APIR Code: ECL1411AU

Ellerston Asia Growth Fund

Monthly Newsletter, July 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	$0.8285
Net Asset Value	$0.8264
Redemption Price	$0.8243
Liquidity	Daily
No Stocks	33
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^	-3.92%	-6.34%	-17.87%	-21.71%	-6.45%	-1.24%	3.68%
Benchmark*	-3.09%	-4.72%	-15.19%	-17.55%	-2.95%	-0.21%	4.59%
Alpha	-0.83%	-1.61%	-2.68%	-4.16%	-3.50%	-1.03%	-0.91%

^ 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 3.9% (net) in July versus the MSCI Asia ex Japan (MXASJ) Index which was down 3.1%.

July saw a return of China related concerns and that negatively impacted EAGF performance during the month. We continue to maintain a positive view on the outlook for Chinese equities and the potential for it deliver uncorrelated returns to the rest of the world in the second half of 2022. Ongoing supportive fiscal and monetary policies, low valuations and light investor positioning support our overweight position to that region.

China Property Concerns Overstated

China/HK markets were buffeted during the month by renewed concerns over the domestic property sector. Specifically, over 300 projects across more than 90 cities were reportedly impacted by mortgage boycotts from buyers of unfinished property developments. Many of these unfinished projects were delayed due to liquidity issues encountered by distressed property developers. Our latest channel checks indicate that mortgages related to suspended property projects that could be at risk equate to RMB500bn-1tn. This would account for only 1-3% of total mortgages or 0.2-0.5% of total loans outstanding within China's banking system. As such, it does not appear that the mortgage repayment issue as it currently stands will lead to a full blown property crisis. Furthermore, the Government has already intervened by announcing a number of policies including targeted liquidity injections for property projects and local governments, and the potential for temporary mortgage 'holidays' for borrowers. We therefore expect the direct impacts from mortgage boycotts to be manageable. There may however be some negative short term spill-over effects to the broader economy from worsening homeowner sentiment. This is something we are closely monitoring, particularly for the domestic consumption names that we own. EAGF has very little direct exposure to the Chinese property sector outside of small positions in Beijing Oriental Yuhong, China Merchants Bank and Postal Savings Bank.

The ongoing issues in the property sector is the result of a multi-year campaign by the Chinese Government to reduce leverage and speculative behavior within the system. Whilst property will continue to be an important pillar of the domestic economy given it directly and indirectly accounts for ~25% of China's GDP and 70% of household wealth, the Government has become increasingly reluctant to rely on the sector to meaningfully drive economic growth. As such, the property sector is likely to be a structurally more stable and a lower growth contributor to China's economy going forward. Other parts of the economy will therefore need to do more of the heavy lifting if China is to achieve its growth ambitions of doubling its GDP to ~US$30 trillion by 2035. This includes a greater focus on consumption, innovation, advanced manufacturing and addressing its demographic issue.

We recently turned constructive on the outlook for Chinese equities. Our positive view was driven by expectations that policymakers will be motivated to ensure a 'healthy' economy leading into the all-important 20th Party Congress later this year. Unlike most countries around the world, China does not have an inflation issue with the latest CPI coming in at +2.7%YoY. This gives the Chinese Government the flexibility to stimulate the economy following the latest COVID outbreak. As such, further supportive policies in areas such as consumption, decarbonisation, innovation and factory automation will be the key drivers of growth in the near term. Indeed, these are the areas where our investments are skewed towards. Ongoing risks associated with China's zero-COVID policy and the property sector could lead to near term volatility. We will however take a patient and disciplined approach and use any further pullbacks to add to high quality companies at even more reasonable valuations.

Reporting Season Observations

Another event that occupied investor attention during the month was the June quarter earnings results. Expectations heading into this reporting season had been lowered due to worries that hawkish central bank action and elevated input costs would result in a material slowdown in earnings growth.

The results reported by companies across Korea, Taiwan, India and ASEAN however have been broadly positive particularly for financials, energy and materials companies due to tailwinds from higher rates and commodity prices respectively. For consumer and technology companies, reported earnings growth remained robust but outlook statements were more muted due to a slowing down in demand particularly for products that benefited during COVID such as electronic and household goods and gaming. Margin pressure was also evident due to surging raw material prices, higher wages and ongoing supply chain related issues.

EAGF portfolio companies fared well during the reporting season with generally positive earnings results and constructive outlook statements. We believe this is a function of our bias towards quality businesses such TSMC, Mediatek, Reliance and Techtronic that have the pricing power to offset volume headwinds with price increases. Meanwhile, our Financials investments such as ICICI Bank, DBS and Bank of Mandiri are benefitting from improving loan growth and margin expansion from rising interest rates.

Portfolio Performance Summary

Taiwan and Singapore were the largest contributors to alpha during the month. Whilst, China, India and Korea were the largest detractors. At a sector level, Information Technology and Financials were the biggest contributors to performance. Meanwhile, Consumer Staples and Materials were the worst performers.

At a company level, ICICI Bank, Zhejiang Shuanghuan Driveline and TSMC were the biggest contributors to relative performance during the month. ICICI Bank reported very strong 1QFY23 results with loan growth and net interest income growing 21%YoY respectively and core operating profit growing 19%YoY. We continue hold a positive view on ICICI Bank given its ability to consistently deliver quality high-teens earnings growth driven by macro tailwinds in India and strong operational execution. Shuanghuan Driveline's strong share price performance was driven by improving earnings growth visibility on the back of China's booming EV sales and the strong demand for domestic industrial robots as manufacturing activities start to recover. Finally, TSMC reported a better than expected result with 2Q22 revenues and operating profit growing 44%YoY/80%YoY respectively. The company also upgraded full year 2022 revenue guidance to +35%YoY (vs +30%YoY previously). Although there is the risk of a minor inventory correction by its end customers in the near term, we remain constructive on the structural outlook for TSMC given market share gains into clients such as Intel, NVIDIA, Qualcomm and Apple and pricing power afforded by its technology leadership.

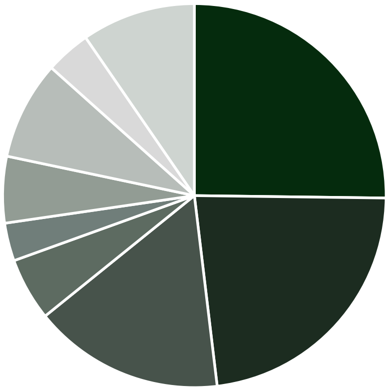
Beijing Oriental Yuhong, China Merchants Bank (CMB) and Mengniu Dairy were the biggest drags on alpha. Yuhong and CMB were sold off on the aforementioned property sector concerns. We note that the potential impact to both companies from the mortgage repayment risk is small. For Yuhong, only 30% of its waterproofing products are sold to domestic property developers of which 70% are considered top tier State Owned Enterprises (SOEs) such as Poly, COLI and Vanke that have no liquidity or balance sheet distress. Further, our understanding is that Yuhong's exposure to risky developers are fully collateralized. As such, we believe the share price reaction on property related risks are overdone and see an opportunity for financially strong suppliers such as Yuhong to further consolidate the waterproofing industry. Similarly for CMB, the company has disclosed that its current exposure to unfinished projects facing mortgage suspension risks is RMB12m (or 0.001% of its total mortgage loan book). Whilst the risks to CMB appear limited, there are worries that domestic banks will be required to carry out 'national service' to help support the property sector. We however believe that there is a preference for local governments (rather than banks) to resolve the unfinished projects issue. Further, CMB is now trading under 1x P/B which is 1x standard deviation below historical average which implies these risks are more than appropriately reflected in the share price. Finally, Mengniu's share price weakness was driven by selling from two major shareholders during the month as well as consensus earnings downgrades heading into the 1H22 results. We had already expected 1H earnings to be soft due to the one-off impact from the recent Shanghai lockdown, but believe the company can still achieve 18% 3 year EPS CAGR (2021-24) driven by 11% p.a. sales growth along with 30-50bps p.a. of margin improvement.

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

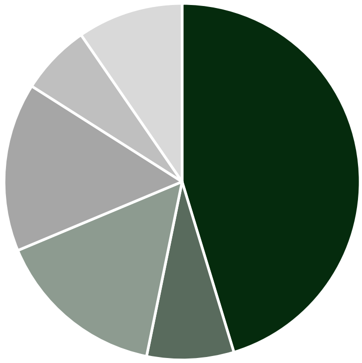
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Country	Weight
TSMC	Taiwan	10.4%
Samsung Electronics	Korea	6.1%
Reliance Industries	India	5.6%
Tencent Holdings	China	5.3%
Alibaba Group	China	4.7%
AIA Group	Hong Kong	4.5%
DBS Group	Singapore	4.4%
China Mengniu Dairy	China	4.2%
ICICI Bank	India	3.6%
Kweichow Moutai	China	3.0%

Regulatory Guide (RG240) Fund Disclosure Benchmark – Periodic Reporting (monthly)

- **Net Asset Value of the Fund and Redemption Price of Units**

Please refer to details on page one.

- **Any changes to key service providers including any change in related party status**

There have been no changes to key service providers, including any change in related party status.

- **Net returns after fees, costs and relevant taxes**

Please refer to details on page one.

- **Any material changes to the Fund's risk profile and strategy**

There have been no changes to the Fund's risk profile and strategy.

- **Any material changes related to the primary investment personnel responsible for managing the Fund**

Please refer to details on page one; there have been no changes to the primary investment personnel responsible for managing the Fund.

Contact Us

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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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