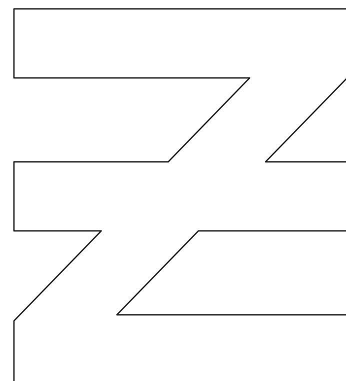


Ellerston Australian Share Fund (ASF)

Monthly Newsletter, May 2021

Investment Objective
The Investment objective for the Ellerston Australian Share Fund is to outperform the S&P/ASX 200 Accumulation Index (Benchmark).

Investment Strategy
The Fund uses a benchmark-independent, high conviction approach that looks beyond investing in the Top 20 stocks in order to capture the neglected opportunities created by under-researched stocks in the broader Australian market.

Key Information

Strategy Inception*	1 April 2009
Portfolio Manager	Chris Kourtis
Application Price	$1.0960
Net Asset Value	$1.0933
Redemption Price	$1.0906
Liquidity	Daily
No Stocks	21
Management Fee	0.90% p.a.
Performance Fee	15%
Buy/Sell Spread	0.25% on application 0.25% on redemption

Net (%)	1 Month	3 Months	6 Months	FYTD	Rolling 12 Months	5 Year (p.a.)	10 Year (p.a.)	Since Inception (p.a)*
ASF	3.82	12.50	14.71	33.10	29.20	7.37	7.56	8.91
Benchmark	2.34	8.48	11.74	24.98	28.23	10.11	8.68	10.27

Past performance is not a reliable indicator of future performance.

MARKET OVERVIEW

Stocks notched their fourth straight monthly advance, as key data signalling prospects for a sustained rebound of the world's largest economy, outweighed inflation worries. Investors focused on the prospect of higher government spending to boost growth. Inflation has certainly been a contentious topic for investors and economists alike, with some observers arguing that price increases are transitory and others, more anxious about elevated costs in the longer-term.

USA

The S&P 500 ended at a record monthly close, while the Russell 2000 of small caps posted its eighth consecutive month of gains - the longest run since 1995. The personal consumption expenditure core-price gauge (PCE) rose 3.1%, the most in two decades. The perception that the latest figures won't be enough to prompt any change in policy by Federal Reserve officials also helped sentiment. President Joe Biden issued his first full budget proposal, detailing his ambitions to expand the size and scope of the federal government, with more than USD$6 trillion in spending over the coming fiscal year. The Dow Jones Industrial Index ended the month up 2.2%, the S&P 500 was up 0.7% and the Nasdaq Composite Index bucked the trend by posting a negative return of -1.4%, after its previous solid month. Despite the strong economic data, the US bond market was well behaved, embracing the Fed's "transitory inflation" view, with the US 10-year bond yield slightly lower at 1.58% from 1.63%.

Bitcoin was in freefall during the month after a fresh warning from Chinese officials over cracking down on cryptocurrencies. The largest digital currency fell almost 40% in May, falling 50% from its April high of over US$60k to its 24th May low, before recovering ~8% to finish closer to US$34k. The sour stretch started with Musk suspending acceptance of Bitcoin payments at Tesla Inc. and trading barbs with boosters of the cryptocurrency on Twitter. China's central bank added to the downdraft with a statement warning against using virtual currencies. Later, it emerged the US may require crypto transactions of USD$10,000 or more to be reported to tax authorities. Musk's actions showed how a few tweets can still usurp the entire crypto market. Even more so, the past few weeks have renewed the regulatory debate and potential threat on the crypto market.

Europe

European markets continued their upward momentum, buoyed by supportive growth indicators, reduced COVID-19 cases and the ongoing vaccination roll out. Global COVID-19 daily case numbers fell from ~800,000 to 470,000 and vaccination levels reached 1.87bn globally. Activity indicators were also stronger, with the May Flash Eurozone Composite PMI sharply higher at 56.9 (53.8 previously), a 39 month high.

The Euro STOXX 50 Index finished the month up 2.3%. Among the major exchanges, France's CAC 40 was up 3.7%, whilst Germany's DAX lagged, up 1.9%. The market was led higher by Energy, Financials and Materials stocks. The UK's FTSE 100 closed up 1.1%.

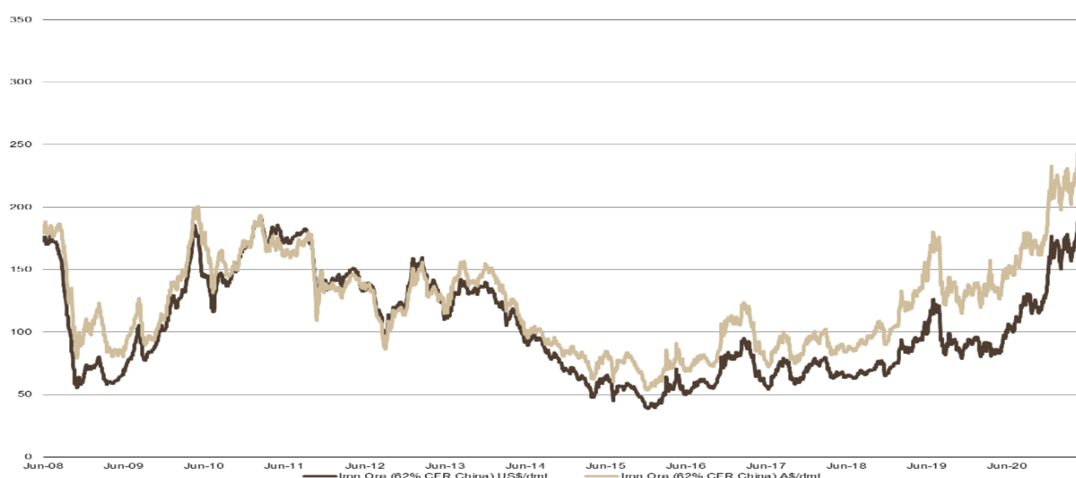
Asia

Asian equity markets were stronger. The Hang Seng Index returned 2.1%, Korea's KOPSI delivered a positive return of 1.8%, and the Nikkei 225 was only up 0.2%. The broader Chinese SSE Index was very strong, closing up 4.7%.

Commodities

The Iron Ore benchmark price reached another record high of US$238 (A$304) per tonne post the Chinese labour day holidays early in the month, before closing at US$199 per tonne, 5% higher than April. Iron ore prices retreated 16% from the record high after Chinese authorities released a five year plan to reduce iron ore imports (from key suppliers like Australia), especially non-Chinese equity owned imports. The Brent oil price rose 3% to US$69 per barrel on stronger demand and expectations OPEC would remain disciplined and stick to its previously stated production increases. Gold posted its largest monthly gain since July 2020 of 8% to US$1,907 per ounce, as the US dollar headed for a second month of decline and inflationary expectations were re-ignited. Base metals were also particularly strong, with copper prices up 4% and both Aluminium and nickel prices up 2%.

Record Iron Ore Benchmark Price in US$ and A$ per tonne



Source: UBS.

Bonds

Global bond markets were well behaved during the month despite stronger economic key data. The US 10-year government bond yield fell 5 bps to 1.58% and Australian 10-year bond saw a modest 6 point decline to 1.63%.

Australia

Australian shares extended the monthly run of gains to eight months in May, the longest stretch in 14 years, despite a mild dip on the last day of the month as the Melbourne COVID-19 outbreak spread and shares in tech group Nuix tumbled, again.

The S&P/ASX 200 Accumulation Index had another strong month (+2.3%), reflecting the robust outlook for the Australian economy as consumer confidence recovered and output picked up, helped along by the big-spending Federal budget announced earlier in the month (see our budget takeaway in the Summary and Outlook section). Persistent low interest rates (which have nudged higher), have also fuelled the recovery fire, boosting the market return for the financial year-to-date to a credible 25.0%.

For the month, the Financials sector (led by CBA) was the most significant contributor to the Index's performance, adding 173 basis points, followed by Materials, contributing 31 basis points and Consumer Discretionary contributing 28 basis points. The bottom three contributing sectors were Information Technology (-0.4%), Utilities (-0.1%) and Industrials (-0.1%) respectively.

The best performing sub-index was the ASX 200 Industrials Index, up 2.6%, followed by the ASX 200 A-REIT Index up 1.7%, with the underperformer being the Small Ordinaries Accumulation Index, up 0.3%, reversing recent outperformance.

The top five stocks that detracted from the index's performance were: Afterpay (-30 points), Macquarie Group (-9 points), a2 Milk Company (-6 points), Xero (-6 points), and Woodside Petroleum (-5 points).

The top five stocks that made a positive contribution to the index's return were: Commonwealth Bank (+98 points), CSL (+45 points), Westpac (+38 points), National Australia Bank (+15 points) and Woolworths (+15 points).

The AUD was flat at 77 US cents, despite the US dollar being slightly weaker.

COMPANY SPECIFIC NEWS

The Market Hits

Resolute Mining (RSG +25.8%) / Gold Road Resources (GOR +20.7%) / Perseus Mining (PRU +18.4%) /Evolution Mining (EVN +16.8%) / Ramelius Resources (RMS+15.9%) / Silver Lake Resources (SLR +15.2%)

The gold sector was up an impressive 10%, in line with the rise in bullion prices. The yellow precious metal posted its largest monthly gain since July 2020, as the US dollar headed for a second month of decline and growing inflationary pressures were front and centre on investors' minds. This resulted in a number of higher cost producers outperforming the sector, given their higher gold price operating leverage.

Whitehaven Coal (WHC +23.0%)

WHC was a beneficiary of the 27% spike in thermal coal prices, as strong China demand and supply issues in Mongolia and Indonesia pushed up prices dramatically, notwithstanding the efforts of Chinese regulators to reign prices in. Late in the month, the Federal Court dismissed proceedings trying to stop the approvals for the company's Vickery extension project. The Vickery extension project has been stalled for many years, so the decision was taken very positively by investors in this bombed out sector.

ALS (ALQ +17.5%)

ALQ delivered a solid FY21 EBIT result of $301.4m and a NPAT figure of $185.9m, beating analyst expectations (with a significant improvement in the second half). With positive momentum continuing into the new year, especially in the geochemistry/commodities business, broker upgrades followed, driving the share price up appreciably.

Treasury Wine Estates (TWE +15.9%)

TWE's investor day was well received as the company outlined its plans to grow volumes and margins post the China lock out. Its guidance for FY21 EBIT-S of $495m to $515m was ahead of consensus, further calming investor nerves.

Corporate Travel (CTD +12.7%)

CTD was assisted by a few brokers upgrades during the month as well as the fast roll-out of the COVID-19 vaccine in two of its biggest markets, the US and UK.

Commonwealth Bank (CBA +12.0%)

After significantly lagging the other major banks by ~25% during the "recovery" phase over the past 13 months to April 2021, CBA performed very strongly in the month of May post its 3Q21 trading update, as investors weighed up the interplay between leverage to recovery and bank-specific operating performance. CBA's Q321 Cash NPAT of $2.4bn was a solid beat (up 24% from the 1H21 quarterly average), mainly driven by lower loan impairments, above system core volume growth and improved margins. CBA's balance sheet remains strong, with provision coverage and a CET1 capital ratio of 12.7%, standing at the top end of it's peer group. CBA's retail banking track record over the past 15 years has been excellent, but it now also looks to be winning share in business banking (where its business lending grew at an impressive >3.0x system). Investors are hopeful that the positive momentum of above-system volume growth, sound margin management and a reversion to its long-held strategy of managing for positive 'jaws' continues and acts as the key driver of pre-provision profit growth, turning it positive for the first time since FY17. The shares closed a whisker under $100, at $99.72.

The Market Misses

EML Payments (EML -41.9%)

The Central Bank of Ireland (CBI) raised "significant regulatory concerns" in relation to EML's European (ex. UK) Prepaid Card Services business which accounts for 27% of EML's group revenue. The concerns relate to EML's Anti-Money Laundering (AML) / Counter Terrorism Financing (CTF) risk and control frameworks/governance. Clearly this creates a high degree of uncertainty around the stock. The worst case is the license could be revoked, which would not only materially impact current earnings, but also the future growth potential of the business. Investors voted with their feet and await the outcome of the CBI's review.

Perenti Global (PRN - 38.5%)

Mining services company PRN, took a hit after issuing a shock earnings downgrade, warning of rising labour costs in the super heated Western Australian mining sector which threatens the company's outlook for the next 18 months.

Nuix (NXL -33.1%)

NXL, the software company specialising in intelligence solutions, issued yet another downgrade - the fourth since listing in December 2020! FY21 revenue is now $173-182m (versus $180-185m guidance on 21 April) and annualised contract of value is guided to between $165-172m (versus prior $168-177m). Pro forma EBITDA of $64.6-66.6m (unchanged from April) offered no comfort. The update pointed out the expected timing of closure of some upsell opportunities and new potential customers. Also, management highlighted that their "revised forecasts were susceptible to a number of risk factors"....caveat emptor!

Costa Group (CGC -27.0%)

CGC provided an unexpectedly weak AGM update citing that 1H21 EBITDA-S will only be "marginally better" than the 1H20, materially below consensus for a ~25% lift. CGC blamed the miss on labour supply shortages in mushrooms, oversupply and pricing pressure across tomatoes and avocadoes plus hail damage and fruit fly costs in citrus as the key reasons. These were only partially offset by growth in their core international and berry businesses. Guidance was particularly disappointing in the context of: 1) >$20m of COVID-19 / drought costs in the pcp; 2) the new Monarto facility in South Australia with >$0.50/kg of efficiencies expected; 3) growth in berry plantings, the cycling of bushfire and crumbly berry in the pcp; and 4) citrus is supposed to be an "on year" in terms of yield and new hectares. Material sell side downgrades immediately followed, leaving investors questioning execution risk and management red faced.

A2 Milk Company (A2M -23.5%)

A2M have dished out their fourth earnings downgrade in a matter of months, which saw their market capitalisation decline $690 million on the day. This follows the company's announcement that inventory levels in the daigou channel are too high, as the aging of its perishable baby formula products is becoming an increasing problem. This resulted in A2M taking a $NZ80 million to $NZ90 million stock provision, bringing the total to $NZ103 million this year. The company is now targeting full-year revenue of between $NZ1.2 billion to $NZ1.25 billion, compared with prior lowered expectations of about $NZ1.4 billion.

Monodelphous Group (MND -22.5%)

Mining, energy and infrastructure engineering company MND, was negatively impacted by Perenti Global's earnings downgrade during the month, highlighting the rising labour costs and shortage in Western Australia's mining sector.

Afterpay (APT -21.1%)

No announcements from the company or note which explains its underperformance for the month. In fact, it has fallen 40% from its high in February just before the company issued $1.5bn in zero coupon convertible notes, used to acquire more of the equity in APT US and acquire US staff equity. At the time, local management also sold down further equity in the company. Recent concern has been the notch up in competition, particularly the entry of CBA into the BNPL arena two months ago, with its offering that will allow up to 4 million of its retail customers to pay in four instalments, in the biggest competitive response by a major bank to the buy now, pay later phenomenon. CBA said it will undercut APT on merchant fees by not charging retailers anything more than their current card transaction fees to accept the instalment payments. It also said it would conduct credit bureau checks on customers - which APT refuses to do - to ensure the deferred payments are suitable for customers. CBA said merchants won't pay any more than standard card fees, distinguishing itself from APT, which charges merchants around 4 per cent of the costs of goods sold. The cost of accepting a CBA BNPL will be around 1.4 per cent.

NRW Holdings (NWH -17.0%)

Mining services company NRW, was also tainted with the same brush as MND after Perenti Global's earnings downgrade, with the future outlook uncertain given the rising labour costs in WA's mining sector.

Fisher & Paykel Healthcare Corporation (FPH -16.9%)

Despite selling 5-plus years' worth of hospital hardware in FY21, fuelled by a surge in COVID-19 related demand, FPH reported FY21 results shy of market expectations. The company reported NPAT of A$525m, 6% below consensus and missed revenue expectations by 5%. Management noted slower growth during the March quarter as the COVID-19 sales boost faded and did not provide guidance given the uncertainty and volatility in their earnings. Demand has been largely tracking COVID-19 hospitalization rates and in countries experiencing declining hospitalizations, there is a lack of evidence to support the sustainability in the utilization rates of the company's hospital hardware and consumables, outside of ICU/COVID-19 situations, leaving the trajectory of FPH earnings unclear.

Redbubble (RBL -16.3%)

Creative online marketplace company, RBL continued to drift lower post its April trading update which saw Q3 revenues down 50% versus Q2 and EBITDA of $2m compared to $23m in Q2, the result of a step change in marketing costs.

FUND PERFORMANCE

Pleasingly, once again the Fund outperformed in a strong month for global equity markets.

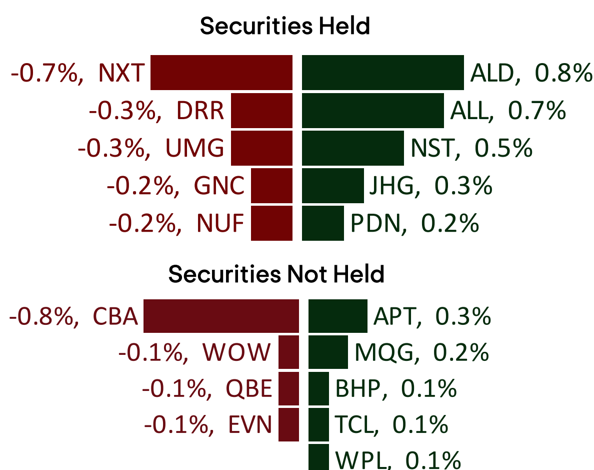
The Fund was able to fully capture the upside, with a solid return of 3.90%, outpacing the benchmark return of 2.34%. This brings the return for the 2021 FYTD to a solid 34.44%, outperforming the benchmark return of 24.98%.

The return for rolling year is now 30.62%.

Returns[1] (%)	*Gross*	*Benchmark**	*Excess*	*Net*
1 Month	3.90	2.34	1.56	3.82
3 Month	12.80	8.48	4.32	12.50
6 Month	15.34	11.74	3.60	14.71
FYTD	34.44	24.98	9.46	33.10
Rolling 12 Months	30.62	28.23	2.39	29.20
5 Years (p.a.)	8.52	10.11	-1.59	7.37
10 Years (p.a.)	8.61	8.68	-0.07	7.56
Since Inception (p.a.)	10.09	10.27	-0.18	8.91

Past performance is not a reliable indicator of future performance.

Month of May Attribution



Source: Ellerston Capital.

The main positive contributors to this month's performance were overweight positions in: Ampol (ALD +12.3%), Aristocrat Leisure (ALL +12.6%), Northern Star Resources (NST +11.3%), Janus Henderson (JHG +11.1%) and Paladin Energy (PDN +20.7%).

Zero weight positions that also helped included Afterpay (APT-21.1%), Macquarie Group (MQG -3.2%), BHP Group (BHP +0.3%), Transurban (TCL -2.0%) and Woodside Petroleum (WPL -4.6%).

The main detractors to performance for the month were overweight holdings in: NextDC (NXT -6.3%), Deterra Royalties (DRR -3.9%), United Malt Group (UMG -3.5%), GrainCorp (GNC -1.6%) and Nufarm (NUF -7.3%).

Not holding a number of larger cap shares that outperformed the broader market and somewhat constrained returns included: Commonwealth Bank (CBA +12.0%), Woolworths (WOW +5.9%), QBE Insurance (QBE +11.1%) and Evolution Mining (EVN +16.8%).

[1] The return figures are calculated using the redemption price for Class A Units and on the basis that distributions are reinvested. The Gross and Excess return figures are before fees and expenses whereas the Net Return figures are net of fees and expenses for the Class A Units. Returns of the Fund may include audited and un-audited results. Past performance is not a reliable indicator of future performance.

* The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2012.

FUND ACTIVITY

In May, the Fund was highly active, locking in some profits in stocks that have outperformed, exiting ALS and Reliance Worldwide, right sizing other positions (namely Aristocrat, ANZ and, Nextdc) and strengthening other key holdings (Carsales, JB Hi-Fi, Janus Henderson and Resmed) .

We introduced **CSL**, a high quality business (formerly the largest stock in the Australian market) which has dramatically underperformed, into the portfolio. See detailed write-up below.

NEW STOCKS ADDED	STOCKS EXITED
• CSL	• ALS
	• Reliance Worldwide Corp

INCREASED	DECREASED
• Carsales.com.au	• Aristocrat Leisure
• JB Hi-Fi	• ANZ
• Janus Henderson Group	• Nextdc
• Resmed	

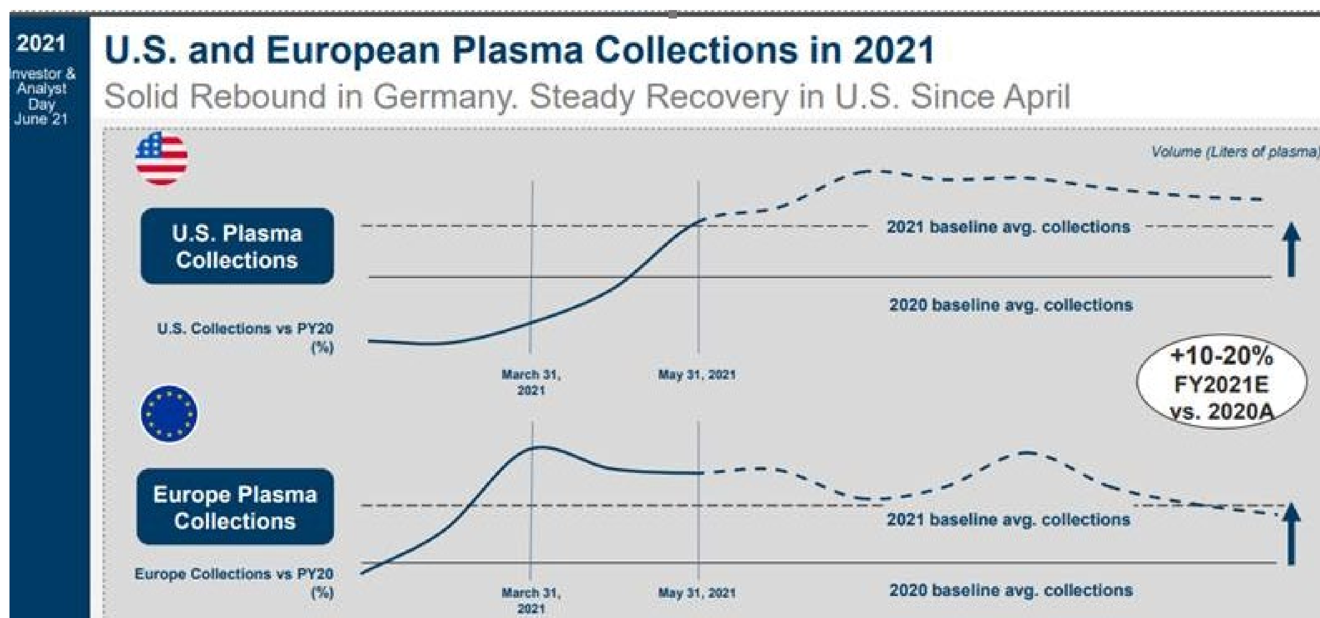
CSL Limited (CSL)

CSL is a leading global biopharmaceutical company with a significant competitive advantage in the plasma product industry that has been severely impacted by a temporary COVID-19 related supply shortage. Given the company's strength and breadth of their plasma product portfolio, they are able to produce higher margins per litre of plasma collected and price their key immunoglobulin (IG) products lower than their peers, supporting their dominant market position and ability to boost research and development spend. The long term IG demand outlook remains strong and this one-off COVID impact should be looked through.

We have introduced CSL to your portfolio because it is a quality business with an under-appreciated R&D pipeline that has been left behind and importantly, at this inflection point, is a defensive position. This leading stock has materially underperformed the market, as the company faced significant COVID-19 related headwinds. As COVID-19 infection rates accelerated, heightened fears of contracting the virus and lockdowns saw CSL plasma collection centre volumes drop sharply. IG volume 12-month rolling growth was 8.8%, the first time in over 15 months that growth has fallen below 10%. The US supplies approximately 70% of the world's plasma requirements, with the most predominant donors of plasma being those who are either under, employed or unemployed, direct beneficiaries of the US stimulus checks - applying additional pressure to collection volumes.

From a thematic perspective, cyclicals have run hard, the banks and big miners have performed very strongly, commodity prices have rallied and this saw the Australian dollar strengthen, which has acted as a further headwind for CSL. Encouragingly for the company, we have started seeing this reverse. Cyclicals are generally looking tired, have started to come off the boil and as we shift from an expansion to a slowdown phase, risk appetite typically falls, with stock leadership in the market shifting to these defensive names.

This thematic change, coupled with a continued increase in vaccination rates, lower COVID-19 cases and the tapering of government stimulus, means that we believe CSL should be a beneficiary of these key drivers. We should see an improvement in second half profitability and a solid recovery in near term earnings as plasma collections return to normal - a positive catalyst for the stock.



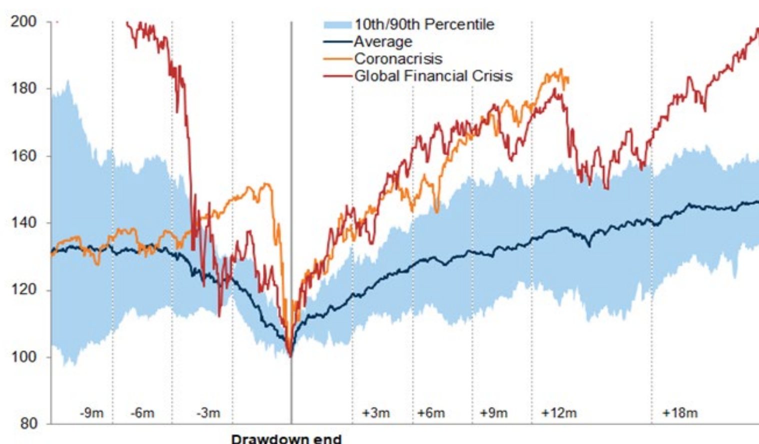
Source: Grifols.

Source: Factset.

FUND STRATEGY AND OUTLOOK

There is little that has changed with respect to the Fund's strategy since our April update, although, we have tempered some of our more economically cyclical names which have done very well, in favour of a select number of defensive stocks which have underperformed.

Global equities have surprised most observers and performed much better than the average recovery from other bear markets since 1970.The current recovery closely tracks that of the GFC 2009 period. The GFC recovery took a dip around this stage in the previous cycle, and it's worth considering the commonality of low rates and high levels of central bank intervention and support to both rallies - and the vulnerability of a rally built on these fundamentals. How much further to go, remains to be seen.



2021/22 Budget, an Election Budget

The Federal budget saw significant upgrades to FY21 outcomes and the economic outlook, thanks to a stronger than expected recovery. However, instead of banking all of the estimated $110bn improvement, the Treasurer included meaningful new policy announcements with a cumulative $96bn of initiatives over four years, 4.5% of FY22 GDP ($18bn in 21/22, 0.8% of GDP). Overall, the budget remained focused on supporting the post-COVID domestic recovery and driving unemployment lower to support a pick-up in wages growth.

FY21 upgraded $37bn, but spending and forecasts mean budget only $10bn better over four years.

Over four years, the budget was only upgraded by a cumulative $10bn, with the FY25 deficit still seen at -$57bn. Gross debt is now expected to rise to $1,199bn (50.1% of GDP, was 51.5%), while net debt is now due to peak at $980bn (41.0% of GDP, was 43.8%). Overall, the budget assumptions appear relatively conservative, assuming unemployment falls to 5.0% by Jun-22 and 4.5% by Jun-24. Interestingly, the budget continues to expect iron ore prices to fall back to US$60/tonne (CIF) by Mar-22, from US$199 today.

$96bn in new spending with care services, tax cuts and business investment the key focus

The budget included significant new policy measures worth ~$96bn, with much of this new spending focused on plugging potential weak points in government policy ahead of the next election, while also extending current popular policies (i.e. LMITO, temporary full expensing, and apprentice wage subsides). Key policy initiatives included:

- $20.7bn to extend temporary full expensing and loss carry-back (positive for business investment).
- $17.7bn towards Aged Care.
- $15.2bn in additional infrastructure spending over 10 years (with $8.3bn over the next four years).
- $13.2bn in additional funding for the National Disability Insurance Scheme.
- $7.8bn extending the Low and Middle Income Tax Offset (LMITO) for another year.
- $2.7bn towards expanding the apprentice wage subsidy program.
- $1.7bn in additional funding for child care.

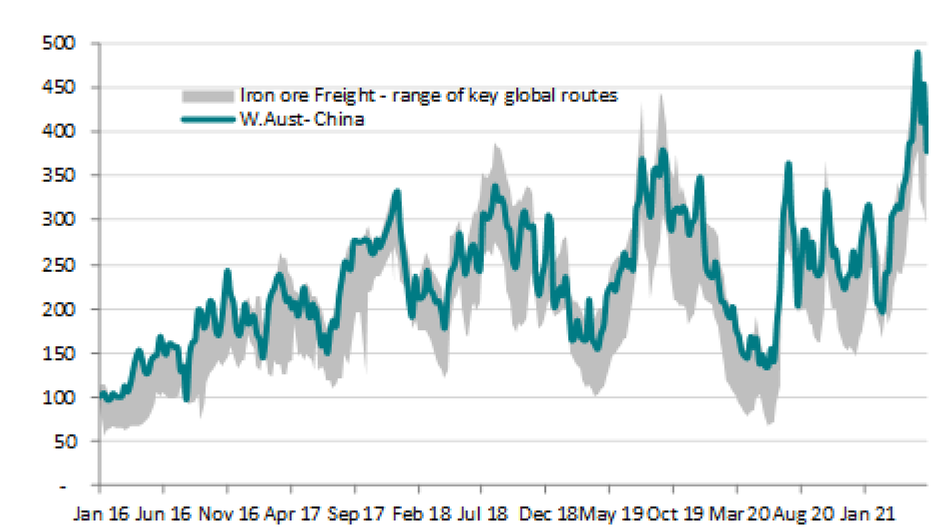
We continue to be of the view that the pivot to Value over Growth and Momentum has some way to run yet, despite value having outperformed Growth materially since last November, see chart below.

Value has outperformed Growth by ~30% since November 2020

Source: Morgan Stanley Research.

Investors remain uncertain as to the duration of this rotational pulse, citing a recent moderating signal from bond yields, potential peaks in commodity signals and ultimate challenges to fiscal execution and Central Bank monetary policy (commensurate tapering). An interesting commodity signal for iron ore, in particular, pertains to freight rates. After being up over 200% over the past year (similar to the iron ore price itself), iron ore freight rates from Western Australia to China have seemingly peaked and fallen 20% in the past 2 weeks - are they a portent of what's to come?

Freight rates; Down ~20% in 2 weeks ... a bellwether of global activity



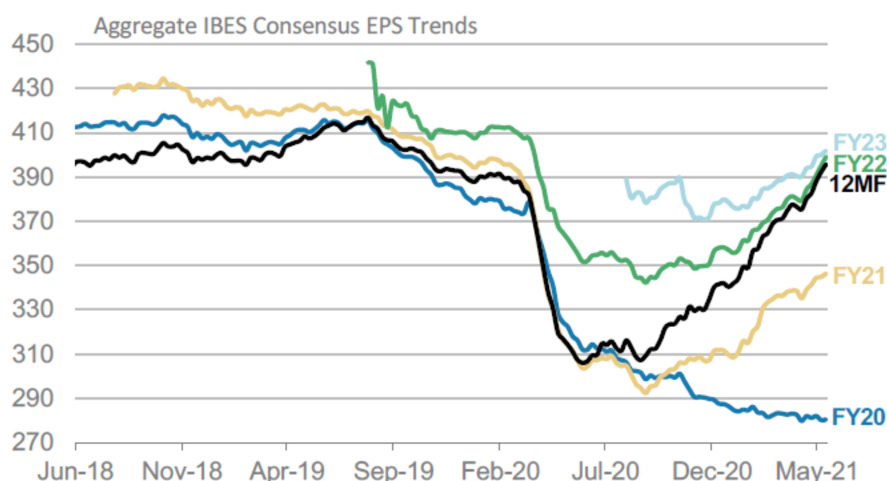
Source: Shaw and Partners.

In our view, the case for selective Value names and sensibly priced growth stocks remains intact. The upshot of a further rise in bond yields from inflationary pressures and the corollary of higher discount rates, continues to pressure asset allocation away from growth scarcity trades and long-duration positioning. That said, the deep value opportunity has largely passed (with many cyclicals doubling from their March/April lows of 2020), yet broader reflation exposure makes sense.

The risk to the speed of recovery remains subsequent waves of COVID-19 constraining activity (as manifest by snap Victorian lockdowns and border closures), however, the level of vaccinations has picked up dramatically, with the US approaching 50% and its northern neighbour at 56%. Global cases passed 170 million in May, driven by India. Overall daily cases decreased by 330k to 470k a day during the month. While Australia is currently lagging behind, with only 14% having received at least one dose, there is no burning platform given the virtual absence of COVID-19 transmission in the broader community and the recent Victorian lockdown should increase the speed of vaccinations. So we remain positively disposed to markets but recognise, as ever, the challenge of stretched valuations in certain pockets of the market against the backdrop of gradually rising interest rates.

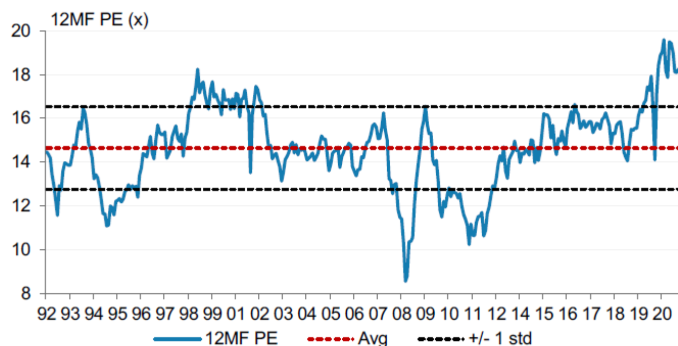
That said, the ASX 200 earnings gap to pre-COVID expectations continues to close, with FY22 EPS levels now 3% below that high watermark (see chart below).

Aggregate EPS levels continue to rise across the forecast period

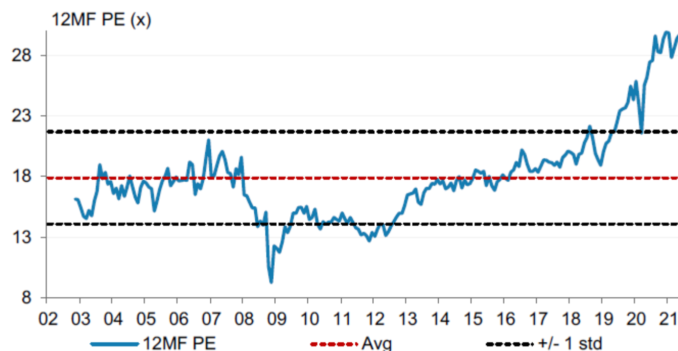


Source: IBES, RIMEs, Morgan Stanley Research.

ASX 200 PE - 18.1x



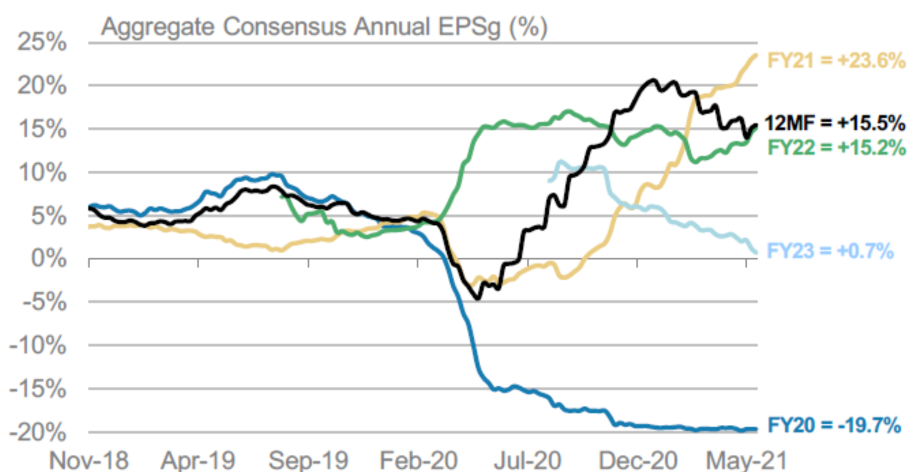
ASX 200 Industrials ex Financials PE - 29.7x



Source: IBES, RIMEs, Morgan Stanley Research.

As we have been saying for the past six months, we would expect the broader Tech sector to de-rate further from current levels. Growth at any price lofty valuations are NOT sustainable and the cracks in this sector continue to get wider - Nuix (NXL) a case in point.

Aggregate Annual Consensus EPS growth (%) Trends FY20-23



Source: RIMES, IBES, Morgan Stanley Research.

To reiterate, our strategy remains the same. We continue to be invested in stocks that we believe are trading below our assessment of intrinsic value and where the market is underestimating their future medium term earnings and recovery prospects.

To summarise your portfolio's positioning:

1. Quality Franchises, Growth at Reasonable, Attractive Valuations

Solid companies with strong/leading market positions and credible management with good balance sheets

Aristocrat Leisure, Carsales.com, CSL, JB Hi-Fi, NextDC, Resmed and United Malt

2. Businesses that are highly cyclical or seasonal in nature, facing headwinds

Heavily discounted companies with strong market positions and strategic assets, but very sensitive to economic conditions/seasonality/weather

Ampol, Graincorp and Nufarm

3. Turnarounds

Sound businesses that have historically generated poor returns, have been poorly managed, under-earned versus their potential, are in transition and where we think earnings/returns will improve over the medium term. Out of favour with the market, somewhat contrarian positions

Janus Henderson and Tabcorp Holdings

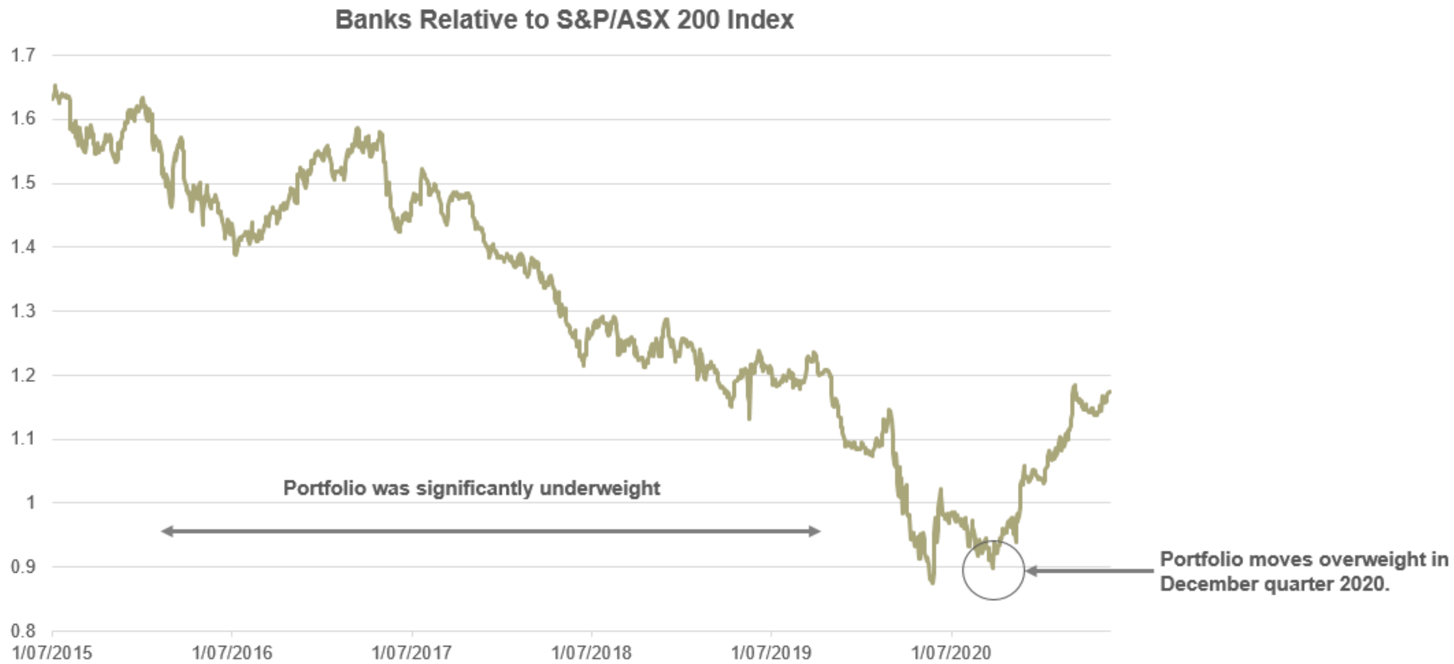
4. Deep Value Resource Plays

Stocks trading at discounts to NPVs, where much of the heavy lifting has been done (cost out, self help deleveraging)

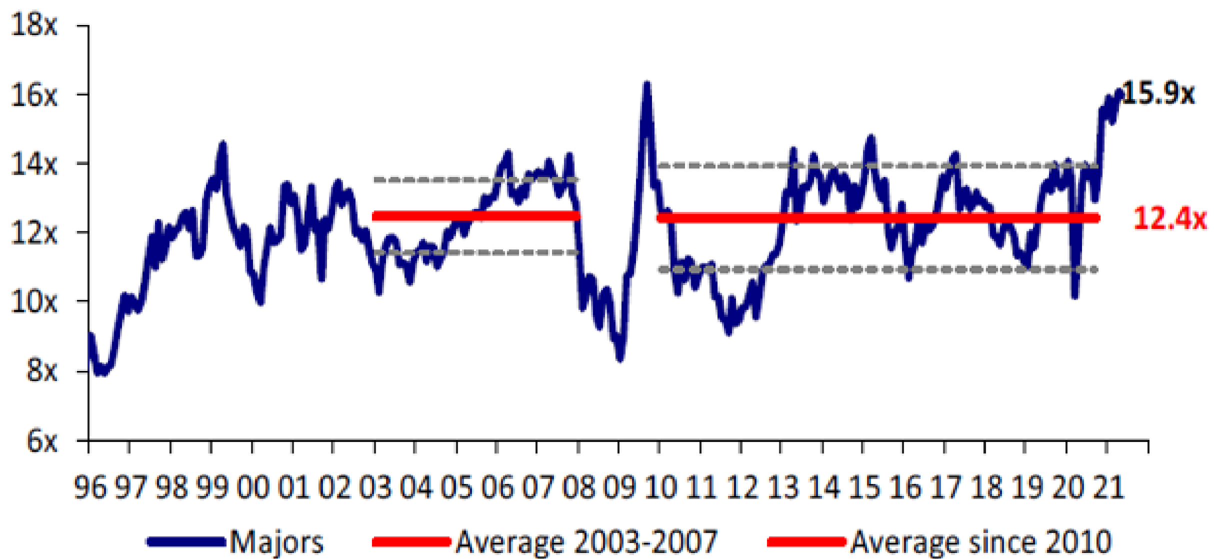
Deterra Royalties, Northern Star Resources, Paladin Energy and Western Areas

Outlook for Banks

Banks outperformed the broader market by ~4% in May, bringing the YTD outperformance to ~18%. Fortuitously, the fund went overweight Banks in late 2020 after more than 5 years of being underweight, during which period the banks significantly underperformed. The strategy proved fruitful and has certainly been be a major source of alpha in the current financial year.



Source: Bloomberg.

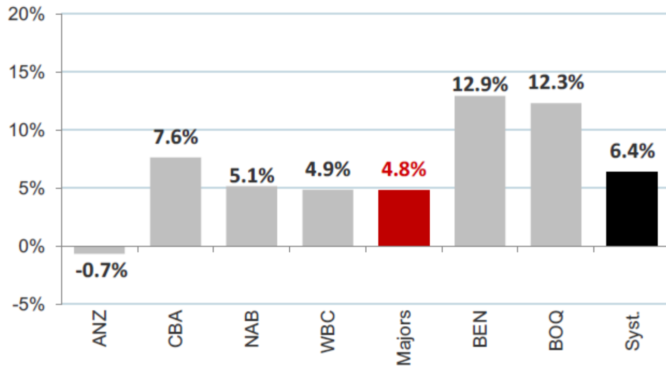


Multiples now back above Long-Term Average, profits taken at recent highs

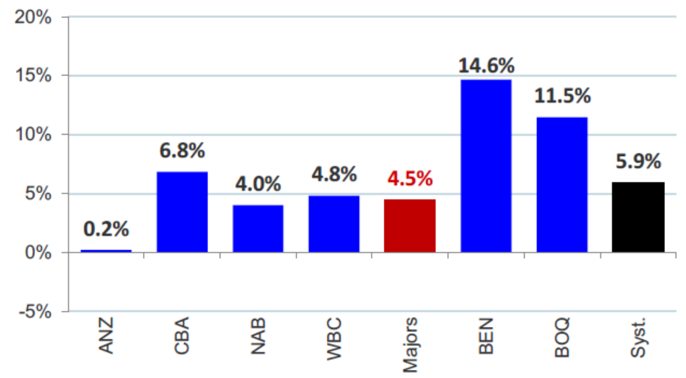
The positive thematic around improving credit quality, provision releases, volume growth and capital management appear to be well understood and in our view, are unlikely to drive further significant sector re-rating. **We think the "easy" money has been made, but that said, we maintain a preference towards WBC and NAB (and BOQ in the regionals) on valuation grounds.** As highlighted in the activity section, we have significantly reduced the Fund's position in ANZ after its stellar run.

CBA's mortgage franchise is currently outpacing major bank peers, while ANZ's recent lagging performance (with mortgages going backwards in the month of April in a ripping market for owner occupier home loans) continues to disappoint after a very strong 1Q21. This is clearly a result of less attractive pricing and "manual application" processing issues, which seem to be at the centre of ANZ's issues. Conversely, NAB and WBC have gained previously lost share, growing at ~0.7x and ~0.8x system respectively, with both banks relying on competitive pricing to drive this uplift (particularly WBC). Regionals also continued to take share, with BEN and BOQ growing at ~2.5x and ~2.0x, respectively, which, when coupled with favourable deposit tailwinds, bodes well for their earnings in FY21F.

One-month Annualised Housing Loan growth



Three-month Annualised Housing Loan Growth



Source: Morgan Stanley Research.

To conclude, we have almost entirely exited ANZ, continue to hold two of the big banks, one regional bank in Bank of Queensland and Janus Henderson which trades on a PER of 10 times and a dividend yield of 4.0%.

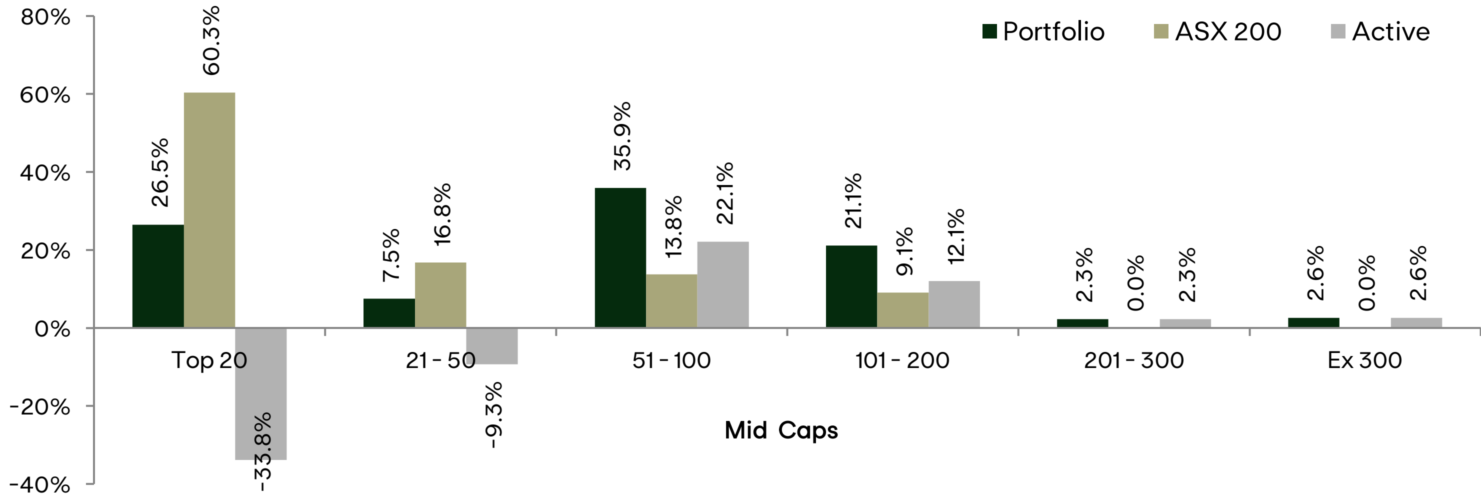
Warm Regards,

Chris Kourtis

Portfolio Manager

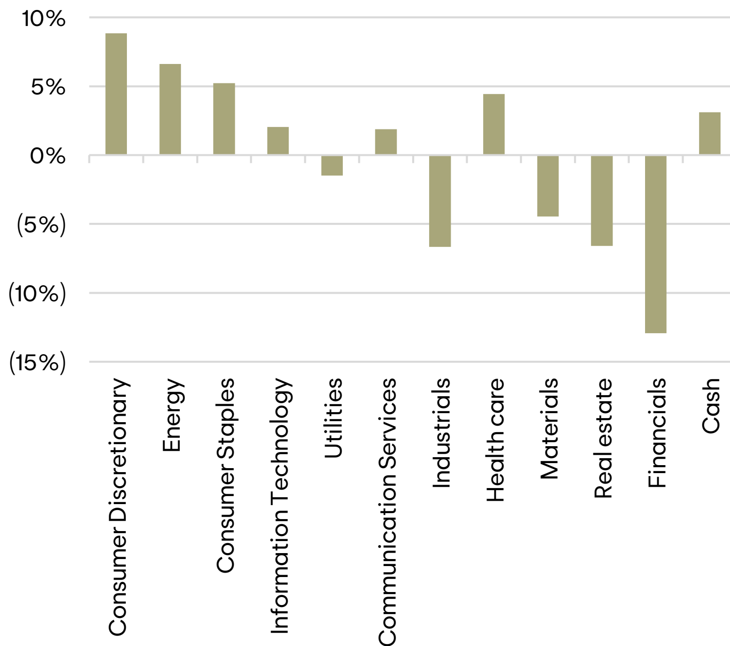
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



^Size Comparison Data as at 31 May 2021
Source: Bloomberg, Ellerston Capital.

Active Sector Exposures*



TOP 10 HOLDINGS**
AMPOL
ARISTOCRAT LEISURE
CARSALES.COM
CSL
GRAINCORP
JB HI-FI
NEXTDC
NORTHERN STAR RESOURCES
RESMED
WESTPAC BANKING CORP

Source: Ellerston Capital.

* Active sector exposures are determined by subtracting fund sector weights from benchmark weights. Positive percentages represent over-weight sector exposures relative to benchmark and negative percentages represent under-weight sector exposures relative to the benchmark.
** Top 10 Holdings are listed in alphabetical order.

About the Ellerston Australian Share Fund

The Fund aims to achieve its performance objectives by adopting a fundamental "bottom-up" investment approach to stock selection which is focused on identifying and then constructing a portfolio of the highest conviction ideas.

Investment opportunities for the Fund are identified by analysing and understanding the factors affecting (amongst other things): business model, industry structure, management team and overall valuation. Ellerston Capital typically favours businesses that can sustain high returns or improve their return on capital and looks to invest in businesses with a market value below the value we attribute to them.

Benchmark weightings do not drive our stock decisions, our approach is totally benchmark independent.

Due to the high conviction nature of the portfolio and the resulting deviation in portfolio composition relative to benchmark weighting, it is expected that the returns from the Fund will differ significantly from the broader market indices.

FUND FACTS

STRATEGY FUNDS UNDER MANAGEMENT	$800 Million
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$3.46 Million
APPLICATION PRICE	$1.0960
REDEMPTION PRICE	$1.0906
NUMBER OF STOCKS	21
INCEPTION DATE	1 APRIL 2009

Source: Ellerston Capital.

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Find out more

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**

All holding enquiries should be directed to our register, Link Market Services on **1800 992 149** or **ellerston@linkmarketservices.com.au**

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