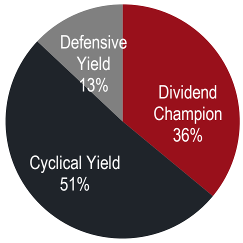
HOLDINGS

Top 10 holdings	Sector	%
Westpac Banking Corporation	Financials	9.6
Australia and New Zealand Banking Group	Financials	7.3
CSL Limited	Health Care	5.2
Rio Tinto Limited	Materials	4.9
Dexus	Real Estate	3.6
Northern Star Resources Ltd	Materials	3.5
Ampol Limited	Energy	3.4
Coles Group Ltd.	Consumer Staples	3.2
Sonic Healthcare Limited	Health Care	3.2
QBE Insurance Group Limited	Financials	3.1

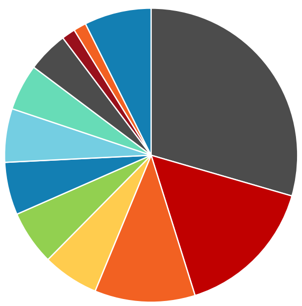
KEY PORTFOLIO METRICS

FY21(e)	Fund	Benchmark
Price/Earnings (x)	20.6	22.1
Dividend Yield (%)	3.1	3.2
Dividend Growth rate (%)	27.2	20.8
Beta*	0.95	1.00

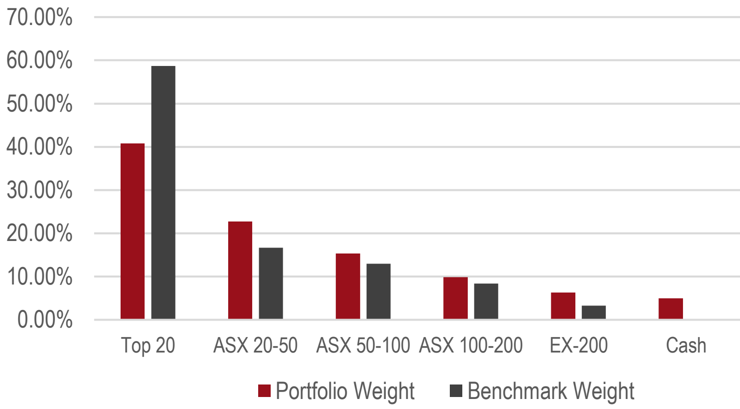
PORTFOLIO YIELD EXPOSURE



SECTOR ALLOCATION



MARKET CAPITALISATION



Source: Ellerston Capital

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, please contact our Investor Relations team on 02 9021 7797 or info@ellerstoncapital.com or visit us at https://ellerstoncapital.com/

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