Ellerston Global Equity Managers Fund (GEMS) Class C

Monthly Newsletter, June 2021

Investment Objective

To generate superior returns for unitholders with a focus on risk and capital preservation.

Investment Strategy

The Fund provides investors with exposure to global markets through a long short equity strategy. The strategy overlays fundamental bottom-up stock selection with global macroeconomic and market outlook.

Key Information

Inception Date ^^	1 December 2009
Portfolio Managers	Ashok Jacob & Arik Star
Application Price	$2.3258
NAV Price	$2.3200
Redemption Price	$2.3142
Unit Pricing	Monthly
Management Fee	1.50%
Performance Fee	16.50%
Buy/Sell Spread	0.25% on application 0.25% on redemption

PERFORMANCE SUMMARY

Performance (Net)*	CYTD	FY2021	2 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.) ^^
GEMS C	22.8%	58.6%	37.8%	15.5%	14.1%

Source: Ellerston Capital.

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

PERFORMANCE – Fiscal Year in Review

Fiscal Year to Date from July 1 to June 30, 2021, the Australian S&P/ASX 200 Index is up +27.8%, and the US S&P500 Index is up +40.8%. **Your Fund is up net after fees +58.6%.**

Calendar Year to Date from January 1 to June 30, 2021, the Australian S&P/ASX 200 Index is up +12.9%, and the US S&P500 Index is up +15.3%. **Your Fund is up net after fees +22.8%.**

For the Month of **June 2021**, the Australian S&P/ASX 200 Index was up +2.3%, and the US S&P500 Index was up +2.3%. **Your Fund was down net after fees -3.1%.**

Under The Hood FY21:

Your Ellerston Global Equities Managers Fund (GEMS) uses a consistent and dynamic hedging strategy to insure against both portfolio and market risk. There is a cost to this much like home or car insurance, and much like home or car insurance we hope we won't need it. Below is a table that takes you under the hood and shows the Gross performance of the GEMS portfolio. In order to provide more insight we have also broken out the performance of the Long Portfolio and the cost of the hedging. We feel this highlights the true underlying strong risk return dynamic of the GEMS portfolio.

FY21 Gross Performance	Q1	Q2	Q3	Q4	FY21
Long Portfolio	19.2%	31.2%	23.0%	15.6%	
Hedging Strategies	-8.3%	-8.1%	-3.4%	-8.2%	
GEMS Gross Return	**10.9%**	**23.1%**	**19.5%**	**7.4%**	**75.3%**
MSCI World Index – Net Return (Local)	6.7%	12.4%	6.1%	7.6%	36.9%
US S&P500 – Gross Return	8.9%	12.2%	6.2%	8.6%	40.8%
S&P/ASX 200 – Total Return	-0.4%	13.7%	4.3%	8.3%	27.8%

Return on Net Exposure

Average Net Exposure (monthly)	73.9%
Gross Returns	75.3%
Annual Return on Net Exposure	101.9%

PORTFOLIO COMMENTARY, STRATEGY AND MARKET OUTLOOK

Firstly, even though we had a good year, the result was an outcome of what we do every year. We are equally as proud of our performance in the COVID affected first half of last calendar year. During this period, the Fund returned 8.1% gross when the MSCI World Index did -5.3% and our attribution was -0.6% from the long side and +8.7% from the short side.

In our view, no one should look at any Fund based on what it did in FY 2021. The two years from July 1, 2019 – June 30, 2021 covers the positioning going into the pandemic, the reaction to the pandemic and the recovery out of it. Over the two year period on a cumulative basis your Fund did a return of +89.9% net of all fees vs MSCI World Index of +41.4%.

This Fund is run with a beta adjusted exposure that ranges between 30-60%, 95% of the time. Since the onset of Covid, we have modified our hedging strategy in order to increase its efficiency. As a consequence, over 90% of out hedging has been through index put options. A sharp increase in the delta of our hedge, circa 5% for every 1-2% move down in the market has allowed us to operate with an exposure slightly above our normal 60% target.

We buy options to protect the Fund from sharp downturns all the time. Fire insurance is not a timing exercise. No one gets up at the time of insurance renewal and says, "I don't think my house will burn down this year, so I won't insure it for a year to save money". This Fund always hedges a material (in excess of 30%) part of the portfolio. In addition, we insure against major market downturns to ensure the whole portfolio is protected. We will continue to do that.

In reality, if we had run an unhedged and uninsured portfolio, our returns would have been significantly higher and well in excess of 100%. But that's not how we operate and will never be so.

The returns we generate are a function of our process and the way we think. This does not lead to steady 18% gross returns over almost 11 years, but it winds up there. The outcome varies from year to year, and in some years quite sharply. We have never been able to predict our returns on an annual basis.

Last year we made as many mistakes as we got things right. Our process is such that mistakes are usually around missed opportunities, rather than bad investments. In fact, we made more major mistakes last year than any year that we can remember.

Not buying great stocks at fair prices was the biggest one. Alphabet (Google) the company we admire more than any other was one. COVID presented us with a once in a decade (or two) buying opportunity. We overanalysed, convinced ourselves that the travel headwind was too powerful and completely fluffed it.

We made the mistake of being put off by bad investor relations personnel (a mistake we won't make again) and most importantly were faked out of great holdings by fears of sharp interest rate rises.

All rookie errors. We will sadly make all these errors again but hopefully less frequently.

However, the important point to make was that these decisions were all made consequent to our absolute return philosophy and overwhelming desire to prevent significant capital loss.
So, we hedge our portfolio, we insure our portfolio, and we try to minimise volatility.

The returns therefore have to come from what we get right. The outcome is unpredictable but has a positive bias. The annual return that we generate is therefore an outcome and nothing about it is pre-set.

Whenever anyone asks us what we think we will make next year, the real answer is that we genuinely have no idea. Our returns will however reflect the risk mitigation strategy we have in place.

PORTFOLIO STRATEGY

The year ending June 30, 2021 was a year to remember. It was also a year to watch the macro economic environment carefully.

Our Fund is driven by a rigorous bottom up stock picking process. The performance of our long only ideas drives the performance of the Fund. We follow the macro simply to make sure we are not driving into a headwind and to potentially take advantage of a tailwind. Macro is not a part of our investment process but it is a parallel process which we overlay on our stock selection.

However, the world is driven by the macro environment more than ever before.

The GCC (Great COVID Crisis) has created a monetary and fiscal response in excess of anything outside of a wartime environment the modern world has ever seen. We saw the unrelenting QE that came out of the GFC beginning to lose its efficacy. Anaemic global growth, very low interest rates and no fiscal response anywhere.

The GCC turned that around. Powell's QE starting with 3T$ and the fiscally driven bailouts shifted the gears of the economy into overdrive straightaway. A new US president with potentially a two year window has seen a powerful fiscal response at a level we haven't seen since the WW2 recovery.

Suddenly, the Global Economy has a monetary response and a fiscal response. Global GDP is estimated to do 7%, 5%, 4% and 3.5%. A 21% expansion of the Global economy over 4 years! How does the world expand by a fifth in a relatively short time without significant output gaps emerging?

Sure, inflation may well be transitory. Over the next few months we should see growth scares, inflation scares and goldilocks scenarios. With this backdrop, investors need to prepare for each eventuality. The most important thing is not to take advantage of this, but to protect a portfolio from significant capital loss if the train leaves the station in the wrong direction. Taking advantage is important but secondary.

We do have a view as to how this plays out, but the most important thing for us is to have a portfolio full of stocks that we think can provide great returns.

MARKET OUTLOOK

The 2021 Fiscal Year was framework based. In fact, getting the framework right, which meant following the Fed, was the most important thing. No, actually it was the only thing that mattered. Monetary mega stimulus, plus fiscal stimulus, created a rising tide in a gale force wind. Financial assets rose across the board. That game is more nuanced now.

The combined push from both fiscal and monetary stimuli with the promise of even more fiscal stimulus to come has changed the post GFC paradigm. COVID 2019 could well become known as a WW2 type event as it seems to have created a financial reset. Political leaders have finally come to the party with a determination to kick start the Global economy even if it risks breaking the bank. The world has missed a full business cycle and the last cycle peak was in 2006. That is the framework that we are following.

If this reset works as we believe, there is going to be an output gap of a magnitude not seen in living memory. China signing up for zero emissions by 2050 creates a decarbonisation impact that further exacerbates this. The pandemic and the rise of China has created global distrust and a "circle the wagons mentality", particularly in the US. Consequently, the most important theme that we have identified for 2022 is the impact of this. Supply demand imbalance in select industries.

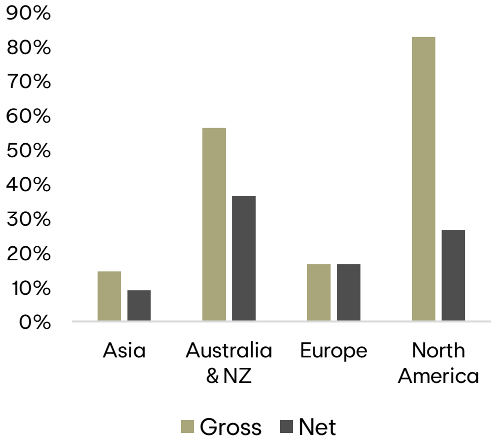
If you asked us about a theme for the next decade, nothing resonates more than the "Decade of the Supply Chain". Firstly, we see a white hot capex cycle running for years to come. Secondly, even though many supply chains will get fixed in the next six months, many will not. In fact, some supply chains are completely broken, with no solutions in sight for years to come. Chemicals, Cement, Steel and Aluminium are all shining examples with different levels of supply demand imbalance over differing periods of time. In some cases, such as parts of the Chemical industry and Cement, there is minimal incremental supply on the horizon. This is the backdrop when the Global Economy is going to expand by a fifth over the next four years. Managements have no intention of bringing new supply to the market even if possible. Permitting and time lags leave them too nervous about jumping the gun. Management and Boards are too scared by the long wait. Aluminium and Steel are prime beneficiaries of Decarbonisation and thumping global demand. For example, Alcoa with a US$7.6B EV will do US$2.5B of Adj. EBITDA and over a US$1B of free cash flow. New capacity is not on the horizon with the energy content required for manufacturing Aluminium. If China accidentally embraces its 2050 target, the outlook for some commodities is scary.

However, if for any reason this economic expansion fails, where does that leave us?
Despite Yellen and Powell promising to go "all in" or "doing whatever it takes" it is conceivable that it all does not work. That would leave us with more money printing and a USD debasement of a magnitude not thought possible. Good for growth and good for gold. Investors need to factor this possibility in today. The consequences of this global stimulus surge failing to kick-start the Global Economy would be catastrophic with nothing left in the cupboard for Central bankers. This "Death of the USD" scenario, however remote, would be the indirect consequence of this mega spend by Central Banks who will have no option at that point other than significant monetary debasement. Good for Gold, bad for the USD, hyper inflationary for Financial Assets.

That brings us back to the framework. What the Fed wants, the Fed gets. Our challenge is to be attuned to this world and not push into any Policy driven headwinds. The Fed is walking a tightrope, but it remains firmly in command.

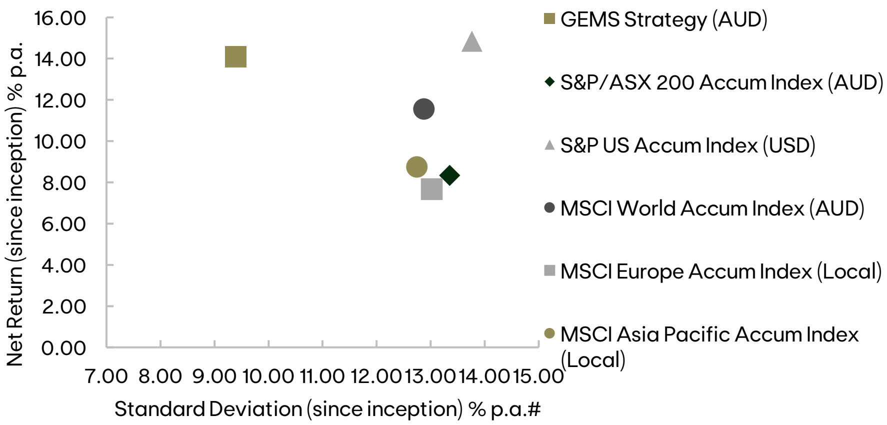
PORTFOLIO CHARACTERISTICS

Market Exposure as a % of NAV



Source: Ellerston Capital.

GEMS Strategy Performance & Volatility^



Source: Ellerston Capital.

Top 10 Holdings (Alphabetical, Long Only)

- BED BATH AND BEYOND
- BLUESCOPE STEEL
- CAMECO
- CELLNEX TELECOM SA
- CEMEX SAB DE CV
- FACEBOOK INC
- GRAINCORP
- OLIN CORP
- RELIANCE INDUSTRIES
- SOITEC

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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**

^ Actual performance for your account may vary from that set out in this newsletter and will vary for investments made in different classes, or at different times throughout the year. Some performance data is estimated and preliminary and subject to change.

The standard deviation is often used by investors to measure the risk of an asset. The standard deviation is a measure of volatility: the more an asset's returns vary from the average return, the more volatile the asset. A higher standard deviation means a greater potential for deviation of return from the average return of the asset. The returns and risk of the Fund and the relevant Indices are net of taxes, fees and expenses and assuming distributions are reinvested. The performance figures presented are for the Ellerston Global Equity Managers Fund GEMS C Units. The one month return figure may be an estimate and not the final return. This estimate also impacts other performance information provided. Estimated performance figures are preliminary and subject to change. Returns for other classes may differ slightly. Past performance is not indicative of future performance. Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000 is the responsible entity of the Ellerston Global Equity Managers Fund ARSN 118 887 095 (Fund). This newsletter has been prepared by Ellerston Capital Limited without taking account of the objectives, financial situation or needs of investors. Before making an investment decision you should consider your own individual circumstances and obtain a copy of the Product Disclosure Statement for the Fund which is available by contacting Ellerston Capital. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. To the full extent permitted by law, none of Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this newsletter and disclaims all liability that may arise due to any information contained in this newsletter being inaccurate, unreliable or incomplete.

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