April, 2021

Ellerston Low-Vol Income Strategy Fund

Monthly Newsletter, April 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	$1.2360
Net Asset Value	$1.2329
Redemption Price	$1.2298
Liquidity	Monthly
No Stocks	31
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)

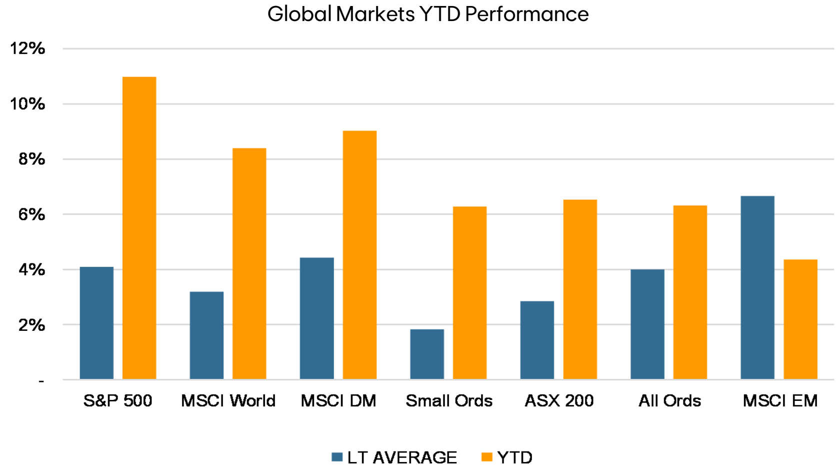
Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	Since Inception (p.a.)^^
Net^	4.98%	11.34%	18.90%	32.45%	12.02%
Benchmark*	3.47%	7.54%	20.33%	30.76%	9.05%
Alpha	1.51%	3.80%	-1.43%	1.69%	2.97%

^ 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.

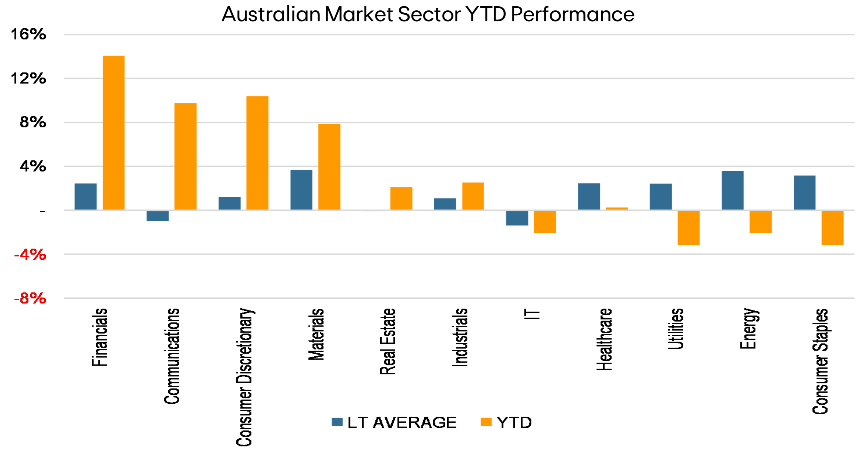
Portfolio Commentary

Equity markets globally have experienced a very solid start to the year, with the MSCI All World gaining 9.0%, well above the 3.2% long term average of the first four months of the year since 1990. In Australia, it has been the same experience with the local market rising over 7.6% year to date.



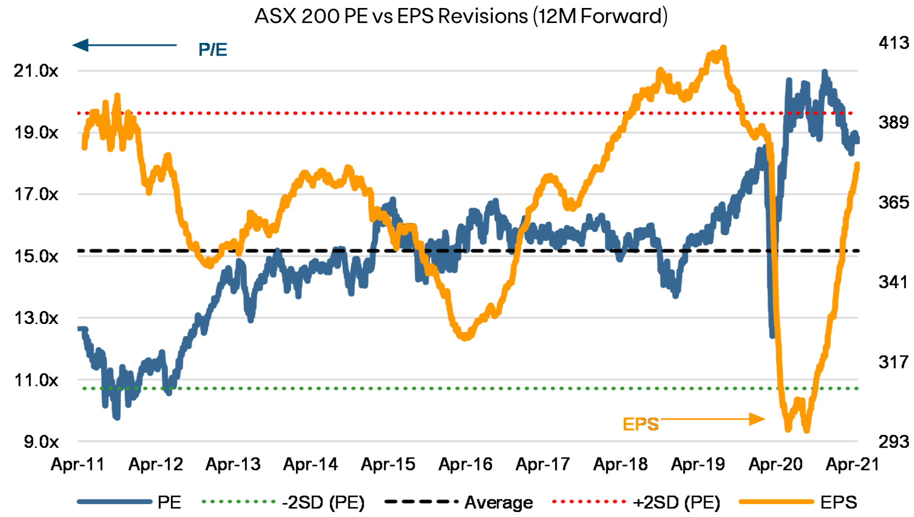
Source: JP Morgan.

We have also seen significant variance at the sector level in Australia, with Financials rising 15.7% and Materials 10.1% respectively. This is well above their long-term average return for the first four months of the year. Conversely, Healthcare and Information Technology sectors have struggled as rising bond yields continue to place pressure on growth stock valuations.



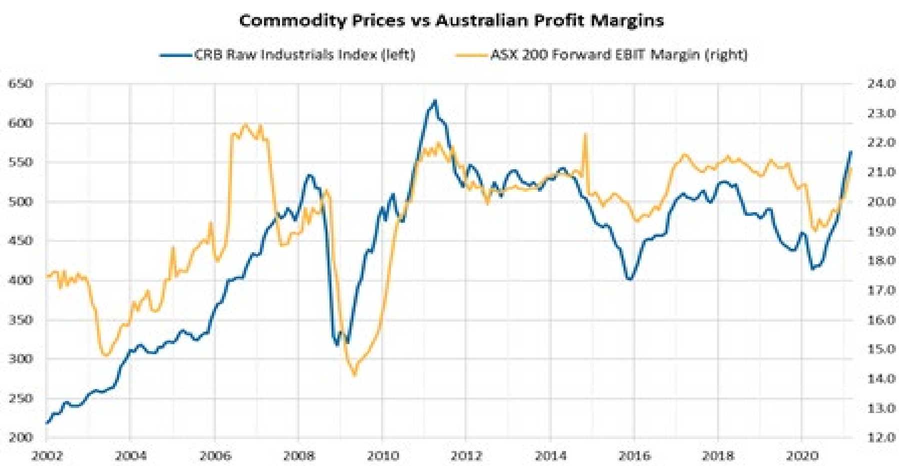
Source: JP Morgan.

Over the past few months, earnings growth in Australia has continued to accelerate as stronger levels of economic growth drive commodity prices meaningfully higher (Materials & Energy) whilst rising bond yields and robust consumer spending (Financials & Consumer Discretionary) drive continued earnings upgrades from lower bad & doubtful debt charges and an insatiable demand for retail products. The reality is that the earnings recovery has been broadly based with just under 70% of the ASX 200 companies in upgrade mode. Notably, the PE valuation multiple has seen a 10% contraction as bond yields rise. However, continued positive earnings revisions have more than offset this valuation headwind to date.



Source: JP Morgan.

The strong move upward in commodity prices has many investors asking what happens to company profit margins going forward. At an aggregate level profit margins tend to rise with commodity prices as the increase in both is usually driven by an improving cycle.



Source: Macquarie Capital.

In April, we saw the bulk of S&P500 companies in the US report Q1 earnings. The reporting season was significantly above expectations with around 80% of companies beating earnings forecasts. Notably, share prices barely moved, indicating the level of earnings optimism already priced into the share market. Despite such a robust reporting period, company share prices fell by an average of 0.5% the day they reported their results.

Fund Performance & Commentary

The first four months 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 April, the Fund outperformed its benchmark by 151 bps on a relative, net basis, achieving a monthly absolute return of 4.98%.

From a sector and stock perspective, relative outperformance came from Consumer Discretionary (overweight Peter Warren Auto, Aristocrat Leisure & Domino's Pizza), Energy (underweight Woodside Petroleum & Origin Energy) and Communication Services (Overweight Uniti Wireless).

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 ASX Limited back into the portfolio on valuation grounds and its more defensive earnings stream as we begin to reduce the cyclicality in the portfolio following strong outperformance from this part of the market. ASX saw a meaningful price decline over the past several months and is now trading on a relative price earnings ratio at the low end of its long-term trading range. The stock is trading on a 3.5% fully franked dividend yield with 5-7% medium term compound DPS growth. We also increased our weighting in Dexus Property as fears of the demise in quality office properties seems overstated.

To fund these transactions, we reduced our holding in QBE Insurance Group and Westpac Banking Group after recent price appreciation.

Markets and Macro News

The ASX 200 rose by 3.5% in April, underperforming the MSCI World Developed World Index increase of 4.7%. Emerging markets index lagged, with an increase of 2.5%. Locally, best sector returns came from REIT's, Communication Services and IT, with Energy, Industrials and Utilities being the laggards.

Global bond yields retraced, with the US 10 year government bond yield falling 10 bps to 1.63%. Australian bond yields followed the U.S, with 10 year bonds also falling 10 bps to 1.69%. The US Dollar stayed relatively flat in April, with the AUD appreciating marginally against the USD.

Commodity prices rose US$1.12 per barrel to US$67.25, driven by the reflation trade and stronger global demand. Iron ore prices surged to US$187.00/Mt, almost a record, as supply side disruptions in Brazil stimulated price gains.

Overall global COVID-19 cases passed 150 million in April, driven by a rapid surge in cases in India. Globally, daily cases increased significantly to around 800,000 on 30th April, 2021. USA still significantly leads global cases, followed by a rampant India, then Brazil. On the 27th April, Australia closed all passenger air travel with India until 15th May. Importantly, the global vaccine supply chain has been put under tremendous pressure due to the rising COVID-19 cases in India.

US February activity indicators were released during April and were mixed. The manufacturing ISM rose to 64.7, surpassing expectations of 65.0 yet non-farm payrolls were below expectations, with a reading of 916,000 and subsequent unemployment rate of 6.0%. February retail sales & housing starts were also below consensus due to the big winter chill and continued supply chain disruptions.

China's economic data was also mixed with the March Caixin manufacturing PMI reading of 50.6, below expectations of 51.4. Conversely, February CPI came in better than expectations at -0.2% year on year.

In Australia, dwelling prices continued to boom in April, rising 1.7% for the month. This followed the strongest increase in March since 1988, taking the yearly price lift to 7.8%. Regional areas continue to be achieving the strongest results and housing is outperforming apartment price growth. Consequently, we have seen a decent pickup in private credit growth, especially housing credit which is up 4.1% over the past 12 months. March retail sales fell -0.8% month on month with the unemployment rate also declining further to 5.6%. The Federal Budget will be released later in May, with fiscal stimulus likely to run at $40 billion (or 2% of GDP) until the unemployment rate falls below 5%.

The Fund continued 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. We have moderated our overweight position in Value stocks as a result of this and have increased exposure to Quality stocks.

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 16.1% and 11.7% respectively. The expected dividend yield of investee companies held within the portfolio is currently 3.4%, 84% franked vs the market dividend yield of 3.8%, 79% franked.

Portfolio Characteristics

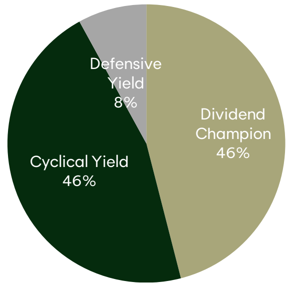
TOP 10 HOLDINGS

Australia and New Zealand Banking Group Limited	8.0%
Westpac Banking Corporation	7.9%
National Australia Bank	6.6%
Aristocrat Leisure Limited	4.7%
Woolworths	4.0%
CSL Limited	4.0%
Tabcorp	3.8%
Sonic Healthcare Limited	3.8%
Rio Tinto Limited	3.6%
Peter Warren Automotive	3.6%

KEY PORTFOLIO METRICS

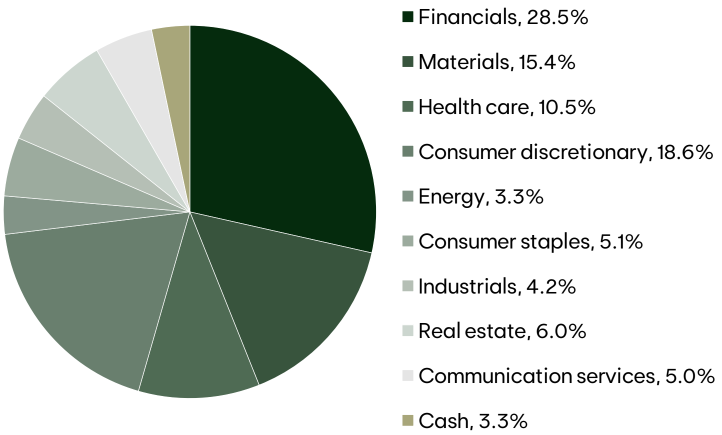
FY22(e)	Fund	Benchmark
Price/Earnings (x)	17.9	18.1
Dividend Yield (%)	3.4	3.8
Dividend Growth rate (%)	16.1	11.7
Beta*	0.98	1.00

PORTFOLIO YIELD EXPOSURE



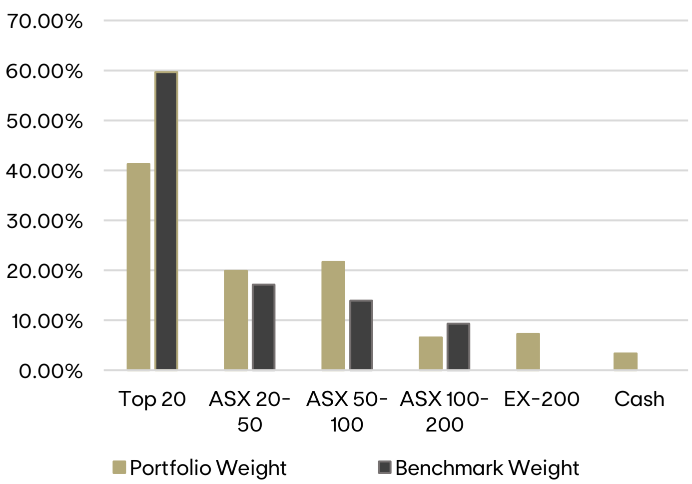
Source: Ellerston Capital.

SECTOR ALLOCATION



Source: Ellerston Capital.

MARKET CAPITALISATION



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Find out more

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Should investors have any questions or queries regarding the Fund, please contact our Investor Relations team on **02 9021 7701** or info@ellerstoncapital.com
Or visit us at ellerstoncapital.com

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