Ellerston Asia Growth Fund

Monthly Newsletter, January 2023

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	$0.8502
Net Asset Value	$0.8481
Redemption Price	$0.8460
Liquidity	Daily
No Stocks	34
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	3 Years (p.a.)	5 Years (p.a.)	Since Inception ^^ (p.a.)
Net^	4.64%	16.26%	2.70%	-15.65%	-3.10%	-0.29%	3.82%
Benchmark*	4.11%	16.08%	3.29%	-12.40%	-1.08%	0.07%	4.76%
Alpha	0.52%	0.19%	-0.59%	-3.25%	-2.02%	-0.36%	-0.94%

^ 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 up 4.6% (net) in January versus the MSCI Asia ex Japan (MXASJ) Index which was up 4.1%.

Global equities got off to a strong start in January driven by falling stagflation concerns leading to expectations of less hawkish monetary actions by central banks in 2023. The China reopening story has also fueled optimism that a 'hard landing' scenario for global growth can be averted. Indeed, MSCI World, S&P500 and ASX200 finished the month up 6.5%, 6.3% and 6.2% respectively. Asia was a relatively outperformer with the MXASJ (in USD) up 8.2% led by North Asian countries such as China (+11.8%), Korea (+8.4%) and Taiwan (+8.0%).

The strong start for global market equities is in stark contrast to the reality that inflation in most countries (ex-China) remain above central bank target ranges, interest rates continue to rise and the US Federal Reserve (Fed) is withdrawing liquidity from the system. Markets are 'fighting the Fed' despite the fact that risks to elevated inflation are still in place such as tight labour markets, the ongoing war in Ukraine and the reflationary impulses from the China reopening. We therefore continue to see greater downside risk to the outlook for developed markets equities relative to Asia in 2023. Furthermore, Asia led by China looks significantly more attractive than developed markets from a risk reward perspective. For instance, the MXASJ is currently trading on a forward PE of 12.5x, with MSCI China on a cyclical depressed 11x PE. Earnings growth for MXASJ and MSCI China are forecast to be ~6% and ~20% respectively over the next 12 months. This compares favourably to the S&P500 and ASX200 which are trading on 18.5x and 15x respectively and forecast to deliver flat to low single-digit earnings growth over the next year.

Overweight China

Within Asia, we are most optimistic on the outlook for China/HK equities. Although MSCI China has rallied ~50% off its October lows, the market is still trading below its long term average valuation. Importantly, there are a number of near term catalysts that could drive the market higher. Firstly, we believe Chinese equities are at the beginning of a new earnings upgrade cycle driven by the upsurge in demand post reopening. As we noted in last month's newsletter, Chinese households have up to RMB3-4tn (A$650-850bn) of excess savings that could be unleashed back into the economy. This is a powerful tailwind for earnings growth for Chinese goods and services companies and we expect the upcoming reporting season to confirm this trend. Furthermore, for the first time since 2019, there is complete policy alignment from both the government and regulators towards restoring economic growth. We believe these factors could motivate investors to close their existing underweights to Chinese equities in the coming months. China/HK accounts for ~50% of the EAGF portfolio and we continue to be on the lookout for potential opportunities that provide an appropriate margin of safety.

The Adani Saga

In contrast to the strong start to the year for developed markets and Chinese equities, the Indian market was rocked during the month by a short seller report on the Adani Group of companies alleging fraud and stock manipulation. These allegations against the Adani Group, with a combined market cap of INR17.8tn (or A$310bn) as at the end of December 2022, raised concerns over the corporate governance practices of companies across the broader market. As regular readers are aware, EAGF has a very stringent ESG (Environmental, Social and Governance) policy and the Adani Group of companies did not pass our criteria. As such, Ellerston Asia has never invested in Adani stocks. But given Adani's status as one of India's largest conglomerates, there have also been worries over potential contagion effects to suppliers and financiers. Companies in our portfolio with exposure to Adani are banks such as ICICI Bank and HDFC Bank. Our channel checks on these two companies however, suggest only very limited exposure (i.e. <1% of total loans) to the Adani companies.

At this stage, we view the correction in Indian equities during January as a healthy pullback given the market's relative outperformance in 2022 and elevated valuations. We continue to appreciate India's structural growth story which is driven by favourable demographics, rising penetration, technology leapfrogging and infrastructure/manufacturing investments. We believe these drivers will likely play out irrespective of the outcome in the Adani saga. As such, we stand ready to increase our India exposure on any further meaningful correction.

Portfolio Performance Summary

China, Taiwan and India were the largest contributors by country to alpha during the month. Whilst, Singapore and Indonesia were the relative underperformers. At a sector level, Consumer Discretionary and Industrials were the biggest contributors by sector to relative performance. Meanwhile, Energy and Financials were the worst performers.

At a company level, Alibaba, China Merchants Bank and TSMC were the biggest contributors to relative performance during the month. Alibaba's share price surged 25% during the month on expectations that a China reopening and easing regulatory backdrop will benefit its ecommerce, Cloud and Fintech businesses. Furthermore, the stock was boosted by news that activist investor Ryan Cohen had built a stake in the company. China Merchants Bank meanwhile reported a stronger than expected preliminary 4Q22 result with net profit growing ~18%yoy despite ongoing COVID disruptions. Finally, TSMC share price was boosted by improved global growth sentiment and positive commentary at its 4Q22 result pointing to a 2H2023 recovery for the logic semiconductor market.

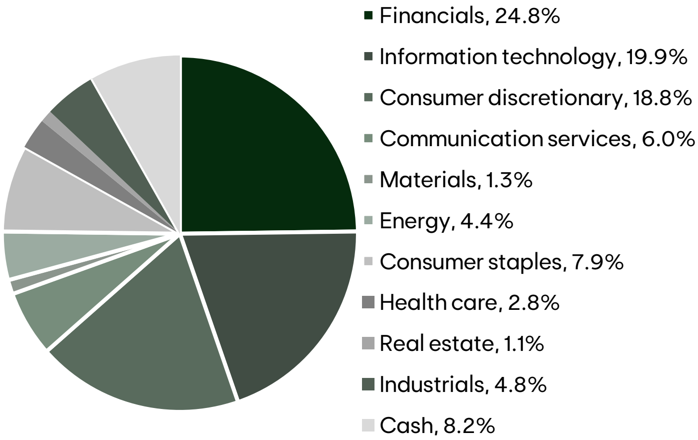
Reliance and ICICI Bank were the biggest drags on alpha. Reliance was sold off due to volatility in global refining margins and negative sentiment spillover from the Adani saga. ICICI Bank meanwhile saw some profit taking from investors despite reporting solid 3QFY23 numbers with net interest income and core pre-provision operating profits growing 35% and 34% respectively. Although we continue to view ICICI as one of the highest quality banks in India, the company's share price had increased by 66% over the past two years and was trading on a lofty 3x P/B (vs ROE of ~16%). As such, we took the opportunity to trim our position during the month.

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

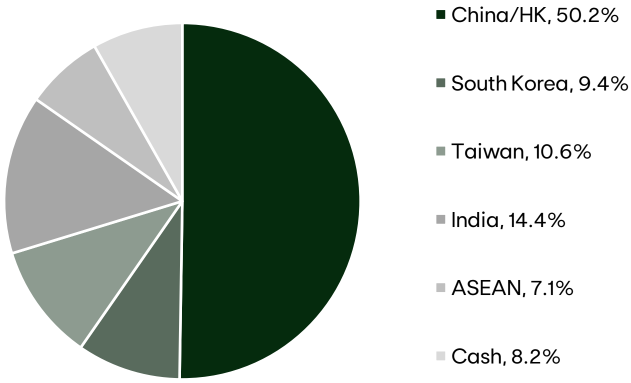
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Country	Weight
TSMC	Taiwan	9.0%
Samsung	Korea	6.5%
Tencent Holdings	China	6.0%
Alibaba Group	China	5.1%
AIA Group	Hong Kong	4.8%
Reliance Industries	India	4.4%
DBS Group	Singapore	4.3%
Kweichow Moutai	China	3.2%
HDFC Bank	India	3.2%
China Mengniu Dairy	China	3.1%

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

Sydney

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

Find out more

Should investors have any questions or queries regarding the Fund, please contact our Investor Relations team on **02 9021 7701** or **info@ellerstoncapital.com** or visit us at **ellerstoncapital.com**

All holding enquiries should be directed to our register, Automic Group on **1300 101 595** or ellerstonfunds@automicgroup.com.au

Ellerston Capital