

Ellerston Asia Growth Fund

Monthly Newsletter, February 2022

Investment Objective

To outperform the MSCI Asia Ex Japan (non-accumulation) (AUD) benchmark on a net of fees basis, with a focus on capital growth and downside protection.

Investment Strategy

The Fund's investment strategy is to provide access to a high quality portfolio of primarily large cap Asian Companies using the Manager's distinctively high growth, high conviction and benchmark independent investment approach.

The Manager believes that the trade-off between risk and potential returns at the portfolio level is improved by implementing highest conviction ideas from a filtered universe of securities that offer the best risk/reward.

Key Information

Strategy Inception	4 January 2017
Portfolio Manager	Fredy Hoh
Application Price	\$0.9508
Net Asset Value	\$0.9484
Redemption Price	\$0.9460
Liquidity	Daily
No Stocks	31
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception ^{^^} (p.a.)
Net[^]	-5.74%	-7.27%	-10.16%	-12.24%	0.48%	4.84%	6.79%
Benchmark*	-5.24%	-6.50%	-10.27%	-10.25%	1.92%	3.86%	7.25%
Alpha	-0.51%	-0.78%	0.11%	-1.99%	-1.44%	0.98%	-0.46%

[^] The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance
^{*} MSCI Asia ex Japan (non-accumulation) (AUD)

Commentary

Ellerston Asia Growth Fund (EAGF) was down 5.74% (net) in February versus the MSCI Asia ex Japan Index which was down 5.24%.

It was another volatile month for Asian markets driven by rising geopolitical tensions and renewed regulatory and COVID related concerns in China.

Geopolitical Risks

Global markets were roiled during the month by Russia's military incursion into Ukraine. The Russia/Ukraine situation has a number of potential implications for Asian markets. Firstly, Ukraine is a major global supplier of gases used in the manufacturing process for many products including semiconductors. For instance, Ukraine is responsible for 70% of global Neon gas, 40% of the world's Krypton and 30% of global Xeon supply. The armed conflict could therefore disrupt already fragile global supply chains. Our channel checks with semiconductor companies in the EAGF portfolio suggest that there is sufficient (up to 6 months) specialty gas inventory on hand to navigate any short term supply disruptions. A prolonged military conflict however could materially impact global semiconductor production.

The second implication is the surge in oil and commodity prices. Russia is the second largest producer of oil in the world and a major producer of natural gas, aluminum, thermal coal and palladium. Potential curbs on the country's oil exports either through voluntary trade withdrawal or external sanctions have created an exogenous shock to energy and commodity prices. Asian countries with the exception of Malaysia are major importers of oil in particular. Higher energy prices will put upward pressure on inflation and could have an adverse impact on near term growth across the region. This is a risk we are monitoring, particularly with our overweight position in India. EAGF has a very stringent ESG (Environmental, Social and Governance) policy and therefore has no direct exposure to the energy sector other than via conglomerate Reliance Industries. We note also that higher energy and commodity prices could result in margin pressure for many supply chain companies. The EAGF portfolio is skewed towards companies with pricing power such as TSMC and Samsung Electronics.

Finally, the outcome of the Russia/Ukraine situation could have potential read-throughs on how China handles the matter of Taiwan sovereignty. There are concerns that a lenient response from NATO allies on Russia could embolden China to take a more forceful approach to Taiwan. Although we believe a China invasion of Taiwan is a non-zero probability, it is certainly not our base case because of the latter's dominant position in global semiconductor manufacturing (~70% global market share in foundry). As such, an incursion into Taiwan risks destroying important semiconductor infrastructure that China needs in order to achieve its economic goals. Further, China has not been involved in any armed conflicts since 1979 and has instead focused on 'soft diplomacy' and playing the long game on geopolitical matters. For example, China has openly urged Russia to resolve the current Ukraine crisis through dialogue.

China Risks Resurface

February saw a resurfacing of regulatory and COVID concerns in China. On the regulatory front, new restrictions on the live streaming, ride-hailing and food delivery platforms created a fresh wave of negative sentiment for the internet sector. The regulatory crackdown over the past 12 months has eroded significant corporate and shareholder value, with most companies down 50-70% from their February 2021 highs. Many internet names are now trading at trough valuations with multiples akin to value stocks. For example, Tencent and Alibaba are currently trading at 18x and 10x forward P/E respectively. Yet both companies continue to operate growth businesses with enormous scale, excellent balance sheets, good free cash flow generation and likely to sustain double digit earnings growth in the long term. Although we acknowledge 'cheap' valuations alone are an insufficient precondition for these companies to outperform, they are now trading at levels where there is undoubtedly a margin of safety for patient investors. We remain cautiously optimistic on the China internet sector and expect the regulatory environment to turn more benign this year. A break in policy announcements along with the potential resumption of IPO, M&A and online games approval activity are the positive catalysts we are watching for.

On COVID, surging cases in HK saw the local government re-introduce stringent social distancing restrictions. This dashed hopes that the Chinese Government would relax its COVID-zero policy post the Winter Olympics. A possible reason behind China's reluctance to reopen is the lower efficacy of the domestic Sinovac and CanSino vaccines. So despite high double dose vaccine penetration rates (90%+ in China and 69% in HK), the Government is likely concerned about the potential stress on the hospital system if the country was to fully reopen. During the month however, China approved Pfizer's COVID antiviral pill (Paxlovid) for domestic use. The rollout of Paxlovid in the coming months could pave the way for a formal reopening. Until then, China remains susceptible to COVID related disruptions.

Despite the ongoing regulatory and COVID related risks, we continue to be constructive on the outlook for Chinese equities. We believe slowing consumption and GDP growth is likely to result in easier monetary policy, progressive moderation of China's COVID zero policy and a more benign regulatory environment. This should provide a supportive backdrop for Chinese equities to outperform in 2022. As such, China/HK remains our largest country exposure in the portfolio.

Portfolio Performance Summary

Taiwan and Hong Kong were the largest contributors to alpha during February. Whilst, China and South Korea were the largest detractors. At a sector level, Information Technology and Consumer Discretionary were the biggest contributors to performance. Meanwhile, Financials and Industrials were the worst performers.

At a company level, Unimicron and Mengniu Dairy were the main alpha generators for the portfolio. Unimicron reported very strong 4Q21 numbers during the month with revenues and net profit up 35% YoY/144% YoY respectively. Unimicron is one of the biggest beneficiaries of the supply shortage situation in the IC substrate market and this should underpin ~35% earnings CAGR in the next 3 years. Meanwhile Mengniu's continued outperformance was driven by rotation into high quality stocks amidst the market volatility.

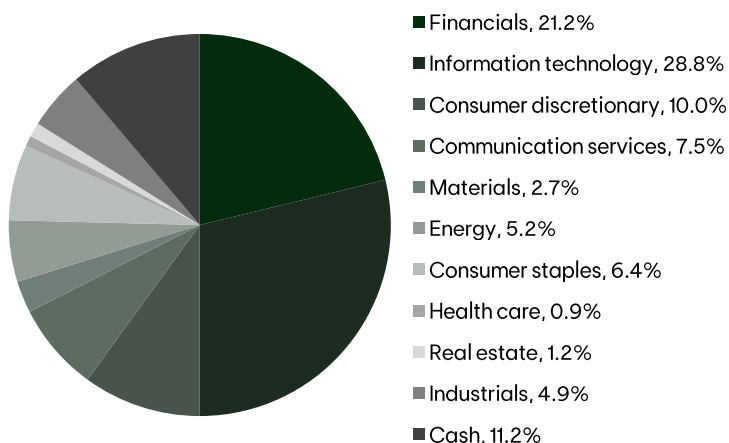
Wuxi Biologics and CATL were the biggest drags on performance. Wuxi Biologics was sold off after the company was placed on the US Unverified List on the grounds that certain end-use verifications of equipment exported from the US have not been conducted over the past two years. There remains uncertainty on if/when the company can be removed from the Unverified List and also the potential impact to Wuxi's future growth prospects. As such, we exited from Wuxi during the month. Meanwhile, the share price weakness in CATL reflected investor concerns over rising input costs and rumours that the company could face US sanctions. We see very little reason for CATL to be sanctioned. The company has also subsequently verified that it does not use any US originated technology or equipment in its battery production, which would suggest minimal earnings impact even if sanctions were to be imposed.

As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

Kind regards,
Fredy Hoh

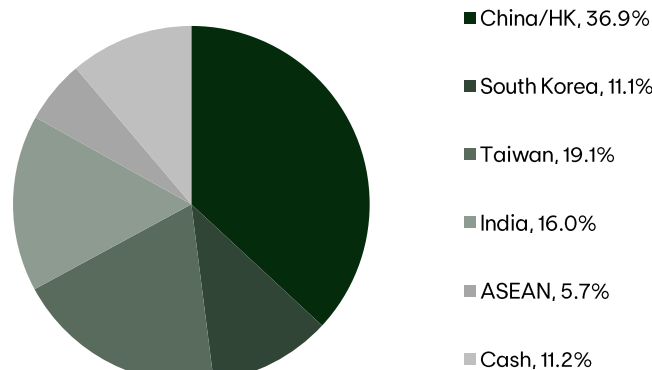
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Sector	Weight
TSMC	Taiwan	11.13%
Samsung Electronics Co.	Korea	7.63%
Tencent Holdings	China	6.07%
Reliance Industries	India	5.16%
DBS Group Holdings	Singapore	4.67%
China Mengniu Dairy Co.	China	4.09%
MediaTek Inc.	Taiwan	3.42%
AIA Group Limited	Hong Kong	3.35%
Unimicron Technology Corp	Taiwan	2.84%
ICICI Bank Limited	India	2.81%

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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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