Ellerston Global Mid Small Cap Fund

Monthly Newsletter, August 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	$1.4440
Class A Net Asset Value	$1.4404
Class A Redemption Price	$1.4368
Class B Net Asset Value	$1.2214
Class B Redemption Price	$1.2183
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

Performance	1 Month	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.)^^
Class A^	0.64%	8.01%	18.31%	9.92%	9.70%	11.67%
Benchmark*	0.39%	6.72%	14.93%	11.13%	7.33%	9.72%
Alpha	0.24%	1.29%	3.38%	-1.21%	2.37%	1.95%

Performance	1 Month	3 Months	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception (p.a.)***
Class B^	0.63%	7.98%	18.29%	-3.29%	10.59%	9.78%
Benchmark*	0.39%	6.72%	14.93%	-0.05%	11.13%	10.26%
Alpha	0.24%	1.26%	3.36%	-3.24%	-0.54%	-0.48%

^ 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

Equity markets are clearly operating in a cloudy backdrop as current economic conditions and earnings outcomes have come in better than many were anticipating. Economic growth has remained pretty robust, while inflation prints are confirming a slowdown in price increases. Consumer spending has been underpinned by excess savings associated with the war like level of pandemic stimulus payments, while infrastructure spending associated with a plethora of fiscal packages has not yet been meaningfully deployed. All that said, the market narrative seems to focus on the impending, albeit delayed, recession as excess consumer savings are depleted and the higher cost/lower quantity of money impacts economic activity.

As we have highlighted a number of times, with >500bps of fed funds rate increases in the US alone, it is difficult to see how this tightening in financial conditions can't have a substantial impact on the economy. With US mortgage rates increasing to >7%, we have seen the pace of existing home sales declining to levels not seen since the mid 90's. This comes at a time when student loan payments will resume, which is estimated to provide a $16bn headwind starting this month.

Equity markets have been underpinned by the view that the Fed is on the path to engineer a soft landing. While the "long and variable lags" associated with monetary policy create a decent level of uncertainty, Chairman Powell indicated in his Jackson Hole speech (August 25th) that inflation remains too high and "We will keep at it until the job is done". This underscores a higher for longer interest rate regime. However, he was quite clear that doing too much would cause unnecessary damage to the economy and forward policymaking would be agile.

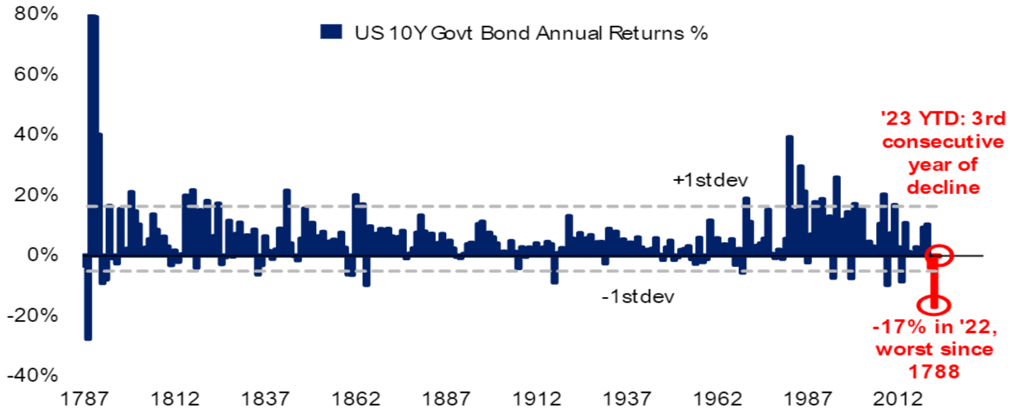
Recent job reports are showing a cooling in labour costs which are coming in quite a bit lower than expectations, while unemployment rates ticked up slightly as more people returned to the workforce (albeit still quite tight conditions).

Arguably, the most anticipated earnings report of the season was Nvidia's. The stock had been incredibly strong leading into the print with concerns around the potential impact on the overall market if the "King of AI" disappointed. The result was very strong, especially in its data center segment which grew 141% sequentially, driven primarily by the accelerating demand for cloud. Interestingly, despite the stock being bid up in aftermarket trading, Nvidia's share price performance on the day of trading was relatively muted.

Cloud service providers are undertaking a generational transition to upgrade their data center infrastructure for the new era of accelerated computing, and we have a number of positions levered to this thematic. We anticipate that the ramifications, both from revenue generation, as well as cost out and margin enhancement, will be significant over the coming years.

We thought this chart from Bank of America was very telling, and while we don't have anything particularly insightful to add, to think that we have not seen 3 consecutive years of losses in the US 10yr Treasury market EVER just shows the extremes we have seen in markets post pandemic. The main takeaway to us is that it really highlights the new investment environment we are operating in as the era of low inflation, low interest rates is behind us.

Chart 2: Never in the history of the US republic have US Treasury returns fallen 3 years in a row
US 10-year government bond annual returns %



Source: BofA Global Investment Strategy, Bloomberg, Global Financial Data

BofA GLOBAL RESEARCH

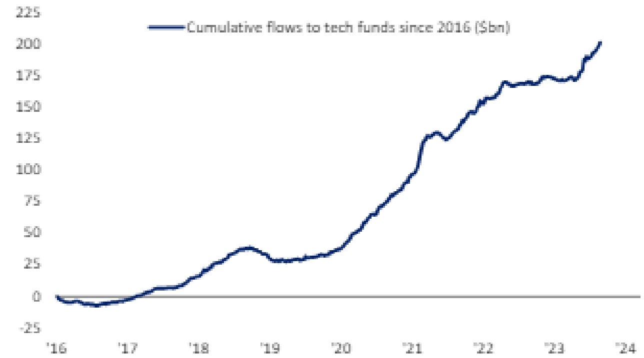
Market breadth remains incredibly narrow as the large megacap stocks continue to attract fund flows, despite rising real rates potentially impacting longer duration valuations. With AI, and especially generative AI, supporting sentiment around the "magnificent seven" (Meta, Apple, Amazon, Alphabet, Microsoft, Nvidia and Tesla), shows how important the positive Nvidia print was for those overweight these names.

Chart 6: Breadth in global stocks narrowest since 2003
MSCI ACWI Equal Weighted vs MSCI ACWI (price relative)

Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Chart 12: Longest streak of inflows to tech since Sep'21
Cumulative flows to tech funds since 2016 ($bn)



Source: BofA Global Investment Strategy, EPFR

BofA GLOBAL RESEARCH

Overall, global equity markets were quite weak during August. The S&P500 and Nasdaq were down by 1.8% and 2.2% respectively, while the FTSE (down 3.4%), CAC (down 2.4%) and DAX (down 3.0%) all gave back recent gains. Even the Japanese juggernaut, the Nikkei 225, was haircut by 1.7%.

The Ellerston Global Mid Small Cap Fund increased 0.64% net during the month compared to the MSCI World Mid Cap (AUD) Index which rose by 0.39% over the same period. While the stocks within the portfolio were down in aggregate, the unhedged A$ exposure more than offset this impact.

The portfolio's top three contributors Ciena, Digital Bridge and Azek added 83bps to performance, while Willscot Mobile Mini, TKH Group and Webster Financial detracted 128 bps during the month.

Ciena is a global leader in providing networking systems, services and software for some of the largest communications companies around the world. It delivered a cracking result at the end of the month and increased almost 16% on the night of its earnings. Comparable companies such as Lumentum, Coherent and Infinera had delivered quite weak results in the weeks preceding the Ciena print, so there was a fair bit of negativity baked into the price. Revenue grew 23% yoy while EBIT grew c74% as margins expanded 350bps on last year. Management remains encouraged by the solid pipeline in place as customers ensure their networks are ready for machine learning and AI traffic coming out of data centers. Year end backlog is expected to come in around $2.7bn which is still double historical norms and helps the business position for another growth year in 2024.

Digital Bridge is the only dedicated, global-scale digital infrastructure firm investing across five key verticals: data centers, cell towers, fiber networks, small cells, and edge infrastructure. It also delivered a solid earnings print during August as it meets the persistent and growing demand for digital infrastructure investment. CEO, Marc Ganzi, indicated that it is seeing the early signs of new demand driven by Generative AI. Fundraising remains on track with strong yoy growth in its investment management platform, with fee income up 47% and fee earning assets coming in at $29bn or >50% up on last year. As part of its simplification strategy, and part of our investment thesis, Digital Bridge received final commitments for its Databank recapitalization and will see company level debt decrease dramatically. The final leg in this strategy will likely come closer to year end when it finalises capital inflow for its Vantage data centers. Monthly recurring revenue for its datacenters is up 22% while towers were up 21% as carriers proliferate their 5G networks around the world. Overall, a solid performance as Management has now almost completed peeling back the onion to the core business of digital infrastructure.

Azek also reported its results during August, delivering an earnings beat which underpinned its raised full year guidance. Azek operates in a duopoly in the North American composite decking market with Trex, and this set up has underscored a very rational inventory and pricing environment. Production levels have now normalised, as a self-inflicted inventory cleanse a couple quarters ago benefits current utilisation levels. Importantly, the cleanse got rid of high embedded input and freight costs, with current margins benefiting from lower commodity prices and lower freight rates. Residential margins were up 350bps to 30% with more margin expansion expected to flow through to 2024. Azek is a great example of a business and industry structure that can hold prices even when input costs are coming down – pretty powerful margin jaws.

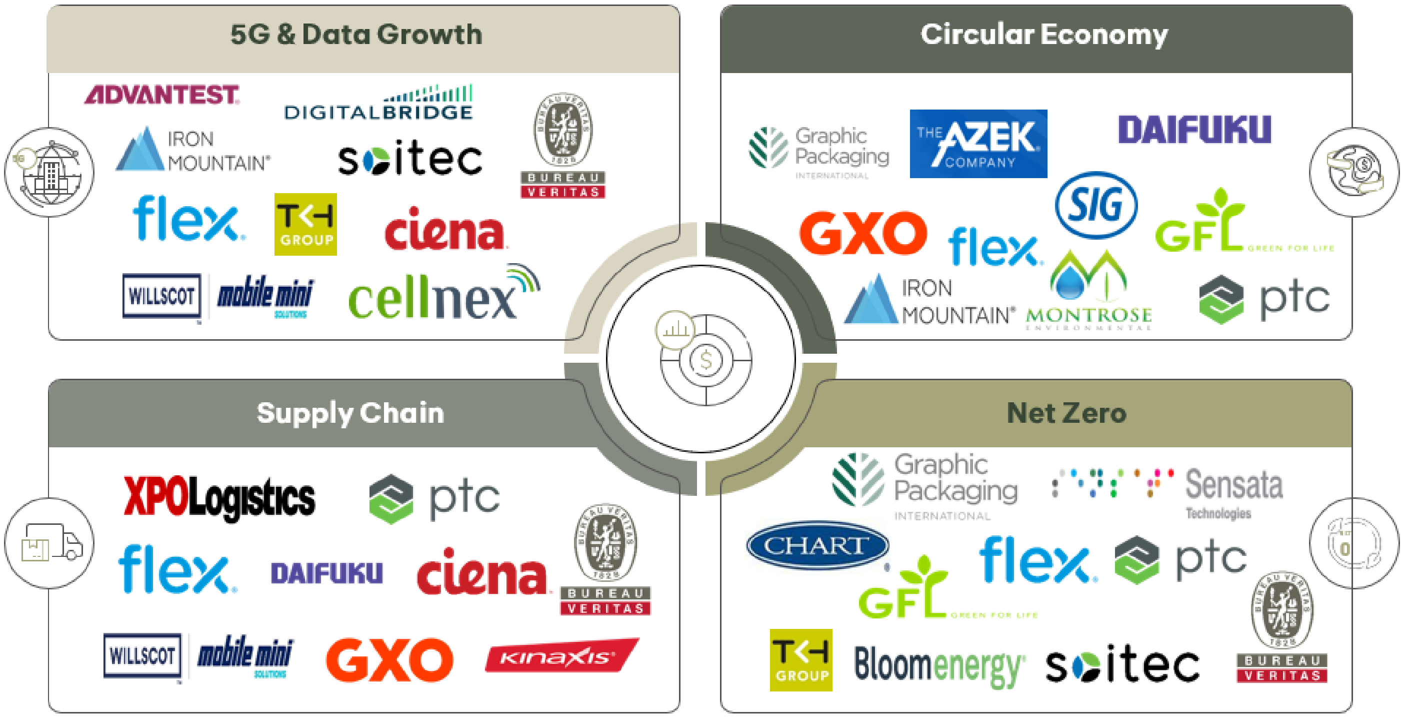
Willscot Mobile Mini is the largest provider of modular offices in North America and while it delivered solid results in early August, the stock ended down on the day. The business continues to benefit from strong pricing as leasing revenues were up 16% yoy. Additionally, given its three-year durations and very healthy spot rate spreads, which are >30% above the average of the fleet in field, we see a solid top line backdrop into 2024. EBITDA was up 25% as margins expanded 500bps to 44.9% this quarter. Strong cashflow performance is now annualising at $640m which provides Management with a clear line of sight to $3.00 of free cash flow per share, likely in the next 12 months. The market is concerned around non-residential construction activity and potential impact on volumes, however, we note that there are several large scale infrastructure projects commencing which should underpin leasing volumes.

TKH Group is a global leader in 3D machine vision, high voltage cables (onshore and offshore electrification) and provider of next generation tyre manufacturing technology. While it provided a solid first half 2023 performance, it is still being impacted by some componentry delays (expected to normalise by year end), inventory destocking in electronics and project delays associated with large scale electrification plans, primarily in the Netherlands. The stock has come back about 10% post result, however, we consider delay resolution as a matter of when, not if, and anticipate some positive deal announcements over the coming quarters. The stock trades cheaply on 10x PE, 7.5x EBITDA with a 4.4% dividend yield underpinning the stock.

Webster Financial had no company specific news over the month although the market is considering what credit oversight might look like for the banking sector post the regional banking crisis earlier in the year. In talking with Management, the business remains on track to deliver core deposit growth of 8-10% with loans growing 4-6% during 2023.

With strong share price performances over the past several months we have trimmed some of our positions to lock in some profits during August, while adding to some that we considered to have delivered strong profit results while not being adequately rewarded. Webster Financial had appreciated >40% from its May low of $32.25, so we trimmed some of the position at just over $45.00. XPO continues to surprise to the upside on the back of the bankruptcy of a large LTL competitor (Yellow) in the US and has appreciated from $30.00 in April to just over $70.00 currently, providing an opportunity to lock in profits. We also booked some profits in Floor and Décor at around $105.00 and will hold it as a small core position in anticipation of an add opportunity. Funds were deployed into existing positions which delivered solid earnings reports underpinning substantial upside potential. This list includes Kinaxis, Daifuku, Montrose Environmental and Radnet, each with their own idiosyncratic drivers.

We continue to have a differentiated exposure to some pretty powerful long term thematics 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".



Source: Ellerston Capital

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.

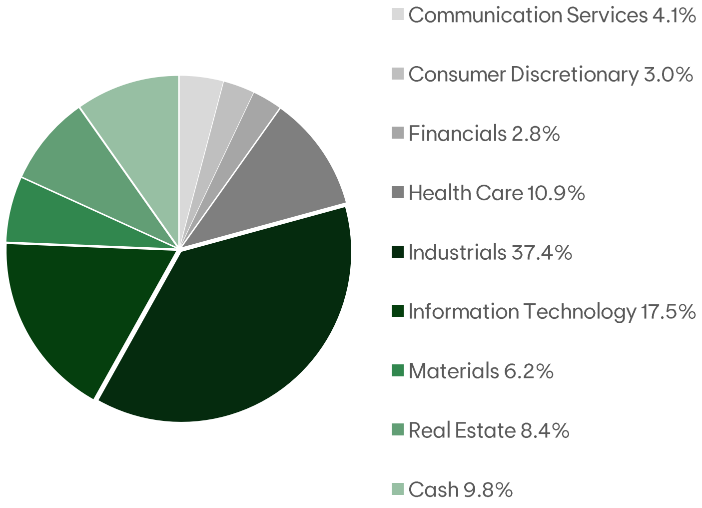
Portfolio Characteristics

Holdings

Company	Country	Sector	Portfolio Weight
GFL Environmental Inc	Canada	Industrials	5.4%
PTC Inc.	United States	Information Technology	4.9%
Option Care Health Inc	United States	Health Care	4.4%
GXO Logistics Inc	United States	Industrials	4.3%
Cellnex Telecom S.A.	Spain	Communication Services	4.1%
WillScot Mobile Mini Holdings Corp. Class A	United States	Industrials	4.0%
Chart Industries, Inc.	United States	Industrials	3.9%
Rentokil Initial plc	United Kingdom	Industrials	3.7%
Graphic Packaging Holding Company	United States	Materials	3.6%
DigitalBridge Group, Inc. Class A	United States	Real Estate	3.5%

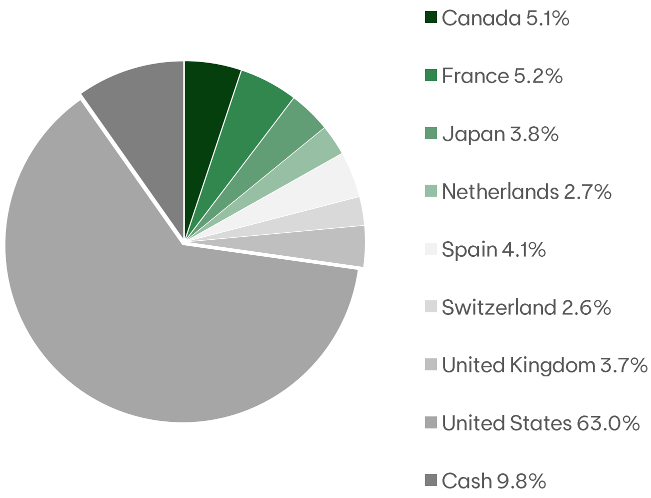
Source: Ellerston Capital

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.

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

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