APIR Code: ECL1411AU

Ellerston Asia Growth Fund

Monthly Newsletter, May 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	$0.8610
Net Asset Value	$0.8589
Redemption Price	$0.8568
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^	-2.65%	-9.44%	-16.02%	-20.84%	-0.72%	1.74%	4.53%
Benchmark*	-0.74%	-6.76%	-12.81%	-16.91%	2.88%	2.59%	5.53%
Alpha	-1.92%	-2.68%	-3.21%	-3.93%	-3.60%	-0.85%	-1.00%

^ 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 2.65% (net) in May versus the MSCI Asia ex Japan Index which was down 0.74%.

May was a story of two halves with concerns over the US interest rate and growth outlook and China's COVID situation dragging down global markets in the first half of the month. This was followed by a strong technical rebound in the second half of May driven by certain positive developments coming out of China. We discuss these points in detail below.

China Green Shoots

There were a number of positive events in late May that could prove to be an inflection point in the economic and regulatory trajectories for China. On the economic front, the latest COVID outbreak has been largely contained with Shanghai slowly coming out of lockdown and the number of cities under localized restrictions falling to ~20 (vs over 40 in April). We had previously viewed an improving COVID situation as a precondition for the government to announce meaningful stimulus policies. Indeed, the PBOC cut the 5-year loan prime rate by 15bps to 4.45% during May which will help to alleviate pressure on the property/mortgage sector. Furthermore, the State Council announced a raft of fiscal measures to boost consumption and infrastructure activity including tax rebates, loan support for small businesses and issuance of construction bonds. A number of local governments such as Shenzhen have also rolled out subsidies for electric vehicle, travel and technology related purchases. Collectively, we see these measures and events as a strong signal of intent by the Government to revive the economy.

On the regulatory front, a major symposium was held in May between private sector tech companies and key policymakers including Vice Premier Liu He. This meeting again advocated for the healthy development of the platform economy and further IPOs of companies both domestically and offshore. The meeting followed other recent events such as the resumption of online game approvals in April and the proactive efforts by the Chinese Securities regulator to resolve the US auditing issues for its ADR companies. We view these events as a potential turning point in the regulatory cycle towards a more conciliatory and market-friendly phase.

Last month, we highlighted that investor sentiment towards China was weak and that any tangible policy action (rather than just rhetoric) could be a catalyst for a rally in China/HK markets. Indeed, throughout May we have seen a number of positive actions to justify an improvement in investor sentiment. Despite this, we acknowledge ongoing risks such as the continuation of China's zero-COVID policy and US/China geopolitical tensions still remain. These are factors that currently prevent us from turning outright bullish on China. Nonetheless, we are optimistic on the near term outlook for China/HK and this region remains our largest exposure within the portfolio.

Global Stagflation Concerns

Global markets continued to be concerned that a concurrent increase in US interest rates and the reduction in the Federal Reserve (Fed) balance sheet will induce a potential economic recession. We acknowledge that the mandate to bring down inflation, which is currently sitting at a 40 year high (of 8.6%YoY in May), whilst orchestrating an economic 'soft landing' will be extremely difficult. The Fed Fund Futures are currently pricing in ~260bps of additional rate hikes in 2022, suggesting at least 50bps in hikes at each of the next 5 Fed meetings. Meanwhile, the consumer backdrop is softening with the latest US consumer sentiment reading at the lowest levels since the late 1970s. The prospects of the Fed accelerating its pace of rate hikes into a slowing demand environment is likely to lead to further volatility for risk assets.

In order to prepare for further market choppiness, EAGF continues to take a barbell approach for portfolio construction with overweight positions in high quality structural growth companies as well as rate sensitives such as banks and insurers. Additionally, the clear policy divergence that is occurring between China (counter cyclical easing) and most developed markets globally (tightening) provides further validation for our portfolio tilt towards China/HK. We note that as at the end of May, the weighted average PE ratio of EAGF was 17x and the weighted average forward earnings growth was ~17% for a PEG ratio of 1.0x. Average ROE of the portfolio was 18% and the weighted average forward FCF yield of our portfolio companies (ex financials) was 4%.

Portfolio Performance Summary

Taiwan was the largest contributor to alpha during the month. Whilst, China and India were the largest detractors. At a sector level, Information Technology was the biggest contributor to performance. Meanwhile, Materials and Consumer Discretionary were the worst performers.

At a company level, BYD and Mediatek were the main alpha generators for the portfolio. The BYD share price was boosted by continued strength in auto sales, with April/May vehicle volumes up +134%YoY/148%YoY respectively. The company has been able to perform resiliently throughout the latest COVID wave in China due to the high level of vertical integration of its supply chain. Mediatek meanwhile was supported by comments from CEO Rick Tsai confirming guidance of 20% plus revenue growth in 2022 and 3-year revenue CAGR of 14-16%. This helped to allay concerns that Mediatek would be negatively impacted by the slowdown in the Chinese smartphone market.

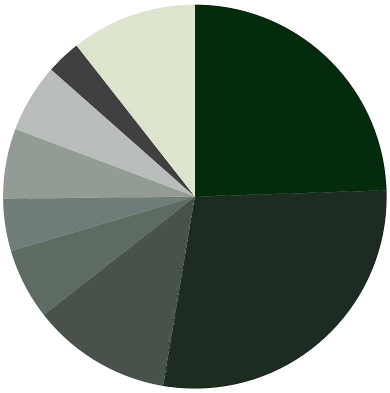
JSW Steel and DBS were the biggest drags on performance. JSW Steel was negatively impacted by the Indian Government's surprise decision to impose a 15% export duty on steel products. This policy move was part of swathe of measures introduced during the month to tackle rising inflation. India has been a net exporter of steel over the past 3 years and this area has helped domestic steel producers achieve record high profitability. We believe the introduction of an export duty and the resultant negative impact on realizations is likely to result in a sharp earnings drop for the current year. This represents a material change to our investment thesis. As such, we exited our JSW Steel position during the month. DBS's share price weakness during the month reflected concerns over the potential slowdown in global growth. We however see DBS as one of the biggest beneficiaries of the rising interest rate environment. Interest rate driven NIM expansion along with mid to high single digit loan growth and solid fee income growth should deliver low teens EPS CAGR.

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

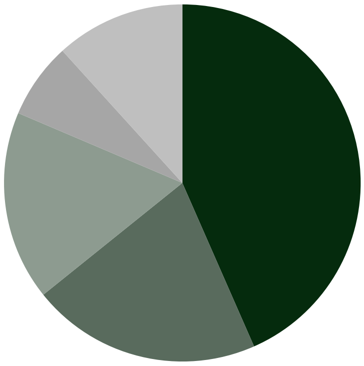
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Country	Weight
TSMC	**Taiwan**	**11.1%**
Samsung Electronics	**Korea**	**7.7%**
Tencent Holdings	**China**	**6.0%**
Reliance Industries	**India**	**5.9%**
AIA Group	**Hong Kong**	**4.3%**
DBS Group	**Singapore**	**4.2%**
Alibaba Group	**China**	**3.7%**
ICICI Bank	**India**	**3.4%**
China Mengniu Dairy	**China**	**3.3%**
Unimicron Technology	**Taiwan**	**3.0%**

Contact Us

Sydney

Level 11, 179 Elizabeth Street,
Sydney, NSW 2000
+612 9021 7701
info@ellerstoncapital.com

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**

Ellerston Capital