Ellerston Equity Income KIS Fund

Monthly Newsletter, September 2023

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-19
Portfolio Manager	Chris Kourtis
Application Price	$0.9876
Net Asset Value	$0.9851
Redemption Price	$0.9826
Liquidity	Daily
No Stocks	31
Strategy FUM	$39.84m
Management Fee	0.70% p.a.
Performance Fee**	10.00%
Buy/Sell Spread	0.25% on application 0.25% on redemption
Minimum Investment	$10,000
Minimum Additional Investment	$5,000
Distribution Frequency	Quarterly

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

FY24(E) Key Portfolio Metrics	Fund	Benchmark
Grossed Up Dividend Yield (%)	7.3	5.6
Price/Earnings (X)	12.8	15.2
Dividend Yield (%)	5.6	4.2
Beta	0.87	1.00

PERFORMANCE SUMMARY

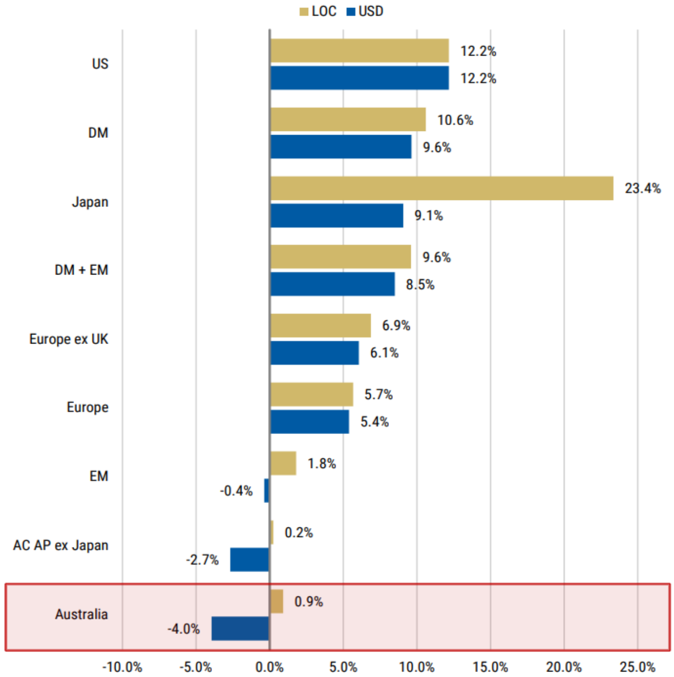
Performance	1 Month	FYTD 2024	12 Months Rolling	3 Years (p.a.)	4 Years (p.a.)	Since Inception (p.a.)^^
Net^	-1.63%	-3.39%	8.31%	9.49%	6.39%	7.37%
Benchmark*	-2.84%	-0.77%	13.46%	11.00%	5.27%	6.59%
Alpha	1.21%	-2.63%	-5.15%	-1.51%	1.13%	0.78%

^ 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

Investors took a cautious stance in September, a period where bond yields shot through their cycle highs. The MSCI Developed Markets suffered over the month, falling 3.7% and underperforming their Emerging Market counterparts (-2.0%), while the S&P 500 fell 4.8%, in local currency terms. The domestic market outperformed Developed Markets, finishing down 2.8%, but still underperformed the CYTD. Energy and Financials were the best performing sectors globally, as well as locally.

MSCI Global Country/Regional Indices Performance CYTD to September



Source: Morgan Stanley.

USA

The Federal Reserve, at its September FOMC meeting, left rates unchanged with the committee pencilling in one more hike for the balance of the year in either early November, or mid-December. Chair Jerome Powell made it clear that the central bank was close to done raising interest rates, but his colleagues delivered the message that resonated: borrowing costs must remain higher for longer amid renewed strength in the economy. The big takeaway for investors from the Fed's quarterly economic projections, released following the policy meeting, was the revelation that policymakers see fewer rate cuts than previously anticipated in 2024 (50bps versus 100bps), in part due to a stronger labour market. This, along with rising US bond yields and a US dollar that hit a 10-month high, set the tone for US equities. Worries that higher interest rates were beginning to affect the U.S. consumer and housing market also contributed to market weakness. Sales of newly built homes in the U.S. fell in August as interest rates and home prices stayed elevated, dampening buyer demand. U.S. new-home sales fell 8.7% to an annual rate of 675,000 in August, from a revised 739,000 in the prior month. New-home sales were down to the lowest level since March 2023. The Consumer Confidence Index fell to a four-month low, coming in at 103 in September, reflecting angst about rising interest rates, still-high inflation and a budget stalemate in Washington, as well as consternation about high gasoline prices.

In the wash up, the Dow Jones Industrial Average and S&P 500 were down 3.4% and 4.8% respectively, with the NASDAQ Composite Index, the laggard, falling 5.8% for the month, but is still way out in front with a +27.1% return for the CYTD. The Small Cap Russell 1000 also struggled, retreating 4.7% and the Russell 2000 fell by 5.9%, contracting their CYTD returns to 13.0% and 2.5%, respectively.

Europe

Not unexpectedly, the European Central Bank again hiked rates by 25bps to a record 4.0%, with President Christine Lagarde commenting; "can't say if this will be the peak", but at the same time admitting that growth will be "very, very sluggish". Elsewhere, the Bank of England halted the most aggressive cycle of interest-rate rises in more than three decades amid falling inflation and mounting fears of a pending recession. The central bank held its key rate at 5.25%, ending a series of 14 successive hikes since December 2021, when rates were just 0.1%. In contrast, Norges Bank raised the policy rate 25bps to 4.25% and surprisingly, the Committee said, "there will likely be one additional policy rate hike, most probably in December ".

The Euro STOXX50 Index finished the month down 2.8%. Among the major exchanges, UK's FTSE 100 was 2.4% higher, France's CAC 40 was down 2.4% and Germany's DAX was again the laggard, falling 3.5%.

Asia

China's key activity data was overall a strong beat on low expectations, but economic stimulus to date is still not hitting the tarmac. The PBOC cut banks' required reserves for a second time this year by 25 bps, to an average 7.4%, freeing up over 500 billion yuan (US$70b) in an attempt to stimulate its sluggish economy. After relaxing home purchase restrictions in more tier-two cities in an effort to boost China's depressed property market, Guangzhou relaxed home purchase restrictions, becoming the first among tier-one cities to take such a step, with expectations that Beijing, Shanghai, and Shenzhen will follow suit to prop up the sluggish home market. China property group Evergrande's woes continued, with the shares plunging again and then being suspended after the heavily indebted developer missed another debt payment and former executives were detained by the authorities. Not helping the mood was nervousness across Asian bourses amid increased worries about China's property sector as a result.

Asian equity markets were mixed but did a little better than the rest of the world. Korea's KOSPI was the standout at -3.6%, the Hang Seng fell 2.6% and the Nikkei 225 was down 1.7%. Japanese equities fared well against the backdrop of sovereign yields which rose sharply amid rumours that the BOJ panned to terminate its ultra-dovish monetary policy and initiate another bond-buying plan to bring down yields, currently standing at 10-year highs. China's SSE finished down 0.6% and India's SENSEX was the outperformer, up 1.5%.

Commodities

Commodities were mixed in September as stimulus attempts in China kept bulk commodities elevated. Iron ore prices finished flat at US$120/tonne and coking coal prices rallied 24% to US$333 per tonne, given on going supply issues in Australia. The base metals complex continued to weaken, with nickel falling 8% and copper down 2%, however aluminium bucked the trend and was the standout, closing up 8%. The Brent oil price pushed 10% higher to US$95/barrel, with Saudi Arabia tightening its grip on supply by extending its 1m bpd unilateral production cut to the end of this year, with Russia also rolling forward its 0.3bn bpd cut to December. Gold ticked down 5% to US$1,849 per ounce, on the stronger US Dollar. Lithium carbonate prices continued to weaken, - 22% in September and spodumene prices were 11% lower, as major battery producers continued destocking in China and new capacity ramped up.

Bonds

The US 10-year treasury yield rose 47bps in September to 4.57%, its highest level since 2007, with continuation of the Fed's hawkish tone at the September FOMC meeting re-iterating that rates must remain higher for longer amid renewed strength in the economy. On the domestic front, the Australian 10-year bond yield also rose in step with the global trend, up 46bps to 4.49%.

Australia

The A$ closed the month 1% down to US$0.64. A stronger US dollar offset the benefit of stronger commodity prices.

The RBA kept rates on hold at the September meeting, maintaining its "wait and see" policy stance. Expectations are that the new RBA Governor will continue to hold rates at 4.1% at its October meeting, in what should be the fourth consecutive hold decision. An unexpected bounce back in the August CPI from 4.9% to 5.2%, coupled with a strong employment rebound of 65k following a 1.5k fall in July, highlight that core services inflation could raise hawkish risks for the RBA going forward. There is of course scope for changes in the Statement given the somewhat stronger than expected inflation outcomes. That said, the market now generally sees a final rate hike at the forecast update meeting in November.

The S&P/ASX 200 Accumulation Index was down 2.8% in September. Energy, Financials and Consumer Staples led the performance charts. The Energy sector (up 1.6%), was the best performer, spurred by Whitehaven Coal (+16.7%), followed by Financials (-1.6%) and then Consumer Staples (-1.8%). The bottom three sectors were Real Estate (-8.5%), dragged down by Goodman Group (-8.2%), Information Technology (-7.9%) and Health Care (-6.2%).

For the month, the top stocks that made a positive contribution to the Index's return were BHP (+14bps), QBE Insurance (+5bps), ANZ Group (+5bps), Whitehaven Coal (+4bps) and Fortescue Metals (+4bps). Conversely, the bottom five stocks detracting from the Index's performance were CSL (-47bps), CBA (-17bps), Macquarie Group (-16bps), Goodman Group (-15bps) and Westpac (-13bps).

The ASX Small Ordinaries closed down 4.0%, underperforming the broader benchmark. Within the ASX Small Ordinaries, the Small Resources did much better at -1.2%, versus the Small Industrials, which dropped 5.0%.

COMPANY SPECIFIC NEWS

The Market Hits

Paladin Energy (PDN +30.2%)
PDN continued to rally strongly this month as uranium prices rose dramatically in September, with spot U3O8 up 20% to US$70/lb. Uranium prices have been buoyed by the steady increase in Utility long-term contracting, major producers are sold out until 2026 and the spot market has tightened up, increasingly hard to find spot supply. PDN's Namibian Langer Heinrich uranium mine will restart production in 1QCY24 and has six offtake agreements, which account for ~18mlbs or 48% of production out to CY30 with 29% market-related but 19% is base-escalated with a fixed price mechanism.

Coronado Global Resources (CRN +23.1%)
CRN had the tailwind of the strong price rise in coking coal of 23% for the month. In addition, Czech group Sev.en Global Investments picked up 51% of CRN from private equity firm Energy and Minerals Group for $1.5bn, which requires regulatory approval in Australia and the US. Sev.en has stated it will support CRN in its strategy to grow and strengthen its position in the US and Australia, which means that there is less likelihood that CRN's dividend payout ratio of 60-100% of free cashflow, will see the light of day.

Whitehaven Coal (WHC +16.7%) / New Hope Corporation (NHC +12.8%)
NSW government announced that from 1 July 2024, coal royalties would rise from 8.2% to 10.8% for open cut mines and from 7.2% to 9.8% for underground mines and will affect WHC in FY25 by around 10% at the EBITDA line. Despite the new royalties and activist investor Bell Rock Capital Management trying to stop WHC from acquiring the Daunia and Blackwater mines in Queensland, the stock rallied hard. NHC reported FY23 NPAT of $1.1bn, which was in line with consensus expectations and a three cents higher final dividend of $0.30 per share. Thermal coal prices were steady during the month, albeit at elevated levels, so it appears that both WHC and NHC share prices reacted to the better thermal coal outlook.

Pro Medicus (PME +14.0%)
PME announced that it had signed its largest contract to date, a minimum of $14.0m p.a. versus its historical average of $2.6m p.a. Baylor Scott & White Health (BSWH) is the largest non-profit network in Texas and the second largest in the state overall, spanning 51 hospitals, 800 patient care sites and more than 7000 active physicians (of which almost 500 are radiologists). BSWH marks PME's fifth contract win in 2023 YTD (second in FY24) and is materially higher than the recently announced wins in Memorial Sloan Kettering Cancer Centre ($3.4m p.a.) and UW Medicine ($3.6m p.a.). Investors liked the healthcare imaging software providers win, pushing the stock price up 12.3% on the day of the announcement.

Seven Group Holdings (SVW +12.3%)
SVW's WesTrac is the sole CAT dealer in WA & NSW/ACT and contributed 51% of SVW's revenue and 42% of group EBIT. One of the largest global CAT dealers, Canada's Finning had an investor day during the month, highlighting increased capex from the mining sectors, and increased demand for fleet re-build, including parts and service. Finning's read on the current market conditions was taken positively for SVW's largest business and share price.

Karoon Energy (KAR +10.0%)
KAR is the most leveraged to oil prices versus it peers, outperforming them as oil prices rose during the month. The Brent oil price pushed 11% higher to US$97/barrel, which was the highest this year.

Costa Group Holdings (CGC +9.8%)
Paine Schwartz Partners (PSP) cut the amount it is prepared to pay for Costa Group, Australia's largest fruit and vegetable processor, which has been an underperformer since listing on the ASX eight years ago. PSP sliced an original offer of $3.50 a share, made in May, to $3.20 a share after two months of due diligence and accounting for Costa's weaker profit outlook and a $30 million hit from adverse weather conditions. The stock rallied when CGC agreed to enter the scheme implementation agreement.

Liontown Resources (LTR +8.1%)
Albemarle, the world's largest lithium producer by market capitalisation, upped its non-binding offer to $3 a share from $2.50 a share subject to due diligence, which has been granted. Interestingly, Australia's richest person, Gina Reinhardt and Hancock Prospecting have been raiding the LTR stock register, accumulating 12.4%. Stay tuned.

Deterra Royalties (DRR +7.6%)
DRR has a royalty over the Mining Area C iron ore area mined by BHP based revenue of iron ore sold. Typically, DRR does better than its iron ore peers when prices are falling and vice versa given its lower price leverage. Iron ore prices have been flat during the month so DRR has caught up after underperforming its peers in the previous month.

The Market Misses

Chalice Mining (CHN -35.0%)
Chalice Mining is still smarting from a 54% slump in its share price since the release of last month's scoping study for its 100% owned Gonneville Nickel-Copper-Platinum Group Element (Ni-Cu-PGE) Project in Western Australia. Capital expenditure was much higher, grades were lower and project timing was pushed out a couple of years. The update was very disappointing compared to high investor expectations.

The Star Entertainment Group (SGR -34.0%)
Casino operator SGR got thumped after the company did another capital raise of $750m ($565m Institutional Rights Issue and $185m Retail Offer) at $0.60/share, a 20% discount to its previous close. It was only in February of this year that SGR raised $800m of equity, but at a price of $1.20/share. Surprisingly, SGR's largest shareholder, Rich Lister Bruce Mathieson, did not tip into the institutional leg of its $750 million equity raise, which has been pitched to investors as a complete reset of its capital structure. He is not the only investor to have been horribly burnt on this stock, but seemingly an increasing number who don't want to throw good money after bad, given the AUSTRAC case is looming and Queens Wharf issues. Time will tell.

Block, Inc. (SQ2 -23.0%)
Formerly known as Afterpay, the Square chief executive Alyssa Henry resigned, with no reason provided and will leave the firm on Oct 2. Jack Dorsey will take on the additional role as Square head in addition to helming Block. The market didn't take this news well at all, especially after the weak guidance for a flat second half in the previous month's 2Q adjusted earnings announcement.

De Grey Mining (DEG -22.0%)
DEG released a Definitive Feasibility Study (DFS) for its Mallina gold project, which follows the Pre-Feasibility Study (PFS) released in September 2022. Capex is now estimated to be ~$1.35bn, above the $1.05bn in the original PFS. DEG also launched a fully underwritten $300m equity raise over two tranches. Tranche 1 ($246m) will utilise the company's placement capacity, while Trance 2 ($54m) will be subject to shareholder approval. The raise was priced at $1.05/share (a 5.8% discount to previous close) and will see DEG's total shares on issue lift by 18%. Uses for the raise include the ordering of long-lead time capex items, exploration drilling, early works and engineering, contracting and approvals. Investors have speculated that DEG would need to do a raise and the share price weakened into the DFS disclosure.

Cromwell Property Group (CMW -22.0%)
CMW's result featured meaningful falls in asset values, with the Australian portfolio down 9%, Polish assets down 20% and lower transactional income. The NTA now stands at $0.84 and gearing at +40% stays elevated, so the focus remains on debt reduction via asset sales. Current assets contracted and under due diligence ($560m+) including the Polish retail assets would move pro-forma gearing to the low 30%s. No FY24 guidance was provided, although a distribution of 0.83c paid for the September quarter, if annualised, equates to 3.32c (vs 5.5c in FY23). CMW has adopted a conservative distribution policy given current uncertainties (interest costs, lower income from asset sales, valuations). While CMW's longer-term focus is on simplifying the business and transitioning to a capital light FM model, the near-term focus is on reducing gearing, managing earnings and executing on asset sales, in a challenging environment.

Weebit Nano (WBT -20.1%)
WBT is a developer of advanced semiconductor memory technology. The company's Resistive RAM (ReRAM) addresses the growing need for significantly higher performance and lower power memory solutions in a range of new electronic products such as Internet of Things (IoT) devices, smartphones, robotics, autonomous vehicles, 5G communications and artificial intelligence. WBT continued to drift lower and closed at $3.18 on no particular news during September, with the stock way off its $8.75 high achieved in February of this year.

Bellevue Gold (BGL -16.3%)
After the previous month's strong performance, BGL gave some back, underperforming its gold peers, which were down 8.9%.

Healius (HLS -17.9%)
Medicare data has shown improved recent trends, but volumes remain soft, with Australian pathology volumes ~11% below trend. HLS is still struggling to adjust, and management seem to be side-tracked by Australian Clinical Lab's attempted all stock merger. HLS has rejected the offer, but the dust is yet to settle.

Allkem (AKE -16.2%) / Sayona Mining (SYA -15.5%)
Lithium stocks came under pressure across the board, with the Lithium Carbonate price down 22% in September alone and way off their highs, as major battery producers continued destocking in China.

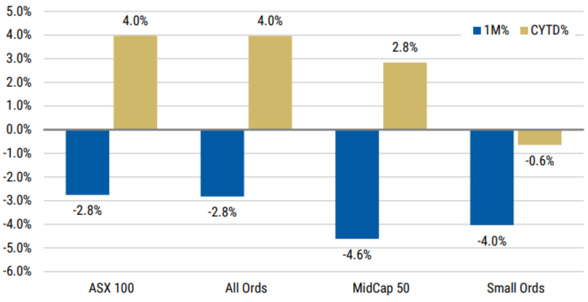
FUND PERFORMANCE

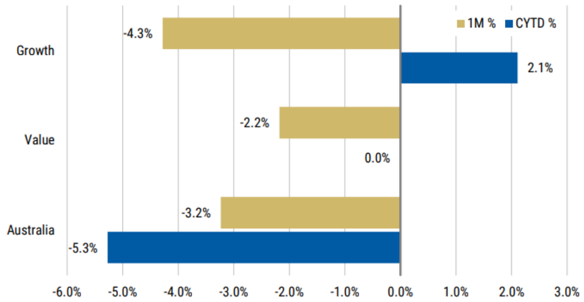
Global macro influences remained elevated during September, namely the strong USD, rising bond yields and sluggish global growth, with the Energy and Financial sectors limiting our domestic market's fall to just 2.8% for the month.

The Fund's gross return of -1.57% for the month of September outperformed the Benchmark return of -2.84%.

Large-Cap stocks (where the Fund retains a material underweight vs. benchmark) again outperformed during the month, significantly leading their Mid-Cap and Small-Cap peers for the CYTD. Small-Caps are still the worst performers for the CYTD.

MSCI Australia Value outperformed Growth in September, but continues to trail Growth for the CYTD.





Source: Morgan Stanley

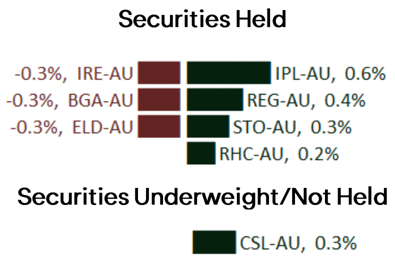
Energy, which rose 1.6%, posted the largest contribution (+9bps) to the market's return in September (led by Whitehaven Coal +16.7% and Santos +3.0%), followed by Utilities (Origin Energy +3.2%) and Consumer Staples (Treasury Wines Estates+5.7%).

Health Care, Real Estate and Materials sectors weighed on the market. Health Care was the largest negative contributor (-58bps) to the market's return, closing down 6.2% (dragged down by CSL -7.6% and Cochlear -5.3%), then Real Estate (Goodman Group -8.2%) and Materials (James Hardie Industries -12.3%).

Returns" (%)	*Gross*	*Benchmark*	*Excess*	*Net*
1 Month	-1.57%	-2.84%	1.27%	-1.63%
FYTD 2024	-3.22%	-0.77%	-2.46%	-3.39%
12 Months Rolling	9.07%	13.46%	-4.39%	8.31%
3 Years (p.a.)	10.46%	11.00%	-0.53%	9.49%
4 Years (p.a.)	7.50%	5.27%	2.24%	6.39%
Since Inception (p.a.)	8.46%	6.59%	1.86%	7.37%

"The return figures are calculated using the redemption price 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. Returns of the Fund may include audited and un-audited results. Past performance is not a reliable indicator of future performance.

Month of September Attribution



Source: Ellerston Capital.

In the month of September, the main positive contributors to the Fund's performance were active overweight positions in Incitec Pivot (IPL +7.2%), Regis Healthcare (REG +6.3%), Santos (STO +3.0%), Ramsay Healthcare (+0.8%) and not owning any CSL (CSL -7.6%).

The main detractors for the month, which impacted performance, were active overweight positions in IRESS (IRE -9.1%), Bega Cheese (BGA -16.3%) and Elders (ELD -10.2%).

FUND ACTIVITY

Activity levels were relatively subdued for the month of September. The Fund trimmed the Metcash position following the bounce in price off their June lows. We also used the weakness in share prices to selectively strengthen positions in Iluka Resource and Perpetual, where we still have reasonable conviction and believe the market has become far too short-sighted.

NEW STOCKS ADDED	STOCKS EXITED
• None	• None

INCREASED	DECREASED
• Iluka Resources	• Metcash
• Perpetual	

FUND STRATEGY AND OUTLOOK

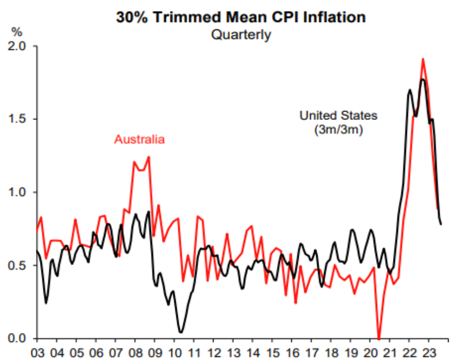
We continue to hold the view that headline inflation rates (as measured by the CPI) have peaked across Australia and in most developed economies and that official interest rates (as opposed to US Treasury yields) have also peaked. Central bank meetings in September have been broadly supportive of this view (i.e. that most are done with rate rises), albeit Powell kept the door open for one more increase later this year, if the key data so warranted. The focus going forward is on how long the Fed's "hawkish hold" will last, after the dot point estimates forecast 2024 interest rate to fall by only 50bps, which rattled global bond markets during September.

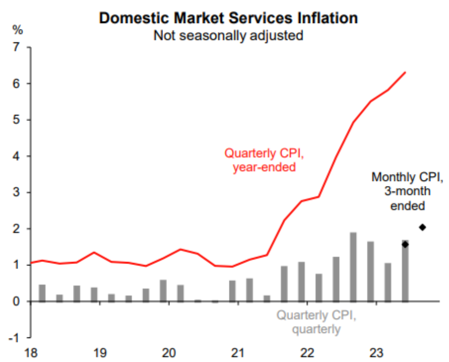
The recent breakout in oil prices is challenging a number of widely held conventional views that a tidy, soft landing in the US is the most likely scenario. When everyone is expecting a soft landing, naturally brace for impact! We would also not rule out 10 Year US Treasury yields punching well through 5.0%, given the widening budget deficit, recent surprisingly strong economic key data points and other driving forces. Already, we are seeing 30-year fixed mortgage rates at 7.72%, their highest levels since 2000. NOT GOOD!!!

US 30 Year Fixed Mortgage Rates – highest since 2000

Source: Morgan Stanley

Back home, momentum in the Australian economy has been steadily fading since early 2022 and this trend is likely to continue over the remainder of the year on the back of stalling private domestic demand growth. Households face ongoing budget pressures from inflation and repricing of fixed-rate mortgages. Given the weaker economic outlook, the RBA is close to finishing its tightening cycle, but may have one further rate hike to go. Whilst we would expect the RBA to pause in their early October meeting, the nearer-term risk of an RBA rate hike reflects the strengthening of services price inflation, with strong Q3 wage growth and other costs being passed on to consumers. As highlighted in the charts below, core inflation has been retreating, but services inflation is still rising.

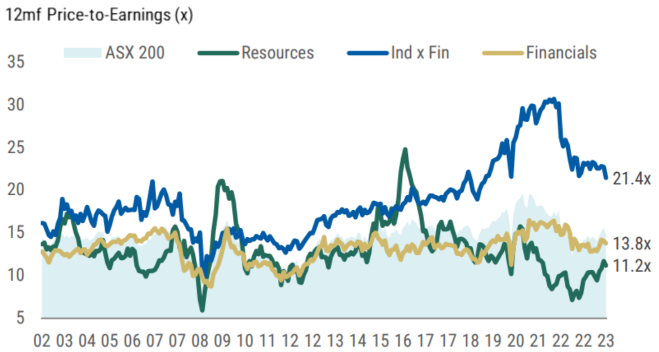




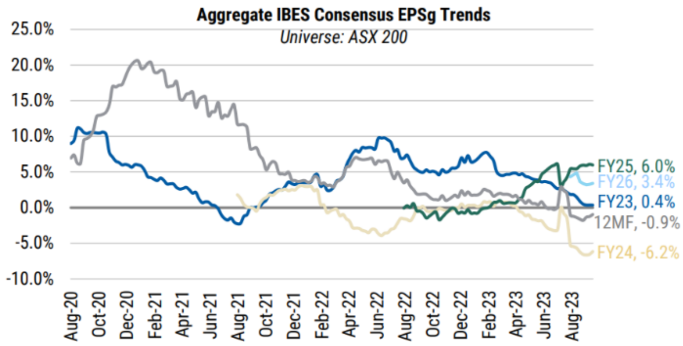
Source: Macquarie Research

Post the reporting season, the ASX 200 consensus earnings levels have rolled over, with FY24 earnings growth having fast faded to -6.2%. The domestic market 12MF P/E now stands at 14.8x. Outer year earnings growth forecasts remain fairly anchored in very low-single-digit territory.

Valuation: the 12M forward PE of the Industrials ex-Financials has Fallen from 30.2x to 21.4x



Annual Consensus EPS Growth Trends FY23-26



Source: Morgan Stanley Research.

Given that we would not rule out further upward pressure in long bond yields, acting as a headwind to equity valuations, we would expect equities to have a short-term pull back. Stay tuned!

The grossed up dividend yield on the portfolio for FY24e now rests at 7.3%, which remains superior to the market dividend yield, despite owning no Banks and many other conventional traditional income payers.

MARKET CAPITALISATION

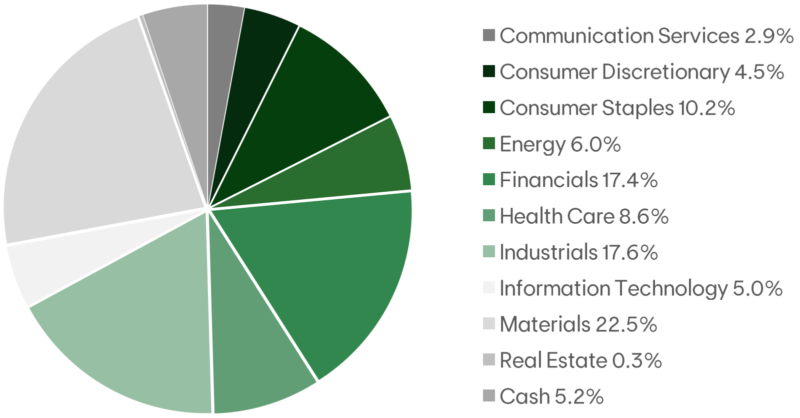
Source: Ellerston Capital

Top 10 Holdings

Company	Portfolio Weight
ATLAS ARTERIA	7.62%
BHP GROUP LTD	7.34%
INCITEC PIVOT LIMITED	7.23%
SANTOS LIMITED	5.98%
INSIGNIA FINANCIAL LTD	5.58%
RAMSAY HEALTH CARE LIMITED	5.28%
IRESS LIMITED	4.98%
CHALLENGER LIMITED	4.66%
LIBERTY FINANCIAL GROUP LTD	4.48%
METCASH LIMITED	3.91%

Source: Ellerston Capital

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 and HUB24 Platforms.

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

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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