Ellerston Asia Growth Fund

Monthly Newsletter, October 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	$0.7318
Net Asset Value	$0.7300
Redemption Price	$0.7282
Liquidity	Daily
No Stocks	32
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^	-6.51%	-11.67%	-17.26%	-27.33%	-15.28%	-5.80%	1.34%
Benchmark*	-5.62%	-11.02%	-15.22%	-24.22%	-11.37%	-4.38%	2.32%
Alpha	-0.89%	-0.65%	-2.04%	-3.12%	-3.91%	-1.42%	-0.98%

^ 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 6.5% (net) in October versus the MSCI Asia ex Japan (MXASJ) Index which was down 5.6%.

It was an extremely volatile month for Asian markets with the MXASJ rising as much as 3.8% (in AUD terms) in early October on the back of positive global sentiment, before finishing down 5.6% on further negative events out of China.

China Volatility

The China/HK markets underperformed during October with the CSI300 and HSI Indices down 15% and 8% respectively. A major trigger for the underperformance was the outcome of the 20th National Congress where President Xi was elected for an unprecedented third term and filled the seven member Standing Committee with loyalists. This led to concerns that future policy decisions may lack checks and balances, thus increasing the likelihood of future policy mistakes. Although investors had wanted some more progressive politicians elected into the Standing Committee, the reality is not entirely surprising given President Xi has spent much of the past two terms consolidating power. A Standing Committee containing politicians that President Xi trusts does however send a message of unity at the top. Furthermore, policy execution is likely to be enhanced given the more concentrated political structure. It should be noted that one of the key takeaways from the commentary coming out of the Congress was the importance placed on economic growth and we expect a renewed focus on this area now that the 'election' is over.

The most powerful way for the government to reignite economic growth is to ease its suppressive zero-COVID policy. Indeed, we have started to see signs of a potential shift on this policy in recent weeks. Firstly, China has resumed hosting key events over the past month such as the visits by German Chancellor Olaf Scholz and Vietnamese leader Nguyen Phu Trong to Beijing, the running of the Beijing Marathon and the successful staging of the Hong Kong Sevens tournament. Secondly, on the vaccine front, China has reportedly agreed to offer BioNTech COVID shots to expatriates living in the country. Further, the rollout of Cansino's inhaled COVID treatment and the imminent Emergency Use Authorisation (EUA) approvals of domestic MRNA based vaccines are likely to help facilitate a reopening. Thirdly, we have seen a number of regional rail stations drop the requirement for proof of negative COVID test results before travelling. Finally, we have started to see a shift in the government propaganda around COVID. Local governments such as Zhengzhou and Guangzhou have recently tried to downplay the impact of the latest Omicron strain in order to ease public concerns. There has also been a notable decline in the mentions of COVID in official government mouthpieces such as the People's Daily and on social media since the conclusion of the Party Congress.

All these factors suggest that it is likely a matter of 'when' not 'if' before a China reopening. The spillover effects from China's zero COVID policy has been evident in economic data, which has been improving in a non-linear trajectory. Ultimately, we believe that a sputtering economy characterized by high unemployment, weak domestic demand and property sector distress is inconsistent with President Xi's 'common prosperity' ideology. Whilst a China reopening is likely in the coming months, we however do not expect a big bang announcement. Any reopening will likely be a gradual transition to living with COVID and it appears that the Government is beginning to lay the groundwork for this to happen.

Despite the weakness in Chinese equities during October, we have maintained our overweight on China as we believe the issues facing domestic companies are mostly cyclical rather than structural. We continue to take a diversified approach to investing in China with a preference for high quality companies that are either supported by government policies or operating in policy neutral sectors. We also own companies that are regulated by the Government but strategically important to the economy such as the Chinese internet names.

Portfolio Performance Summary

Indonesia and Singapore were the largest contributors to alpha during the month. Whilst, China and South Korea were the largest detractors. At a sector level, Energy and Communications Services were the biggest contributor to relative performance. Meanwhile, Consumer Staples and Consumer Discretionary were the worst performers.

At a company level, Reliance Industries, Bank of Mandiri and Samsung Electronics were the biggest contributors to relative performance during the month. The Reliance share price was boosted by a rebound in refining margins during October. Bank of Mandiri meanwhile reported strong 3Q22 results with net interest income and pre-provision operating profit up 22% and 26% respectively. Finally, Samsung Electronics bounced as memory peers such as SK Hynix and Micron announced capex cuts which could help to stabilize memory prices earlier than expected.

Moutai, Mengniu and China Merchants Bank (CMB) were the biggest drags on alpha. Moutai was sold off during the month on concerns that the Chinese Government could look to ban baijiu consumption for government officials. We note however that government related baijiu sales account for less than 10% of Moutai revenues. Moutai meanwhile reported solid 3Q results during the month with revenue and profit grow up 15%yoy and 16%yoy respectively. Mengniu's share price was impacted by negative read-throughs from its competitor Yili, which reported a weaker than expected 3Q result. Mengniu management has subsequently confirmed that drivers of Yili's earnings miss such as decelerating liquid milk sales and high operating costs are idiosyncratic. Our channel checks meanwhile suggests that Mengniu has likely gained market share in the liquid milk segment and expanded margins marginally during the quarter. Finally, CMB corrected during the month on news that ex-President Tian Huiyu was expelled from the Communist Party on corruption violations. We believe that CMB has been overpenalised on this event as the violations are related to individual rather than institutional misconduct. CMB has historically demonstrated a cautious risk management culture characterized by low non-performing loan ratio of 0.95%, high provision coverage of 456% and Tier 1 capital ratio of 14.9%. As such, we believe CMB is unlikely to deviate from its more market focused business strategy and is therefore fundamentally undervalued at P/B of 0.8x vs ROE of 16.5%.

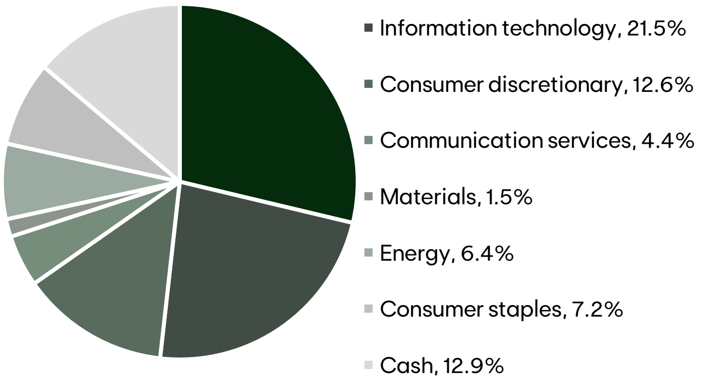
As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

Kind Regards,

Fredy Hoh

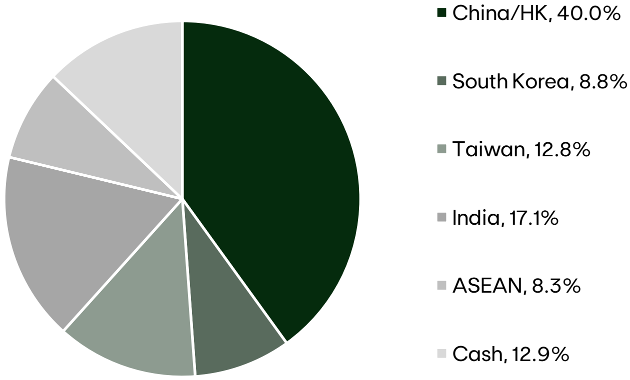
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Country	Weight
TSMC	Taiwan	8.4%
Samsung	Korea	7.0%
Reliance Industries	India	6.4%
DBS Group	Singapore	4.9%
ICICI Bank	India	4.4%
Tencent Holdings	China	4.4%
AIA Group	Hong Kong	4.3%
Alibaba Group	China	3.8%
PT Bank Mandiri	Indonesia	3.4%
China Mengniu Dairy	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, Automic Group on **1300 101 595** or ellerstonfunds@automicgroup.com.au

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