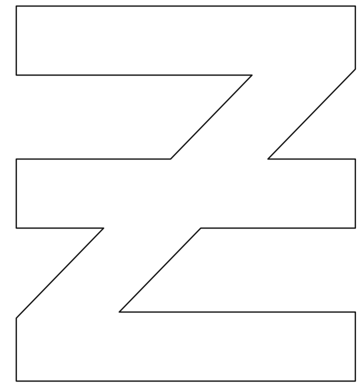


Ellerston Asia Growth Fund

Monthly Newsletter, April 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-Jan-17
Portfolio Manager	Fredy Hoh
Application Price	$0.8280
Net Asset Value	$0.8259
Redemption Price	$0.8238
Liquidity	Daily
No Stocks	36
Management Fee	1.00% p.a.
Performance Fee**	15%
Buy/Sell Spread	0.25% on application 0.25% on redemption
Distribution Frequency	Half Yearly (i.e. June & December)

**** Of the investment return above the benchmark, after recovering any underperformance in past periods**

Performance Summary

Performance(%)	1 Month	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.)^^
Net^	-1.97%	-2.62%	-6.32%	-2.16%	-0.85%	3.24%
Benchmark*	-0.87%	0.34%	-1.26%	0.78%	-0.02%	4.62%
Alpha	-1.10%	-2.96%	-5.07%	-2.95%	-0.83%	-1.39%

^ 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 1.97% (net) in April versus the MSCI Asia ex Japan (MXASJ) Index which was down 0.87%.

Developed Markets vs. Asia Divergence

Volatility eased in April particularly in developed markets as expectations that global central banks are at the tail end of their respective hiking cycles and a better than feared reporting season in the US eased market concerns. Despite the recent respite, global market sentiment remains fragile given ongoing concerns around the regional banking system and debt ceiling deadline in the US and lingering recession fears in both the US and Europe.

Asian markets underperformed developed markets during the month dragged down by Chinese equities. This was despite the release of better-than-expected 1Q23 GDP growth (+4.5% YoY) and retail sales (+10.6% YoY) data along with improving property activity (sales +4.1% YoY in 1Q). The underperformance of Chinese equities since January despite growing evidence of economic cycle divergence between China (accelerating) and the US and Europe (slowing) has been surprising.

It is apparent that the wall of worry for investing in China remains high. We however believe that the vectors of uncertainty with regards to Chinese equities have gradually been removed. Indeed over the past 6 months, the Chinese Government has abandoned zero-COVID, eased regulatory restrictions, provided stimulus for the property sector and maintained a supportive monetary policy environment. Importantly, these catalysts have started to translate into positive economic data and corporate earnings growth. Yet despite these positive developments, MSCI China continues to trade at the same multiple as it did back in December last year of 10.3x forward PE and 1.2x PB. These depressed valuations compare favourably to forecast earnings growth for the market of ~15% over the next 12 months and low teens ROE.

One of the major reasons that Chinese equities remain largely out of favour is the ongoing geopolitical tensions between the US and China. Recent reports suggest that the US Government is considering further curbs on investment into key areas of the Chinese economy such as advanced semiconductors, artificial intelligence and quantum computing. We believe that geopolitical risk is here to stay and our base case is that further economic sanctions are likely. A military conflict however is much less likely given the severe ramifications on the global economy. Further US Government restrictions will likely accelerate China's transition away from export related growth towards a more independent development path. This creates investment opportunities in sectors that are likely to benefit from increased Chinese government financing such as green energy, technology, pharmaceuticals and food and energy security. The EAGF portfolio has exposure to these sectors through companies such as CATL, Longi and By-Health. These companies are industry leaders, generate solid earnings growth (+20% YoY) and FCF (~3.5% yield on average) and trade on undemanding valuations (<20x PE).

Portfolio Performance Summary

India and Singapore were the largest contributors to alpha during the month. Whilst, China and Taiwan were the largest detractors. At a sector level, Communication Services and Consumer Staples were the biggest contributor to relative performance. Meanwhile, Consumer Discretionary and Real Estate were the worst performers.

At a company level, HDFC Bank, By-Health and Midea were the biggest contributors to relative performance during the month. HDFC Bank reported robust 4QFY23 results with net interest income growing by 24% YoY driven by 17% YoY loan growth and net interest margin expansion. The company also reaffirmed that the much-anticipated merger with HDFC could be completed by as early as July 2023. By-Health also released impressive 1Q23 results during the month with revenues and earnings growing 36% YoY/55% YoY respectively driven by surging vitamin sales in mainland China. Finally, Midea's share price was boosted by investor anticipation of a better-than-expected 1Q23 financial result. Indeed in early May, Midea reported solid revenue and earnings growth of 6% YoY/12% YoY respectively on the back of recovering air conditioning sales, price increases and margin expansion from lower raw material costs.

Alibaba, Longi and Mediatek were the biggest drags on alpha. Alibaba was sold off during the month on geopolitical and competition concerns. We note however that Alibaba is primarily a domestic demand story with domestic ecommerce accounting for 70% of company revenues and all of group earnings. Alibaba meanwhile continues to command the largest market share (~48%) in China's ecommerce space, which is likely to grow ~13% CAGR over the next 3 years. Furthermore, we view the China economic recovery, easing regulatory restrictions on the domestic internet sector and Alibaba's corporate restructure as positive tailwinds for the company's earnings and valuation. On valuations, Alibaba continues to trade on 8.5x (ex cash) forward PE, which looks attractive against earnings growth of ~15% CAGR over the next 3 years.

Longi's recent share price weakness has been driven by geopolitical concerns and local investors rotating from renewable energy names towards SOE and artificial intelligence concept stocks. On the geopolitical front, there have been reports that the European Union (EU) may look to restrict solar imports from China. We note that the proposed policy is at a very preliminary stage and will take some time for it come into effect. Furthermore, we view this news with some scepticism given China accounts for over 80% of the world's supply of polysilicon, solar modules, wafers and cells. Europe on the hand has insufficient solar capacity (e.g. only 2GW and ~9GW of wafer and module capacity) to meet the region's target of 380GW of new solar installations between 2023-30. As such, it will be very difficult for the EU to avoid China solar imports if it wants to achieve its targets. The fundamentals for Longi meanwhile continue to be strong with 1QFY23 revenues and net profit growing 52% YoY and 36% YoY respectively. The company remains the global leader in solar modules and wafers, yet trades on 12x forward PE.

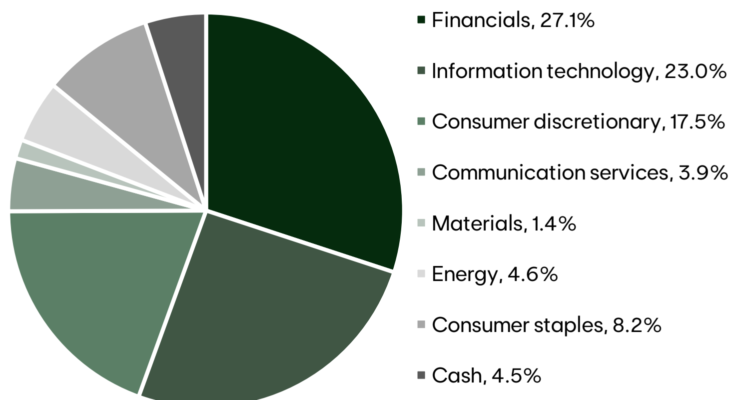
Finally, Mediatek's share price was negatively impacted by several broker downgrades on potential competition concerns and slower than expected recovery in the China smartphone market. We continue to like the duopoly structure (Mediatek and Qualcomm) within the smartphone system-on-chip industry and believe rational competition will likely prevail in order to preserve margins and returns. Longer term, we expect Mediatek to be a structural beneficiary of Chinese smartphone makers looking to localise their sourcing of components. The company meanwhile trades on 13x forward PE and an attractive 9% free cash flow yield.

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.

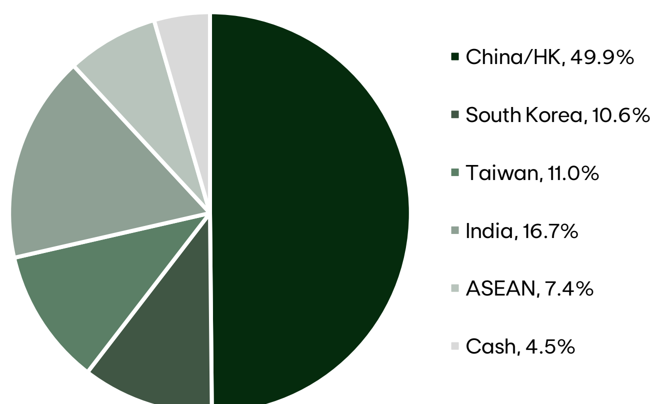
Kind Regards,
Fredy Hoh

Portfolio Characteristics

Sector allocation



Geographic allocation



TOP 10 HOLDINGS

Company	Country	Sector	Weight
Taiwan Semiconductor Manufacturing Co., Ltd.	Taiwan	Information Technology	9.3%
Samsung Electronics Co., Ltd.	South Korea	Information Technology	7.7%
AIA Group Limited	Hong Kong	Financials	5.1%
Reliance Industries Limited	India	Energy	4.6%
Alibaba Group Holding Limited	China	Consumer Discretionary	4.1%
DBS Group Holdings Ltd	Singapore	Financials	4.1%
HDFC Bank Limited	India	Financials	4.1%
Tencent Holdings Ltd.	China	Communication Services	3.9%
Kweichow Moutai Co., Ltd.	China	Consumer Discretionary	3.4%
PT Bank Mandiri (Persero) Tbk	Indonesia	Financials	3.3%

Source: Ellerston Capital.

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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