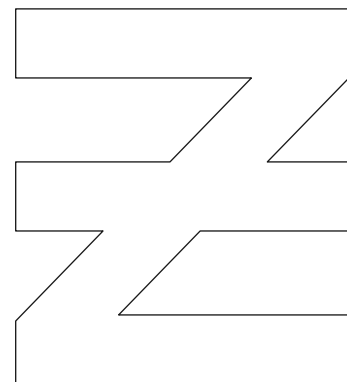


Ellerston Equity Income KIS Fund



Monthly Newsletter, December 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	\$1.0286
Net Asset Value	\$1.0260
Redemption Price	\$1.0234
Liquidity	Daily
No Stocks	31
Strategy FUM	\$31.0m
Management Fee	0.70% p.a.
Performance Fee	10%
Buy/Sell Spread	0.25% on application 0.25% on redemption
Minimum Investment	\$10,000
Minimum Additional Investment	\$5,000
Distribution Frequency	Quarterly

PERFORMANCE SUMMARY

Performance	1 Month	FYTD	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception (p.a.)^^
Net^	-1.66%	5.46%	-1.38%	9.78%	6.72%	8.65%
Benchmark*	-3.21%	9.82%	-1.08%	7.69%	5.55%	6.92%
Alpha	1.55%	-4.36%	-0.30%	2.09%	1.17%	1.73%

^ 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

World equity markets gave back most of the previous month's performance in December, closing out a dismal year for global equities and bonds. It was the worst year since the GFC in 2008 and the 3rd worst since 1987 for global equities, down 18.1%. In the month of December, the MSCI World Index fell (-4.2%), the S&P 500 lost (-5.8%) in local currency terms and Emerging Markets outperformed on the back of China's sudden pivot away from its Zero COVID stance.

Defensives were relative outperformers, with big tech faring the worst.

For the year, the best performing sectors were Energy, Utilities and Consumer staples, whilst the worst performers were Communication Services, Consumer Discretionary and Information Technology.

Locally, the S&P/ASX 200 marginally outperformed the MSCI World in December, as the strength in iron ore prices put a floor under the Materials sector. Australia was one of the best performing equity markets globally in 2022.

USA

Economic indicators continued to soften in December, employment data remained elevated and inflationary pressure eased further. The November Core PCE price index, the US Federal Reserve's (Fed) preferred inflation measure, decelerated again from 5.0% to +4.7% YoY.

The Fed, as expected, raised its benchmark interest rate by 0.5 percentage point to a range of 4.25%-4.5%, the highest since 2007 and signalled more tightening in 2023. During a post-meeting press conference, Fed Chair Jerome Powell said that "we have more work to do" and he once again stressed the need to restore price stability. Powell also echoed language in the Fed's statement by saying that policy makers continue to anticipate that ongoing increases in the fed-funds rate target "will be appropriate," and that the central bank will keep shrinking its balance sheet. In new projections about future policy, Fed officials pencilled in 5.25% as the top end for its benchmark rate, higher than their previous forecast of 4.75% in September.

The Dow Jones Industrial Average continued its relative outperformance, falling 4.1%. The S&P 500 finished 5.8% lower, with the NASDAQ Composite Index again the laggard, posting an 8.7% fall as a number of big tech names came under further pressure, especially Tesla which fell 37%.

In a volatile year, U.S. indices delivered their worst performance since 2008, as highlighted and summarized below

Returns for CY2022

S&P 500: The broad market returned -18.5% in 2022, troughing out at -24.9% in October after plunging into steep bear market territory. Over the past 40+ years, only 2002 and 2008 were worse than in the year 2022

Growth vs. Value: Value topped Growth by 20.2% (-9.6% vs. -29.8%)

Sectors: Energy stocks jumped 58.9%, while TECH+ declined -33.8%

Best/Worse Stocks: The largest 4 stocks (AAPL, MSFT, GOOGL and AMZN) each fell -25% to -50%, while 9 of the best 10 performing names were in Energy sector

Rates

Fed Funds: Fed Funds rose from 0.1% at the start of the year to 4.4%, the largest annual move since 1973

10 Year: Treasury yields rose from 1.5% to 3.9%, the primary catalyst for PE multiple contraction

Yield Curve: The 3 month-10-yr spread is -47 bps vs. +145 bps at the beginning of 2022

Credit: HY spreads rose from 347 bps in Jan. to 614 bps in July and 516 bps at year end

Mortgages: 30-yr rates rose from 3.1% to a peak of 7.1% and now stand at 6.4%

Economy

GDP: Forecasts for 2022 GDP fell from 3.9% at the start of the year to 1.9% today

ISM Manufacturing: The first reading of 2022 was 58.8, while the final reading is projected at 48.5

Inflation: CPI rose from 7.0% in Jan. to 9.1% in June, and is forecasted at 6.7% for December

Housing: Median home prices rose from \$359k to a peak of \$414k and are at \$371k

Commodities & Currency

Energy: WTI rose from \$75 to a peak at \$124 and has since declined to \$86 similarly, gasoline increased from \$3.3 to a peak of \$5.0 in June and is now at \$3.2

US\$: The US\$ index (DXY) started at 95.7, peaked at 114.1 in October, and has fallen to 103.5

Earnings

2022: EPS estimates started at \$223.5 and finished at \$220.5, a modest -1.3% decline

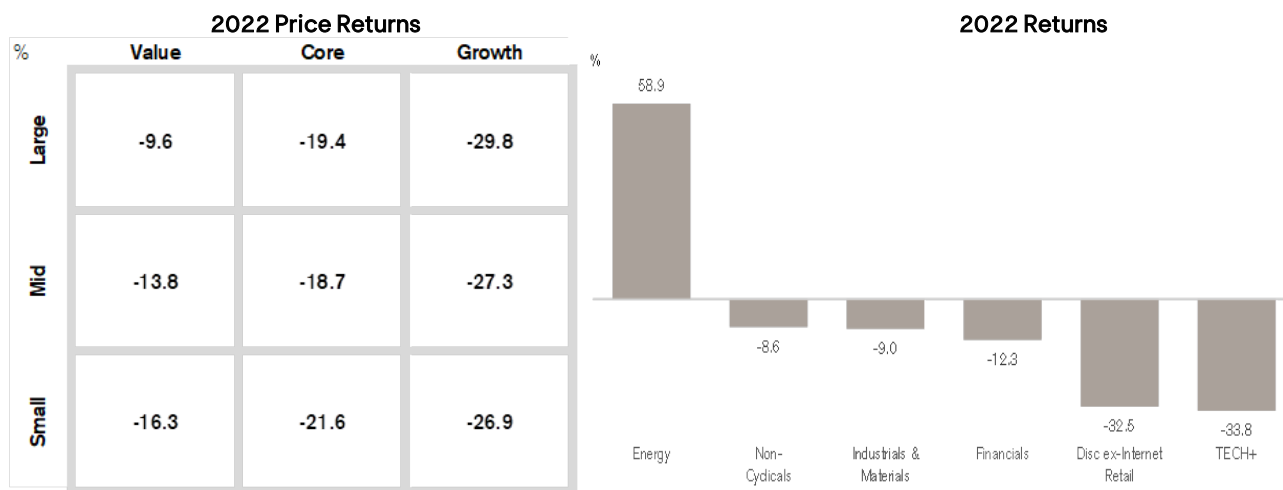
Sectors: Forecast EPS is positive in all sectors, save Financials (-14.4%), with TECH+ just 0.8%. All sectors saw negative revisions, save Energy

Valuations

S&P 500: NTM P/E multiples fell from 21.4x to 17.6x over the course of the year

Growth vs. Value: Growth multiples fell from 30.2x to 20.9x; Value from 15.1x to 13.6x

Most Expensive: The 100 most expensive stocks fell from 43.0x to 30.5x, while the next 400 fell from 17.2x to 14.6x

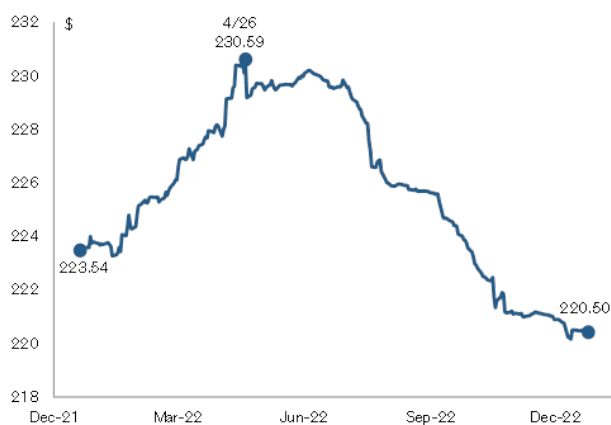


Source: Credit Suisse.

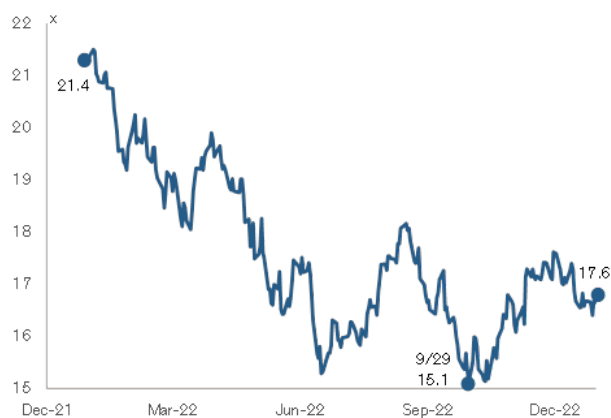
Top 10 Stocks by Market Cap

Ticker	Company	Sector	Return (%)
AAPL	Apple	Technology	-27.1
MSFT	Microsoft	Technology	-29.3
GOOGL	Alphabet	Comm Svcs	-39.7
AMZN	Amazon.com	Discretionary	-50.2
BRK.B	Berkshire Hathaway	Financials	3.0
UNH	UnitedHealth Group	Health Care	5.1
JNJ	Johnson & Johnson	Health Care	2.5
XOM	Exxon Mobil	Energy	81.4
JPM	JPMorgan Chase	Financials	-15.4
NVDA	NVIDIA	Technology	-50.6

Path of Consensus 2022 EPS Estimates



S&P 500 NTM P/E



Source: Credit Suisse.

Europe

The Euro-zone economy remains clearly in contractionary territory (below 50) based on the December PMI data which is still flashing red, however the Composite gauge rose for a second successive month from 47.8 to 48.8. Manufacturing fared better at a 3-month high (47.8, up from 47.1) and Services also printed higher (49.1 versus 48.5).

The ECB and the BOE raised rates by 50 bps to 2.5% and 3.5% respectively, signalling "significant" further rate increases to ensure a timely return of inflation back to medium term target levels.

The Euro STOXX50 Index finished the month down 4.3%. Among the major exchanges, UK's FTSE 100 ended down 1.5%, Germany's DAX fell 3.3%, and France's CAC 40 finished 3.8% lower.

Asia

Signs of re-opening in China, which propelled Asian markets the previous month, turned to an abrupt about-face on China's Zero-COVID policy. Concerns increased in late December that a major new wave of COVID was taking hold and thus labour shortages were starting to appear, causing renewed disruptions in both supply-chains and on the demand side.

Asian equity markets were a mixed bag, with the Hang Seng again being the standout jumping a staggering 6.4%. The China SSE fell 1.2%, India's SENSEX was down 3.6%, followed by the Nikkei 225 down 6.6% and Korea's KOSPI and was the laggard, down a whopping 9.6%.

Commodities

Commodity prices were stronger across the board, with China's stimulus and accelerated shift away from its Zero-COVID stance buoying sentiment. Iron ore was the major winner, with the price up 16% to US\$117/tonne. The Brent oil price was flat at US\$86/barrel and natural gas prices weakened, as weather conditions improved, particularly in Europe. The base metals complex was mixed, with the major metals; aluminium down 4%, copper was 2% higher and nickel rose 12%. Gold was 3% higher at US\$1826/ounce as the US dollar weakened by 2.5% on a trade weighted basis.

Bonds

Bank of Japan Governor Haruhiko Kuroda shocked world markets by suddenly adjusting the YCC targets by doubling its cap on 10-year yields, sparking a rally in the JPY against most currencies and a slide in government bonds. The move was aimed to help pave the way for possible policy normalisation under a new BoJ Governor in April 2023.

The US 10-year yield rose 23bps to 3.88% and Australian 10-year bond yields also rose, up 52bps to 4.05%, given the less dovish stance by the RBA than in the previous month.

Australia

As expected the RBA, delivered another 25bp interest rate increase (the 8th in a row) to 3.10% with its next meeting on 7 February. The messaging was clear, the RBA expected more rises in 2023 and the size and timing of future interest rate increases will continue to be determined by the incoming data and the board's assessment of the outlook for inflation and the labour market.

The AUD closed the month flat at US\$0.68, despite a weaker US dollar and the strong move in iron ore prices.

In the month of December, the S&P/ASX 200 Accumulation Index finished down 3.2%. Resources (-1.4%), buffered by higher iron ore prices, outpaced Industrials (-3.9%). The Materials sector (down 0.9%) was the best performer, led by the large iron ore miners Rio Tinto and Fortescue Metals, followed by Utilities (-1.2%) and then Consumer Staples (-1.8%). The bottom three sectors were Consumer Discretionary (-7.0%), Information Technology (-5.4%) and Industrials (-4.9%). For the month, the top stocks that made a positive contribution to the Index's return were: Rio Tinto (+11bps), Fortescue Metals (+8bps), QBE Insurance (+4bps), Newcrest Mining (+3bps) and Evolution Mining

(+2bps). Conversely, the bottom five stocks detracting from the Index's performance were: Commonwealth Bank (-41bps), CSL (-28bps), National Australia Bank (-21bps), Macquarie Bank (-20bps) and Woodside Energy (-16bps).

The ASX Small Ordinaries finished down 3.7%, trailing the broader benchmark by 0.5%. Within the ASX Small Ordinaries, the Small Resources lagged, -4.7%.

The best performing sectors of 2022 were Energy (+49.0%, led by Woodside Energy +78.6%), Utilities (+30.0%, as a result of the takeover of Origin Energy +54.9%) and Materials (+13.0%, with BHP Group up 38.0%, the largest contributor). The worst sectors were Information Technology (-33.7% with Xero down 50.3%), Real Estate (-20.5%, Goodman Group at -33.4%, the biggest contributor) and Consumer Discretionary (-20.4%, dragged down by Wesfarmers -19.6% and Aristocrat Leisure -28.9%).

The top 5 best stock performers of CY22 were coal stocks, Whitehaven Coal (+288.8%), New Hope Corporation (+234.4%) and Coronado Global Resources (+119.1%), followed by Core Lithium (+78.6%) and Woodside Energy (+78.6%).

The bottom 5 stock performers of CY22 were retailer City Chic Collective (-91.4%), BNPL provider Zip Co (-88.2%), battery anode hopeful NOVONIX (-84.2%), payments solutions company EML Payments (-80.5%) and artificial intelligence service provider Appen (-77.5%). With the exception of NOVONIX, the others started the year in the index, but didn't end the year in the S&P/ASX 200 Index.

COMPANY SPECIFIC NEWS

The Market Hits

Chalice Mining (CHN +18.6%)

CHN is in the process of developing its Julimar nickel-copper-platinum group elements (PGE) project in Western Australia. CHN's shares rallied after the company announced promising drilling results, with particularly impressive PGE grades from its Hooley prospect, just 5km north of the Gonville resource, the major orebody of the Julimar project. Early days, but this discovery could continue to increase the already sizeable existing resource.

Champion Iron (CIA +14.9%)

High cost iron ore producer CIA benefitted from the 16% rise in the iron ore benchmark price during the month, spurred on by the abrupt ditching of China's COVID-19 restrictions. CIA outperformed its local iron ore peers given its significantly higher operating costs, providing much higher earnings leverage to higher iron ore prices.

A2 Milk Company (A2M +11.0%)

There was no specific news emanating from the company but a few external monitoring platforms used by sell-side analysts indicated that even though A2M's November sales were down on pcp, it was gaining market share. After underperforming dramatically since touching the dizzy highs of \$20 midway through 2020, this provided some light at the end of the tunnel for long-suffering investors.

Bega Cheese (BGA +10.9%)

It was a no news month for BGA. BGA had underperformed the benchmark by ~40% CYTD to November, a near 20-year stock price low. The company was trading at an FY24 EV/EBITDA of 6.8x, a 30% discount to its historical average and the gap between its tangible asset backing of \$6.00 and the share price was large, attracting corporate interest such as Andrew Forest's Tattarang Agrifood Investments, now owning 11.5% of the register. The market is slowly coming to terms with the fact that BGA, even post the 11% rally in December, is still an attractive strategic Australian dairy asset with earnings capacity materially higher than what the company is currently delivering. The shares squeezed higher.

Evolution Mining (EVN +10.8%) / Capricorn Metals (CMM +9.5%) / Ramelius Resources (RMS +8.8%)

Most gold producers locally and abroad benefitted from the continued rise in the gold price to US\$1826, driven primarily by a weaker US dollar.

Sandfire Resources (SFR +8.8%)

Copper miner SFR completed a \$200m equity capital raising to de-risk its balance sheet and be better placed to complete its Motheo project in Botswana, with investors taking the de-risking positively. Additionally, with the BHP/Oz minerals merger pretty much done and dusted, SFR is now the only remaining pure copper producer still listed.

Virgin Money UK (VUK +7.9%)

The VUK share price momentum continued in December after announcing a stronger FY22 result the previous month. The VUK share price surged in November post reporting a FY22 result that came in 6% ahead at the profit line, albeit due to lower impairments, as the result was largely in line at the pre-provision operating profit (PPoP) level. Given the FY22 NIM of 1.85% came in at the top-end of guidance and FY23 guidance was ahead of consensus (with the NIM guidance of 185-190bps), there was enough to maintain the rage.

Bendigo and Adelaide Bank (BEN +7.2%)

BEN released a trading update reporting cash earnings of \$245M (+22% on pcp) for the 5 months to November 30. NIM post revenue share arrangements reached 1.85% and the exit NIM of 2.01% all bettered analysts' expectations. BEN's CET1 Ratio of 9.98% (Oct-22), was up 22bps compared to Sep-22 and its Cash ROE for the 5 months reached 8.82%, up 110bps compared to the FY22 result. Investors liked the update, pushing the stock price up 6.9% on the day of the release.

The Market Misses

Star Entertainment Group (SGR -34.7%)

SGR shares collapsed after NSW Treasurer Matt Kean announced via a media release, that the NSW Government planned to increase the tax rate on main floor gaming products (Electronic Gaming Machines (EGM)'s and tables) across Sydney casinos - the release was totally unexpected. The new reform aimed to raise ~\$120m of additional tax annually, of which Star would pay around \$100m on market estimates - this equated to ~42% of Sydney EBITDA, ~20% of SGR's group EBITDA and ~48% of overall group EPS. Whilst the development was at a very early stage (with no bill) and no parliamentary sittings before the state election, investors were shocked. Government modelling suggested the changes could raise A\$364mn over 3 years across Crown Sydney and SGR, implying a new ~40% casino tax rate. As a reminder, NSW Casinos currently pay 29% tax (non-rebate tables) and 32-34% (non-rebate) for EGMs. The onerous changes were proposed to commence 1 July 2023, assuming no other changes (such as extra slot machine allocations previously considered). Part of the reform intention was to: (1) achieve tax equality with EGMs at NSW pubs/clubs, given NSW clubs pay 26.55% and NSW hotels pay 50% (2) to "bring NSW into line with Victoria", whereby Victoria increased their casino tax rate in May-22 from 21.25% to a scale up to 60% on EGMs. If the suggested reforms do in fact progress, legal issues will no doubt arise as to whether compensation would be due to SGR, as in 2020, SGR and the NSW Government signed a "long-term gaming tax agreement" to achieve regulatory certainty to FY41 (which included financial compensation provisions). Uncertainty abounds, as it is unclear whether the recent changes to the NSW Casino Control Act and the in-

place NSW Independent Casino Commission special manager has negated SGR's right to financial compensation. The market was stunned and investors reacted to this ongoing regulatory risk by shooting first and asking questions later.

Novonix (NVX -34.4%) / Liantown Resources (LTR -31.8%) / Core Lithium (CXO -24.4%) / Lake Resources (LKE -20.0%) / Pilbara Minerals (PLS -19.5%) / Allkem (AKE -17.7%)

Lithium producers PLS and AKE, together with developers LTR, CXO and LKE which focus on the battery cathode and aspiring synthetic graphite producer NVX, which is a battery anode play all came under pressure. This was driven by lower lithium prices amid concerns around reports of battery de-stocking in China, which started in November and continued through to December. Chinese and other international peers were also dragged down by weaker demand concerns. However, the great battery juggernaut has continued despite the recent "wake-up" calls and underperformance, with all the stocks mentioned having significantly outperformed the market in 2022, the exception being NVX which is not surprising, as its fortunes are tied to the negative electrode (anode).

Downer EDI (DOW -28.2%)

If investors in DOW were angry when they delivered a 56 per cent protest vote against the company's remuneration report at November's AGM, then they would have been absolutely furious after Downer abandoned its profit guidance for 2023 and revealed "accounting irregularities" stretching back to at least September 2019. One of the few universal, unbreakable rules in public markets is the numbers are sacrosanct - however good or bad a company is travelling, investors must be able to have total and utter faith in a company's accounts. Downer has broken that rule and the 20.4% fall in its share price on the day of the profit downgrade/accounting irregularities - to levels not seen since the depths of pandemic panic in early 2020, shows exactly what the market thinks. Downer's market value is down \$1 billion for the month. The protest vote at last month's annual general meeting (more than double the 25 per cent that denotes a "strike" against a company's remuneration report) was driven by concerns that executives had received 65 per cent of their short-term bonuses despite profits going backwards. Now investors find out that those profits were actually even worse than previously declared.

Imugene (IMU -21.6%)

IMU is a clinical-stage immune-oncology company focusing on developing a range of immunotherapies to treat and eradicate tumours across various cancer indications. IMU's stock price continued to drift lower following its \$80m deeply discounted capital raising two months ago, with little positive news to get investors excited.

HMC Capital (HMC -18.4%)

HMC owns and manages real estate-focused funds in Australia, operating hyper-convenience retail centres. Its property portfolio consists of ~50 shopping centres under the HomeCo brand name. During the month, HMC gave an update on their proposed Last Mile Logistics unlisted fund (LML) which is on track for a \$500m first close by June 2023. The fund aims to target subregional, mixed-use, vacant land and transitional neighbourhood and LFR assets. Mixed-use projects may include a combination of housing, office, retail, medical or industrial components. HMC claimed that they were on track for a \$500m first close by June 2023. Some sell-side analysts however were underwhelmed due to the size of the equity being 30% lower and that current equity commitments of \$94m will not be paying fees.

FUND PERFORMANCE

Global equity markets fell 18.1% in 2022, the worst year since the GFC in 2008. During the year, world equities had been down -27%, before staging a recovery in October-November. Surging inflation prompted central banks to aggressively raise short-term rates. US inflation hit a 40-year high and the US Fed hiked official rates from 0.1% to 4.5%. The Russia-Ukraine War and China's zero-COVID policy also weighed heavily on markets throughout the year.

Sector allocation had a major impact on investors' performance in 2022 given the 70% spread across global sectors. The standout sector during the year was Energy (+27.5%), which benefitted from the oil price reaching a 13-year high. Financials and defensive sectors also outperformed. In contrast, long-duration interest rate sectors fell the most, as did Media & Entertainment (-42.2%) and Semiconductors (-37.5%), as surging inflation pushed bond yields up by over 200bps.

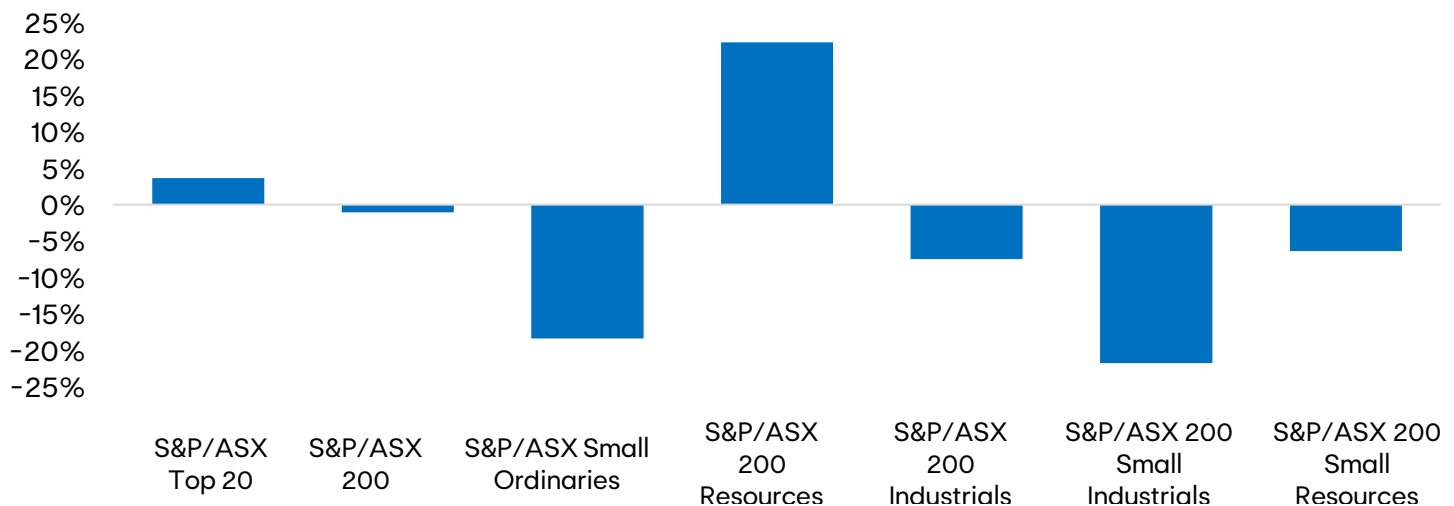
Wrapping up CY22, there has been a huge disparity domestically between the performance of Large Caps and their Small Cap peers, with size winning out.

The S&P/ASX 200 Resources Sector outperformed the S&P/ASX200 Industrials Sector by an astonishing 29.8%, as shown below.

The Top 20 Leaders (up 3.6%) also outperformed, which has not suited our style bias away from the leaders (Mid Caps declined by 6.3%).

The 5th best performing stock last year was emerging lithium hopeful Core Lithium (CXO), which returned an astonishing 78.6%. It's dividend yield is zero and its market cap is \$2.0bn. We have little intention of investing in, or being drawn into such speculative higher risk plays - we will leave that for the brave. The Top 3 performing stocks were all coal companies, with Whitehaven up 288.8%. These are proper and exceptionally high dividend yielding companies, but unfortunately don't meet the "E" in our ESG criteria and process.

Australian Equities Performance Total Returns: CY2022



Source: Factset.

For the month of December, equities quickly gave back half of November's rally on the back of rising bond yields and heightened concerns that the U-turn in China's restrictive zero-COVID policy would impact short term growth, particularly consumer spending.

For the last few months, the Fund's more defensive positioning and underweight stance in resources (BHP being our main exposure) meant the strategy could not keep pace with the market returns. However, it proved relatively effective in December by delivering a return of -1.6%, our second best monthly alpha performance of the year at 1.6%, compared to the ASX200 Accumulation Index which returned -3.2%. Materials which were only down 0.9%, outperformed the market in December, having benefitted from higher iron ore prices. Large Cap stocks also outperformed this month relative to their Mid Cap counterparts, however Value outperformed Growth. Materials was the best performing sector (led by Rio Tinto up 6.2%) followed by Utilities (AGL, +1.4%) and Consumer Staples (A2 Milk +11.0%). Information Technology and Industrials were two of the three weakest performing sectors. Consumer Discretionary closed down 7.0% and fared the worst (with Aristocrat Leisure down 12.9%).

Against the above backdrop in a tough market, this brings the return for the 2022 calendar year to -0.1%, modestly exceeding the benchmark return of -1.1%.

Returns ^d (%)	Gross	Benchmark*	Excess	Net Return
1 Month	-1.60	-3.21	1.61	-1.66
FYTD	5.87	9.82	-3.95	5.46
1 Year	-0.09	-1.08	0.99	-1.38
2 Years (p.a.)	11.01	7.69	3.32	9.78
3 Years (p.a.)	7.87	5.55	2.32	6.72
Since Inception (p.a.)	9.82	6.92	2.90	8.65

¹The 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 December Attribution

Securities Held



Securities Underweight/Not Held



Source: Ellerston Capital.

In what turned out to be a solid month of relative performance, the main positive contributors were active overweight positions in: QBE Insurance Group (QBE +4.4%), Ampol (ALD -1.1%), Liberty Financial Group (LFG +0.6%) and zero holdings in the major banks, namely Commonwealth Bank (CBA -4.9%), Macquarie Group (MQG -6.6%) and National Australia Bank (NAB -4.7%).

The main detractors for the month which were insufficient to derail performance was a modest underweight position in BHP Group (BHP +0.2) and zero holdings in Rio Tinto (RIO +6.2%) and Fortescue Metals (FMG +5.8%).

FUND ACTIVITY

The Fund took profits in Amcor, GPT Group, The Lottery Corporation and exited the remnant position in Deterra Royalties, given recent share price moves. The proceeds were used to top up Ampol, Perpetual and QBE Insurance Group and add two new 5% dividend yielding industrial stocks to the portfolio; AP Eagers and Elders.

NEW STOCKS ADDED	STOCKS EXITED
<ul style="list-style-type: none"> AP Eagers Elders 	<ul style="list-style-type: none"> Deterra Royalties
INCREASED	DECREASED
<ul style="list-style-type: none"> Ampol QBE Insurance Group Perpetual Ltd 	<ul style="list-style-type: none"> Amcor GPT Group The Lottery Corporation

FUND STRATEGY AND OUTLOOK

Front and centre are investor's pre-occupation with central bank policy direction, concerns about a synchronised global growth slow down and recession risk, coupled with the prospect of an earnings recession in the US.

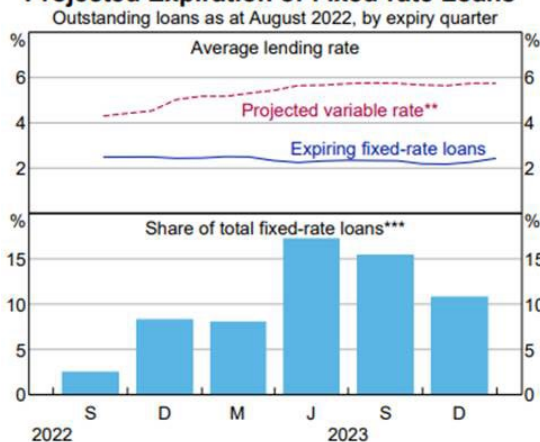
US interest rates in 2022 were raised at the fastest level since the 1980's to counter inflation at 40-year highs. **The era of cheap money and "growth at any price" is clearly over.**

Despite nearing the peak in the interest rate cycle we are still not there yet, nor do we have any line of sight on the duration and stubbornness of higher rates. US Federal Reserve Governor Powell was clear in his press conference after the decision to hike rates by another 50bps to 4.25%-4.5%, saying "we have more work to do" and he once again, stressed the need to restore price stability. Ongoing increases in the fed-funds target rate "will be appropriate" and Fed officials have now pencilled in 5.25% as the top end for its benchmark rate (vs. their previous forecast of 4.75%). Furthermore, cutting rates in 2023 is off the cards until inflation gets "substantially down to 2%". The Fed knows very well that monetary policy works with a lag and that the tighter it becomes, the more it not only slows inflation, but economic growth and hiring too. It's again, all about the adage of not fighting the Fed! The RBA too will no doubt raise rates, but the size of expected hikes have moderated, so too for the Fed.

Whilst we have seen extreme volatility in the more "speculative" areas of the equity market, it's very doubtful that it will be BAU going forward. Many of the "asset price bubbles" that persisted during the era of zero rates (crypto included) have now proven to be transitory and have been pricked.

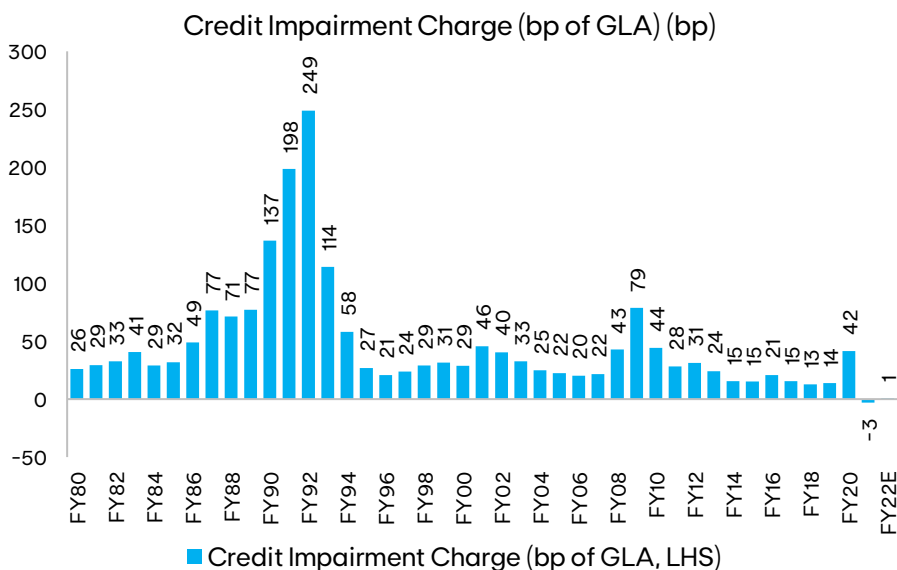
Domestically, one of the key drivers for the market going forward will be the resilience and performance of the banking sector. We remain concerned that the major banks are fast approaching the so called "mortgage cliff". The value of Australia's home loan market is ~\$2.1 trillion and about 35 percent, or \$735bn of that total were fixed-rate mortgages as of early October 2022, according to the Reserve Bank. Around 65 percent, or \$478bn of these fixed-rate loans were due to expire by the end of 2023, with the bulk maturing in the June-quarter 2023. **There are no historical precedents for the scale of this fixed-rate mortgage cliff and bankers have their fingers crossed that the transition will be smooth and cause minimum stress. Errrrr, time will tell.**

Projected Expiration of Fixed-rate Loans*



* Assumes fixed-rate loans are not repaid early or refinanced.
 ** Based on OIS market path for the cash rate as at 4 October and assuming full pass through to variable mortgage rates.
 *** Another 38 per cent of fixed-rate loans will expire in 2024 and beyond.

Credit Impairment Charges are the lowest on record as pandemic provisions are released, but is this about to change?

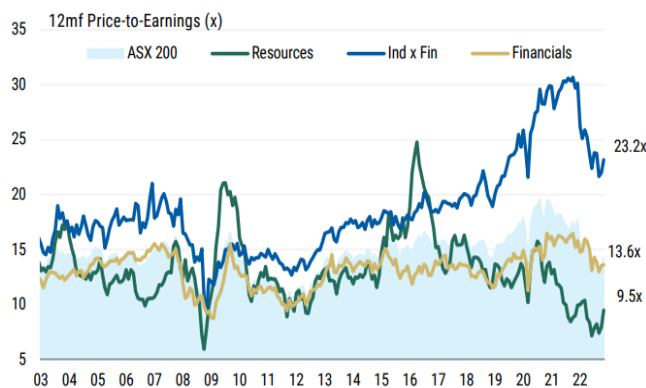


Source: RBA, ANZ, CoreLogic, Stats NZ, REINZ

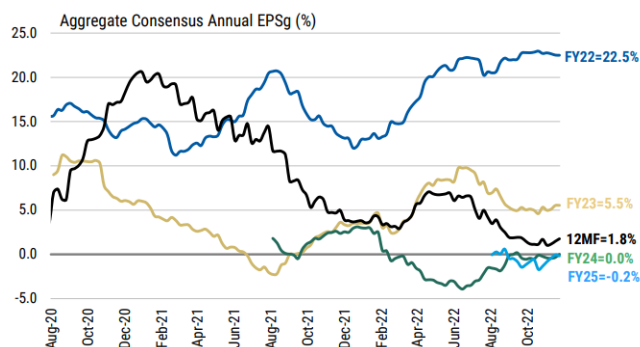
The canary in the coal mine is just over the Tasman. Average prices in New Zealand fell 5% in December from 12 months earlier, the biggest drop for a calendar year since 2008, according to data from CoreLogic New Zealand, with more declines expected in 2023, as the RBNZ continues to fight inflation with a series of aggressive interest-rate increases. In the capital city Wellington, house prices have already fallen 16.9% from a year earlier. Just to recap, the RBNZ lifted the OCR by a record 75 basis points to 4.25% in late November and projected that the benchmark will need to reach 5.5% this year to return inflation to its 1-3% target. Property prices in Australia have also come off the boil and we would expect this to have a "wealth affect", which will no doubt dampen consumer sentiment. When coupled with slowing mortgage growth and the major banks competing very aggressively for term deposits, it's another reason to be cautious the domestic Banks.

Valuations: The domestic market multiples have de-rated meaningfully over the past year but have reversed somewhat in the past few months, with the 12MF P/E now standing at 14.2x. Outer year earnings growth forecasts are fairly anchored in the low-single-digit territory.

Valuation: the 12M forward PE of the Industrials ex-Financials has Fallen from 30.2x to 23.2x



Annual Consensus EPS Growth Trends FY21-24



Source: Morgan Stanley Research.

The investment climate still remains foggy, with all eyes on the Fed's next move. A positive catalyst could be a resolution of the war in Ukraine, but that's difficult to call, so our strategy remains unchanged. We are maintaining a defensive tilt, which has kept us in relatively good stead given the flip flop market behaviour last year, which is likely to continue. Following strong gains in equities over the Q422, we would expect this relief rally to run into some stiff resistance at current levels. European equities have jumped out of the gate so far in January as the early-year slate of CPI data releases in Spain, Germany and France has been friendlier than expected. Without stating the obvious, the key to a more convincing and sustainable global market rally will be the resolve of central banks to contain inflation without triggering a deep and protracted recession. So far, the labour market and earnings have been surprisingly resilient. The real test for earnings will come in the next reporting season.....stay tuned.

The grossed up dividend yield on the portfolio now rests at 8.5%.

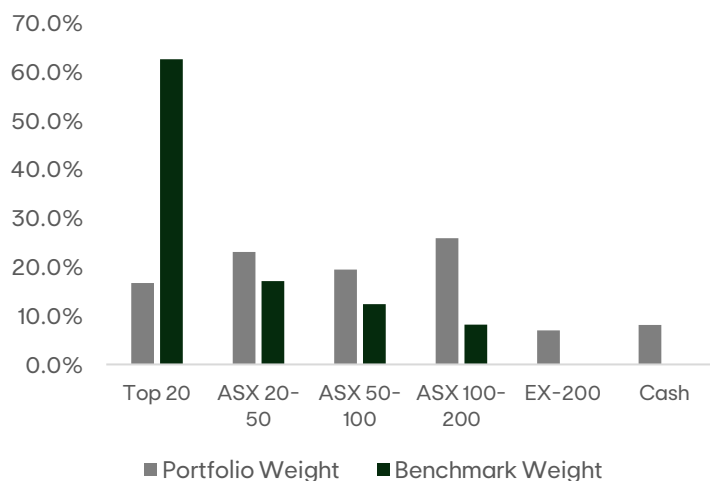
Portfolio Characteristics

FY23(E) Key Portfolio Metrics	Fund	Benchmark
Price/Earnings (X)	10.6	14.1
Dividend Yield (%)	6.6	4.5
Grossed Up Dividend Yield (%)	8.5	6.0
Dividend Growth Rate (%)	2.8	-0.2
Beta	0.86	1.00

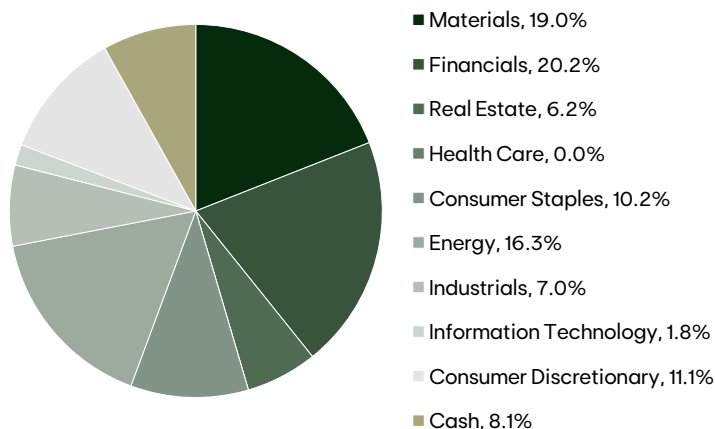
TOP 10 HOLDINGS

BHP GROUP	7.9%
AMPOL	7.1%
QBE INSURANCE GROUP	6.5%
CSR	6.5%
PERPETUAL	6.3%
GPT GROUP	6.2%
HARVEY NORMAN	5.3%
TREASURY WINES	5.0%
SANTOS	4.5%
WOODSIDE ENERGY	4.2%

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](#).

The Fund is also available for application through the NetWealth Platform.

All holding enquiries should be directed to our register, Automic Group
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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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