APIR Code ECL7259AU

Ellerston Equity Income KIS Fund

Monthly Newsletter, August 2022

Investment Objective

The investment objective of the Ellerston Equity Income KIS Fund ("KIS" or "the Fund") is to provide investors with returns and income growth greater than the S&P/ASX 200 Accumulation Index over rolling 5 year periods.

Investment Strategy

The Fund is a fundamental, bottom up, concentrated Australian equities strategy with a clear focus on delivering sustainable dividend income for investors through an actively managed portfolio of stocks throughout the market cycle.

Key Information

Strategy Inception^^	1 May 2019
Portfolio Manager	Chris Kourtis
Application Price	$1.0572
Net Asset Value	$1.0546
Redemption Price	$1.0520
Liquidity	Daily
No Stocks	32
Strategy FUM	$19.3m
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	Quarterly

PERFORMANCE SUMMARY

Performance	1 Month	FYTD	3 Months	CYTD	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception (p.a.)^^
Net^	0.11%	5.76%	-2.61%	-1.10%	-0.36%	12.78%	8.62%	9.65%
Benchmark*	1.18%	6.99%	-2.39%	-3.63%	-3.43%	11.24%	5.51%	6.80%
Alpha	-1.06%	-1.24%	-0.22%	2.53%	3.08%	1.54%	3.11%	2.85%

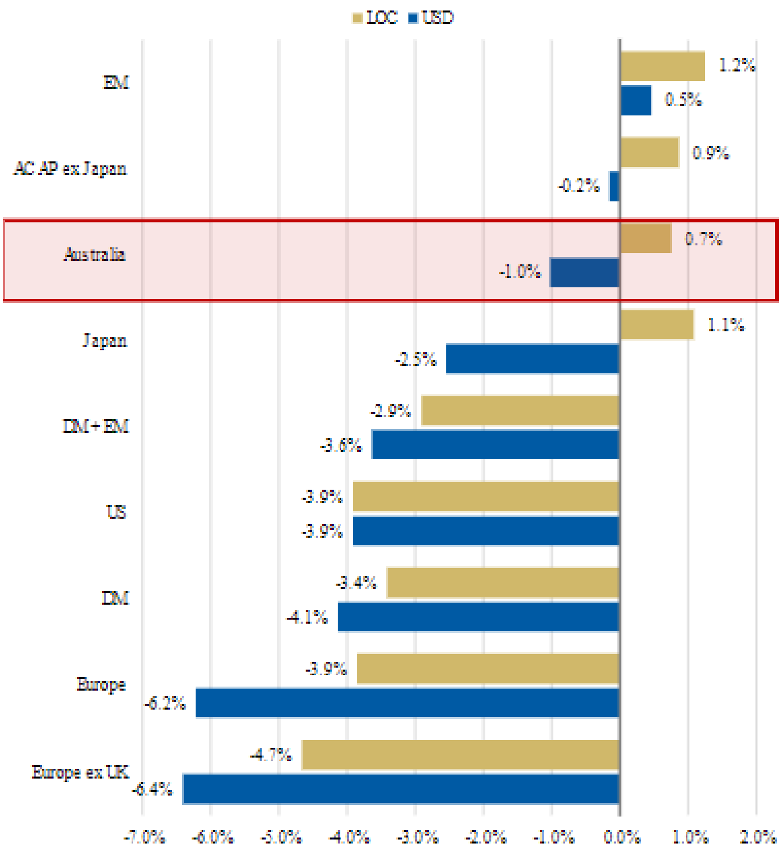
^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

*S&P/ASX 200 Accumulation Index.

MARKET OVERVIEW

The MSCI's 47-country world stock index gave back some of July's 7.9% "reprieve" rally, after the massive 21% drop in the 1H, falling 2.5% in the month of August. The bond market was clearly the most important driver. Yields rose sharply on prospects that the US Federal Reserve (Fed) would continue hiking rates, holding them higher for longer than was previously expected in their pledge to combat inflation. Fed Chair Powell's comments that "the Fed will keep at it until the job is done" dashed any hopes investors had that the Fed would pivot anytime soon.

MSCI Global Country/Regional Indices in August 2022



Source: Morgan Stanley.

USA

Economic indicators softened further during the month, but inflation and employment data remained elevated. July nonfarm payrolls surged by 528k and combined with positive revisions, pushed employment above the Feb-2020 level for the first time in the post pandemic recovery. The unemployment rate dropped to 3.5%, also back to the pre-COVID level. The July core CPI at +0.3% MoM (+5.9% YoY) was better than expected and so too was headline inflation at -0.02% MoM. The annual rate now stands at +8.5% but is lower than June's +9.1% print (the highest in four decades). This was taken positively by the equity market, with odds of a 75bps September hike seemingly diminishing.

The FOMC minutes released later in the month and Powell's Jackson Hole speech drastically changed the direction of bond and equity markets, confirming the hawkish tone set by Fed speakers leading up to his eagerly awaited speech. Emphasis was placed on the need to restore price stability and cautioning that doing so, would likely require "a restrictive policy stance for some time". He noted, that while the better July inflation data was welcomed, "it will take some time to restore price stability". Hence, the argument for a restrictive policy stance for an extended period remains, potentially driving a sustained period of below trend growth. The message was clearly about pain management, not pain avoidance, which the equity market didn't like, consequently falling 8% from its intra-month high.

The final wash up was the Dow Jones Industrial Average closing down 3.7%, the S&P 500 finished 4.2% lower, with the NASDAQ Composite Index the laggard, posting a 4.5% fall.

Europe

Europe's inflation accelerated to another all-time high, with a headline CPI of 9.1% YoY and core inflation of 4.9% YoY, strengthening the case for the European Central Bank to consider a jumbo interest-rate hike when it again meets in early September. The Eurozone Manufacturing PMI showed that output fell at a similar pace to that seen in July and new orders also declined sharply, once again. Weak demand conditions were a major drag on goods producers in August, reflecting deteriorating purchasing power across Europe, amid cripplingly high energy induced inflation. In the UK, the average household energy bill will have gone from £1042 p.a. to an estimated £4000p.a. in March 2023.

The Euro STOXX50 Index really struggled and eventually finished the month down 5.1%. Among the major exchanges, France's CAC 40 was 5.0% lower, Germany's DAX fell 4.8% and UK's FTSE 100 was a relative outperformer, only down 1.1%.

Asia

China's IP for July was again weaker and fixed asset investment also slowed to 3.7% YoY - a big drop from June's 5.8, mainly dragged down by a further decline in direct property investment. However, the bright spot was infrastructure investment, which continues to exhibit strong momentum. China has held the course on its stimulatory policy support to cushion the negative impacts of COVID and aims to lift the property sector, this time by "encouraging" banks to increase lending following the collapse of non-bank lending in July.

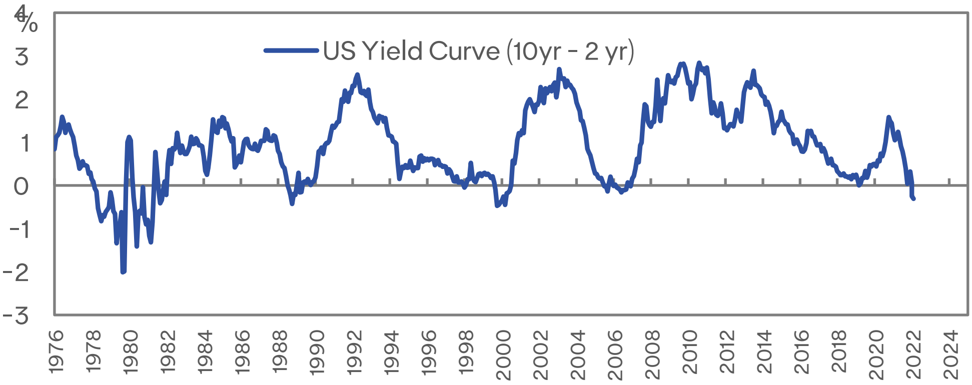
Certain key Asian equity markets bucked the global trend, especially, India's SENSEX which rose a further 3.6% after its previous month's strong 8.7% move. The Nikkei 225 also finished 1.1% higher, the Korean KOSPI rose 0.8%, followed by the Hang Seng which fell 0.8% and China was the laggard, the SSE down 1.5%.

Commodities

Commodity prices were generally weaker as the yield curve inverted further and the US$ was stronger. The Brent oil price was a major casualty and retreated 12% to US$96/barrel. However, natural gas prices continued to rise in Europe and Asia - the European TTF spot gas price spiked 20% to US$71/MMBtu and the JKM spot LNG price ended 28% higher at US$54/MMBtu. The cause was Russia's Nord Stream 1 pipeline, which operated at a lower capacity utilisation rate, coupled with an additional unscheduled maintenance shut down. Whilst these gas prices are eye watering, they were still significantly off their intra-month highs of US$99/MMBtu and US$70/MMBtu for the TTF and JKM prices, respectively. This lifted demand for thermal coal and pushed prices 5% higher to $425/tonne. Iron ore eased 3% to US$101/tonne and coking coal rebounded 43% to US$274/tonne. The base metals complex was generally weaker, with the major metals; nickel and aluminium down 10% and 6% respectively, and copper down 1%. Gold eased 3% to US$1711/ounce, given the stronger greenback and higher bond yields.

Bonds

Global bonds sold off in August despite weaker key economic data and no Fed FOMC meeting in August. Expectations earlier in the month of a possible pivot by the Fed, given weaker data, got hit on the head by the July FOMC minutes and further hammered by Powell's hawkish comments at the Jackson Hole economic symposium. The aggressive Fed rate hikes have now cemented an inverted yield curve. The US 10-year treasury yield finished up 48bps to 3.13% and the Australian 10-year bond yield rose a whopping 54bps to 3.60%.



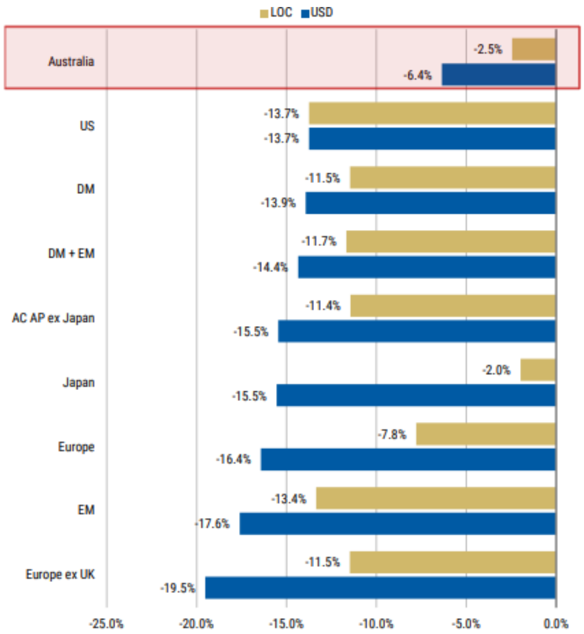
Source: Goldman Sachs.

Australia

As expected, the Reserve Bank of Australia (RBA) at its early August meeting hiked the cash rate by 50bps to 1.85%. Governor Lowe's messaging continued to emphasize high inflation and the resilience of the domestic economy, flagging further tightening to come. Labour market conditions remain strong despite the July data missing expectations. The unemployment rate fell to a fresh 48-year low of 3.4%, even as 41k jobs retraced in the month as the participation rate materially reduced from its record high of 66.8% to 66.4%.

The AUD was 2% lower at US$0.68, given the stronger US dollar and marginally weaker bulk commodity prices.

The Australian share market outperforms Global Peers in CYTD22 - 2nd in Local Currency and 1st in USD terms



Source: Morgan Stanley.

In August, the S&P/ASX 200 Accumulation Index finished 1.2% higher, continuing to outperform global peers for the month and the calendar year to date. Resources led the charge and outpaced Industrials. The Materials sector (up 4.4%, driven by BHP Group, which was up 5.0%) was the highest contributor to the Index's performance, adding 95bps, followed by Energy up 7.8%, with Woodside Energy Group, (7.1% higher on a strong 1H profit result), contributing +43bps and then Communication Services (up 2.5%, with Telstra delivering 4.2%) adding +10bps. The bottom three contributing sectors were generally interest rate sensitives, namely Real Estate (-21bps) being the worst, followed by Financials (-16bps) and then Consumer Staples (-10bps).

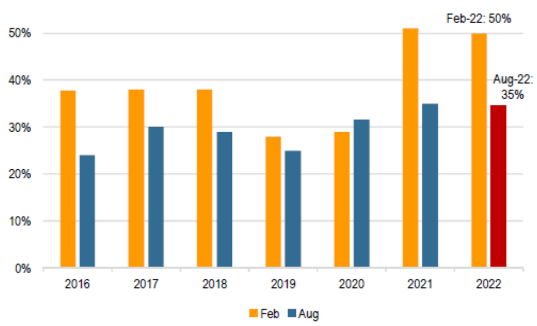
The ASX Small Ordinaries finished up 0.6%, lagging the broader benchmark by 0.6% and within the ASX Small Ordinaries, the Small resources were up 5.9%. Resources were the best performing sub-index (+5.9%), benefitting from the lower A$ and the large dividend payments being handed out.

For the month, the top stocks that made a positive contribution to the Index's return were: BHP Group (+45bps), Woodside Energy Group (+20bps), OZ Minerals which was bid for by BHP (+11bps), Santos (+10bps), and Telstra (+9bps). Conversely, the bottom five stocks detracting from the Index's performance were: Commonwealth Bank (-10bps), ASX (-9bps, following an underwhelming 1H result with a major dividend disappointment), Goodman Group (-9bps), Transurban Group (-8bps) and Coles Group (-8bps).

August Reporting Season Wrap

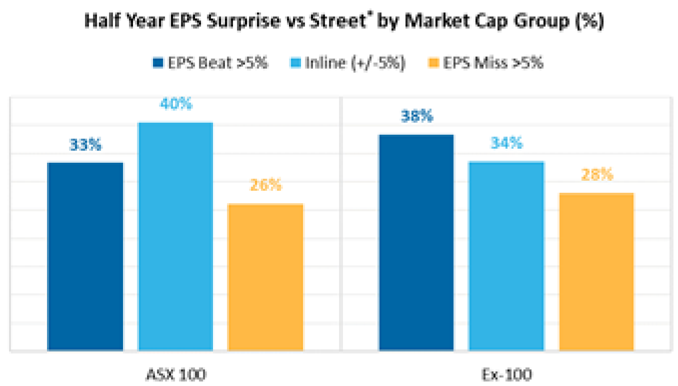
The expectation that the Aug-22 results season would precipitate a raft of FY23 downgrades failed to materialise. Company results were broadly in-line with consensus earnings expectations (over 50% of results delivered an in-line outcome); there was a positive skew outside of this, **with EPS beats exceeding misses by 1.4x. Revenue beats were greater than misses by 1.7x**, whilst DPS announcement met expectations, with a modest 1.2x beat to miss ratio. Around 43% of companies have provided guidance, and where given, has largely led to more downgrades than upgrades, to the tune of ~1.7x.

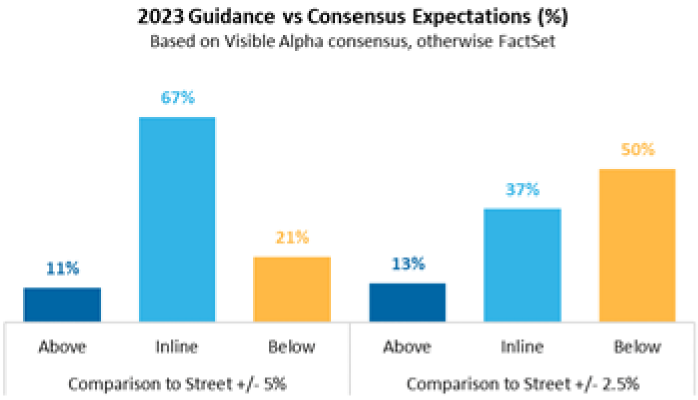
Compared to consensus, Sales, EPS and DPS all beat, although below the February (1HFY22) level of beats as shown below.



Source: JP Morgan, Macquarie Bank.

Small Caps had more EPS beats than Large and guidance was mostly below expectations.





Source: Macquarie Bank.

In terms of **positive surprises**, a few names stood out. In the IT/Software space, Altium and Wisetech Global surprised with their strong outlook in the large end of the market and so did IRESS and Tyro Payments at the smaller end. In the Consumer area, Treasury Wines, JBH Hi-Fi, Harvey Norman, and Nick Scali delivered strong results and trading updates. QBE was the best in the Insurance space, with one of its better quality results in years. Woodside Energy was the Energy stand out with a result ahead of expectations and a bumper dividend.

Negative surprises came from the likes of Coles, Woolworths, Dominos, Bendigo Bank, Lendlease Group, Beach Energy, Transurban, AGL Energy, Kogan.Com, and Ramsey Health Care, just to mention a few.

COMPANY SPECIFIC NEWS

The Market Hits

Lake Resources (LKE +44.4%) / **Pilbara Minerals** (PLS +31.8%) / **Liontown Resources** (LTR +31.4%) / **Allkem** (AKE +23.32%) / **IGO** (IGO +21.74%) / **Core Lithium** (CXO +21.2%)

Lithium stocks took off again globally after the Biden Administration passed the Inflation Reduction Act, which aims to lower drug, health care, and energy costs and is the most aggressive action on tackling the climate crisis in US history. Included in the Act is the push to build clean energy supply chains, requiring battery minerals, which includes lithium. Also, a number of local sell-side reports, promoting the stronger for longer price outlook for lithium, propelled all the companies listed above their global peer comparatives.

OZ Minerals (OZL +36.6%)

Copper producer, OZL received a non-binding indicative proposal on 5 August 2022 from BHP Group to acquire 100% of the issued share capital in OZL by way of a scheme of arrangement for a cash consideration of $25.00 per share, a 32% premium to the previous day's closing price. The OZL board rejected the proposal as inadequate and the ball is currently in BHP's court.

Whitehaven Coal (WHC +28.2%)

WHC was a beneficiary of the sustained, near record, level of thermal coal prices, with the Newcastle benchmark price up another 5% to US$425/tonne.

Coronado Global Resources (CRN +23.7%)

Coking Coal producer, CRN caught the tailwind of the strong rebound in met coal prices with the export price benchmark up 43% to $274/tonne.

A2 Milk Company (A2M +22.25%)

A2M delivered a strong FY22 result, 12% ahead of consensus estimates. The result featured increased marketing spend which drove market share gains, strong cash conversion of 114% and was accompanied by stronger China label sales (~30% of group revenue). In addition, with the balance sheet in a net cash position, A2M announced a NZ$150m share buy-back, re-instilling confidence with investors that management had stabilised the business through clearing its excess inventory in China and that the stock was bombed out and undervalued.

The Market Misses

City Chic Collective (CCX -29.1%)

Inventory woes hit CCX, in what has been a running thematic for retailers this reporting season. CCX's inventory grew 192% YoY and was~20% higher than consensus estimates. The company stated that they had reached peak inventory levels, which would unwind over FY23 to a targeted balance of $125-$135m at FY23 end (vs. $196m current). CCX is carrying more than 400 days inventory, whereas typical apparel businesses would hold 100-150 days. CCX also highlighted that 80% of their inventory was core or non-seasonal, which should carry them through the season if there is no sell-through. The market didn't buy the story and inventory concerns will remain until there are signs of a material improvement. Combined with a weak FYTD trading outlook, the stock got hammered, down 19% on the day.

Megaport (MP1 -25.1%)

MP1 is a global Software Defined Network (SDN) provider, with an emphasis on cloud connectivity. The company is highly leveraged to the rapid growth in the global cloud and data centre thematic. MP1's FY22 result was largely pre-released from its Q4 update, but post results trading was disappointing. A decline in ARPU and subdued commentary around existing customers increasing their spend was not taken well by investors.

Ramelius Resources (RMS -25.0%)

RMS materially downgraded its Edna May gold hub operations in Western Australia. The impairment, plus surprisingly higher FY23 AISC guidance and risks associated with the Edna May pit expansion, all suggest potential margin difficulties for RMS. The market agreed and the stock closed down sharply.

St. Barbara (SBM -18.2%)

SBM was in the M&A headlights back in July when discussions were confirmed with Genesis Minerals, which has a consolidation strategy for the Laverton goldfields. The July gains were quickly erased in August, with bad news of lower head grades and thus higher costs at Gwalia for FY23/24. The company also flagged another impairment at its Atlantic gold operations in Canada, which was not well received. At the end of the month, the Atlantic write-down was confirmed at $224m and saw its carrying value fall to $704m, which is still way above most analysts' valuation. The stock continues to disappoint due to poor management execution and has underperformed the gold sector by 54% over the past 3 years.

Telix Pharmaceuticals (TLX -16.1%)

TLX disclosed inits interim result that receipts from its key Illuccix prostate cancer PET imaging agent in the US disappointingly only totalled US$9.1m in July. Revenue was towards the bottom end of analyst expectations. While Illuccix seemingly remains on track to meet forecast for US sales of ~US$80m for the calendar year, costs in H122 were far above expectations. It appears that SG&A costs have been pulled forward, delaying the market's initial forecast profit from 2023, pushing it out to 2024. The next key near term catalyst for the stock is the decision by Danish regulators regarding the initial European approval of Illuccix (expected by the end of September). The jury is out.
Zip Co (ZIP -15.9%)

ZIP had pre-reported top-line metrics in its Q4 July update, however, the company's losses widened and trends were concerning. The reported cash EBTDA loss of -$207m compared to a -$48m loss in FY21 was mainly driven by declines in unit cash transaction margins (from 3.1% to 2.3% of TTV) through higher net bad-debt write-offs and higher marketing/salary costs. Further, Zip saw negative operating leverage in both its main opex components - salaries from 1.7% of TTV to 2.1% and marketing from 1.3% to 1.4%. Early reads into FY23 YTD were not positive, with sluggish MAU growth. This unsettled investors further, in what's been a roller-coaster white knuckle ride!

TPG Telecom (TPG -15.6%)

TPG released soft interim financials, with EBITDA below expectations on weaker-than-expected ARPU growth. The post pandemic recovery was much slower than expected and after delivering flat 1H EBITDA at A$873m vs. A$872m, TPG needed to do +13% in 2H to A$973m in order to achieve full year consensus EBITDA of A$1,846m. This now appears ambitious. Consensus forecasts were overly optimistic going into the result, with the market expecting 20% growth in the second half of the year. Soft post-paid mobile ARPU and higher-than-expected costs have weighed on earnings and while the company is still targeting $125-$150 million in synergies, those cost savings are being offset by other inflationary pressures. Investors took a dim view and the stock sold off.

Credit Corp Group (CCP -15.0%)

CCP surprised the market by announcing customer remediation around two key issues that it quantified as potentially amounting to up to $4.8m of customer repayments (company error around payment arrangements early in the pandemic, coupled with ASIC's change to its regulatory guidelines). The first issue was a disappointing oversight by CCP management and the second was seen as the company proactively looking to assuage the concerns of its regulator and maintain its reputation with debt sellers and consumer advocates, as a company with the highest compliance standards. The result was the shedding of $87m in market capitalisation on the day, driving the shares back towards the relative lows hit during COVID-19 in late 2020.

Novonix (NVX -14.5%)

Aspiring synthetic graphite producer, NVX focused on the battery anode, rather than lithium used in the battery cathode, failed to catch any of the battery tailwind other lithium companies enjoyed. A lack of news flow, for a fledgling company a long way away from validating its $1bn enterprise value, didn't help.

BrainChip Holdings (BRN -12.9%)

Artificial intelligence company, BRN, which had benefitted from the global tech rebound in June and July, faltered in August. The shares fell 15% near month end after a reality check came in the form of a quarterly activities and cash flow report, showing a less than rosy balance sheet and share-based payment expenses that swelled to $5.3m. Inclusion into the FTSE index announced on 22 August came to no avail, rendering BRN into the top ten under-performers this month.

FUND PERFORMANCE

The month of August saw a sharp reversal of July's spectacular rebound, as a more hawkish tone from the Fed drove global equity markets lower, leaving Energy as the only sector in the black. The Fund delivered a return of +0.2%, lagging the benchmark return of +1.2%, as investors chased lithium stocks such as Lake Resources with a zero dividend yield (up a staggering 44.4%) and coal producers.

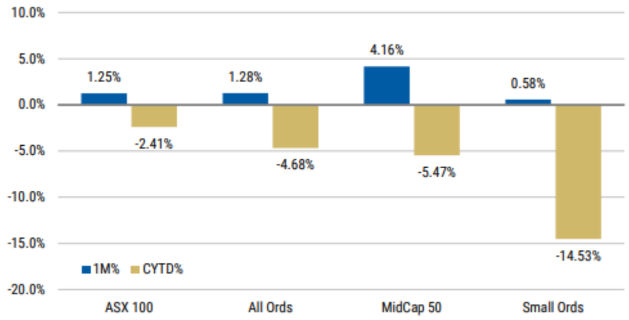
Nine of the top ten best performing stocks for the month were of the "green metal", EV thematic and coal cohort. The only industrial stock to rank in the top 10 was A2 Milk. "Green metal" stocks are not famous for their dividend attributes!!

The ASX200 continued to outperform its global peers for the month of August, cementing its CYTD22 outperformance vs. most developed and emerging markets.

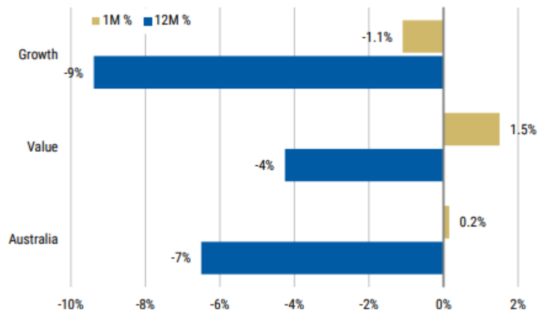
Large Cap stocks underperformed this month relative to their Mid Cap counterparts. The Energy sector was easily the best performer (led by Woodside Energy), followed by Materials (BHP Group), and Communication Services (Telstra).

Consumer Staples and Utilities were two of the three weakest performing sectors and Real Estate, down 3.2%, impacted by higher cap rates, fared the worst (Goodman Group was down 7.6% and Dexus fell 8.3%).

Mid-Caps outperformed in August but Large Caps still lead CYTD



Value outperformed Growth in August



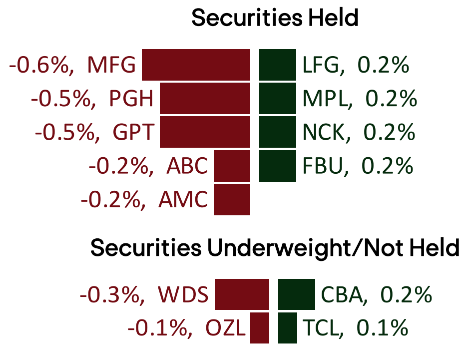
Source: Morgan Stanley.

Returns[1] (%)	*Gross*	*Benchmark**	*Excess*	*Net Return*
1 Month	0.20%	1.18%	-0.98%	0.11%
FYTD	5.92%	6.99%	-1.07%	5.76%
3 Months	-2.32%	-2.39%	0.07%	-2.61%
CYTD	-0.04%	-3.63%	3.59%	-1.10%
1 Year	1.04%	-3.43%	4.48%	-0.36%
2 Years (p.a.)	13.97%	11.24%	2.73%	12.78%
3 Years (p.a.)	9.84%	5.51%	4.33%	8.62%
Since Inception (p.a.)	10.87%	6.80%	4.07%	9.65%

[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.

Past performance is not a reliable indicator of future performance.

Month of August Attribution



Source: Ellerston Capital.

The main positive contributors to this month's performance were overweight positions in: Liberty Financial Group (LFG +5.7%), Medibank Private (MPL +8.8%), Nick Scali (NCK +14.5%) and Fletcher Building (FBU +7.8%).

Zero holdings in select large cap stocks that underperformed also helped, namely Commonwealth Bank (CBA -1.2%) and Transurban Group (TCL -3.8%, which rebased the distribution to below consensus numbers and was sold off).

The main detractors to performance for the month were the overweight holdings in: Magellan Financial Group (MFG -6.0%), Pact Group (PGH -23%), GPT Group (GPT -4.7%), Adbri (ABC -12.7%) and Amcor (AMC -3.6%)

An underweight position in Woodside Energy Group (WDS +7.1%) and not holding OZ Minerals (OZL +36.6%) that significantly outperformed the broader market somewhat constrained returns.

FUND ACTIVITY

We took advantage of the wild swings during August, particularly in the first half of the month, to make some further portfolio adjustments. We totally exited remnant positions in **ALS, Wesfarmers and Woolworths**. Positions in **Ansell, GrainCorp and Medibank Private** were reduced during the month into share price strength, to help fund other purchases. The existing holdings in **Metcash** and **The Lottery Corporation** were strengthened **and we introduced CSR (refer to write-up below), EQT Holdings, Nick Scali, Treasury Wine Estates and re-introduced Woodside Energy Group into the portfolio, which is cum a sizeable dividend.**

CSR - Feature Stock of the Month

CSR is an integrated building products manufacturer which also holds a 25% interest in the Tomago aluminium smelter. The company is focused on the Australian residential and non-residential sectors - key products include gyprock plasterboard, fibre cement, lightweight concrete blocks, clay bricks, insulation products and roofing tiles. CSR building products make up ~70% of earnings, with property and aluminium at ~15% each. CSR has a low exposure to medium density housing representing 10% of its building products business, with detached housing representing ~55% and the balance is made up mainly of non-residential and high density exposure. The aluminium business is largely hedged for the next few years and its power costs are locked in at attractive levels out to 2028. CSR's property portfolio of legacy sites and surplus land has an "as is" valuation of $1.1bn (~50% of the current share price).

CSR has, along with all building materials stocks, underperformed the market CYTD, however, with a fully franked dividend yield of 7%, a very low EV/EBITDA multiple of 5x, a pristine balance sheet (with net cash of $178m) and with a $100m on-market buyback to boot, we saw the investment opportunity hard to resist. A peer-leading ROFE, coupled with excellent execution also reinforces our investment thesis. While the housing cycle is maturing, we believe the stock is mispriced, as the pipeline is still solid and detached housing provides a good degree of visibility and should continue to drive earnings and dividends going forward. The current yield is a solid 7.5%, pre gross up.

NEW STOCKS ADDED	STOCKS EXITED
• CSR • EQT Holdings • Nick Scali • Treasury Wine Estates • Woodside Energy Group	• ALS • Wesfarmers • Woolworths

INCREASED	DECREASED
• Metcash • The Lottery Corporation	• Ansell • GrainCorp • Medibank Private

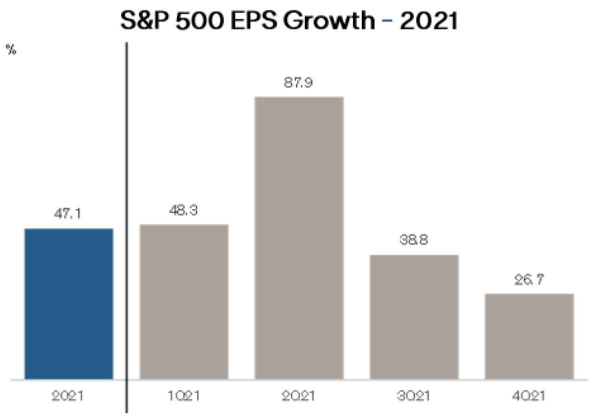
FUND STRATEGY AND OUTLOOK

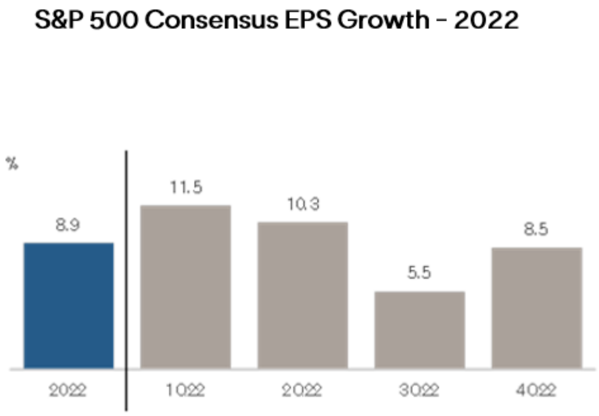
Front and centre are investor concerns about a global synchronised growth slow down and recession risk.

Whilst current investor discussion is centred on Fed and ECB monetary tightening, the inflation-recession balance, China's rolling lockdowns, the protracted Russia-Ukraine conflict and Taiwan straits, there are other key issues brewing near term, namely the Italian elections and the all-important US mid-terms. Starting with the mid-terms, there appears a big turnaround in the Democrat's prospects and a possibility that they not only increase their majority in the Senate, but end up controlling both chambers. This will have significant ramifications for Government spending and taxation policy. The other potential political flashpoint is the Italian general election on September 25th, with recent polls pointing to the high probability that a right-wing fascist coalition may be victorious (i.e., the 'Brothers of Italy') and parties favouring exiting the Euro/major geopolitical repositioning. These elections could elevate risk and volatility, especially in the US post mid-terms, but arguably should be contained. Nonetheless, they need to be monitored.

US 2Q Reporting Season Wrap:

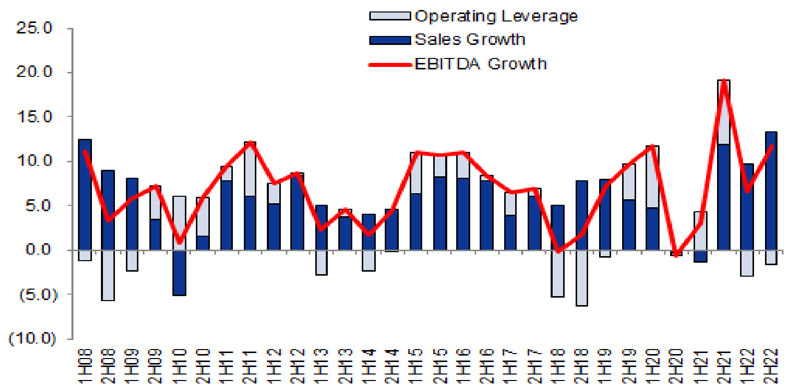
- 10.3% forecasted 2Q EPS growth obfuscates underlying strength
- S&P 500 EPS was projected to grow 10.3% in 2Q, on 13.4% in revenues. Both sales and EPS were expected to grow ~15.4% ex-Financials. Managements universally continued to highlight cost pressures.
- 2Q was forecast to be the weakest quarter of 2022 on difficult comps, but has surprised on the upside.
- The year-ago quarter (2Q21) delivered well above trend EPS growth (87.9%), as the economy reopened. As a result, current quarter growth (+10.3%) looks relatively subdued on a YoY basis.





- Cyclicals delivered the highest EPS growth at 70.4%, vs. Non-Cyclicals (+3.8%), while TECH (-5.5%), and Financials (-19.5%) saw their EPS decline.
- Within Cyclicals, Energy was expected to grow EPS 243% going into reporting season, followed by Industrials 30.7% and Materials 17.3%
- However, 2Q22 estimates were revised up to 300% for Energy and up 24.5% for cyclicals during the course of reporting.
- **Large Cap TECH were expected to be areas of weakness**
- The largest 6 TECH companies (AAPL, MSFT, GOOGL, AMZN, NVDA, META) experienced margin contraction of -30%.
- **EPS for FAANGs fell by ~23% in 2Q22.**

What we took away from our local August reporting season were questions regarding margins, consumer demand, peak cost pressures, destocking, post pandemic normality and capital management. Although revenues in 2HFY22 were very strong, weaker margin trends showed that most firms are now struggling to pass on rising costs as easily as they could earlier.

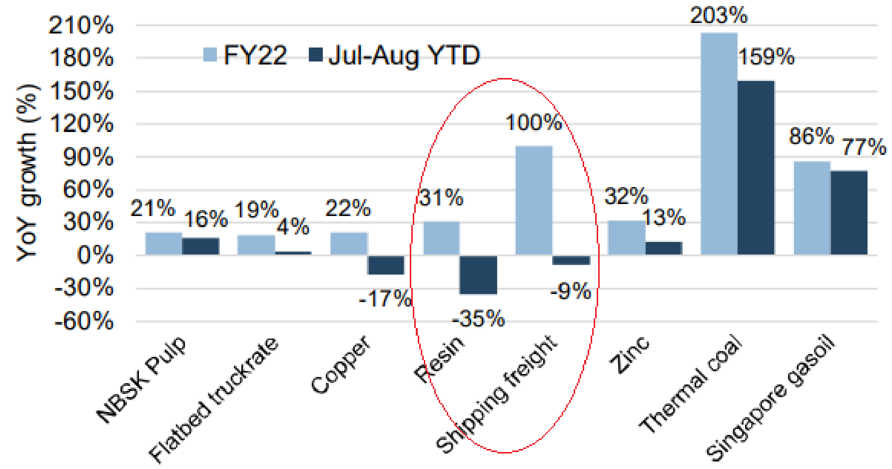


Source: Goldman Sachs

Consumer demand appears more resilient than the sceptics had feared in the face of higher inflation and rising interest costs. Trading updates have been generally more positive than expected, consistent with the recent positive surprise in retail sales, noting that many firms are now cycling weaker comps due to the second-wave lockdowns in 2H21. Outlook commentary was more cautious given the tightening in financial conditions, but there was little evidence of a significant slowdown in activity yet. Spending, while surprisingly strong, is clearly trending to services and away from goods. Within the goods categories, consumers are buying fewer big-ticket discretionary items, switching to more essentials, as they look for greater value given the hit to disposable income.

Input cost pressures look like they may be peaking, as shown in a number of areas in the slide included in Amcor's latest results presentation. Central bankers concern is focused on labour costs, which in Australia haven't taken off as yet outside of sectors where labour shortages are most acute (construction, mining and professional services).

Figure 5: Key Commodity Price Exposures

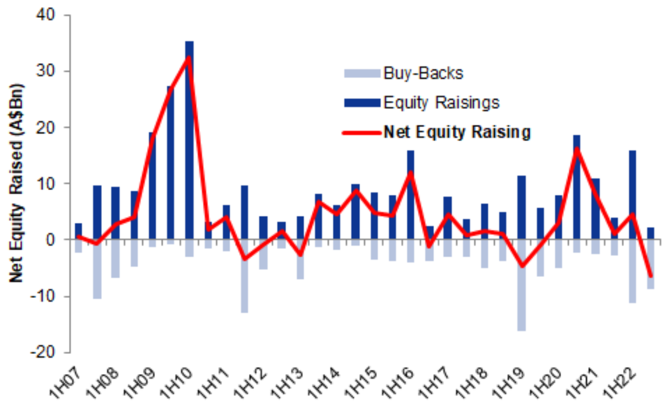


Destocking and discounting is likely to be a drag on margins going forward. Many firms have followed a deliberate strategy to build a buffer against future expected supply chain disruptions, but now with consumer demand likely to soften and inventories at very elevated levels, there is rising risk of firms needing to discount to clear stock. *This was a common theme with companies delivering poor cash conversion in their results.*

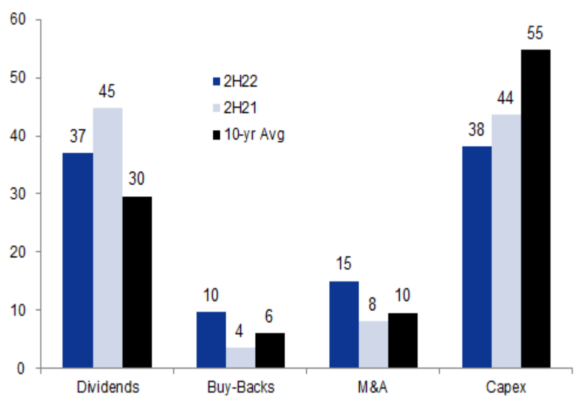
Despite almost no pandemic restrictions remaining in place, earnings momentum trends were stronger across "Stay-at-Home" stocks while "Go-outside" stocks disappointed more frequently. A number of factors seem to be at play here. Labour shortages continue to challenge capacity in many services categories. Workers are returning to offices at a slower than expected rate, as is the normalisation of international travel/migration flows. Digital consumer strategies have become more important as online sales penetration has stayed elevated. At the same time, many household goods categories are now likely more defensive given a larger replacement cycle, thanks to the larger pool of WFH employees.

The other feature during reporting season were companies directing a larger than normal share of their free cash flow to buy-backs and M&A, over Dividends and Capex. The weakest market for capital raisings, combined with a large amount of buy-back activity, saw the largest reduction in net equity capital raisings in over a decade ($2.3Bn raised vs $8.8Bn bought back in 2HFY22). With a more cautious macro backdrop, capex intentions remain relatively muted across the market, but there has been a noticeable pick up in M&A in recent months.

ASX 200; Equity Raisings vs Buy-backs



ASX 200 ex-Fin use of cash (%)



Source: Goldman Sachs.

Dividends per share (DPS) revisions remained in-line with EPS revisions, with 25% of the index seeing upgrades versus 43% in downgrade mode. The average DPS revision across the market came in at -1.0%, an improvement from the mid-season mark of -1.9%. Financials, Staples and Materials saw the highest average revisions, while Utilities, Energy and Healthcare were at the bottom of the table. Tech saw positive revisions despite negative earnings changes, with the highest proportion of stocks upgrading.

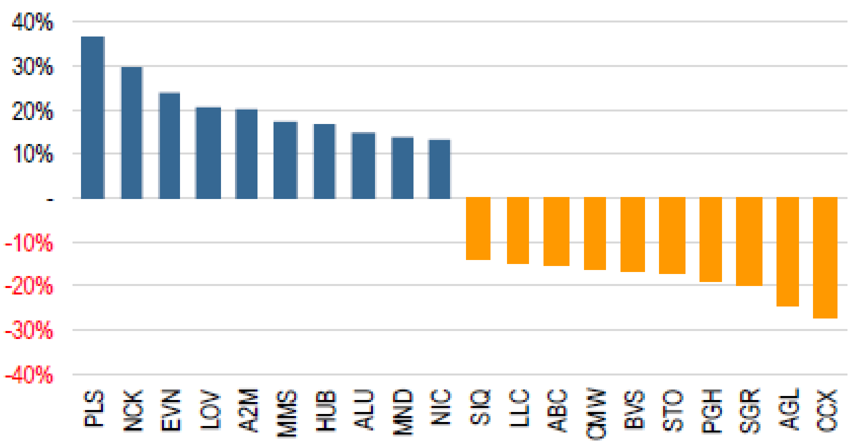
Consensus Dividend Revisions

DPS REVISIONS

SECTOR	Rept'd	Total	% Rept'd	Cons REV*	Post PF**	U-grade***	Flat	D-grade***
Financials	27	27	100%	0.7%	-1.4%	28%	44%	28%
Consumer Staples	10	10	100%	0.6%	-1.3%	30%	30%	40%
Materials	34	34	100%	0.4%	-1.8%	25%	36%	39%
Information Technology	19	19	100%	0.3%	-0.9%	36%	18%	45%
Consumer Discretionary	28	28	100%	-0.8%	-1.0%	35%	23%	42%
Industrials	23	23	100%	-0.8%	0.9%	30%	17%	52%
Communication Services	13	13	100%	-2.6%	-0.8%	25%	25%	50%
Real Estate	30	30	100%	-2.7%	-1.0%	7%	50%	43%
Health Care	14	14	100%	-2.9%	-0.3%	20%	30%	50%
Energy	9	9	100%	-3.0%	5.0%	29%	29%	43%
Utilities	3	3	100%	-10.1%	-0.9%	0%	0%	100%
Grand Total	210	210	100%	-1.0%	-0.7%	25%	32%	43%

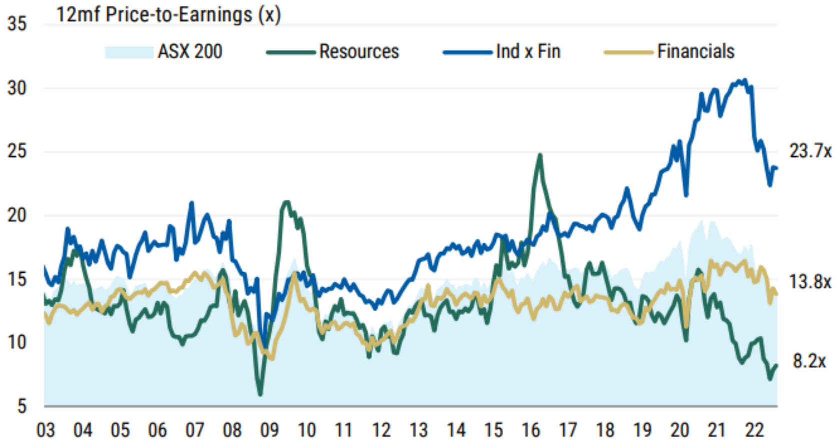
DPS REVISIONS: TOP 10 & BOTTOM 10

DPS Revisions: Top 10/Bottom 10

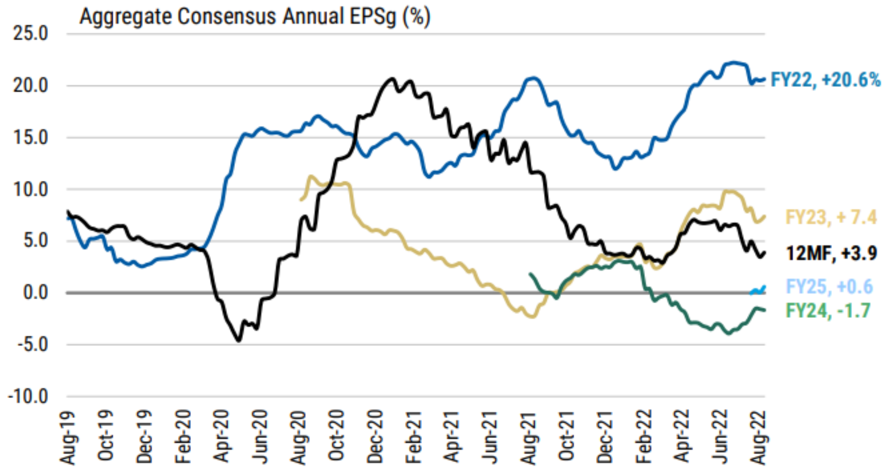


The Australian equity market has proven more resilient than its global peers. The domestic market multiples have de-rated meaningfully over the past year, with the 12MF P/E now standing at 13.7x. Industrials ex-Financials have compressed to 23.7x from 30.2x whilst outer-year earnings growth expectations stay fairly anchored in the low-single-digit territory. **Resources have fallen from 9.9x to 8.2x through 2022.**

Valuation: the 12M forward PE of the Industrials ex-Financials has Fallen from 30.2x to 23.7x



Annual Consensus EPS Growth Trends FY21-24



Source: Morgan Stanley Research.

The investment climate remains foggy: the conundrum is will the US be plunged into a "real recession" and if so, will it be a hard or soft-landing?

The one thing that is for certain post Jackson Hole, is there will be no Fed "pivot" and that further central bank tightening is coming. Chair Powell in his 9 minute speech, pledged not to repeat the mistakes of the 70's and 80's (by referencing the 1979 statement made by then Chair Paul Volcker) and in his own words, "will keep at it until we are confident the job is done", returning inflation to the 2% objective. He reiterated that another "unusually large" hike could be appropriate (data dependent), thus the 50bpt vs. 75bpt investor debate for the next September Fed meeting remains alive.

In Australia, another RBA 50bps hike on 6th September is a certainty, making it the 4th straight 50bps rise after the initial 25bps hike in May and certainly the fastest start to a tightening cycle since 1994. This is at a time when credit growth is already slowing and the housing market is softening further. It may just be the straw that cracks the consumer's back..... **Investors have forgotten that the Banking sector is highly economic sensitive**. Rising funding costs, just at a time when the Bad and Doubtful Debt line begins to pick up from current benign levels of stress will not end well. CEO of CBA, Matt Comyn recently sold a good chunk of his shareholding - 54k shares on 17 August for $5.4m...mmm!!! **We remain zero weighted towards the Banks.**

We repeat what we emphasised last month - that the portfolio is well positioned medium term against the above macro backdrop, as we have deliberately and progressively been skewing the Fund more defensively. Stocks such as **Treasury Wine Estates** which delivered a stellar result (despite exports to mainland China that completely evaporated on the tariff imbroglio) are expected to deliver flat COGS, yet continue to grow revenue and should be well rewarded/re-rated. **Amcor** are seeing input prices ease, yet the bulk of their business is centred on defensive/essential items, namely groceries, fast moving consumer goods and in the healthcare segment. **The Lottery Group** continues to demonstrate its annuity style, defensive growth income attributes. These defensive stocks are in addition to the gold exposure we added recently.

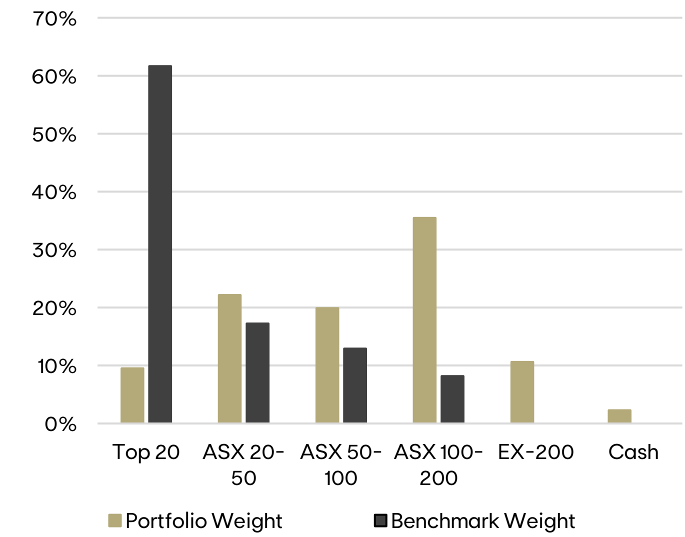
FY22(E) Key Portfolio Metrics	Fund	Benchmark
Price/Earnings (X)	11.3	14.2
Dividend Yield (%)	6.4	4.7
Grossed Up Dividend Yield (%)	8.2	6.4
Dividend Growth Rate (%)	14.9	18.1
Beta	0.87	1.00

Portfolio Characteristics

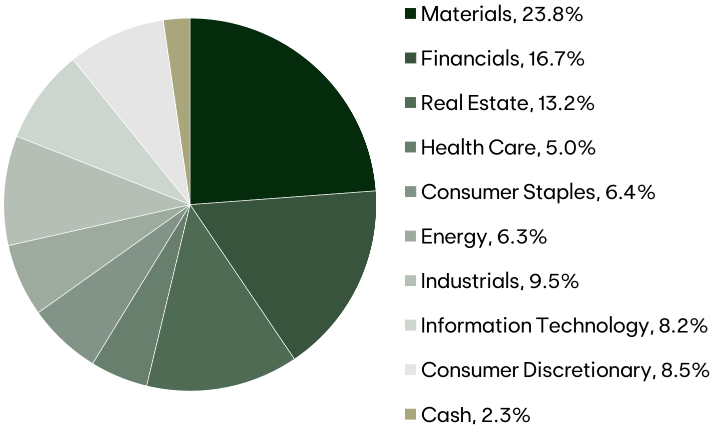
TOP 10 HOLDINGS

Magellan Financial Group	8.8%
GPT Group	8.4%
IRESS	8.2%
BHP Group	6.6%
Ansell	5.0%
Waypoint REIT	4.7%
Lottery Corporation	4.7%
Alumina	4.0%
Premier Investments	3.9%
Liberty Financial Group	3.8%

MARKET CAPITALISATION



SECTOR ALLOCATION



Source: Ellerston Capital.

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Find out more

For new or additional applications into the Fund, please click here.

All holding enquiries should be directed to our register, Link Market Services on **1300 551 627** or **Ellerston@linkmarketservices.com.au**

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

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