Ellerston Global Mid Small Cap Fund

Monthly Newsletter, January 2022

Investment Objective

To outperform the MSCI World Mid Cap NR (AUD) Index by 3% over a rolling 5 year period on a net of fees basis, with a focus on risk management and capital preservation.

Investment Strategy

The Funds investment strategy is to construct a concentrated portfolio of global mid small cap securities using the Manager's distinctively contrarian high conviction, benchmark independent investment approach. The Manager believes that the trade-off between risk and potential returns is improved by implementing highest conviction ideas from a filtered universe of securities that are in a period of "price discovery" and offer the best risk/reward.

Key Information

Strategy Inception^^	1 March 2017
Portfolio Manager	Bill Pridham
Class A Application Price	$1.5546
Class A Net Asset Value	$1.5507
Class A Redemption Price	$1.5468
Class B Net Asset Value	$1.3361
Class B Redemption Price	$1.3328
Liquidity	Daily
No Stocks	20 - 40
Management Fee (Class A)	0.75%
Performance Fee	10%**
Buy/Sell Spread	0.25% on application 0.25% on redemption

**10% of the investment return over the benchmark return (MSCI World Mid Cap Index NR (AUD)), after recovering any underperformance in past periods.

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception^^ (p.a.)
Class A^	**-8.02%**	**-2.35%**	**-0.17%**	**13.76%**	**21.16%**	**16.01%**
Benchmark*	-4.32%	-0.75%	0.08%	19.29%	14.99%	12.39%
Alpha	-3.69%	-1.60%	-0.25%	-5.53%	6.18%	3.62%

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception*** (p.a.)
Class B^	**-7.93%**	**-2.15%**	**0.22%**	**14.56%**	**-**	**21.82%**
Benchmark*	-4.32%	-0.75%	0.08%	19.29%	-	19.90%
Alpha	-3.61%	-1.40%	0.14%	-4.73%	-	1.92%

^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance.
* MSCI World Mid Cap Index NR (AUD)
***Class B Inception Date is 18 August 2020

Portfolio Commentary

The month of January proved to be a difficult month for equity markets globally with smaller cap companies underperforming their larger cap brethren as investors moved up the market cap scale in a flight to safety. This was especially evident when comparing the S&P 500 which declined 5.2% while the Russell 2000 index was down 9.6% - a 445bps difference between the two.

The Ellerston Global Mid Small Cap Fund declined 8.02% net during January compared to the MSCI World Mid Cap Index (AUD) which declined by -4.32% over the month. Following the impact in January, the Fund is now pretty much flat FYTD.

Inflation and supply chain bottlenecks continued to overhang sentiment however a very hawkish Fed statement and press conference fuelled a dramatic increase around the trajectory of rate increases as well as bringing forward the prospect of quantitative tightening later in the year. When coupled with the Omicron impact on economic activity during December and January, the market has become increasingly concerned about a "policy mistake" where the Fed would be raising rates in a slowing growth environment.

While there are many moving parts to be mindful of, current US inflation with a 7 handle will begin to normalise over the coming months (albeit settling at a higher rate than we have seen over the past several years) while economic activity should prove relatively solid compared with past cycles.

That said, what we have seen over the past month is a step function shift upwards in inflation expectations which caused a step function down in equity valuation multiples – this is still working its way through the market.

The portfolio's top contributors for the month **Comerica Bank, Webster Financial and hedging added 83bps** to performance while **Tempur Sealy, Cellnex Telecom and Azek detracted 236bps**. While we were disappointed with the short-term performance in January, it is always important to focus on our businesses and how they are delivering in this environment. At the time of writing, we are in the midst of the December quarter reporting season and so far we note that our portfolio companies are performing at, or ahead of, expectations.

Comerica Bank reported FY21 EPS of $8.35 ahead of our estimates and consensus expectations of $8.25. EPS for 4Q21 was driven by ~$600m in average loan growth. The company noted particular strength in general middle market, corporate banking and national dealer. Management expects real GDP to increase >4% in 2022 however its primary markets of California, Michigan and Texas should come in above this level. Comerica's loan book is predominately Commercial and Industrial linked to short term floating rates; therefore Comerica is arguably one of the banks best exposed to a rising rate environment.

Webster Financial reported Q4 adjusted EPS of $1.31, significantly ahead of the market at $1.09. The beat was driven by stronger than expected loan growth and better cost management than peers. The merger with Sterling was finalised on February 1st and on the call, Management reiterated its combined loan growth outlook of 8-10% over the next couple years. We note that the analyst community is now recognising the attributes of Webster with a couple strong upgrades over the past few weeks with price targets >20% above the current price.

Flex is one of the largest contract manufactures worldwide and is benefiting from its differentiated capabilities in managing customer supply chains. Strong sequential growth in its cloud, communications and industrial businesses is driven by bookings growth and successful ramps of these new businesses. Investments in optical and 5G technology, electrification products and data center solutions are also helping to accelerate growth this year. Flex reported revenues and earnings above the top end of its guidance range and subsequently upgraded full year earnings expectations. Next year Flex will benefit from the inclusion of its $540m purchase of Anord Mardix which is a global leader in critical power solutions in data centers. The acquisition will be accretive to growth and margins and looks like a great fit to the business. In early February, Flex announced TPG (private equity company) had invested $500m in its NEXTracker business (largest solar tracking business globally) at an implied $3bn valuation which was well ahead of our expectation. This will pave the way for a future IPO of the NEXTracker business providing the catalyst we have been anticipating for some time.

PTC delivered strong first quarter results with bookings up double digit organically which was well ahead of internal expectations. Management planned for a slight bookings decline as it was cycling a very strong period from last year therefore it outperformed this metric by 20%+. PTC raised its annual recurring revenue guidance on the back of the first quarter beat which places it well to achieve full year expectations. PTC is currently shifting its customer base from on premise delivery to more of a SaaS model and while this will take a couple of years to really move the needle, it is seeing strong early traction in its Windchill business.

Advantest operates in a global duopoly with US based Teradyne (50% share each) in the semiconductor "system on chip" testing market. It is a clear beneficiary from increased spending in semiconductor capacity with Q3 orders up 43% driving revenue and earnings up significantly. On the back of the strong results, Advantest lifted full year guidance across all metrics. Management's SoC tester market outlook projects a 10-20% YoY gain in 2022 with the HPC business as a driver. Notably the company indicated demand increased in response to continued 5G phone evolution and higher sales volumes. The shortage of semiconductors for automobiles, industrial equipment and consumer electronics has spurred active investment in production capacity for various semiconductors as well as in advanced technology.

Sensata is a global leader in mission critical sensing devices, predominately found in automotive, heavy vehicle and industrial applications. FY results came in ahead of market expectations driven by 4Q21 EPS of $0.87, ahead of consensus at $0.81 and company guidance of $0.76-$0.82. Revenues of $935m were solidly above consensus at $916m and guidance of $895-$925m. Management is expanding its capabilities in electrification – vehicles, charging and grid. New electrification wins totaled $270m in annual future revenue in FY21. The company is in discussion with customers around additional opportunities representing a pipeline of >$1bn. The company anticipates a >50% increase in annual revenues in 2022 from these efforts. We look forward to its Electrification teach in on February 22nd.

Azek is benefiting from a secular shift from wood to composite materials in the North American decking market. It delivered Q1 sales of $260m (+22% YoY) ahead of the market at $257m and higher end of guidance. Residential sales increased +19% YoY to $221m. Adjusted EBITDA was $59m (+21% YoY) beating consensus at $57m and ahead of higher end of guide. Quite a solid statement from Management: *We continue to see a strong underlying market driven by positive demographic trends increasing focus on outdoor living and the ongoing conversion away from wood towards our types of low maintenance, high performance alternative materials. In decking as an example, we see our market opportunity is almost five times the current market, including wood.*

XPO Logistics is a top 3 less-than-truckload (LTL) player in North America and the second largest truck brokerage operator globally. It reported its highest revenue of any quarter in company history in the fourth quarter and provided FY22 EBITDA and EPS guidance nicely ahead of market forecasts. The stock has been under pressure as it underperformed in its third quarter results however Management has taken a number of important operational adjustments which are now clearly bearing fruit as it expects its operating ratio to expand by 100bps by year end.

Assurant is a leading global provider of lifestyle and housing solutions that support, protect and connect major consumer purchases, primarily mobile phones and autos globally. It delivered full year EPS growth at the top end of its 10-14% guided range as it benefits from increased 5G phone trade ins and a strong used car market driving higher attach rates. Management guided FY22 EBITDA to grow another 8-10% despite significant investments in new programs recently won with AT&T and T-Mall as it builds out its in-store repair model. Following the sale of its Preneed business earlier this year it holds >$800m excess capital which will be allocated to share buybacks and tuck in M&A this year.

LiveRamp operates at the epicenter of enabling first party data in a secure private environment and has become an essential buy for companies marketing to customers online. In the past quarter Walmart, JD.com and Amazon became customers of its platform and as core tenants, they should drive outsized growth going forward. Subscription net revenue retention came in at 120% while gross margins expanded 340bps to 77%. The business is already profitable and generates positive cash flow however over the coming years we expect significant profit drop through as the business scales into its revenues.

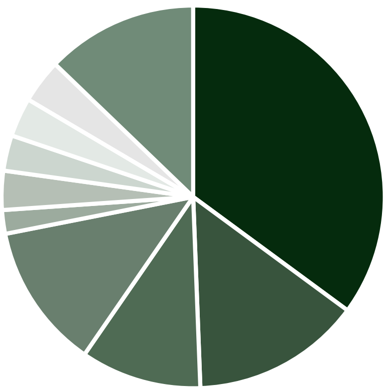
Portfolio Characteristics

Holdings

Top 10 holdings	Country	Sector	%
WillScot Mobile Mini	United States	Industrials	3.97%
Webster Financial	United States	Financials	3.80%
DigitalBridge Group	United States	Real Estate	3.74%
XPO Logistics	United States	Industrials	3.70%
TKH Group	Europe	Industrials	3.51%
GXO Logistics	United States	Industrials	3.43%
PVH Group	United States	Consumer Discretionary	3.42%
Cellnex	Europe	Communication Services	3.33%
Option Care Health	United States	Health Care	3.29%
Bureau Veritas	Europe	Industrials	3.19%

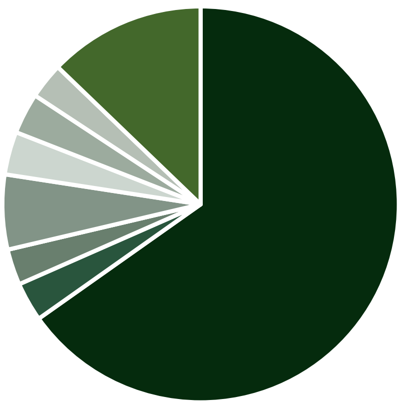
Source: Ellerston Capital.

Sector Allocation



Source: Ellerston Capital.

Geographic Allocation



Source: Ellerston Capital.

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Find out more

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