Ellerston Low-Vol Income Strategy Fund

Monthly Newsletter, November 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 Kourtis
Application Price	$1.1835
Net Asset Value	$1.1805
Redemption Price	$1.1775
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	FYTD	CYTD	1 Year	2 Years (p.a.)	Since Inception (p.a.)^^
Net^	1.03%	-2.10%	1.34%	18.74%	18.40%	8.76%	11.86%
Benchmark*	-0.54%	-2.48%	1.07%	14.10%	15.48%	6.39%	9.28%
Alpha	1.56%	0.38%	0.27%	4.64%	2.92%	2.37%	2.58%

^ 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

Australia equities outperformed in a volatile November, with the US market down 0.7%, European markets posting a 4.3% fall and Asian markets also weaker.

Volatility in global markets became elevated late in the month after the discovery of a more transmissible South African COVID variant named Omicron, casting doubts over the efficacy of existing vaccines, driving markets back into risk-off mode. This added to growth concerns when the cycle was already showing signs of slowing and monetary stimulus was being reduced. Moderna Inc.'s CEO Stephane Bancel's comments that it might take months before variant-specific jabs are available in scale further unsettled investors, causing havoc on re-opening trade stocks, namely in the travel, entertainment and airline industries. As well, on the last day of the month, re-elected Fed chair Powell signalled that tapering may be accelerated as inflation is less transitory than first thought. This double whammy was a headwind for risk assets and flattening yield curves, with the US 10-year treasury yield sinking to 1.45% as at 30 November 2021.

The Australian share market showed resilience but took its third breather, after the previous eleven straight months of positive returns. The S&P/ASX 200 Accumulation Index closed down 0.5% and outperformed most global developed peers, in what was a weak month for equity markets.

USA

The vaccine doubts overshadowed generally positive data, with stronger economic activity indicators in November. The Manufacturing ISM fell marginally from 61.1 from 60.8, with a decline in new orders. Non-farm payrolls of 531k in October were way above consensus of 450k and the September print of 194k benefitted from reopening momentum across goods and services. The unemployment rate ticked down to 4.6% with a flat participation rate. The October core CPI at +0.60% MoM (+4.6% YoY) was above expectations of +0.35% - further, the headline print was also above consensus at +6.2% YoY, the highest level since December 1990. Finally, September retail sales which were up 1.7% MoM, exceeded expectations after a rise in the previous month of 0.8%.

US equities were generally weaker, with the S&P 500 down 0.7%, The NASDAQ Composite Index actually surprisingly rose 0.3% and the laggard being the Dow Jones Industrial Average, down 3.5%.

Europe

In the Euro arena, inflation surged to a record for the era of the single currency and exceeded all forecasts. On the economic front, the Eurozone Manufacturing PMI for November rose to 58.6 from 58.3 and the composite PMI rose to 55.8 from 54.2 in the previous month.

The Euro STOXX 50 Index finished the month down 4.3%. Among the major exchanges, France's CAC 40 shed 1.5%, UK's FTSE 100 fell 2.2% and the Germany's DAX was the laggard, closing down 3.8%.

Asia

China's economic activity was mixed, with October industrial production higher at 3.5% YoY from 3.1% YoY, but October FAI was weaker at -2.9% YoY versus -2.5% YoY, driven by ongoing weakness in the property sector. The November NBS Manufacturing PMI rose to 50.1 from 49.6, the first uptick since August. The recent arrest by Chinese authorities of Suncity Group's CEO and resignation of its Chairman Chau and the disruption in VIP gaming rooms in Macau hit gaming stocks very hard.

Asian equity markets were weaker, with the Hang Seng down 7.4%, Index Korea's KOSPI down 4.4% and India's SENSEX down 3.8%, whilst the Nikkei 225 was down 3.7% and China's SSE finished 1.1% lower.

Commodities

Iron ore fell a further 6% to US$100 per tonne, but recovered 15% from its monthly low. The Brent oil price ended 16% lower at US$71 per barrel, impacted by demand concerns raised by the Omicron variant and moves to release 50m barrels from the US Strategic Petroleum Reserve. The base metals complex was slightly weaker, with copper and aluminium down 3%, but nickel firmed 2%. Coking and thermal coal prices fell 22% and 32% respectively, albeit from record mind snapping levels, as China fast tracked production and even allowed previously banned Australian coal through their ports, ahead of winter and even instituted price controls. Gold was flat at US$1,777 per ounce.

Bonds

US 10-year treasuries fell 10 basis points to 1.45% but traded in a wild 0.25% range, similar to October and the Australian 10-year bond fell 38 basis points to 1.70%.

The AUD was 5% weaker at US$0.71, driven by the fall in bond rates and a weaker prices for our major commodities.

Australia

The Australia equity market pared back for a third month in a row after the previous eleven straight months of advances, the longest winning streak since 2007.

In November, the S&P/ASX 200 Accumulation Index finished 0.5% lower. The Materials sector (up 6.3%, driven by BHP's stellar 7.6% rise) was the most significant contributor to the Index's performance, adding 106 basis points, followed by Real Estate (up 4.3%), contributing 29 basis points and then Consumer Staples (up 4.4%) adding 22 basis points. The bottom three contributing sectors were Financials (-211 points, dragged down by Westpac's woeful -17.7% return) being the worst, followed by Energy (-26 points) and Information Technology (-13 points). The best performing sub-index was again the ASX 200 A-REIT Index, which actually finished up 4.5%, outperforming the broader benchmark, whilst the major underperformer was again the ASX 200 Industrial Index, which closed down 1.5% as a result of the weakness across all the major and regional banks post reporting season and weakness in the insurers.

The top five stocks that made a positive contribution to the Index's return were: BHP Group (+39 points), Fortescue Metals (+24 points), Goodman Group (+22 points), Woolworths Group (+16 points) and Telstra (+14 points).

Conversely, the top five stocks detracting from the Index's performance were: CBA (-93 points), Westpac (-80 points), Afterpay (-17 points), National Australia Bank (-12 points) and ANZ Banking Group (-10 points).

FUND PERFORMANCE

The Fund's positive return of 1.1% outperformed the benchmark return of -0.5% and caps off a satisfying performance run by the Fund for the CYTD. For the rolling year to November, pleasingly the Fund has now returned 19.5%, 4.0% above the benchmark return of 15.5%.

In terms of factor analysis, cyclicals and defensives outperformed. Materials (+6.3%), led by Fortescue Metals up 22.1% and BHP up 7.6%, Communication Services (+5.2%) with Telstra rising +6.5% and Consumer Staples (+4.4%) driven by Woolworths +7.2%, were particularly favoured.

Vaccination rates have climbed strongly through the year and CPI prints have surprised to the upside around the globe. Value as a factor, has lost momentum since mid-year, with Value now underperforming Growth YTD in all regions except for Emerging Markets. There are two key factors at play here: flattening yield curves and moderating growth expectations. It will be interesting to observe whether there is a reversal of these trends as we fast approach 2022, with yield curves set to steepen and growth to pick up. This should bode well for Value and Cyclicals, which tend to thrive in the underlying macro conditions that underpin curve steepening.

Returns[1] (%)	*Gross*	*Benchmark**	*Excess*	*Net*
1 Month	1.12	-0.54	1.66	1.03
3 Months	-1.86	-2.48	0.62	-2.10
2022 FYTD	1.72	1.07	0.66	1.34
CYTD	19.74	14.10	5.65	18.74
1 Year	19.47	15.48	3.99	18.40
2 Years (p.a.)	9.78	6.39	3.39	8.76
Since Inception (p.a.)	12.96	9.28	3.68	11.86

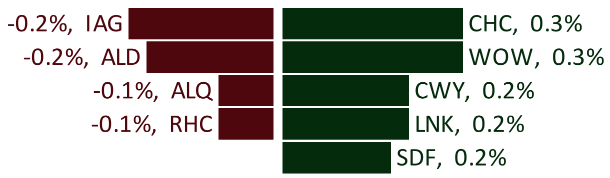
Past performance is not a reliable indicator of future performance.

Month of November Attribution

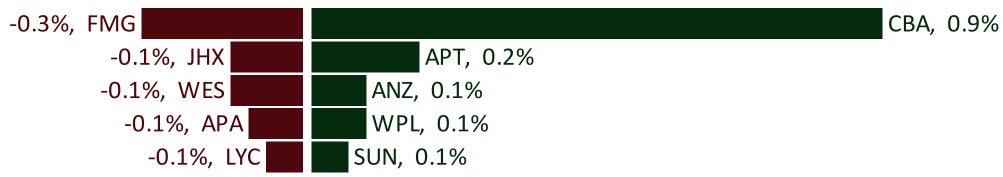
[1] The return figures are calculated using the redemption price for Class A Units and on the basis that distributions are reinvested. The Gross and Excess return figures are before fees and expenses whereas the Net Return figures are net of fees and expenses for the Class A Units. Returns of the Fund 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.

Securities Held



Securities Not Held



Source: Ellerston Capital.

The main positive contributors to this month's performance were overweight positions in: Charter Hall Group (CHC +11.5%), Woolworths (WOW +7.2%), Cleanaway Waste Management (CWY +8.1%), Link Administration (LNK +13.5%) and Steadfast Group (SDF +5.8%).

Zero weight positions that also helped included Commonwealth Bank (CBA -11.0%), Afterpay (APT -11.7%), ANZ Banking Group (ANZ-2.7%), Woodside Petroleum (WPL -7.9%) and Suncorp Bank (SUN -7.7%).

The main detractors to performance for the month were overweight holdings in: Insurance Australia Group (IAG -9.8%), Ampol (ALD -6.2%), ALS Limited (ALQ -5.8%) and Ramsay Health Care (RHC -5.1%).

Not holding the following shares that outperformed the broader market and somewhat constrained returns were: Fortescue Metals (FMG +22.1%), James Hardie Industries (JHX +8.9%), Wesfarmers (WES +2.7%), APA Group (APA +16.2%) and Lynas Rare Earths (LYC +21.0%).

FUND ACTIVITY

Whilst many stocks and sectors have re-rated significantly from their March 2020 lows, we continue to seek, and more importantly are still finding opportunities that we believe are highly compelling, are mispriced and should deliver over the medium term.

During November, we added to the BHP position that was initiated in the previous month. We also strengthened the holdings in gold producer Northern Star and in Link Administration (currently under takeover offer). Profits were taken in a number of stocks (Aristocrat Leisure, Insurance Australia Group, NAB and Westpac), overall increasing the Fund's cash holding.

FUND STRATEGY AND OUTLOOK

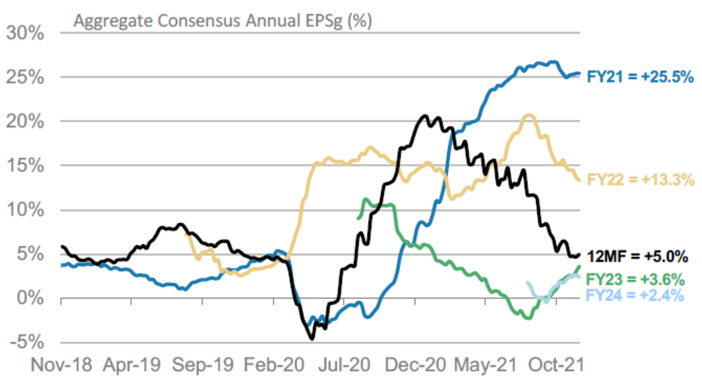
While we would like to believe that fundamentals will drive market internals, recent experience indicates that the direction of key interest rates and threat of a relapse caused by a fourth wave of the pandemic will dominate the investment debate, culminating in restless sector and factor rotation. Central banks are finally now fessing up that inflation is less "transitory" and more persistent, which makes it more likely that rises in official interest rates will be occurring earlier rather than later. **Fed chair Powell signalled that tapering may be accelerated as inflation is less transitory than first thought.** More and more observers are now moving towards the "stagflation" camp, a period many market participants, particularly millennials, have never experienced. The recent Omicron variant will also be a key new driver of sentiment and will have an impact on both rates and sector rotation. We should have a better line of sight during mid to late December as to how things play out. That said, despite the certain prospect of tapering by the Fed and RBA and pre-emptive official rate hikes in countries like Norway and New Zealand, central banks will aim to keep interest rates relatively low. In Australia, the market continues to challenge the RBA's guidance regarding rate hikes and the local equity market has remained very resilient, despite all the macro headwinds.

Another key feature of 2021 has been the ongoing strength of the M&A cycle, with the ASX 200 value of M&A at its highest level since 2006, with over $200bn of activity CYTD. Continued rampant takeover activity is pouring petrol on the fire. Watch this space....

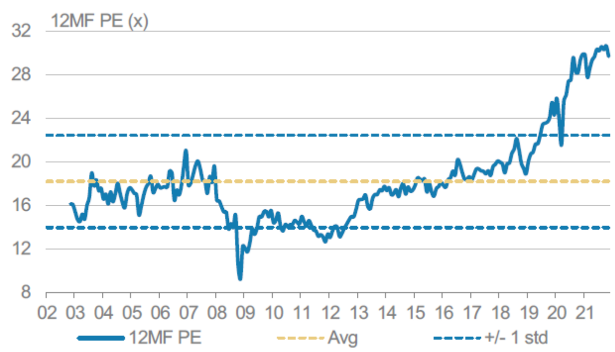
The trend in deceleration in earnings growth rates continues, with 12 month forward aggregate earnings now +5.0%. Earnings revisions have remained negative, with the pace of downward revisions accelerating. The December quarter will start to see NSW and Victoria relax COVID restrictions, with the prospect of approaching some sense of "normal" again. The All Industrials ex-Financials PE, which suggested that the re-opening trade had plenty of optimism already baked in is starting to look more fragile. These stocks will need to deliver significant earnings upgrades over and above current forecasts to stabilise the recent sell-off.

At the aggregate level, the ASX 200 has de-rated this calendar year from a PER of 19.4x to 16.9x 12 month forward, with most of the market de-rating coming from the collapse in the All Resources multiple from 13.8x to 9.0. The All Industrials ex-Financials has remained acutely elevated at 29.7x and the broader Industrials cohort is now trading at 21.0x. Valuations thus far have been supported by bond rates and earnings growth, although as just mentioned, we continue to see of downward revisions, especially in the Banking sector, but even in Resources as iron-ore prices have more than halved from levels in June.

Annual Consensus EPS Growth Trends FY21-24



ASX 200 Industrials ex Financials PE is at 30x



Source: Morgan Stanley.

The Beta of the Fund (a measure of volatility) sits at 0.81 from 0.88 in October, compared to the market beta of 1.00. This reflects the more defensive stance we have taken in the portfolio recently. The expected FY22 dividend growth rate of investee companies held within the portfolio sits at 16.3% and is comfortably above that of the market at 7.7%. The forecast dividend yield of 3.6% and the level of commensurate franking is broadly in line with the market.

Portfolio Characteristics

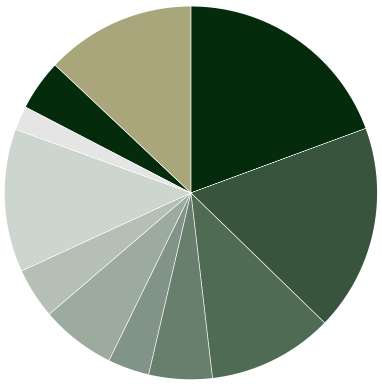
TOP 10 HOLDINGS

BHP Group	8.6%
CSL Limited	7.7%
NAB	6.6%
Woolworths Group Ltd	6.2%
Ampol	3.5%
Amcor	3.5%
OZ Minerals	3.4%
Charter Hall	3.1%
Steadfast Group	3.1%
Goodman Group	3.0%

KEY PORTFOLIO METRICS

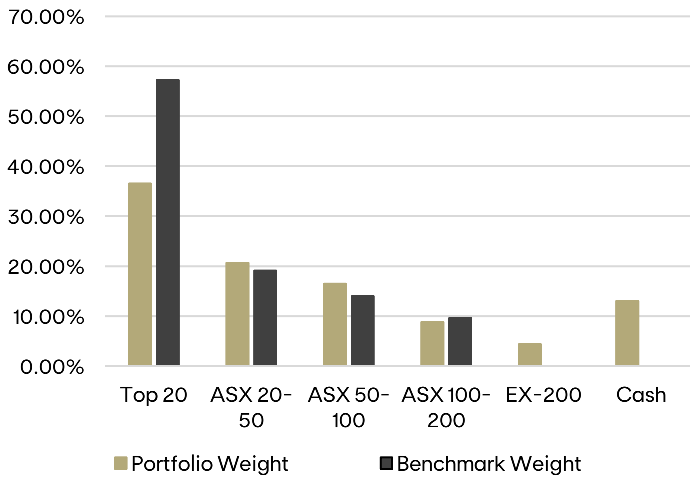
FY22(e)	Fund	Benchmark
Price/Earnings (x)	18.0	18.2
Dividend Yield (%)	3.6	3.7
Dividend Growth Rate (%)	15.8	7.7
Beta	0.81	1.00

SECTOR ALLOCATION



Source: Ellerston Capital.

MARKET CAPITALISATION



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Find out more

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