March, 2021

Ellerston Low-Vol Income Strategy Fund

Performance Report, March 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	$1.1773
Net Asset Value	$1.174
Redemption Price	$1.1715
Liquidity	Monthly
No Stocks	30
Management Fee	0.70% p.a.
Performance Fee	10%
Buy/Sell Spread	0.25% On application 0.25% On redemption
Minimum Investment	$50,000
Minimum Additional Investment	$10,000
Distribution Frequency	Half Yearly (June & December)

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	Since Inception^^ (p.a.)
Net^	2.97	6.25	14.59	35.43	9.75
Benchmark*	2.44	4.26	18.54	37.47	7.52
Alpha	0.53	2.00	-3.95	-2.03	2.23

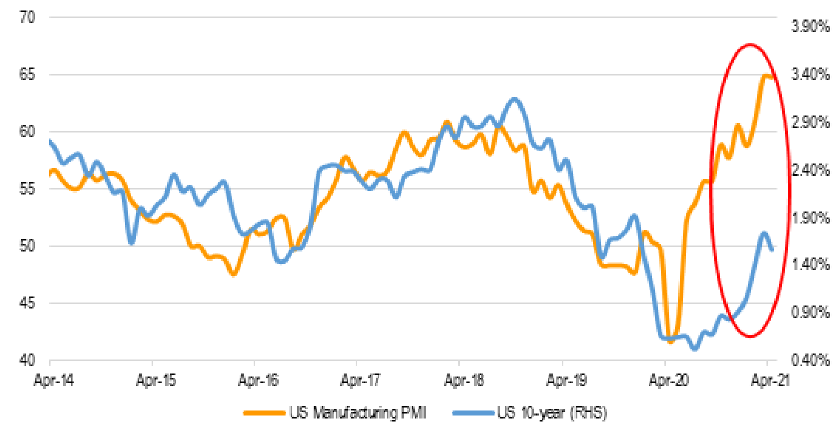
^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

*S&P/ASX 200 Accumulation Index.

Portfolio Commentary

Global equity markets continued to rally in March despite global bond yields continuing their rise. The ASX 200 Index rose 2.4% while Australian 10 year bond yields went against global market trends, retracing 9bps to 1.79%. Interestingly, the ASX 200 Index dropped -0.8% in USD terms. Notably, the gap between US Manufacturing PMI and bond yields still remains wide and needs to be monitored closely as the debate between transitory or structural inflation pressure continues.

US Manufacturing PMI vs US 10 Year Bonds



Source: JP Morgan.

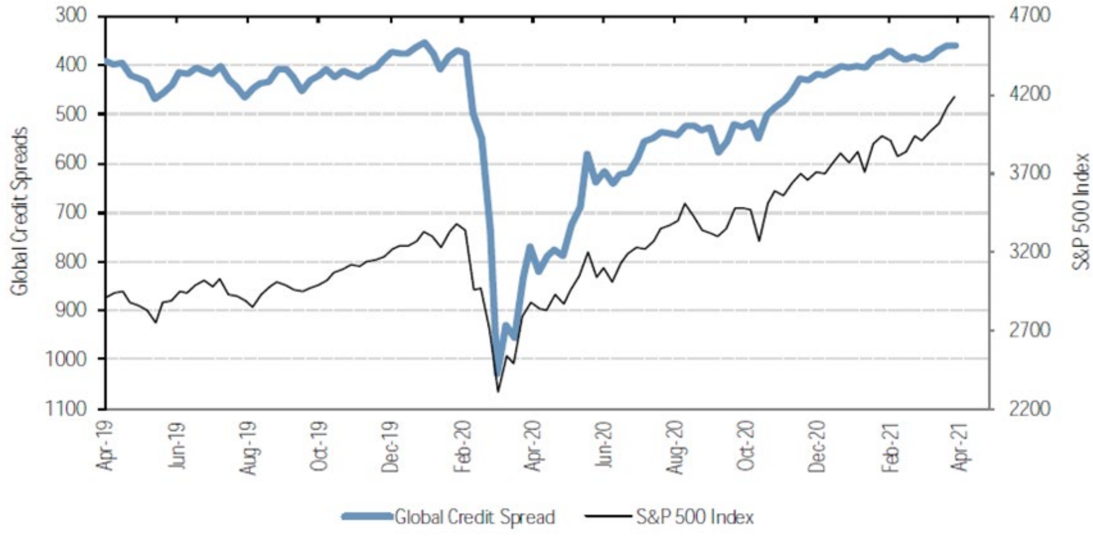
The other challenge is whether equities will be able to tolerate higher yields, with the S&P500 now trading at a 36% premium to its long term average.

S&P500 12m Fwd PER

Source: JP Morgan.

For the market to do that effectively, we will need to see continued earnings upgrades to justify the valuation multiples. One of the other key supporting factors is that despite rising nominal bond yields, credit spreads have continued to tighten. This will continue to give support to the equity market until this dynamic changes.

Chart 1: Global Credit Spreads, weekly 2 years



Source: BAML.

In April, we will head into the Q1'21 US reporting season, with earnings expectations expected to surpass current forecasts. Economic acceleration should be a powerful tailwind this quarter and ensure earnings growth jumps 30% year-on-year off a low base. All eyes will be on corporate profit margins in the wake of rising input costs (commodity / freight prices etc).

Fund Performance & Commentary

The first quarter of the year has been dominated by rising economic growth forecasts, steepening yield curves, rising inflation expectations and surging commodity prices, all of which has favoured value stocks outperforming the market.

For the month of March, the Fund outperformed its benchmark by 53bps on a relative, net basis, achieving a monthly absolute return of 3.0%.

From a sector and stock perspective, relative outperformance came from Consumer Discretionary (overweight Tabcorp, Super Retail, SeaLink & Aristocrat Leisure), Healthcare (overweight Sonic Healthcare, Ansell) and underweight BHP & Fortescue Metals.

Given the meaningful premium the Australian market is trading on relative to its history, the impact of rising interest rates on valuation multiples could be quite pronounced should rates continue their upward trajectory.

Portfolio Activity – Major Transactions

During the month, we added Domino's Pizza Enterprises (DMP) into the portfolio as the stock became oversold on the back of rising bond yields at a time when company fundamentals continue to improve. DMP is in an increasingly strong position as it builds on recent momentum and takes advantage of opportunities in the market. Japan and Europe are set to deliver significant store and earnings growth over the next three years, amounting to 24% and 23% EBITDA CAGR to FY23. Dividend growth will follow the earnings trajectory. We also added Mineral Resources due to the company's growth ambitions over the medium term, including a doubling of mining services volumes, an increase in iron ore shipments to 90Mtpa (vs. 18Mt in FY21), and the conversion of all spodumene produced into lithium hydroxide. Finally, we participated in the Peter Warren Automotive IPO at an offer price of $2.90 per share and CY21 PE ratio of 15.0x. The market cap of the company will be around A$500m with a dividend yield of 4.3%. The stock is scheduled to list in late April.

Some of these purchases were funded by exiting Woodside Petroleum following a strong rebound in the oil price yet growing concerns over the growth outlook and capex program post an impending change in the CEO. We also trimmed our position in Rio Tinto and Oz Minerals following strong share price performance.

Markets and Macro News

Global demand is poised to rotate back towards consumption in the coming quarters as elevated savings rates continue to get redirected into consumer spending. This dynamic, coupled with further fiscal stimulus will see continued upgrades to US GDP as we move through 2021. The big impediment to the trajectory of the economic recovery is a renewed acceleration in COVID-19 infections. Those countries with a slower vaccine rollout, i.e. Italy and Brazil continue to see upward pressure on the virus reproduction rate.

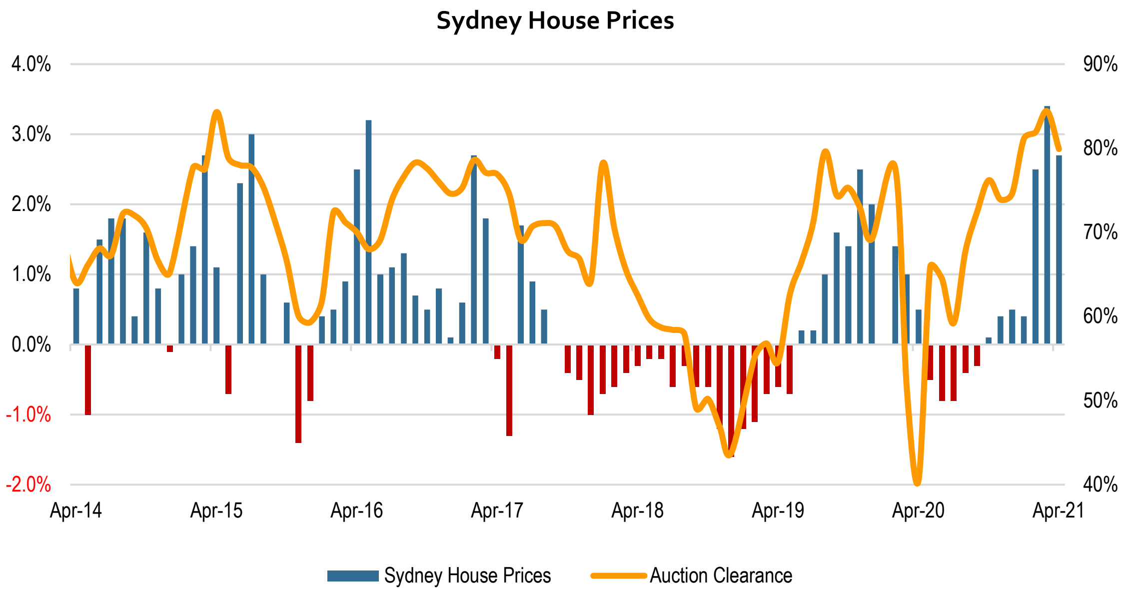
In the US, the FOMC meeting in March saw the Fed keep its accommodative settings in place despite Committee participants revising up their GDP growth outlook from 4.2% to 6.5%, a very significant upgrade. This has been partly driven by continued strong improvement in US payroll numbers, and therefore the rate of decline in unemployment, coupled with a rapid improvement in the ISM Manufacturing Purchasing Managers Index (PMI), which recorded its highest reading in March since 1983. The US market (S&P500) rallied 4.4% and is now beginning to outperform the technology sector (Nasdaq), which rose 0.5%. US bond yields rose 30 bps over the month to 1.74% due to higher inflationary expectations as President Biden's US$1.9tn relief package became law.

China's activity data was mixed as financial conditions show signs of tightening. Total social financing (TSF) moderated in March after a strong rebound in January and February. A contraction in shadow lending was the main reason for this moderation. TSF slowed to 10.6% month on month annualised growth. Credit growth should continue to moderate back to nominal GDP growth levels due to a moderation in government and corporate bond issuance, along with slower loan growth. The broader Chinese SSE Index closed down 4.3%.

The Brent Oil price fell 4% to US$63.54 per barrel on concerns over weaker demand due to further lockdowns in Europe. Iron Ore prices pulled back 6% from record highs to close the month at US$165 a tonne. Gold was down 2% to US$1,707 per ounce due to the rise in bond rates and a slightly higher US Dollar. Base metals were broadly flat, but Nickel prices fell 13% following an announcement by China's Tsingshan that it would significantly lift Nickel output in Indonesia.

Global bond markets reflected better economic prospects, with yields rising. The US 10-year government bond yield rose to 1.74% and Australian 10-year bonds saw a slight decline to 1.79%.

In Australia, we have seen the end of JobKeeper after the Australian Government delivered an unprecedented stimulus in the past year. The program delivered A$83.0bn in wage subsidies to eligible firms over the past 9 months. The impact on employment and utilisation is difficult to gauge post its cessation but will need to be monitored carefully. As in the U.S, economic growth forecasts in Australia have been revised upward in CY'21 from 3.8% to 4.2%. Housing prices continue to surge so all eyes are on the introduction of any potential macro prudential controls, as we have seen in New Zealand, to try and slow the growth rate in house price appreciation.



Source: JP Morgan.

Conclusion

The Australian market continues to move higher following accelerated earnings trends and a belief that any inflationary pressures will be transitory, thereby seeing bond yields begin to fall as inflation expectations moderate.

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 the market to moderately rise further over the next 1-3 months before facing serious headwinds in H2. At this stage, we are not of the view that inflation will be transitory, resulting in bond yields continuing to move higher throughout the year.

The Fund has begun to reduce its Cyclical Yield exposure and rotate more into Dividend Champions as cyclical earnings expectations are likely to see a peak in coming months and these stocks have seen a dramatic recovery in share prices, many back to all-time highs.

The beta of the Fund (a measure of volatility) sits at 0.98 vs a market beta of 1.00. The expected FY 22 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 20.6% and 11.9% respectively. The expected dividend yield of investee companies held within the portfolio is currently 3.3%, 84% franked vs the market dividend yield of 3.7%, 79% franked.

PORTFOLIO CHARACTERISTICS

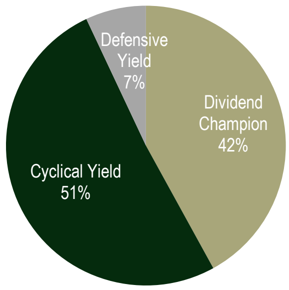
Top 10 Holdings

Westpac Banking Corporation	10.5%
Australia and New Zealand Banking Group Limited	8.2%
National Australia Bank	6.7%
Aristocrat Leisure	4.6%
Woolworths	4.4%
CSL Limited	4.1%
Peter Warren Automotive	3.9%
Sonic Healthcare Limited	3.9%
Tabcorp	3.8%
Rio Tinto	3.5%

KEY PORTFOLIO METRICS

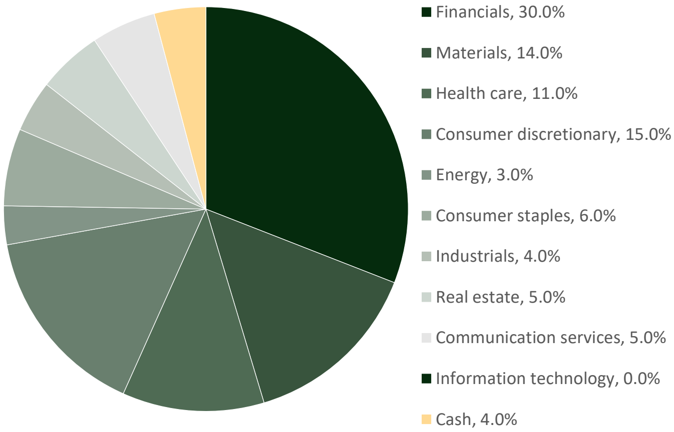
FY22(e)	Fund	Benchmark
Price/Earnings (x)	18.3	18.8
Dividend Yield (%)	3.3	3.7
Dividend Growth rate (%)	20.6	11.9
Beta*	0.98	1.00

PORTFOLIO YIELD EXPOSURE

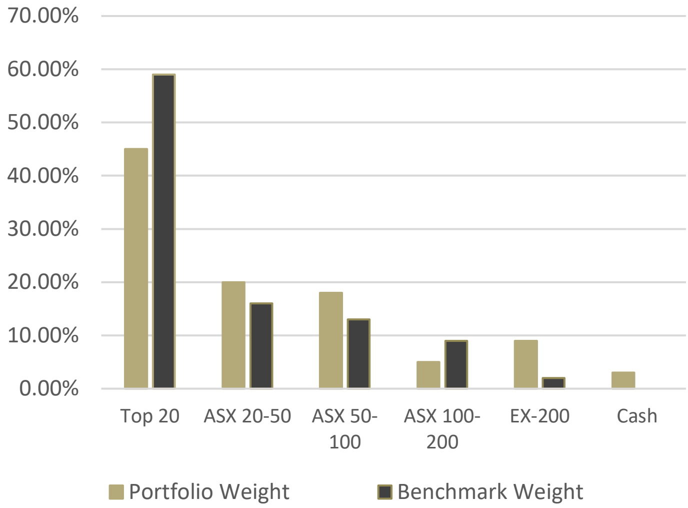


Source: Ellerston Capital.

SECTOR ALLOCATION



MARKET CAPITALISATION



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Find out more

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