Ellerston Equity Income KIS Fund

Ellerston Capital

Monthly Report as at 30 November 2023

APIR Code: ECL7259AU | ARSN 662 683 123

Concentrated portfolio of 30-40 Australian listed securities that display stable and growing dividend streams.

Looks beyond traditional "income sectors" (e.g. banks and telecoms), recognising "cyclical sectors" are now experiencing structural shifts towards the provision of more reliable income.

Aims to provide investors with returns and income growth greater than the Benchmark over rolling five-year periods.

Performance Summary

Performance	1 Month	3 Months	FYTD 2024	CYTD 2024	12 Months Rolling	3 Years (p.a.)	4 Years (p.a.)	Since Inception (p.a.)^^
Fund Net Return^	8.84%	2.29%	0.45%	5.00%	3.26%	8.06%	5.96%	8.01%
Benchmark*	5.03%	-1.80%	0.29%	4.81%	1.45%	7.15%	4.79%	6.59%
Alpha	3.81%	4.09%	0.16%	0.19%	1.81%	0.91%	1.17%	1.42%

^The net return figure is calculated after fees & expenses, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance.
** S&P/ASX 200 Accumulation Index. ^^Inception date is 1 May 2019.*

Key Information

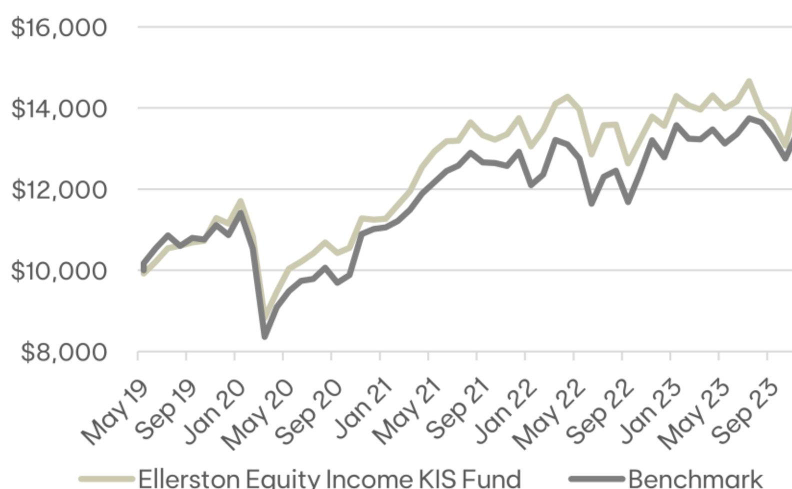
Portfolio Manager	Chris Kourtis
Investment Objective	To provide investors with returns and income growth greater than the Benchmark over rolling five year periods.
Benchmark	S&P/ASX 200 Accumulation Index
Liquidity	Daily
Target Number of Holdings	30-40
Number of Holdings at Month End	31
Minimum Investment	Initial investment - $10,000 Additional investment - $5,000
Distribution Frequency	Quarterly (where available)
Management Fee	0.70% p.a.
Performance Fee[1]	10.00%
Buy/Sell Spread	0.25% / 0.25%
Strategy FUM[2]	$61.56m
Platform Availability	HUB24, Netwealth
SQM Rating[3]	Superior / 4.25 Stars

[1]*Of the investment return above the benchmark, after recovering any underperformance in past periods.*
[2]Funds invested across all Equity Income KIS strategies.
[3]Rating assigned 6 October 2023.

FY24(E) Key Portfolio Metrics	Fund	Benchmark
Grossed Up Dividend Yield (%)	**6.5**	**5.6**
Price/Earnings (x)	13.6	15.6
Dividend Yield (%)	5.1	4.2

Source: Ellerston Capital.

Growth of $10,000 Investment



Fund Performance shown is net of fees, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance. Source: Ellerston Capital.

The Team

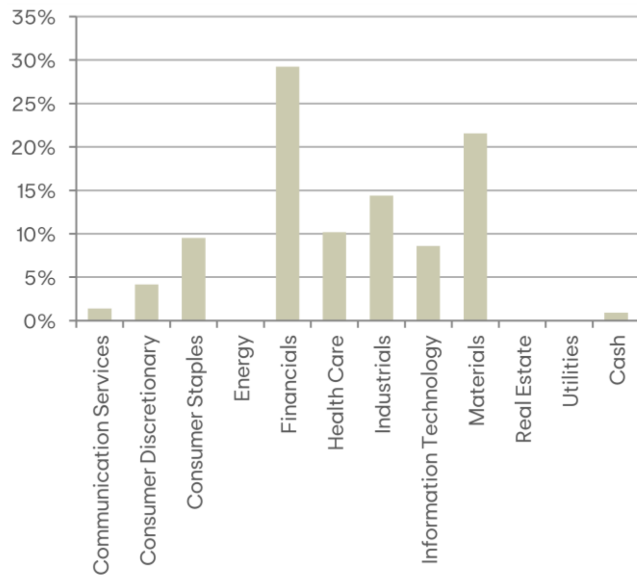
Chris Kourtis
Director & Portfolio Manager

38 years of industry experience.

Stephen Giubin
Senior Investment Analyst

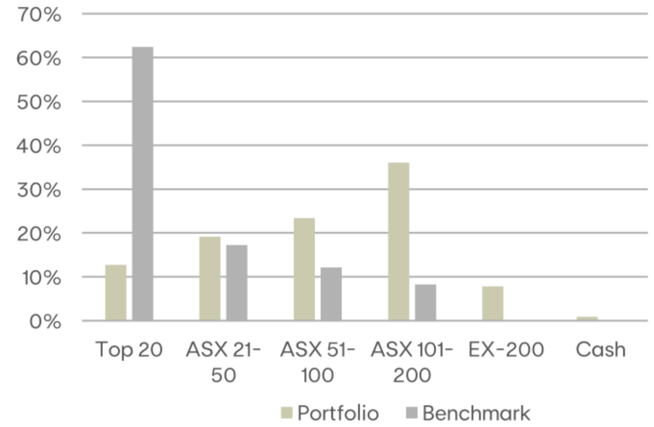
35 years of industry experience.

Sector Allocation



Source: Ellerston Capital.

Exposure by Mark Capitalisation



Source: Ellerston Capital.

Top Holdings

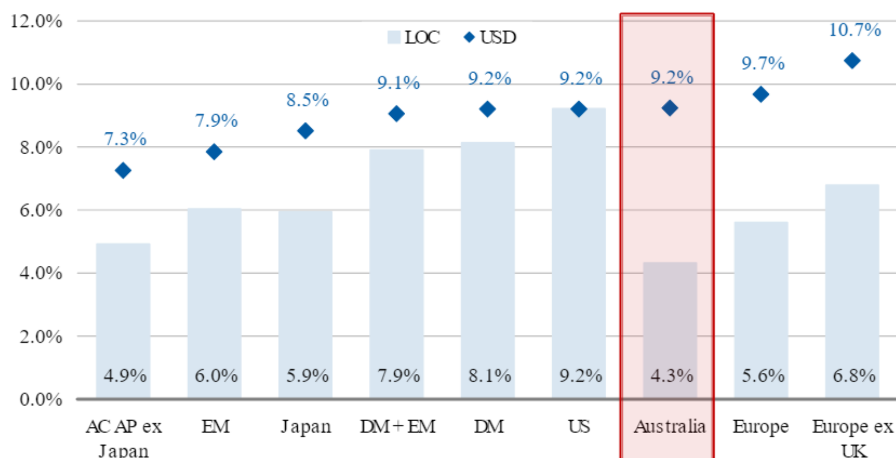
Company	Portfolio Weight (%)
Insignia Financial	9.0
IRESS	8.6
BHP Group	7.5
Liberty Financial Group	6.0
Insurance Australia Group	5.9
Atlas Arteria	5.7
Challenger	5.3
Ramsay Health Care	5.1
Resmed Inc	5.1
Bega Cheese	4.4

Source: Ellerston Capital

MARKET OVERVIEW

Global equity markets took off in November, led by the US, which rallied 9.2%. Lower inflation expectations, with growing optimism that central banks may have peaked in terms of the tightening cycle, saw the US 10-year Treasury yield experience its largest monthly fall (-55bps) since 2008. This was responsible for most of the equity moves and against this positive backdrop, the ASX 200 posted its largest monthly gain since the start of the year with a solid +5.0% total return, closing at 7,087. In USD terms, the domestic market climbed as high as 9.2%, thanks to an AUD tailwind. MSCI Emerging Markets lagged the Developed Markets by 2.1% in local currency terms over the month. Info Tech and Real Estate were the best performing sectors globally, whilst locally, Healthcare (+11.7%) and Real Estate (+10.8%) were the stand out performers.

MSCI Global Country/Regional Indices Performance for November



Source: Morgan Stanley.

USA

The Federal Reserve's next FOMC meeting is to be held on 12 December. This follows its October FOMC meeting, where the fed funds target rate was left unchanged at 5.25 to 5.5%. The FOMC Minutes enunciated a "watch the data and evaluate" approach to policy before deciding on any next steps. Ahead of the December meeting, we have seen the Fed's preferred inflation measure, the Core CPE Deflator, print in line with expectations at 3.5% YoY. This was below 3.7% the previous month and better than the FOMC's September full year projections, which stood at 3.7%, pointing to another pause in December. Further, the stronger GDP figure of 5.2% versus consensus at 5.0%, mixed with the weaker PCE data point, adds to investor's "Goldilocks" scenario, which the equity markets seem to have embraced.

The Dow Jones Industrial Average and S&P 500 were up 9.2% and 9.1% respectively, with the NASDAQ Composite Index, rising 10.8% for the month and still way out in front, with a +37.0% return for the CYTD.

Europe

Euro-area inflation continued to retreat, cooling to 2.4% in November from 2.9% previously. Core inflation fell to 3.6% from 4.2%, which has added fuel to the prospect of ECB rate cuts soon. ECB President Christine Lagarde commented: "Euro zone inflation pressures are easing as expected but wage growth is still strong, and the outlook is especially uncertain, so the ECB's fight to contain price growth is not yet done. We need to remain attentive to the different forces affecting inflation and firmly focused on our mandate of price stability".

The Euro STOXX50 Index finished the month up 8.0%. Among the major exchanges, Germany's DAX was up 9.5%, France's CAC 40 was 6.2% higher and UK's FTSE 100 was the clear laggard, rising 2.3%.

Asia

China's economy has been recovering, seeing household consumption, industrial production and market expectations improving, but domestic and foreign demand is still sluggish, employment pressure remains high, and its economic recovery has yet to find a solid footing. Beijing increased its pace of liquidity injections and supportive measures over the past month with the roll out of a 1 trillion yuan ($139 billion) bond issuance to spur infrastructure spending and economic growth in the coming months. The government was also seen preparing more funding support for China's beleaguered property sector, which has been a major drag on economic growth over the past three years.

Korea's KOSPI was the standout performer in the Asian region, up an impressive 11.3%, followed by the Nikkei 225 up 8.5% and India's SENSEX closed 5.0% higher. On the flip side, the Hang Seng fell 0.2% and China's SSE underperformed, down 1.4%.

Commodities

Volatility in commodities continued in November, with the Middle East crisis affecting oil and precious metals. Iron ore prices squeezed higher, rising 7% to US$132/tonne but coking coal prices fell 7%, albeit to an elevated level of US$325 per tonne. The base metals complex continued to weaken, with aluminium falling 4%, nickel down 8%, but copper bounced 4% on technical buying. Despite Middle East tensions, crude prices continued to fall, with Brent down 5% to US$83/barrel, due to higher OPEC+ production and less concern about supply, given the situation in Gaza has yet to spread to Middle East oil producing countries. OPEC+ met on the last day of the month and announced deeper production cuts for 1Q24, with a headline number of a 2.2Mb/d cut. The cut in supply included the existing Saudi/Russian voluntary curtailments plus an addition 0.2Mb/d from Russia and 0.7Mb/d from six other members that have been struggling to meet their existing quotas. It was less than what oil traders were expecting, although it does carry over the existing cuts to March 2024, so focus remains on compliance. Gold continued its momentum, up 3% to US$2036/oz, but this month it had more to do with lower bond yields and a weaker US dollar than geopolitics.

The key feature in commodity markets was that lithium carbonate and spodumene prices had a massive leg down in November, falling around 25%. This follows the 40% slump in the previous three months. The destocking in the EV battery supply chain continues!

Bonds

The US 10-year bond yield was down 55bps last month to 4.34%, the biggest fall since 2008 on renewed bets that the Federal Reserve will be able to start cutting rates in the first half of 2024. Hopes for a fed pivot intensified after economic data reinforced the "Goldilocks" economic scenario. On the domestic front, Australian 10-year bond yields also fell in step with the global trend, helped by a cooler October CPI print of 4.9%, below market expectations of 5.2%. By month end, the Australian 10-year bond yield fell by 52bps to close at 4.41%.

Australia

The RBA raised the cash rate on 7 November, Melbourne Cup Day by 25bps, to 4.35%, after four consecutive pauses. This outcome was widely expected, so the market took it in its stride, similar to Without a Fight's win in the cup. The RBA signalled an increase to its data dependency in November, as it upgraded its forecasts for activity, labour market and inflation, consistent with the economy showing resilience. The changed forecasts have increased the hurdle to another hike but reduced the RBA's tolerance to upside surprises. During the month, a rise in the unemployment rate, decline in retail trade and sharp slowing of monthly inflation has materially reduced the risk of another late interest cycle hike. The A$ closed the month up 3% to US$0.66, a beneficiary of the rate hike and higher iron ore prices, but mainly the weaker greenback which was down 3% on a trade weighted basis.

The S&P/ASX 200 Accumulation Index was up 5.0% in November. Healthcare, Real Estate and Information Technology led the performance charts. The Healthcare sector (up 11.7%), was the best performer, spurred on by CSL (+12.9%), followed by Real Estate (+10.8%) driven by Charter Hall Group (+20.0%) with Goodman Group (+9.7%) and Information Technology (+7.3%). The bottom three sectors were Energy (-7.4%) dragged down by Woodside Energy (-9.5%), Utilities (-6.0%) and Consumer Staples (-0.76%).

For the month, the top stocks that made a positive contribution to the Index's return were CSL (+71bps), CBA (+67bps), BHP (+45bps), Westpac (+26bps) and Fortescue (+23bps). Conversely, the bottom five stocks detracting from the Index's performance were Woodside Energy (-30bps), Santos (-12bps), Origin Energy (-8bps), South32 (-5bps) and Treasury Wine Estates (-5bps).

The ASX Small Ordinaries rebounded very strongly in November and closed up 7.0%, outperforming the broader benchmark. Within the ASX Small Ordinaries, the Small Industrials did much better at +8.6% (with Healthcare leading the charge, +16.6%), versus the Small Resources, which rose 3.1%, dragged down by the lithium flu and Energy.

COMPANY SPECIFIC NEWS

The Market Hits

Block Inc. (SQ2 +58.8%)

SQ2's 3Q results included a top line miss, with revenue coming in at 1.1% below consensus, however, SQ2 more than made up for the shortfall by cutting SG&A, which on an operating basis came in 8.1% better than consensus. As a result, adjusted EBITDA blew past the Street's expectations, coming in at US$477m, a 26% beat. SQ2 also guided 4Q adjusted EBITDA to US$430-450m, 10-14% ahead of consensus and provided FY24 guidance of US$2.4b adjusted EBITDA, again - well ahead of sell-side estimates at US$1.94b. To add sizzle, SQ2 announced a US$1bn buy-back to partially offset the dilution from its share-based compensation. Investors reacted very positively, pushing the stock up 25% on the day. Existing holders were relieved that SQ2 bounced hard, after hitting a recent low on the ASX on 31 October 2023, albeit climbing back to $96.39, levels where the share price was 3 months ago.

Neuren Pharmaceuticals (NEU +44.6%)

NEU develops new drug therapies to treat multiple serious neurological disorders that emerge in early childhood and have no, or limited approved treatment options. DAYBUE™ (trofinetide) is approved by the US Food and Drug Administration (FDA) for the treatment of Rett syndrome in adult and paediatric patients two years of age and older. Neuren has granted an exclusive worldwide licence to Acadia Pharmaceuticals Inc. (ACAD) for the development and commercialisation of trofinetide. NEU reported highlights from its partner ACAD Q3 earning's announcement, showing sales of DAYBUE in is the US of US$67m and forecast US$80-87m of sales for 4Q which incurs a 10% royalty for NEU. Importantly, apart from the annualised royalties of A$50m + to NEU, pleasingly for investors, all of the

operational metrics exceeded expectations. NEU followed this up with an investor presentation highlighting NNZ-2591 for treatment of Phelan-McDermid syndrome, which is a 5x larger opportunity than DAYBUE. A few days later, NEU announced the completion of its Phase 2 clinical trial of NNZ-2591, with top-line results from the trial expected to be available in December 2023. NEU's stock kept rallying as each release got better and as investors prepared for the top-line trial results.

IRESS (IRE +40.9%)

IRE's surprise 1H23 results downgrade back in August disillusioned investors and drove the stock price down over the subsequent two months, to a 14-year low in October. IRE was heavily shorted and grossly oversold, until the company presented at a conference early in November, without delivering any negative news. The stock price started to rise as investors moved in with less fears of catching a falling knife and traders started closing their short positions. IRE later announced an investor briefing taking place on 30 November to update on the progress of executing its new transformational strategy, as outlined at its Investor Day in April. What an update! IRE increased FY23 and FY24 underlying EBITDA guidance by ~9% (mid-point) to $123-128m (FY23) and $135-145m (FY24; 5-10% growth). 2H23 performance has been underpinned by modest revenue growth (monthly average +2.6% on 1H23); lower staff costs -3.9% (some cost initiatives brought forward); and slightly higher non-staff costs (+2.4%). IRE upgraded the FY24 EBITDA exit run-rate by ~7% to $150-170m (from $142-158m). Importantly, Net Debt fell from $375m at the end of August to $308m at 31-Oct, lowering leverage to 2.3 times and "comfortably within covenants". The company confirmed that no equity raise was required and that deleverage plans continue to progress, with one UK business unit to divest in 1HCY24 and proceeds of their muted platform business sale to be banked. IRE has also arrested historical cost growth momentum, with further cost efficiencies to come.

IRE is only in the early stages of a significant business turnaround strategy, which as shown a few months ago, comes with heightened risk (especially on short-term earnings outcomes). However, early progress has shown core business revenue stability and confidence in the cost efficiency part of management execution. Given the transformation has accelerated and is starting to deliver early benefits towards its Rule of 40 target; investors reacted very positively pushing the stock up 14.9% on the last day of the month.

Cromwell Property Group (CMW +37.5%) / Centuria Capital Group (CNI +27.9%)

Interest rate sensitive REITS performed strongly, up 10% during the month, with the backdrop of a sharp fall in bond yields. CMW and CNI had underperformed their peers by around 50 and 35% respectively up until the end of October CYTD and hence bounced the most.

Elders (ELD +27.9%)

ELD provides agricultural products and services to rural and regional customers, primarily in Australia. ELD reported its FY23 results, which were in line with guidance, but the big positive surprise was the very strong operating cash flow of $169m. This represented OCF/NPAT conversion of 169% versus its previous guidance of greater than 90%, due to a large working capital release. The cash conversion reduced the company's financial leverage to 1.4x, just below ELD's 1.5-2.0x target and covenant of <2.5x, keeping the balance sheet in good shape. Investors liked the result and especially the 18% stock price move on the day.

Genesis Minerals (GMD +26.4%) / West African Resources (WAF +26.4%)

The sector outperformed in November (+6%) with the gold price up US$35 to US$2051/oz, as bond rates fell, and the US dollar weakened. GMD, led by the well-regarded former Saracen CEO, is currently consolidating the Leonora gold district, and having a relatively high AISC, is therefore better leveraged to higher gold prices. WAF had underperformed the gold sector due to the expected Burkina Faso gold royalty increases (for WAF's Sanbrado mine and Kiaka project) but when finally announced, the charge turned out to be better than expected and the stock price rebounded.

James Hardie Industries (JHX +24.6%)

JHX's 2QFY24 results highlighted flawless execution by management, against a deteriorating macro backdrop, given that housing activity continued to soften, whether it was repair and remodelling (R&R), or new dwelling (new home sales in the US in October 2023 hit a 13-year low). With the US R&R market down ~10-15%, JHX seems to have successfully pivoted towards national exclusive deals with America's largest homebuilders, which continued to gain market share. James Hardie shares squeezed higher after announcing a 2Q24 result whereby all operating divisions beat estimates, with North America Fiber Cement delivering volumes above the top-end of their guidance range. Investors were pleased to see strong underlying divisional performance and investment in marketing paying off. JHX appeared to significantly outperform the North American market in 2Q24, given the company had previously flagged R&R as being down mid-teens and new Single Family (SF) construction -14%, but NAFC volumes were only down -5% vs pcp. Turning to cash flow, JHX put in a strong quarter, with an $83m working capital inflow CYTD. The company also provided guidance for 3Q24 volumes of 730-760mmsf, a 30-32% NAFC margin and NPAT of $165-185m, which were all well ahead of market expectations. When coupled with the announcement of a new $250m buyback over the next 12 months, the shares moved higher.

Collins Foods (CKF +24.1%)

CKF reported a strong 1H24 result ahead of consensus expectations, driven by better-than-expected margins and Same Store Sales (SSS) growth across all divisions. KFC Australia delivered 9% revenue growth and 11% Underlying EBITDA growth, but SSS growth had slowed in the 2H. KFC Europe revenue was up 36%, driven by very strong (+ 9%) SSS growth, coupled with consolidation of new stores acquired over the past year. Finally, Taco Bell delivered 19% revenue growth, with SSS growth up 8%. This was particularly impressive for a division largely viewed by the market as failed business.

The Market Misses

Appen (APX -23.64%)

APX's materially weaker trading update and rushed dilutive capital raise lifted the market's concerns over the future earnings and valuation of the business. APX announced a A$30mn equity raising at 55 cents, struck at a 35% discount to TERP and 42% discount to last close for the purpose of balance sheet flexibility. APX noted it was "continuously assessing initiatives and opportunities to realise value for shareholders, including a sale of all or parts of the business." In APX's case, this has involved raising capital (twice), downgrading earnings multiple times, ongoing management changes and diluting shareholders all in the past 12 months. Incremental risks from the trading update provided, combined with recent market channel checks indicating that APX's large tech customers are rapidly bringing AI projects in-house has caused the shares to sell off further. The shares have collapsed from over $35.00 in late 2020, to 64 cents currently. Now that's the complete opposite to "realizing value for shareholders" ....

Core Lithium (CXO -22.2%) / Liontown Resources (LTR -14.6%) / Sayona Mining (SYA -12.0%) / Allkem (AKE -9.9%)

Most of these lithium stocks have been regulars in the monthly misses, not surprisingly, given lithium carbonate, hydroxide and spodume prices have been falling all year but have tanked ~50% in the past 3 months with a 26% fall in November. The stocks have fallen less than the lithium commodities but given such a strong EV thematic, investors have taken the half-full approach: asking themselves, is this the bottom? It may be the bottom in prices, but a number of stocks will still struggle given their high-cost structures and capital requirements, unless prices get back to where we were 3 months ago, and the recent M&A train keeps chugging along.

Karoon Energy (KAR -19.5%)

KAR finally announced its much-anticipated acquisition, a minority non-operated interest in several oil and gas producing assets in the Gulf of Mexico. The US$720m deal was funded via equity A$480m (US$300m), debt (US$274m) and existing cash. The large equity component was done via a $170m placement and $310m Institutional entitlement at $2.05 per share, a 14.6% discount to its closing price. This was a large acquisition at 85% of KAR's market capitalisation and somewhat surprising that it was a non-operated minority interest. It also coincided with weaker oil prices that dragged the sector down by 7% which didn't help.

Chalice Mining (CHN -15.1%)

Chalice Mining's share price has now fallen 70% since the release of its scoping study only three months ago for its Gonneville Nickel-Copper-Platinum Group Element (Ni-Cu-PGE) Project in Western Australia, which was very disappointing compared to high investor expectations. Since the scoping study, CHN has looked at optimisation alternatives including a smaller sized project. Gonneville is rather complex and still a work in progress towards the Pre-Feasibility study targeted for mid-CY25 so it's no surprise that the stock remains friendless.

AGL Energy (AGL -12.3%)

The Federal government announced it has expanded the Capacity Investment Scheme (CIS) to 32GW with the underwriting of 9GW (prior 6GW) of dispatchable generation which can include batteries, pumped hydro and virtual power plants. The implications of the expanded CIS are lower-risk projects for asset developers, likely leading to a faster transition to renewables and batteries in the future. This is expected to accelerate the rollout of renewables. It provides an opportunity for Origin Energy/AGL to fund the replacement of coal generating capacity with renewables more cheaply and with more earnings certainty, but also negative for Origin's and AGL's existing coal and gas fired fleet. AGL benefitted from the Origin takeover by Brookfield/EIG, seeing investors rotate to AGL, however, with the likelihood of the Origin takeover falling over the opposite has occurred.

Treasury Wine Estates (TWE -10.7%)

TWE shares weakened after digesting a fully underwritten 1 for 9.45 pro-rata accelerated renounceable entitlement offer to raise $825 million. The offer price of A$10.80 per new security represented a 9.8% discount to the theoretical ex-rights price of A$11.98 and was pitched at a 10.7% discount to the last close price of A$12.10 on 30 October 2023. The proceeds, of the surprise capital raising, were to partly fund the acquisition in the US of DAOU LLC Family Vineyards and to cover associated costs. The market was generally disappointed with TWE's acquisition of DAOU, a luxury wine brand based in Paso Robles (for a price tag of $1.47b), as returns to shareholders look to have been diluted. The cost of capital for TWE for its US assets is estimated at ~15% and as such, even the bullish supporters of the stock confessed that up to half the value of the acquisition could be lost to shareholders. Given the seemingly full valuation multiple paid (and coming off rapid growth in the business in the past few years), coupled with execution risks, the market took a dim view and was underwhelmed. The market's positive held view towards TWE has always largely been based on the outlook for Penfolds growing its luxury wines in international markets, and more so recently, with the imminent removal of tariffs and opening up of China for Australian wine producers. With China re-opening, the more optimistic analysts noted recently that TWE could reach $1.4bn EBIT by FY30. The US acquisition has effectively diluted valuations and now muddied the water. The shares are currently trading well under TERP and below the $10.80 issue price.

AMP (AMP -10.5%)

AMP held an investor briefing with AMP Bank in focus, which wasn't well received. AMP gave NIM guidance of 125bps for FY23, which implies 111bps in 2H23, a 28bps drop below the 1H23 of 139bps. The guidance implies a 22-24% downside risk to bank division earnings and 11-12% downside risk to consensus AMP group operating earnings in 2H23E and FY24E. The disappointing guidance update raises

more questions about AMP's banks strategy and competitive positioning. The AMP's share price fell 16% on the day to an all-time low of $0.85 before partially recovering later in the month.

Healius (HLS -10.5%)

Healius Ltd (formerly Primary Healthcare) shares totally collapsed after it announced a heavily discounted capital raise to reduce gearing via a ~A$187mn ANREO (~156.1mn shares issues at A$1.20, representing a 34.6% discount to the last traded price of A$1.835 and TERP of $1.698). The proceeds will be used to address Healius' stretched balance sheet by reducing net debt (with pro-forma/FY23 net debt reducing to $263mn from $450mn, and gearing falling to 2.0x from 3.5x). Two and half months have passed since HLS issued its FY24 guidance that 2H23 EBIT was a good base to annualise...so the sting in the tail was updated FY24 guidance, which was way below market expectations. Based on YTD trading conditions, HLS management commented that they expect (1) 1H24 EBITDA of $158-161mn and EBIT of only $14-17mn (previous forecasts $196/$56mn) and (2) FY24 EBITDA of $383-393mn and EBIT of $95-105mn (previous forecasts A$405mn/A$124mn).

Despite repairing the balance sheet and gaining covenant relief, the market remains concerned that the structural impediments to Australia's primary care system (reduced GP hours and declining bulk billing) and the pathology sector's limited pricing power, will leave management few options for the business but to seek further cost efficiencies. Investors remain highly cautious that the repeated efforts to find savings will inevitably impact service levels, placing market share at further risk. As a result, the Street made massive cuts (60-90%) to earnings forecasts to reflect the weak start to the year and the dilution from the raising.

FUND PERFORMANCE

We are very pleased to report a very strong November update.

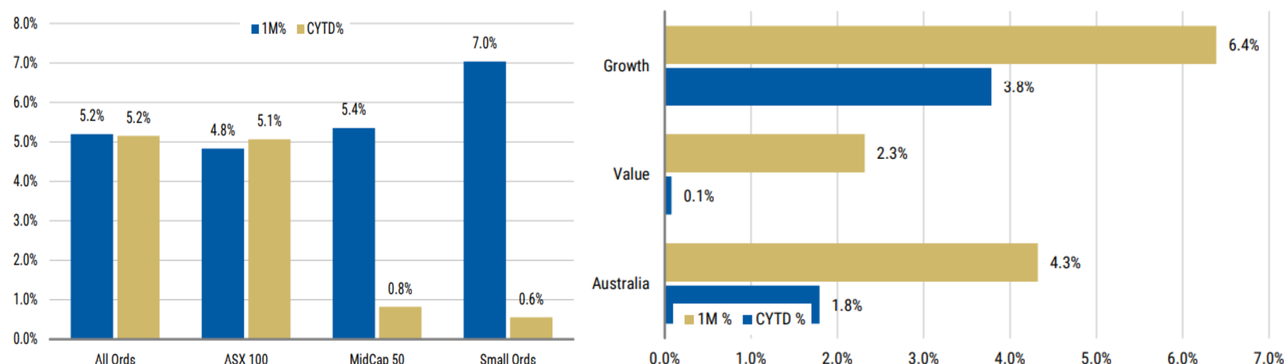
Despite being massively underweight the REIT sector, which proved to be one of the best performing sectors in the market (but where we held a small position in GPT) and coupled with being under invested in other key interest rate sensitive sectors which rallied, pleasingly the Fund more than kept pace on the upside during the month.

Also, despite not owning any high flying shares the likes of Block Inc. (SQ2) which rocketed up 59%, the November monthly gross return of 8.9% significantly outperformed the benchmark return of 5.0%. This is a satisfactory outcome.

Large-Cap stocks (where the Fund retains a material underweight), this time underperformed in November, helping performance, with Small-Caps outperforming their Large-Cap peers by 2.2%.

However, Mid-Caps and Smalls are still the worst performers CYTD and have materially lagged.

MSCI Australia Growth outperformed Value by 4.1% in November.



Source: Morgan Stanley

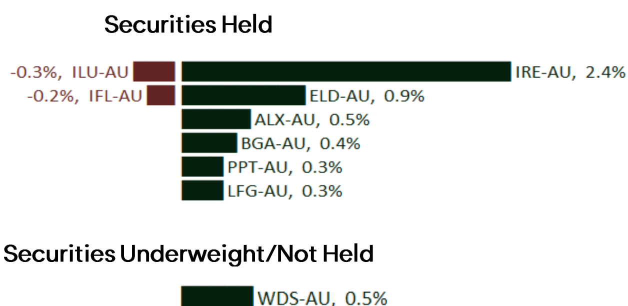
Financials, which rose 5.7%, posted the largest contribution (+163bps) to the market's return during the month (led by CBA which was up 8.4%), followed by the Materials and Healthcare (CSL +12.9%) sectors.

Energy (Woodside Energy -9.5%), Utilities (Origin Energy -9.7%) and Consumer Staples (Treasury Wine Estates -10.7%), as highlighted in the Hits and Misses section, weighed on the broader market.

Returns (%)"	Gross	Benchmark	Excess	Net
1 Month	8.90%	5.03%	3.87%	8.84%
3 Months	2.47%	-1.80%	4.27%	2.29%
FYTD 2024	0.75%	0.29%	0.46%	0.45%
CYTD 2024	5.68%	4.81%	0.87%	5.00%
12 Months Rolling	3.99%	1.45%	2.54%	3.26%
3 Years (p.a.)	9.12%	7.15%	1.97%	8.06%
4 Years (p.a.)	7.00%	4.79%	2.21%	5.96%
Since Inception (p.a.)	9.09%	6.59%	2.50%	8.01%

"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 November Attribution



Source: Ellerston Capital.

In the month of November, the main positive contributor to the Fund's performance was its sizeable active overweight position in IRESS (IRE, +40.9%) which has acted as a drag on short term performance. IRE shares re-bounded hard post its Strategy Day and earnings upgrade (refer detailed commentary in the Hits and Misses section). As a reminder, the Fund kept the faith, believing the stock had been massively oversold and doubled down during the sharp selloff last month at bargain basement levels. Thus KIS was able to capture the upswing.

Other key positive alpha generators included our large holdings in Elders (ELD +27.9%), Atlas Arteria (ALX +9.2%), Bega Cheese (BGA +15.1%) and not holding any Woodside Energy (WDS -9.5%) which disappointed.

There were few detractors during the month. Overweight positions in Iluka (ILU -4.6%) and Insignia Financial (IFL +2.4%) were of little consequence to performance.

FUND ACTIVITY

The Fund used the strong market conditions to take some profits opportunistically in Atlas Arteria (when IFM crept up on the register), as well as exiting remnant positions in Incitec Pivot, Regis Healthcare and Santos at buoyant levels. We used the proceeds to fund two new positions, both of which we have held in the past - Cleanaway Waste Management (see write-up below) and South32. Both stocks have sold off sharply this CYTD. We also strengthened existing positions in Amcor, Bapcor and recent inclusions, general insurer Insurance Australia Group and ResMed on weakness.

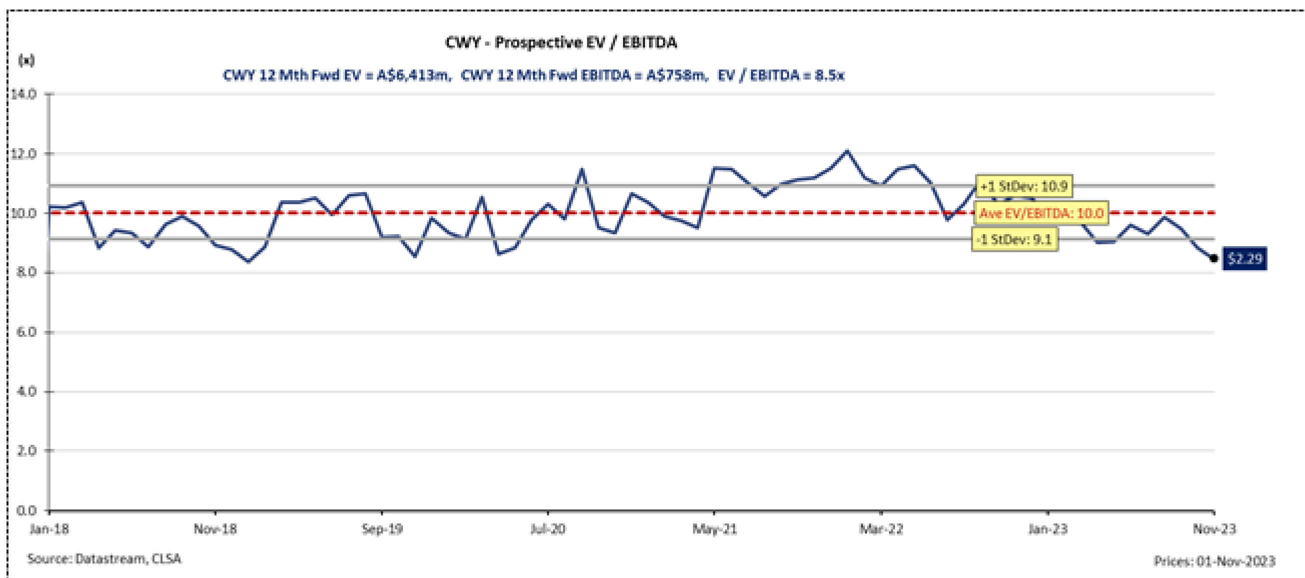
NEW STOCKS ADDED	STOCKS EXITED
• Cleanaway Waste Management	• Incitec Pivot
• South32	• Regis Healthcare
	• Santos

INCREASED	DECREASED
• Amcor	• Atlas Arteria
• Bapcor	• Fortescue
• Insurance Australia Group	
• ResMed	

Cleanaway Waste Management (CWY)

CWY is Australia's leading total waste management services provider, which operates three services divisions: Solid Waste, Liquid Waste & Health and Industrial & Waste and has a number of infrastructure-like qualities. It has fixed medium term contracts, protection from cost inflation with pass through mechanisms, high barriers to entry (large investments for post-collection processing facilities, regulatory approvals and licence conditions) and regulatory headwinds requiring sustainable resource recovery capabilities. We held CWY earlier this year and sold out profitably in June/July. Since then, CWY has underperformed the market, pained by bond-proxy pressure. We used the recent share price lows to come back into the name after its AGM trading update provided better visibility.

CWY gave FY24 guidance of $350m EBIT (16% growth) and noted margin improvement, driven by operational efficiency across the business. In particular, challenging areas of Queensland Solids and Health Services were improving. In Queensland, operational performance appears better on a broad front, while Health Services are seeing the benefit of new technology and price rises. CWY is trading on an EV/EBITDA of 8.5x compared to its 5 year average of 10x and its US peer group, which trade at~13.5x. In CWY, we believe we have picked up a major player in Australia's increasingly circular economy, at an attractive price re- entry point.



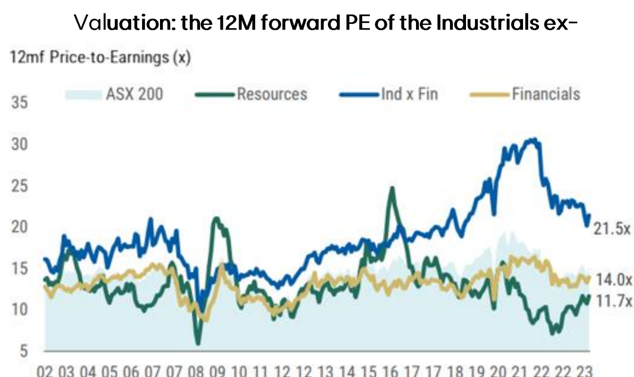
FUND STRATEGY AND OUTLOOK

We reinforce our view that headline inflation rates have peaked, as well as official interest rates. Central bank meetings and minutes by the Fed, ECB and the BOE in November continue to support this view. The focus going forward of course is when do rate cuts start? Given Middle East tensions, geo-political risks and the delayed impacts of previous rate hikes, it might be a little premature to bank the "Goldilocks" scenario that equities seem to be now pricing in.

Back home, households face ongoing budget pressures from inflation and repricing of fixed-rate mortgages. Given the weaker economic outlook and this month's lower inflation print, the RBA looks like it has finished its tightening cycle, after November's rate hike.

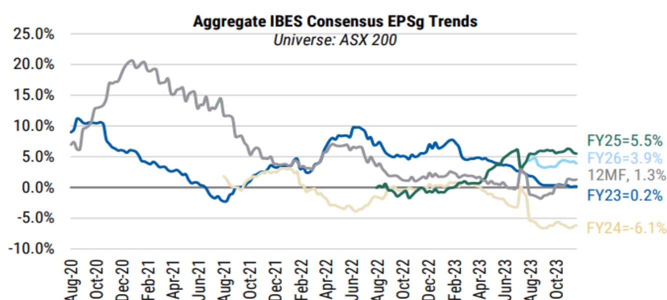
In terms of valuations, ASX 200 consensus earnings, having rolled over in August, have stabilised with FY24 earnings growth flat lining at -6.1%. The domestic market 12MF P/E now stands at 15.2x. Outer year earnings growth forecasts remain fairly anchored in very low-single-digit territory.

Valuation: the 12M forward PE of the Industrials ex-



Source: Morgan Stanley Research.

Annual Consensus EPS Growth Trends FY23-26



Source: Morgan Stanley Research.

Banks Reporting Season Summary

Since the start of the interest rate hiking cycle, Australian Banks have been slight relative underperformers compared to the broader Australian market but have underperformed their global peers. While the Banks 2H23 Result season just completed delivered no real surprises to us, it was nevertheless disappointing. In a period where the Big Four retail banks should have enjoyed an environment of sharply rising interest rates, reasonable credit growth, no real pressure yet on asset quality and economic full employment, the Major Banks delivered Total Operating Revenue growth of a mere -1.5% (h/h, ex notable items). Cost growth of +2.8% (h/h) was also underwhelming, especially given promises made over two years ago by the likes of WBC to materially reshape their cost base. Who can forget WBC's "Cost Re-set Clear path to $8bn cost target" in their Feb 2022 updates, which errrrr, they subsequently walked away from.... **These factors drove a disappointing -4.9% contraction in Pre-Provision Profits (PPOP), *THE WORST UNDERLYING BANKS REPORTING SEASON IN OVER 3 DECADES!*** More concerning, this outcome was largely management self-inflicted. Nearly all the revenue pressure came from Retail Banking, as the industry led by ANZ, lost all price discipline in search of near-term mortgage market share gains (profitless growth), and effectively outsourced distribution to third-party mortgage brokers (~72% of flow). The contraction in PPOP was despite NII and revenue increases of $9B since FY22 and ROE expanding ~500bps. With the banks at a ~3.5% PE relative discount to the ASX200 (vs 10% 2 yr avg.), the sector is not cheap, hence a more cautious bias.

Although a soft set of bank results were largely anticipated, it was still disappointing reading. Rising deposit and funding costs persist. Pricing pressure was evident across both mortgages and deposits, whereby customers continued to rotate into higher yielding accounts to take advantage of more attractive term deposits. Overall sector Net Interest Margin (NIM) fell 6bpts (h/h). By the end of Q323, the banks had competed away more than half of the NIM benefit they received from the rise in official RBA rates. NIM pressure was consistent across the sector, falling 6-7bpts for each bank (ex-Markets & Treasury activity). Adding underlying cost pressure due to inflation, wages, and vendor costs of 2.8% (h/h, skewed mainly to NAB & WBC), we ended up with a sharp 4.9% fall in PPOP. And this is during a period where Asset quality was still modestly supportive. Credit charges will inevitably pick-up and normalise, as the impact of 425bpts of rate rises bites the more overleveraged customers.

In a nutshell, 2H 23 was more difficult than 1H, with Retail Banking the principal saboteur, but Business and Institutional fared better during 2H23 (h/h):

(1) ANZ Retail: NIM -33bp to 2.06%, Net Interest Income (NII) -11%, PPOP -18%; loans +4%
(2) NAB Personal: NIM -22bp to 1.87%, NII -10%, PPOP -18%, loans +1%
(3) WBC Consumer: NIM -24bp to 1.94%, NII -9%, PPOP -30%, loans +3%
(4) CBA Retail (to June): NIM -18bp to 2.55%, NII -6%; PPOP -6%, loans +3. While CBA Sep Qtr (1Q24) Trading Updates saw mortgage margins stabilise, CBA's mortgage book contracted 1% as it chose to prioritise profitability over volume.

What we learned from 2H 23 results:

Bank profitability (on Visible Alpha consensus) over the next few years - the market now expects NIM to decline further through to FY26E, from 184bps in 2H 23 to 174bps. However, surprisingly to us, costs are also expected to decline (good luck), while credit costs look set to peak in FY25E based on sell-side consensus. ROE for the sector declines (which it will) from 11.29% to 10.88% in FY26E, probably bottoming in FY25E.

Our Thoughts into 1H 24:

We have no doubt that intense levels of mortgage and deposit competition will persist into 2024 and it will be interesting to see CBA's response to lost home loan share to the likes of ANZ (CBA has only just begun discounting its front-book pricing closer in towards peers). Themes from latest results were ongoing cost inflation, competitive pressures weighing on NIM and the reallocation of incremental capital into less competitive pockets of the market, particularly in Business Banking.

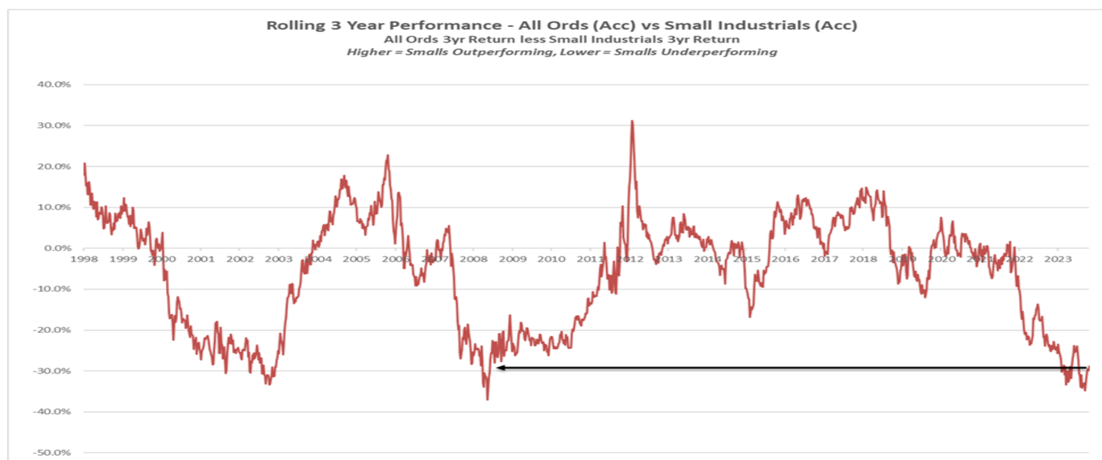
CONCLUSION:

Contrary to most other players in the market and despite their share price resilience thus far, given that we believe the risk/return is skewed to the downside, we *REMAIN ZERO WEIGHT Banks*. Dividend yield premium to the risk-free rate has now compressed to a decade low. We are confident that we have identified far superior opportunities, mis-priced stocks, and income generators in other segments of the market. Banks are going nowhere in a hurry......

Our biggest shift in strategy was made in October 2023, which was to move overweight the ASX Healthcare sector (RMD). November's best performing sector, Healthcare (+11.7%), has thus far vindicated our actions.

Additionally, last month, we noted, "Now that most developed world central banks rates are on hold, we would expect bond yields to fall further after the tumultuous rise in the past two months" and "as a result, we feel the prospect of a sharp short-term relief rally in equities is in the making". Well, yields certainly fell, with the US 10-year treasuries having their biggest monthly fall in 15 years! Global equity markets boomed and the ASX had its best performance since January. More importantly, we saw rotation back into many of the out of love, longer duration equities that have been belted, the likes of Healthcare and Infrastructure, where we were very well positioned. But that was last month. Given exceptionally strong moves, we are likely to see equity markets consolidate the gains into the New Year. We are likely to see the restless sector rotation continue.

It's no secret that CYTD, the Russell 2000 Index has dramatically lagged vs the Magnificent 7 tech led S&P 500 in the US and likewise, here domestically, the mid/small cap segments have generally been left behind.



Source: Evans & Partners

Mid and Small caps are now representing the best value that we have seen for a long while and an area where we think we are very well placed. We would expect to see future alpha generation in our sweet spot Mid-Cap segment.

The grossed up dividend yield on the portfolio for FY24 now rests at 6.5%, which remains superior to the market dividend yield, despite owning no Banks and many other conventional traditional income payers.

Find out more:

For new or additional applications into the Fund, please click here.

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.

Contact Us

Sydney

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

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