

Ellerston Global Mid Small Cap Fund

Monthly Newsletter, May 2023

Investment Objective

To outperform the MSCI World Mid Cap NR (AUD) Index by 3% over a rolling 5 year period on a net of fees basis, with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio of global mid small cap securities using the Manager's distinctively contrarian high conviction, benchmark independent investment approach. The Manager believes that the trade-off between risk and potential returns is improved by implementing the highest conviction ideas from a filtered universe of securities that are in a period of "price discovery" and offer the best risk/reward.

Key Information

Strategy Inception ^{^^}	1 March 2017
Portfolio Manager	Bill Pridham
Class A Application Price	\$1.3369
Class A Net Asset Value	\$1.3336
Class A Redemption Price	\$1.3303
Class B Net Asset Value	\$1.1311
Class B Redemption Price	\$1.1283
Liquidity	Daily
No Stocks	20 - 40
Management Fee (Class A)	0.75%
Performance Fee	10% ^{**}
Buy/Sell Spread	0.25% on application 0.25% on redemption

^{**}10% of the investment return over the benchmark return (MSCI World Mid Cap Index NR (AUD)), after recovering any underperformance in past periods.

Performance Summary

Class A

Performance	1 Month	3 Months	FYTD	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.) ^{^^}
Net [^]	1.55%	3.20%	14.57%	8.14%	9.62%	10.80%
Benchmark*	-1.23%	0.22%	12.79%	9.03%	7.44%	8.99%
Alpha	2.77%	2.98%	1.78%	-0.89%	2.18%	1.80%

Class B

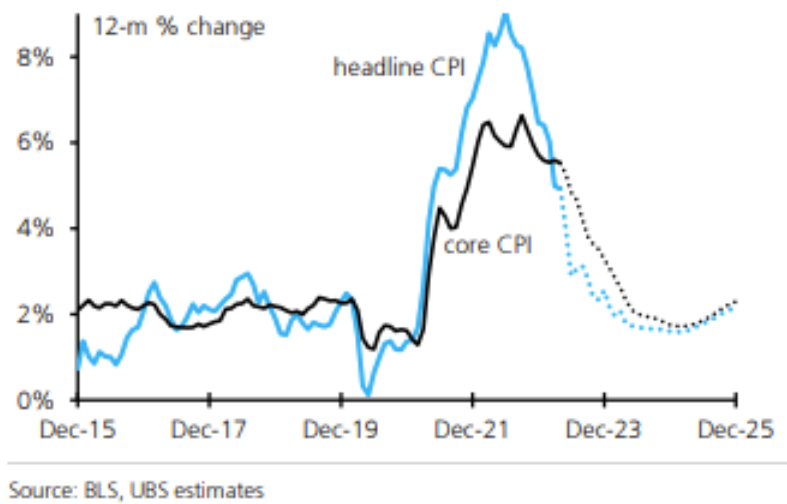
Performance	1 Month	3 Months	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception (p.a.) ^{***}
Net [^]	1.54%	3.20%	5.16%	-1.79%	-	7.73%
Benchmark*	-1.23%	0.22%	5.91%	1.55%	-	8.69%
Alpha	2.77%	2.98%	-0.75%	-3.34%	-	-0.96%

[^] The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance.
^{*} MSCI World Mid Cap Index NR (AUD)
^{***} Class B Inception Date is 18 August 2020

Portfolio Commentary

With the March quarter reporting season now in the rear-view mirror (with a decent beat rate relative to expectations again) the focus quickly shifted to the next inflation print and the escalating concerns around the debt ceiling discussions in the US. Inflation remains on investors minds as a continued decline could see the US Federal Reserve (Fed) finally pause and provide a path to a potential easing, while stubbornly high prices would result in a higher for longer scenario.

The inflation print released in May showed continued abatement and came in pretty much in line with expectations. That said, the report did show that April rent CPI increased at a slightly faster rate than in March however with asking rents (spot) continuing to decline, this metric should deliver a downward bias going forward. As you can see in the chart below, UBS expects future CPI prints to continue the descent that should lead and confirm our long-held expectation that the Fed and inflation headline risks in 2022 would no longer be a feature in 2023. Considering that inflation in the US has declined 420bps from 9.1% to 4.9% we have seen some heavy lifting to get it under control.



In early May, the headline risk baton was passed to the ongoing discussions and horse trading associated with the debt ceiling discussions. The spotlight was triggered by Janet Yellen who wrote to Congress highlighting that the XDate could come as early as June 1st. It seems in every "crisis" we need to learn about a new metric or acronym to monitor so we can estimate when the markets could crater. So, we find ourselves on several conference calls learning about the X Date (the day the Treasury runs out of funds to pay its bills and the US defaults on its debt) and potential market implications.

We quickly found out that we could add little value to what the outcome would be and focused our energy on our businesses with conference calls to discuss recent results and their operating outlooks. To be clear, we maintained a keen focus on the debt ceiling proceedings however we held a base case that, like Winston Churchill is credited as saying, "Americans will always do the right thing – after exhausting all the alternatives". This turned out to be the outcome with a deal finally struck at the end of the month, quickly passing through both the House and Senate.

So now we can get back to the seemingly perennial discussion around the upcoming (and most telegraphed) recession. Hard landing, soft landing, no landing – we have no edge on predicting the outcome however do consider that the tightening of financial conditions, coupled with the recent US regional bank stress, should lead to a slowing of economic activity which would impact earnings. We remain steadfast in our approach in identifying and investing in businesses with strong secular or structural growth opportunities. While these companies will not be totally immune from a slowing economy, they should be relatively insulated and come out the other side in an even stronger competitive position.

The Ellerston Global Mid Small Cap Fund increased 1.55% net during the month compared to the MSCI World Mid Cap (AUD) Index which declined by 1.23% over the same period.

The portfolio's top three contributors **Advantest, Flex Group and PTC added 257bps to performance** while **Chart Industries, Option Care Health and Bureau Veritas detracted 148 bps** during the month.

It feels like we can characterise the world of AI, semiconductors, data growth and compute as pre Nvidia first quarter results and post (similar to pre pandemic and post pandemic discussions). Pre Nvidia results the market was aware of ChatGPT (large language networks) and Generative AI. However, it was in the Nvidia result commentary on May 25th that a tectonic shift was signalled, spotlighting the long term opportunity associated with these next generation technologies.

Here are some of the main quotes from the result commentary that we felt provided the most powerful indication of where the compute market may be heading. Note that we have had a 5G and data growth vertical within our portfolio for several years with several companies benefiting from this megatrend. One corollary that is definitely worth calling out is our ownership in Iron Mountain which is a leader in IT asset decommissioning and recycling (you will see this in point 4):

- ✓ The computer industry is going through two simultaneous transitions, accelerated computing and generative AI
- ✓ CPU scaling has slowed, yet computing demand is strong and now with generative AI, supercharged
- ✓ There is \$1 trillion installed in the global data center infrastructure, based on the general-purpose computing method of the last era. Companies are now racing to deploy accelerated computing for the generative AI era. Over the next decade, most of the world's data centers will be accelerated. The entire world's data centers are moving towards accelerated computing
- ✓ You're seeing the beginning of call it a 10-year transition to basically recycle or reclaim the world's data centers and build it out as accelerated computing. You'll have a pretty dramatic shift in the spend of the data center from traditional computing, and to accelerated computing
- ✓ The workload is going to be predominantly generative AI. inference is now a major driver of accelerated computing because generative AI is used so capably in so many applications already

Advantest had been rallying early in the month however it was post the Nvidia result that the stock really took off, ending the month up almost 70%. Now if you remember there are two companies in the world with close to 95% combined market share in the system on chip (SoC) testing market (basically testing to make sure the chips in our smartphones, datacenters and automobiles don't fail). We estimate Advantest has c80% market share in the high performance compute (HPC) market and is the dominant supplier to Nvidia, hence the strong rally. We did trim a bit post the solid performance and while we have owned the stock for almost 3 1/2 years, we see long term capital growth opportunity for us all as investors.

Flex is one of the world's largest contract manufacturers with many secular tailwinds such as solar, electric everything and medical devices driving the stock. We consider that the performance this month is attributable to its data center capabilities, especially those associated with its recent acquisition of Anord Mardix. Flex has owned the business for almost 2 years now after it bought the company for \$540m in October 2021. Anord Mardix offers an extensive product portfolio of critical power solutions directly tied to data center operators and one thing is certain, this compute associated with Generative AI is going to require a lot of smart power deployments.

PTC held its first in-person Livework Conference in 4 years and the event was well received. Management highlighted a number of growth levers over the next several years including its ongoing shift to SaaS (significant revenue uplift with higher absolute EBITDA), the synergy benefits associated with its recent ServiceMax acquisition and continued strong growth in Codebeamer which is becoming the defacto operating platform for the automotive manufacturing industry.

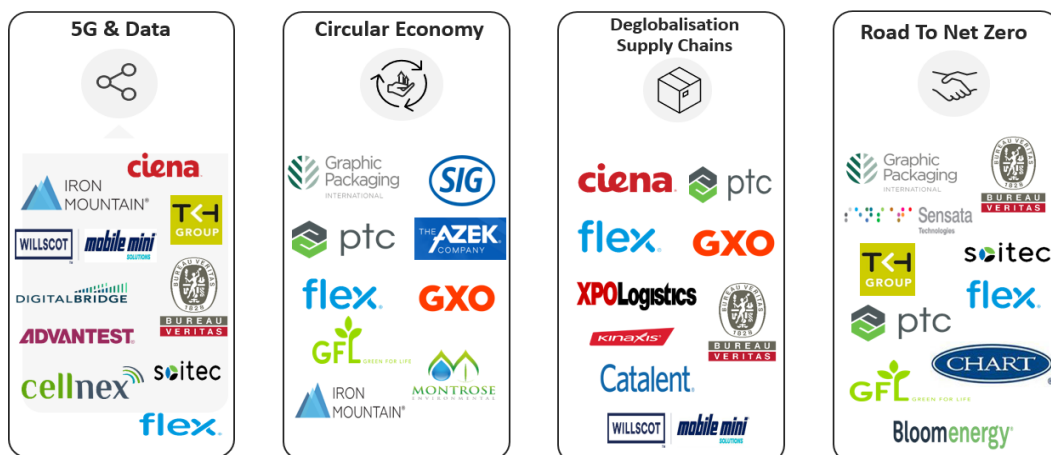
Chart Industries is a leading global manufacturer of highly engineered equipment servicing multiple applications in the Energy and Industrial Gas markets. It is recognized as a leader in the clean energy transition by providing technology, equipment and services related to liquefied natural gas (LNG), hydrogen, biogas, carbon capture and water treatment to global customers. Given it has a decent exposure to energy, its share price does correlate to the price of natural gas and oil which were down by 12.4% and 11.3% respectively during May. The weakness came despite several very positive announcements during the month including expanding its partnership with TECO 2030 ASA to include all Howden solutions for ship efficiency and carbon emissions reductions, successfully testing a new liquid hydrogen valve with Crane, collaborating on carbon capture utilization and storage (CCUS) Projects with Koch Engineered Solutions and collaborating with FuelCell Energy on decarbonization and hydrogen technologies.

Option Care Health reported a set of very strong results on the 4th of May with revenues up almost 11% driving EBITDA ahead by over 20%. Management upgraded full year guidance for both revenue and earnings with full year operating cash now expected to come in above \$240m. With a result like that you would have expected Option Care to be in the plus column. What drove the stock down was the concurrent announcement of an all-stock offer for home care company Amedysis. We have owned and profited from Amedysis in the past, know the company well and understand the acquisition rationale. That said, it is a bit of a pivot from its core home infusion business and understandably the market has lobbed an uncertainty discount on the stock. We continue to discuss the merits with Management and have slightly added to the position.

There was really nothing out to explain the weakness in Bureau Veritas this month. It produced a very solid set of results at the end of April and recent discussions with the company highlight that the business is performing in line with expectations, albeit with China re-opening hopes coming in a bit more muted than hoped.

The fund was a bit more active during May as we trimmed Advantest and Cellnex Telecom, added to Aixtron, Azek, Bloom Energy and GFL Environmental while initiating a position in the #1 global provider of factory automation solutions in Japan based Daifuku. We have owned Daifuku in the past and as part of our library we have been watching for an attractive entry point which presented itself following its most recent set of results.

We continue to have differentiated exposure to some pretty powerful long term thematic which should drive long term compounding benefits to us all as investors. These include 5G and the growth in data as Industrial IoT, AI and large language networks such as ChatGPT and next generation applications associated with 5G drive data demand, companies that enable our push to a circular economy, beneficiaries of deglobalisation as well as those helping to improve supply chain efficiency and companies which are levered to the multi trillion dollar spending required for our "Road to Net Zero".



These businesses as well as idiosyncratic opportunities in the fund should provide solid absolute and relative returns over the long term as secular and structural business drivers help mitigate earnings risk in times of economic uncertainty.

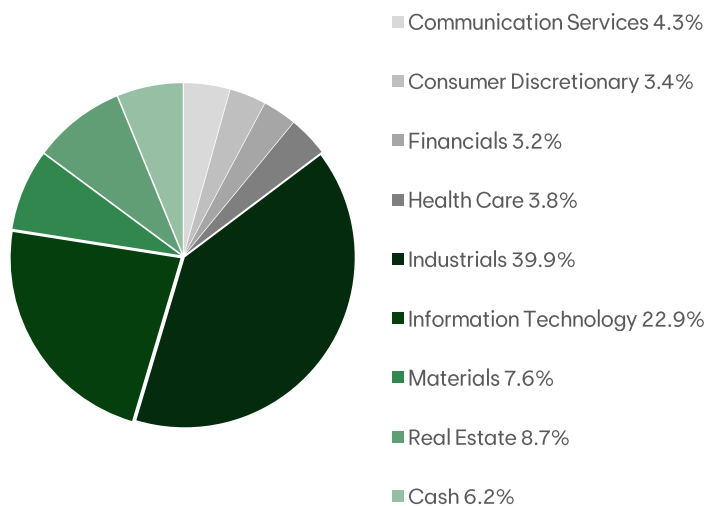
As always, we thank you for your continued support and look forward to providing further updates in the future.

Portfolio Characteristics

Holdings

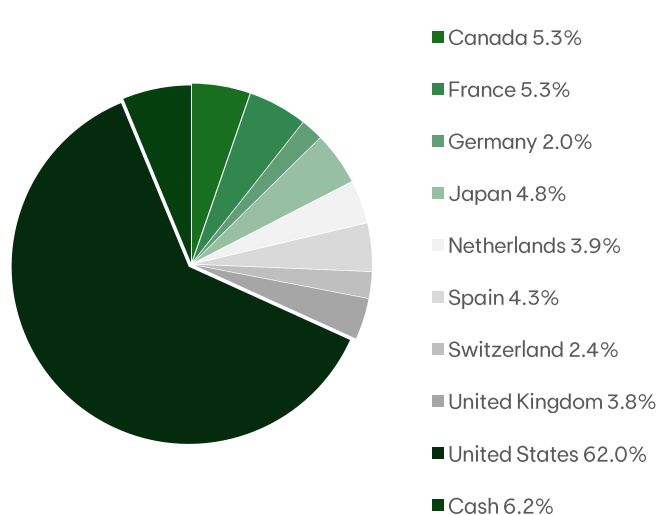
Company	Country	Sector	Portfolio Weight
Graphic Packaging Holding Company	United States	Materials	5.3%
GFL Environmental Inc	Canada	Industrials	5.2%
PTC Inc.	United States	Information Technology	4.9%
GXO Logistics Inc	United States	Industrials	4.5%
Cellnex Telecom S.A.	Spain	Communication Services	4.3%
WillScot Mobile Mini Holdings Corp. Class A	United States	Industrials	4.2%
Ciena Corporation	United States	Information Technology	4.2%
Flex Ltd.	United States	Information Technology	4.2%
TKH Group N.V. Cert	Netherlands	Industrials	3.9%
Option Care Health Inc	United States	Health Care	3.8%

Sector Allocation



Source: Ellerston Capital.

Geographic Allocation



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.

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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, Mainstream Fund Services on **02 8259 8550** or InvestorServices@MainstreamGroup.com

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