Ellerston Low-Vol Income Strategy Fund

Monthly Newsletter, July 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	$1.1691
Net Asset Value	$1.1662
Redemption Price	$1.1633
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	2 Years (p.a.)	Since Inception (p.a.)^^
Net^	0.11%	5.16%	17.09%	26.66%	11.86%	13.11%
Benchmark*	1.10%	5.80%	13.78%	28.56%	7.65%	10.74%
Alpha	-0.99%	-0.64%	3.31%	-1.89%	4.22%	2.37%

^ 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

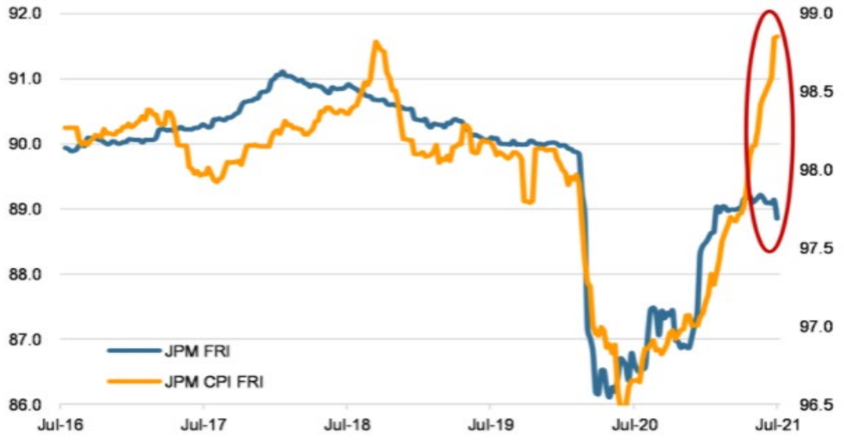
Global markets had a mixed outcome in July as the delta strain continued to spread globally, placing many cities into lockdown. The ASX 200 rose 1.1% despite Victoria and NSW going into lockdown, driven predominantly by falling bond yields. Global bond yields retraced meaningfully, with US Treasury 10 year yields declining 15 bps to 1.23% and Australian 10 year Treasury yields falling 23 bps to 1.18%. Commodity and oil prices moderated over economic growth concerns caused by the delta variant and potential delay of tapering by the Federal Reserve and Reserve Bank of Australia. Gold appreciated to US$1,811.45 as investors became more risk averse. The AUD also retreated 1.6c to US$0.735 over the month.

Globally, more than 4 billion vaccines have now been administered, with 27.8% of the world's population having received at least one dose of the vaccine. The countries with the largest share of their population fully vaccinated include Canada (57.4%), Spain (56.5%) and the UK (55.4%). Australia has lagged most developed countries with only 13.9% fully vaccinated but this will ramp up meaningfully over the next few months.

We continue to witness a very strong US Q2'21 company reporting season. As at month end, 60% of S&P 500 companies had reported, with 88% of those companies having recorded a positive earnings and revenue surprise. Australia is about to enter its FY21 final results period, with expectations of similar outcomes to the U.S. Earnings revisions in Australia have remained comfortably in positive territory. However, FY22 guidance is likely to be tempered or removed due to persistent lockdowns in NSW.

The recent surge in infections in countries with high vaccination rates has come as something of a surprise. As a result, we are beginning to see economists downgrade their global GDP numbers, primarily driven by Western Europe, where current infections are highest. However, CY 2021 global GDP is still likely to achieve 6% due to the tolerance for higher case numbers but low fatality rates due to the vaccine. Conversely, inflation forecasts have continued to rise.

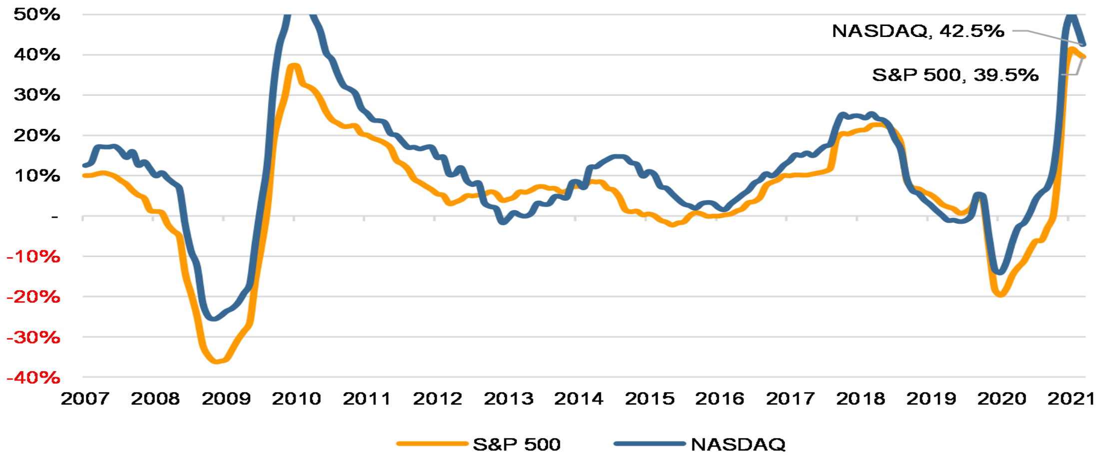
JP Morgan Forecast Revision Index (FRI) vs CPI FRI



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

Notably, the decline in US GDP forecasts is now starting to be reflected in one year forward earnings expectations for both the S&P500 and NASDAQ. This needs to be monitored carefully given the elevated valuations the US equity market is currently trading on.

JP Morgan S&P 500 & NASDAQ – Rolling year on year EPS



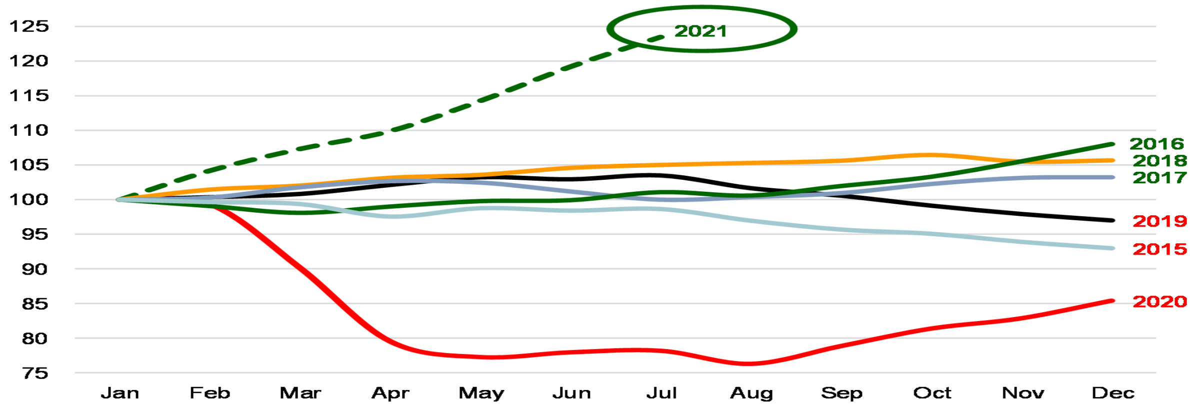
Source: JP Morgan.

During the month, we also saw a brutal sell-off in the China market, with the MSCI China index declining 14.1%, the largest monthly decline in nearly a decade. The reason for this was due to China's regulatory clampdown in internet, childcare and education. Many stocks in these sectors have fallen by 50% or more.

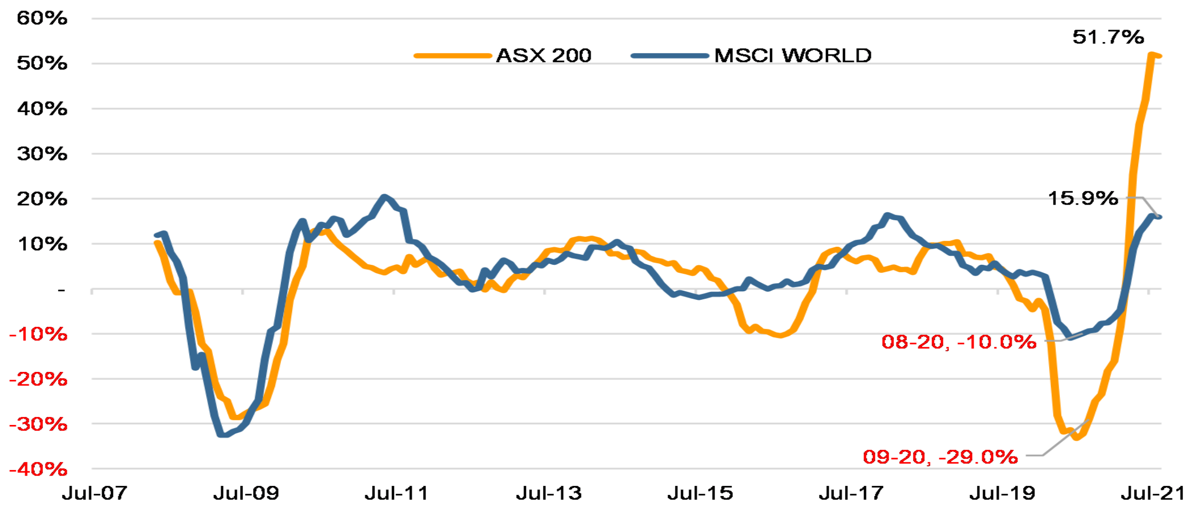
Australian Company Earnings and Sector Performance

With the FY21 earnings reporting season about to begin, expectations are high for a strong reporting period. Pleasingly, earnings per share revisions have been consistently positive all of this year and has actually seen the best start since the GFC. Earnings per share for the market is expected to recover 50%, surpassing FY19 levels, and is then expected to jump 9% in FY22. The dividend outlook is also expected to be very positive given the shape of listed, corporate balance sheets. DPS expectations are now forecasting over 50% recovery in dividends paid since the trough in September 2020, where they declined 29%.

Positive earnings and dividend picture for the ASX 200



Source: JP Morgan, Bloomberg Finance



Source: JP Morgan, Bloomberg Finance.

Other key themes in the lead up to reporting season include, 1) low implied volatility, meaning the market is already expecting strong results, but with little risk priced in for cyclicals, REITS, defensives and banks; 2) Banks are likely to produce strong results and further capital management; 3) The housing boom continues unabated but watch for macro-prudential measures being tightened and 4) The performance of Value vs Growth stocks, given the retracement in bond yields.

When looking at the reporting season itself, Morgan Stanley believes there are three key themes:

1. Revised outlook statements

The escalating lockdowns in NSW and Queensland comes at a time when cost pressures are rising but financial support mechanisms are spasmodic. This has the potential for companies to be more hesitant giving any future earnings guidance, thereby increasing volatility around the reporting period. It should be pointed out that 55% of companies have guidance in the market place or have given recent trading updates.

2. Capital Management

Given the strong state of company balance sheets, there is potential for more meaningful capital management to be undertaken during this reporting period. This may be a way of reinforcing investor confidence in the absence of any earnings guidance being given.

3. Currency

The AUD has now become a valuation and earnings tailwind compared to the last two reporting periods. We may see the currency as one of the drivers of earnings surprise for our offshore earners. Importantly, earnings dispersion has begun to widen again, leading to the potential for heightened results day share price volatility for many companies.

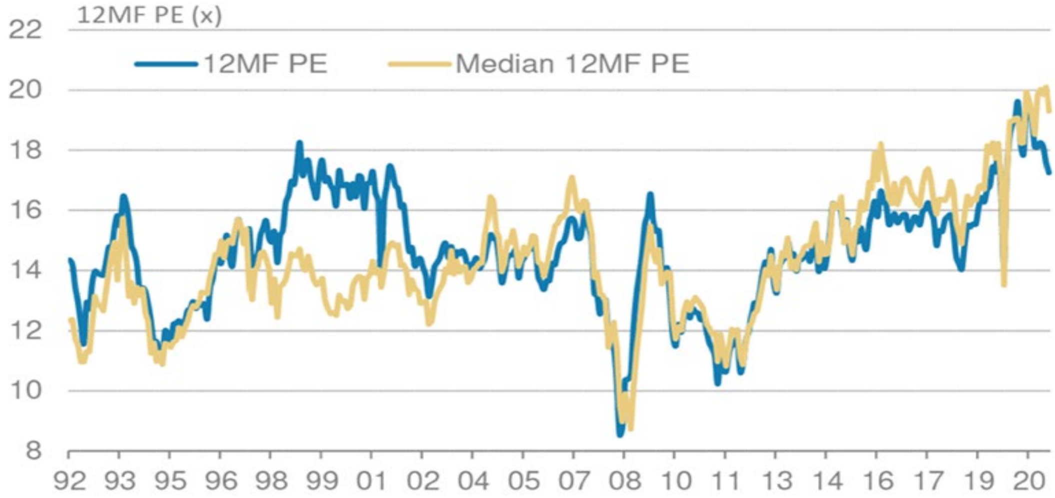
ASX 200 Earnings Dispersion

Source: Morgan Stanley.

Australian Market Valuations

It must be highlighted that valuations are looking very elevated vs history, particularly against a backdrop of longer term rising bond yields and moderating earnings growth expected in FY22. Furthermore, tapering considerations over the medium term by the Federal Reserve are likely to be positive for the USD, which will be a near term headwind for commodity prices, and therefore mining company earnings. However, given the escalation of the delta variant globally, we now believe Central Banks will be reluctant to begin any meaningful talks of tapering this year, the exception being Australia where the Reserve Bank is still committed to reducing its bond buy-back program.

Median 12m Forward PE stands at 19.3x vs cap weighted average at 17.1x



Source: Morgan Stanley

Fund Performance & Commentary

Over the last six seeks, we have seen a decent unwind of the cyclical value trade as recent economic data out of the U.S and China points to a slowing of global GDP growth. This has been further supported by a meaningful pull-back in bond yields. The global surge in the delta strain of Covid-19 has forced many cities into lockdown again, thereby placing the robust economic recovery at risk of a slowdown. A consequence of this is likely to be a delay in Central Bank tapering, thereby keeping bond yields more subdued for a longer timeframe. This is likely to support equity valuations a little longer than previously expected as liquidity provision from Government's and Central Banks continues unabated.

For the month of July, the Fund underperformed its benchmark by -0.99% on a relative, net basis, achieving a monthly absolute return of 0.1%.

From a sector and stock perspective, relative under performance came from Consumer Discretionary (overweight Tabcorp Holdings, Aristocrat Leisure & Peter Warren Automotive) along with Ansell in the Healthcare space. Not owning BHP Limited also hurt portfolio performance for the month. The biggest contributor to performance was being overweight Mineral Resources and not owning Afterpay.

Given the meaningful premium the Australian market is trading on relative to its history, the medium term impact of rising interest rates on valuation multiples could be quite pronounced should rates continue their upward trajectory. However, this outcome may be now be delayed by several months until vaccination rates reach higher levels and our economy opens up again.

Portfolio Activity – Major Transactions

During the month we exited our position in ANZ Banking Group on valuation grounds and replaced this position with the purchase of Nine Entertainment and Independence Group.

Nine Entertainment is an Australian media company with holdings in radio & television broadcasting, newspaper publications & digital media. Nine Entertainment is set to further benefit from television advertising leverage, along with a buoyant housing market which benefits its significant investment in Domain Group. Further upside in streaming services business, STAN also gives us confidence in the Nine Entertainment earnings recovery story continuing.

Independence Group is a leading exploration and mining company focused on discovering, developing and operating high quality assets focused on metals critical to enabling clean energy. The company has begun to see positive earnings revisions.

Macro News

US June economic activity indicators were mixed, with the manufacturing ISM coming in below expectations, at 60.9. Non-farm payrolls rose 850,000, well above expectations, but the unemployment rate ticked up to 5.9% due to flat participation. June core CPI rose 0.9% for the month, seeing the annualised inflation rate hit 5.4% but rising energy and motor vehicle prices were the key driver and were seen by the market as transitory. June retail sales continued their strength as consumers continue to draw down on savings for goods and services. Finally, housing starts came in well above consensus

China economic data continues to look a little softer with the Caixin manufacturing PMI for June ticking down to 51.3, below expectations. Activity indicators in Europe were also mixed with the flash Eurozone manufacturing PMI for June coming in ahead of consensus but the services PMI coming in a little weaker.

Australian economic data followed many parts of the world with mixed economic data results. Residential building approvals retraced sharply in May by 7.1%, albeit off a high base. Employment in June was stronger than expected with the unemployment rate falling below 5.0% whilst NAB business conditions fell to +24.1 in June due to the NSW lockdown.

Fund Positioning

The Fund continues 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 defensive quality stocks.

The beta of the Fund (a measure of volatility) sits at 0.90 vs a market beta of 1.00. This reflects the more defensive stance we have taken in the portfolio. The expected FY 22 dividend growth rate of investee companies held within the portfolio is comfortably above that of the market, at 21.9% and 17.0% respectively. The expected dividend yield of investee companies held within the portfolio is currently 3.5%, 81% franked vs the market dividend yield of 3.9 %, 82% franked.

Portfolio Characteristics

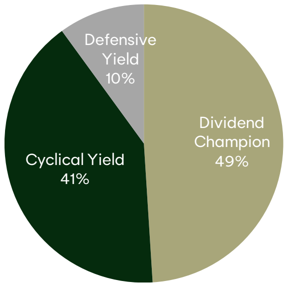
TOP 10 HOLDINGS

National Australia Bank Limited	7.7%
Westpac Banking Corporation	7.4%
Woolworths Group Ltd	6.0%
CSL Limited	5.2%
Sonic Healthcare Limited	4.0%
Rio Tinto Limited	3.8%
Mineral Resources Limited	3.7%
Ampol Limited	3.5%
Dexus	3.4%
Aristocrat Leisure Limited	3.4%

KEY PORTFOLIO METRICS

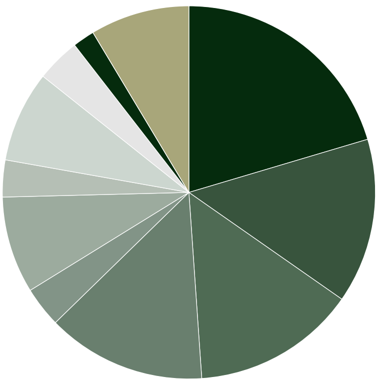
FY22(e)	Fund	Benchmark
Price/Earnings (x)	18.3	17.8
Dividend Yield (%)	3.5	3.9
Dividend Growth rate (%)	21.9	17.0
Beta	0.90	1.00

PORTFOLIO YIELD EXPOSURE



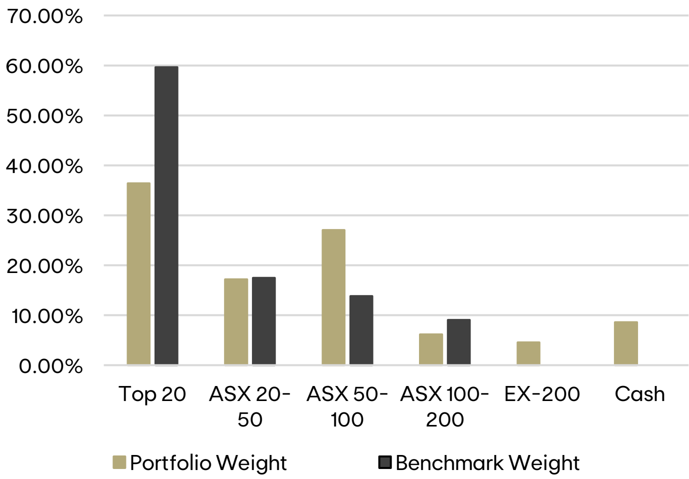
Source: Ellerston Capital.

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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