



Concentrated portfolio of up to 30 Australian listed securities, created via an active "bottom up" approach, seeking to identify mispricing opportunities.



Seeks to take opportunity of shorter-term opportunities via the use of Derivatives and shorter-term trading strategies, in order to enhance income and alpha.



Overall objective of providing investors with a return above the Benchmark, whilst delivering additional income.

## Performance Summary

Performance	1 Month	3 Months	FYTD24	12 Months Rolling	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.) ^^
Net^	-4.43%	0.22%	1.49%	0.45%	4.45%	7.19%	6.97%
Benchmark*	0.92%	1.16%	10.98%	12.93%	6.80%	7.83%	8.83%
Alpha	-5.34%	-0.94%	-9.49%	-12.47%	-2.36%	-0.64%	-1.85%

^The net return figure is calculated after fees & expenses, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance.

\*The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2022.

^^Inception date is 1 July 2011.

## Key Information

Portfolio Manager	Chris Kourtis
Investment Objective	To outperform the Benchmark whilst delivering additional income through option strategies over time.
Benchmark	S&P/ASX 200 Accumulation Index
Liquidity	Weekly
Target Number of Holdings	Up to 30
Number of Holdings at Month End	24
Minimum Investment	Initial investment - \$50,000 Additional investment - \$10,000
Distribution Frequency	Half-Yearly (where available)
Management Fee	0.90% p.a.
Performance Fee <sup>1</sup>	15.00%
Buy/Sell Spread	0.25% / 0.25%

<sup>1</sup>Of the investment return above the benchmark, after recovering any underperformance in past periods.

## The Team



**Chris Kourtis**  
Director & Portfolio Manager

39 years of industry experience.



**Stephen Giubin**  
Senior Investment Analyst

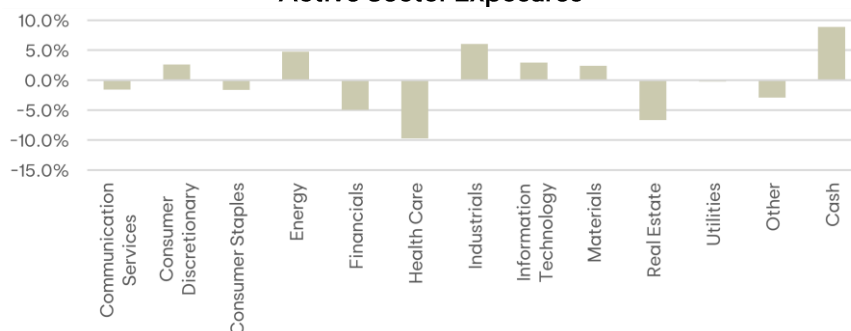
36 years of industry experience.

## Top 10 Holdings\*\*

Ampol	Bapcor	BHP Group	Challenger	IDP Education
Insignia Financial	IPH Ltd	IRESS	James Hardie Industries	Perpetual

\*\*In alphabetical order.  
Source: Ellerston Capital.

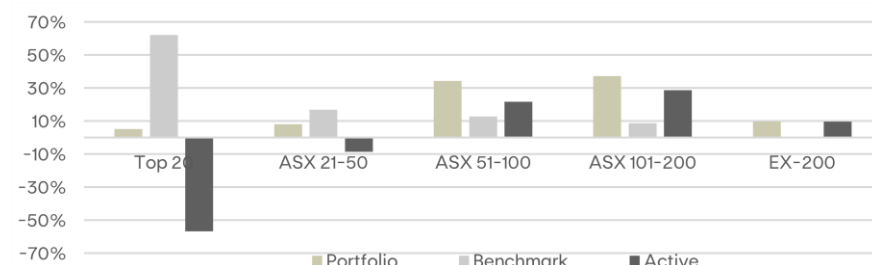
## Active Sector Exposures\*\*\*



Source: Ellerston Capital.

\*\*\*Active sector exposures are determined by subtracting Fund sector weights from benchmark weights. Positive percentages represent over-weight sector exposures relative to Benchmark and negative percentages represent under-weight sector exposures relative to the Benchmark.

## Size comparison Chart vs ASX 200



Source: Factset, Ellerston Capital

## Asset Class Exposures

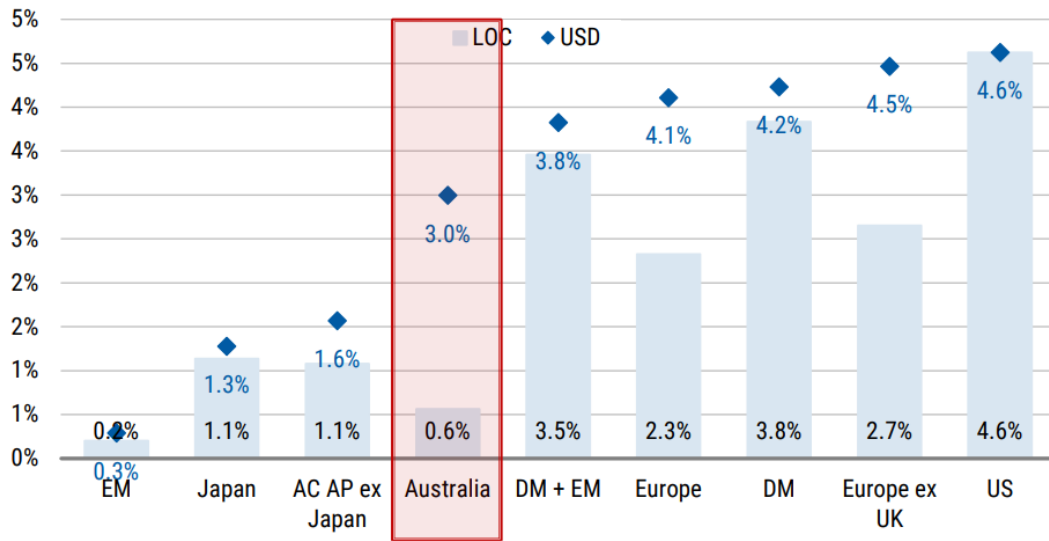
Exposure (% of NAV)	Equity	Long Option	Short Option	Cash	Grand Total
Net	94.06	0	-2.92	8.87	100

Source: Ellerston Capital.

## MARKET OVERVIEW

Global equities squeezed higher during May on the back of surging hopes surrounding the extensive possibilities that AI technologies can bring. The MSCI Developed Markets Index rose +4.1%, with the US proving the strongest region by returning +4.6%, ahead of the Emerging Markets which closed up 1.2%. The S&P 500 increased by +5.0% in local currency terms, with IT leading the GICS sector charge (+9.95%), while Energy (-1.0%) was the only sector to end the month lower. Meanwhile domestically, the S&P/ASX 200 underperformed the DM World performance, rising by a more modest +0.9%. Globally, IT and Utilities were the two best performing sectors in May, and domestically, it was IT (+5.4%), Utilities (+3.4%) and Financials (+2.6%) that outperformed.

MSCI Global Country/Regional Indices Performance for the May CYTD



Source: Morgan Stanley

### USA

The Federal Reserve (Fed) unsurprisingly left the benchmark rate unchanged in a range of 5.25% to 5.5% for a sixth straight meeting. Against the backdrop of a surprise increase in unemployment, Fed officials grew more concerned at this meeting about the stickiness of inflation, as highlighted in the FOMC minutes: "in recent months there had been a lack of further progress toward the Committee's 2.0% objective", with some members posing a willingness to tighten policy further if required. After a run of bad news on the inflation front, the Core PCE Deflator, the Fed's preferred inflation measure, was released at the end of the month and was in line with both the market and the Fed's expectations. The key measure increased by 0.2% mom, lower than the previous 3 monthly readings and was holding steady at 2.8% YoY. The next FOMC meeting is on 11-12 June and will include the Fed's Summary of Economic Projections.

In a lopsided reporting season for US Q1 earnings, the NASDAQ Composite (+7.0%) and the S&P 500 (+5.0%) were major beneficiaries of the Magnificent One (NVIDIA) which finished up 27% (123% CYTD) after posting a better-than-expected result, followed by the Russell 2000 which returned +5.0%. The laggard was the Dow Jones Industrial Average, +2.6%. Having said that, it's the first time in its 128-year history, that the Dow Jones Industrial Average of American "blue chips" has closed above the 40,000-mark intra-month!

### Europe

It's looking like a done deal that the ECB will deliver a June rate cut of 25bps at its next meeting, given the divergent economic growth with the US, however this month's uptick in inflation to 2.6% was a friendly reminder of just how difficult the last mile of bringing inflation back to 2% will be for the ECB.

The Euro STOXX50 Index finished the month up 2.1%, with Financial Services (+6.8%) the top gaining sector, while Travel and Leisure fell the most (-4.02%). Among the major exchanges, Germany's DAX rose 3.2%, followed by the FTSE100 which was up 2.1%, buoyed by dovish Bank of England remarks which signalled that it might need to cut rates more aggressively and France's CAC 40 was the laggard, closing 1.2% higher.

### Asia

China economic activity confirmed stabilizing yet unbalanced growth, marked by robust export driven production and weak domestic consumption. 1Q24 GDP data showed that its economy rebounded stronger than expected, with real GDP growing at 5.3% YoY. A big miss in April retail sales (2.3% YoY versus consensus of 3.7%) re-enforced this divergence, where growth is driven by exports and new energy-related investment, while domestic consumption remains muted.

The latest round of property easing in China appears to be the most comprehensive and forceful in years. It encompasses centralised easing on both the supply and demand side, involving the clearing of property inventory by encouraging local governments to buy unsold homes, coupled with mortgage rate and down-payment relaxation (demand-side stimulus) aimed at stimulating more housing demand from first-time buyers and upgraders. Whilst these measures will take time, the RMD300bn relending scheme for local SOE'S demonstrates Xi Jinping's central government's determination to restore market confidence and attempt to rescue the beleaguered property market.

Asian markets performed mixed, but generally underperformed the US and most European markets, with the Hang Seng again leading with a return of +2.5%, followed by the Nikkei which rose 0.2%, but still powering ahead +19.3% for the CYTD. China's SSE and India's SENSEX were both down 0.3% and at the back was Korea's KOSPI, falling 2.1%.

## Commodities

Iron ore prices were held back by rising port inventories, down 1% to US\$117/tonne and coking coal prices were trading water at US\$242/tonne. The base metal complex consolidated its recent gains after April's double digit run, with nickel 2.0% higher, aluminium up 1.0% and copper and zinc flat. Crude oil was off 6.0% with no Israel/Iran strikes this month and ongoing truce talks unwinding the geopolitical risk premium, which saw Brent closing at US\$81/barrel. Gold edged up, finishing up 2% at US\$2327/oz (equivalent to A\$3493/oz), despite the PBoC slowing the pace of their gold buying, but continuing to increase their gold reserves for the 18<sup>th</sup> month in a row.

## Bonds

The US 10-year bond yield retreated by 19bps to 4.50%, reacting positively to the April nonfarm payrolls at 175k additions, the lowest gain in six months and well below the consensus 240k. An in-line core CPI print early in the month and the better Core PCE Deflator also helped. The Australian 10-year bond yield was only marginally lower, given the late May CPI release, down 1bp to close at 4.41%.

## Australia

On the domestic economic front, labour force data volatility continued in April, with better than expected jobs growth but a sharp unexpected rise in unemployment due to a stronger participation rate. As a result, bonds rallied on the softer data. However, in late May, the inflation print proved hotter than expected. The April CPI jumped 0.7%, ticking up to 3.6% on a YoY basis, much higher than consensus of 3.3%. The trimmed mean, the RBA's preferred measure, also ticked up to 4.1% YoY.

A relatively friendly, yet expansionary Federal Budget was delivered, with a message that fiscal policy would buy time on headline inflation, address consumption risks via cost of living support, while laying a foundation for investment pathways to be built. It posted a FY24 surplus of 0.3% of GDP, thanks to higher than forecast commodity prices and low unemployment. The Federal Budget, the expected July tax cuts and higher inflation data all make the likelihood of any rate cuts this year a low probability. We can be pretty certain that there will be no rate cut at the RBA's next policy meeting scheduled for June 17-18. The A\$ closed the month 3.0% higher at US\$0.67, given the hot inflation print late in the month and buoyant commodity prices.

Australian equities rose in May. The S&P/ASX 200 Accumulation Index closed up 0.9%, with IT, Utilities and Financials the best performers. IT (+5.4%) was driven by Xero (+10.6%) and Technology One (+9.7%) showing that technology firms can still deliver materially positive earnings surprises, followed by Utilities (Origin Energy +4.5%) and Financials (CBA +4.4%). The worst performing sectors were Communication Services (-2.6%) dragged down by Telstra (-5.4%, after the market reacting negatively to the move away from CPI-linked post-paid mobile pricing), followed by Consumer Staples (Wesfarmers -2.8%) and Energy (Woodside -1.9%).

For the month, the top stocks that made a positive contribution to the Index's return were CBA (+37bps), BHP Group (+31bps), Aristocrat Leisure (+15bps, after posting a 1H24 beat), Westpac (+14bps) and Goldman Group (+14bps).

Conversely, there were multiple negative earnings surprises in May. The bottom five stocks detracting from the Index's performance were James Hardie (-14bps), Telstra (-10bps), Fortescue (-10bps), Wesfarmers (-8bps) and Sonic Healthcare (-5bps, after a big earnings miss). The ASX Small Ordinaries closed down 0.5%, worse than the broader benchmark of +0.9%. Within the ASX Small Ordinaries, the Small Resources fared particularly well, up 1.9% (driven by Lithium hopeful Vulcan Energy, +40.2%) versus the Small Industrials, which returned -0.9%. The worst performing Small Cap was Omni Bridgeway, plunging 32.5% in May after its major shareholder class action against the CBA was found in favour of CBA, with the shares proceeding to sink to a 52-week low.

## COMPANY SPECIFIC NEWS

### The Market Hits

#### Telix Pharmaceuticals (TLX +20.6%)

TLX is a biopharmaceutical company focused on the development and commercialisation of diagnostic and therapeutic radiopharmaceuticals and associated medical devices. Its lead product is marketed under the brand name Illuccix, which is an advanced imaging tracer that binds to prostate cancer cells in and around the prostate, or throughout the body. This imaging tracer is then detected with a positron emission tomography (PET) scan to reveal prostate cancer. Telix released its highly anticipated efficacy results from the phase I ProstACT SELECT trial in the treatment of metastatic castrate resistant prostate cancer with better than expected results. The radiographic progression-free survival (rPFS) of 8.8 months was above expectations in this patient population, despite small patient numbers of 23. The result boosted confidence to the idea that Telix will ultimately have an approvable product in this space and that the therapeutic pipeline has legs. Investors took the results very positively pushing the stock up 15% with the announcement.

### **PEXA Group (PXA +19.3%)**

PXA is the leading Electronic Lodgement Network Operator (ELNO) facilitating electronic lodgement and settlement of property transactions in Australia. PXA had launched its service into the UK market a couple of years ago.

PXA confirmed that NatWest would be the first major UK bank which will utilise their soon-to-be launched 48-remortgage product in the UK. The announcement was taken very positively, increasing PXA's chances of success in its UK expansion plans, with NatWest the most concrete sign yet that its ~\$200m capex spend may pay off. Even though NatWest had already funded a Pexa competitor, the market reaction was positive, with the stock up 11% on the day of the announcement.

### **Alumina (AWC +16.6%) / South32 (S32 +10.6%)**

Major alumina producers AWC and S32 benefitted from the 15% rise in the spot benchmark alumina price. China's domestic bauxite supply has fallen 20% recently, leading to higher imports and tight alumina supply in China. On top of this, global alumina producers are experiencing supply disruptions, with some 5.9mnt of global alumina supply disrupted, representing ~10% of global ex-China supply.

### **Pinnacle Investment Management Group (PNI +16.3%)**

At the Macquarie Conference this month, PNI reported strong Jan-Apr-24 flows with retail +\$1.1b, offshore +\$2.8b and domestic institutional +\$0.1b. Despite tougher markets in Apr-24, PNI's FUM came in at \$106bn, 6% higher than at December 2023. PNI also confirmed its intent to establish and back a new affiliate led by former members of the Royal London global equities team, subject to pre-existing contractual obligations. Both updates were taken very positively.

### **A2 Milk (A2M +16.1%)**

A2M has rerated strongly on the back of expectations of improved near-term birth rates in China, with solid top line growth already forecast post its 1H24 update in February. A sell-side China infant formula survey released in May highlighted that; the resurgence of foreign brands (from both a customer preference and quality perception perspective) was building further momentum. Together with CY23 marriages which were up 12%, a post COVID catch up and the Year of the Dragon (historically the year of the highest number of newborns), this drove confidence of a lift in the CY24 birth rate.

### **Paladin Energy (PDN +14.0%)**

In mid-May, US President signed the act prohibiting the import of Russian unirradiated, low-enriched uranium (LUE) into law, with effect 90 days after the enactment. This follows the recently passed spending bill of \$2.72 billion to further build out a LEU and advanced nuclear fuel supply chain. It didn't have much of an impact on the spot uranium price, but it did help the listed yellowcake companies including PDN.

### **Aristocrat Leisure (ALL +13.4%)**

ALL rallied after the company reported a 10% better-than-expected result, which drove consensus upgrades. The main driver of the beat was exceptionally strong Gaming Ops installs, strong RoW outright gaming sales (despite ceding share to LNW in ANZ), a 300bp cut in Digital marketing (user acquisition) and the group's cost optimization program which brought the annualized run rate savings of >A\$60mn, with further benefits expected in 2H24/FY25. Substantial North America Gaming Ops install growth (+3,182 to 66,600 units) and solid North America Gaming EBITDA margins at 56.8% helped deliver strong operating cash flow. Capital management also improved, and the market was pleased with the higher dividend (36cps fully franked) and \$350m buy-back extension (to \$500m authorised buyback to February 2025).

### **Neuren Pharmaceuticals (NEU +12.7%)**

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. NEU's leading pipeline drug, NNZ-2591, delivered promising efficacy signals in its topline phase 2 results for Pitt Hopkins, joining Phelan-McDermid's trial which delivered similar results late last year. These highly anticipated results for Pitt Hopkins added to emerging evidence that NEU's lead pipeline drug may potentially treat multiple neurodevelopmental disorders. Investors reacted positively, pushing the stock up 16% on the day of the release.

### **HMC Capital (HMC +12.3%)**

In early May, HMC upped its FY24 guidance for operating earnings to reach 40cps versus its prior guidance of 33cps. This was driven by a larger embedded performance fee from its HMC Fund No. 1, in addition to its share of valuation changes in the fund. Later in the month HMC announced the acquisition Payton Capital, a high margin Commercial Real Estate (CRE) private credit asset manager for \$142.5m. Together with \$500m of credit already approved fund financing lines from leading global investment banks to support Payton's ongoing growth, this will cement a \$5bn+ diversified private credit platform over the medium-term, spanning real estate, corporate, mezzanine and infrastructure private credit investment management. HMC raised \$100m from a placement during the month and are expecting to receive \$30m from an SPP at \$6.50, a 6.1% discount, which was easily gobbled up by retail investors.

### **The Star Entertainment Group (SGR +11.1%)**

SGR has been like a slow-motion train crash over the last few years, falling 90% from its pre-COVID price level. Star Entertainment has lost a chief executive, chief financial officer, chief legal officer, chief customer officer, chief transformation officer, chief of staff and chairman since December. A ray of hope appeared when SGR confirmed an approach from investors led by Hard Rock Hotels and Resorts, with SGR spiking 20%.

However, Hard Rock issued a statement which clarified that it was not involved in, nor has it authorised, any discussions, activities or negotiations on its behalf in connection with a proposal for SGR. Battered investors hung on the proverb "when there's smoke there's fire" and the share price only retraced modestly.

## **The Market Misses**

### **Bapcor (BAP -26.5%)**

BAP is a leading provider of vehicle parts, accessories, equipment, service and solutions. The company announced that astonishingly, the new CEO who was to start on 1 May, had changed his mind. That totally unexpected news was followed up with a poor trading update, with a forecast of 17% lower FY24 earnings than the previous guidance. Please see the performance section for more details.

### **Eagers Automotive (APE -19.9%)**

APE shares sold off after their AGM outlook commentary, which included a 1H24 trading update and guidance, proved much weaker than expected. The company indicated 1H24 underlying PBT would be approximately 15% lower than its 1H23 result of \$207.1m, broadly equating to \$176m, or ~15.5% below VA median consensus. Despite FY24 revenue tracking at >\$1.0bn, which was ahead of market expectations, the market was overly optimistic with a combined view on increased vehicle volumes and gross margin holding up longer than expected, given an ongoing order backlog. Cyclical weakness, although not across the board and BYD discounting to clear inventory, were significant enough to negatively impact earnings. Excess inventory and soft demand for the BYD Atto 3 saw APE need to offer material discounts (\$2,023 cash back and \$6,000 off the extended range model), which 'materially' impacted profitability. The market estimated that this could be a ~40bps drag on PBT margins in 1H24, implying a 3.3% margin. Weaker demand, increased discounting and a declining order book left investors cautious on the short-term outlook.

Hot on the heels of the disappointing APE trading update, the market anticipated softness, but the magnitude of the earnings decline for Peter Warren Automotive (PWR -20.4%) surprised everyone (~52% of 2H23e PBT at the midpoint). PWR's update was well below market expectations, with FY24 underlying PBT now expected to be in the range \$52-57m (vs VA consensus \$68.8m). The key drivers of the lower-than-expected earnings were: the increase in vehicle supply leading to greater competition and lower gross profit margin, reduced customer demand as a result of cost of living pressure and finally, much higher interest costs versus the prior year. On the flip side, revenue was higher, driven by increased volume of vehicles sold. PWR's service and parts business had also shown growth, along with used cars sales (helping back-end revenue). With regard to the outlook, the company said it should continue to benefit from ongoing growth in service, parts and used cars, along with continued management of costs and inventory. However, importantly, management didn't expect these efforts to offset the impact of excess inventory hitting new car margins.

### **Fletcher Building (FBU -18.2%)**

FBU shares fell sharply to close on two-decade lows following yet another profit warning in the past few months. The revised EBIT guidance range for FY24 is now sitting at \$500-530m pre significant items (previously \$540-640m), compared to consensus of \$567m. The key driver of the downgrade was the slowdown in the company's Materials and Distribution divisions, as construction sector activity in both New Zealand and Australia softened further, leaving margins depressed, whilst their respective property markets struggle against elevated interest rates and building consents continue to trend down. The bigger uncertainty surrounds the prospects for FY25e and the length of the downturn in the NZ economy. The only positive from the update was the Concrete and Construction business holding up well, yet there was no further word on legacy projects or Iplex (both potential catalysts for a change in investor sentiment). Concerns over a potential equity raising are also overhanging the shares, given extremely high debt levels - hence the balance sheet and cash flow remains the key priority for the Board and management. A sizeable raising would be highly dilutionary and thus the company is trying and manage through instead (launching the sale process for its plumbing supplies business Tradelink). Fletcher will focus on cost cuts and preserving capital, however, a further downturn in the macro or negative outcomes on NZICC/pipes imbroglio would have outsized balance sheet implications. Additionally with potential rebase risk from a new Chair/CEO (a reminder that in February, CEO Ross Taylor gave notice to leave the business with Chairman Bruce Hassall also falling on his sword and stepping down from the Board at FBU's ASM later this year), investors simply rushed for the exit gate.

### **Audinate Group (AD8 -16.6%)**

AD8 provides professional audio and more recently, visual digital networking technologies globally. The company's core technology, Dante, distributes digital audio over an existing computer network and is the dominant provider. AD8 announced a record 1H24 result that was ahead of consensus expectations, albeit FY24 guidance was unchanged and was a candidate for ASX200 inclusion, which saw the stock rally 40% in the month of February. Since then, both a major sell-side conference and its investor day in May, failed to stop the shares from drifting lower, as there were no changes to guidance. The resignation later in the month of the CFO who joined in 2017 and served as such during the IPO wasn't taken well, with the shares falling 9% thereafter.

### **Tabcorp Holdings (TAH -16.3%)**

In April, TAH's CEO and Managing Director Adam Rytenskiel, was asked to resign due to inappropriate and offensive language. Against the backdrop of weaker results from offshore peers operating in Australia, TAH continued to languish with a softer wagering industry and without a management team.

### **Regis Resources (RRL -16.2%)**

RRL approved the development of two new underground areas at Duketon for 'growth' capital of A\$150-190m. Were it not for the recent surge in the gold price, these developments would appear to generate marginal returns, driven in part by the relatively low grade of ~2.8g/t.

The mines are adjacent to existing underground mining areas and will extend the life of those operations and replace the open cut feed over time. Certain sell-side analysts rightly questioned whether the capital spend should be treated as sustaining (rather than growth). These new underground mines are expected to contribute ~100-120koz pa of the 200-250kozpa planned at Duketon over the next 6-years and consensus forecasts for Duketon have settled around all in sustainable costs (AISC) at ~A\$2,100/oz. The alternative accounting treatment would see the AISC of the mines more like ~A\$2,600/oz. Either way, it caused target price cuts by some key sell side analysts.

#### **Smartgroup Corporation (SIQ -14.7%)**

Regulatory changes introduced back on 1st July 2022 made allowable EV's avoid the FBT impost if funded via a novated lease. This provided a strong tailwind for major players like SIQ and McMillan Shakespeare (MMS), but the growth in market share of novated leases from 7.5% to ~11%, now seems to have peaked out in February this year, with the stock prices of both SIQ and MMS down around 25%.

#### **Block Inc. (SQ2 -14.1%)**

The US Consumer Financial Protection Bureau announced that providers of the increasingly popular point-of-sale loans must now offer some of the same protections afforded to credit card users. Under the new rules, BNPL lenders must now: investigate disputes initiated by consumers, pausing payment requirements during the process, refund returned products or cancelled services to consumers accounts and provide consumers with periodic billing statements like the ones received for standard credit cards. The announced changes dragged the BNPL sector down.

#### **James Hardie Industries (JHX -13.7%)**

JHX reported 4Q FY24 results slightly below expectations but issued FY25 guidance well below expectations, as the repair and remodelling recovery was pushed back. JHX reported softer North American volumes growth and its NPAT guidance for FY25 NPAT of \$630-700m compared with consensus of \$760m (13% miss at the mid-point) which was way under market expectations. Not surprisingly, investors were nervous, resulting in the share price falling 14% on the day.

#### **Nufarm (NUF -12.9%)**

NUF reported 1H24 underlying NPAT of \$51m which was below consensus of \$74m and -64% vs pcp of \$142m. The interim dividend of 4cps was 1c below the pcp and underwhelmed. Also, NUF guided towards FY24 EBITDA of \$350-\$390m, 18% below consensus FY24 EBITDA of \$438m. The company expected crop protection prices to remain subdued in near term, due to inventory imbalances. What was highly surprising though, was that NUF shares only fell 7% on the day.

#### **Credit Corp Group (CCP -9.6%)**

CCP's shares drifted lower despite a fairly upbeat investor presentation at the Macquarie Conference which highlighted growing consumer demand in their AU/NZ loan book and the continued expansion of US credit card and revolving debt. With elevated levels of AU/NZ lending in FY24, FY25 looks set to capitalise on solid loan book growth. Improving employee productivity in the U.S. PDL business saw collections expand +11.0% in Apr '24, despite the collection environment remaining flat from FY23. The company's guidance statement for FY24 remained unchanged, with provisions tracking within their pro-forma of achieving loss rates of 17.5% or below. However, despite management's optimism, the market was concerned that the company may have missed the crucial upcoming PDL purchasing window, missing new ledger growth opportunities and the shares sold off.

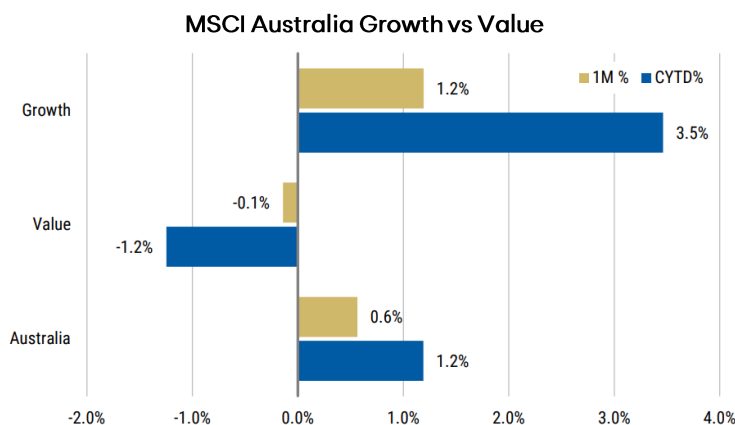
## FUND PERFORMANCE

Against the backdrop of stronger offshore markets, domestic equities lagged, up 0.9% for the month. The IT, Utilities and Financial sectors were the best performers, whilst Communications Services was the worst sector, dragged down by Telstra (-5.5%).

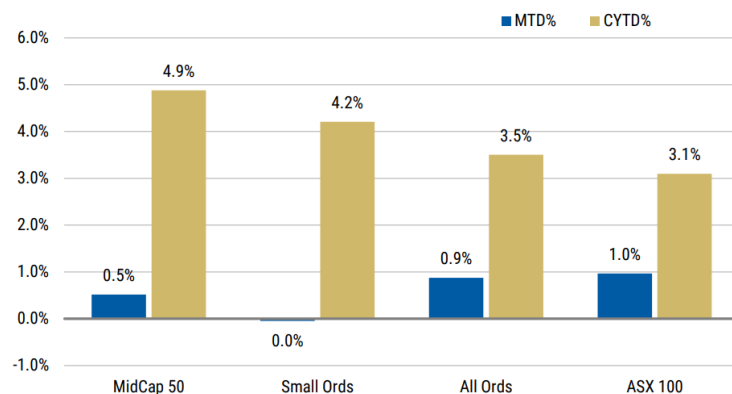
The Fund had a disappointingly frustrating month, giving back all the alpha and more generated in April due to a confluence of stock specific issues in three core holdings. The return of -4.35% during May materially underperformed the benchmark return of +0.92%.

In May, we saw a major reversal and it was deja vu all over again. As you can see below, both Growth and Leaders have turned around and outperformed sharply this month, which doesn't suit our approach.

### Growth outperformed Value during May, and for the CYTD



### Large Caps outperformed in May



Source: Morgan Stanley

Financials, which rallied 2.6%, posted the largest contribution (+79bps) to the market's return during the month of May, driven by the major banks with CBA (+4.4%), Westpac (+3.5%), ANZ (+3.3%) and NAB (+2.8%). Information Technology followed (Xero +10.6%) and the Real Estate sector (+1.9%, driven by Goodman Group +5.8%) also outperformed.

Conversely, Communication Services (Telstra -5.5%), Consumer Staples (Wesfarmers -2.8%) and Energy (Woodside Energy -1.9%) acted as the major drag on the broader market.

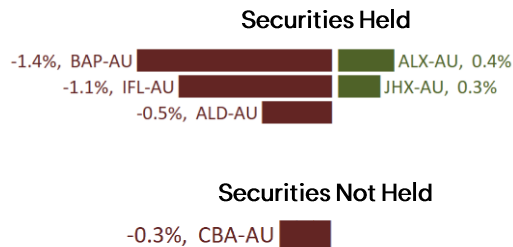
Returns* (%)	Gross	Benchmark*	Excess	Net
1 Month	-4.35%	0.92%	-5.27%	-4.43%
3 Months	0.44%	1.16%	-0.72%	0.22%
FYTD24	2.33%	10.98%	-8.65%	1.49%
12 Months Rolling	1.36%	12.93%	-11.57%	0.45%
3 Years (p.a.)	5.46%	6.80%	-1.34%	4.45%
5 Years (p.a.)	8.28%	7.83%	0.45%	7.19%
10 years (p.a.)	7.03%	7.78%	-0.76%	6.01%
Since Inception (p.a.)	8.08%	8.83%	-0.75%	6.97%

Past performance is not a reliable indicator of future performance

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

\* The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2012.

## Month of May Attribution



Source: Ellerstion Capital

In the month of May, the main positive contributors to the Fund's performance were its overweight positions in Atlas Arteria (ALX +2.5%) and not owning JHX intra-month, but building a position after their sell-off.

The detractors during the month were overweight positions in Bapcor (BAP -26.5%), Insignia Financial (IFL -10.6%), Ampol (ALD -5.7%) and not owning any of the major four banks.

### Bapcor (BAP -26.5%)

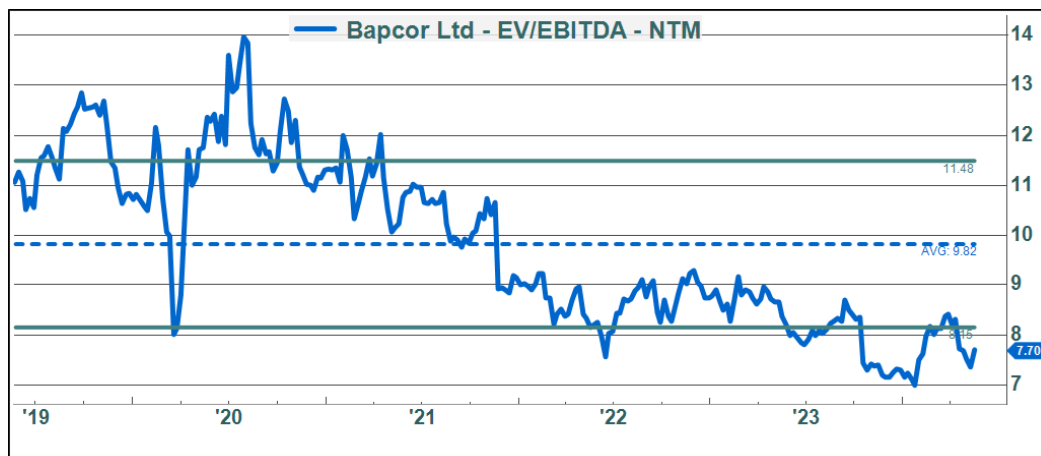
Just to re-cap, BAP is a leading provider of vehicle parts, accessories, equipment, service and solutions. About 80% of BAP's \$2b revenue stream is generated from its Trade and Specialist Wholesale businesses (DIFM), which is typically resilient through the economic cycle given the largely non-discretionary replacement nature of its products and end-markets. The largest business in this segment is the trusted brand with mechanics, distributors and customers - Burson Auto Parts. The other ~20% of turnover is generated from the Retail businesses (DIY) that includes stores under the AutoBarn and Autopro umbrella.

Frustratingly, the company shocked the market (including ourselves), with the announcement that the day before starting on 1 May, highly credentialed incoming CEO Paul Dumbrell, would not be starting (appointed 1 Feb), so the stock went into a trading halt. Two days later, the company released a rushed trading update for FY24 NPAT to be in the range of \$93-97m, with the mid-point being 17% lower than previous guidance. Revenue was broadly in line, but profit margins were hit by tough macro trading conditions in Retail, which was not unexpected, but the highly elevated costs were not. Together with delayed trading, investors feared the worst and rushed for the exit, dragging the stock down 24% on the day.

To be clear, the profit downgrade was not demand driven in the trade, but largely cost related, with higher Better Than Before (BTB) overhead costs and interest expense. BAP flagged that "BTB" revenue benefits were below expectations in the 2H, but the strategy still incurred incremental associated overheads, with a higher portion of the BTB costs taken above the line than was previously forecast. Operational decisions and cost initiatives were delayed by the "caretaker" CEO Mark Bernhard, on the basis that Paul Dumbrell was due to start and vigorously tackle this area. The interim CEO is now taking a more active role in starting to address the cost base and in inventory/working capital management.

We reinforce that we were attracted and remain drawn to BAP given it's a quality business with a leading market position alongside US-listed GPC (Repcor). Previous management (Noel Meehan) who relied on numerous McKinsey projects, had executed poorly (prompting the change of CEO in the first place) and with the right CEO leadership and Board composition/direction, we still believe there is huge turnaround potential. Trading conditions remain resilient across BAP's DIFM trade end markets, with revenue tracking in line. Cost control measures need to be undertaken immediately by the interim and/or future CEO. BAP's balance sheet remains sound, with leverage at ~1.7x below the leverage covenant of less than 3.0x. Even after the recent hefty downgrade, BAP at 7.6x EV/EBITDA, is trading at a significant ~40% discount to its peer group. O'Reilly Automotive in the US for example, trades on 16X EV/EBITDA.

Although investor confidence will take time to restore, in the eyes of the market, BAP remains a potential takeover target and has already attracted involvement by activist investors whilst the current valuation multiple languishes and sentiment is at a rock bottom. The position has impacted negatively on this month's performance, however the business is not broken, it's just been poorly managed and executed. At current levels it remains totally mis-priced.



Source: FactSet



## FUND ACTIVITY

Following the strong run up in their share price early in the month of May, the Fund took profits in Atlas Arteria, IGO, Iluka, IRESS and Origin and also profitably exited Lynas and South32. We used the proceeds to rebuild on our Ampol position (having substantially culled the holding above \$40.00 ex the \$1.80 fully franked dividend back in March) given its share price retracement. We also strengthened positions in some of the Fund's recent acquisitions, namely Kelsian Group, Orora and Perpetual.

Student placement, visa application and English–Language testing company IDP Education was a new name introduced to your portfolio (see write-up below).

We re-introduced GrainCorp and James Hardie (see write-up in the Misses section) post their price falls following the release of disappointing trading updates.

NEW STOCKS ADDED	STOCKS EXITED
<ul style="list-style-type: none"><li>• GrainCorp</li><li>• IDP Education</li><li>• James Hardie Industries</li></ul>	<ul style="list-style-type: none"><li>• Lynas Rare Earths</li><li>• South32</li></ul>
INCREASED	DECREASED
<ul style="list-style-type: none"><li>• Ampol</li><li>• Kelsian Group</li><li>• Orora</li><li>• Perpetual</li></ul>	<ul style="list-style-type: none"><li>• Atlas Arteria</li><li>• IGO</li><li>• Iluka Resources</li><li>• IRESS</li><li>• Origin Energy</li></ul>

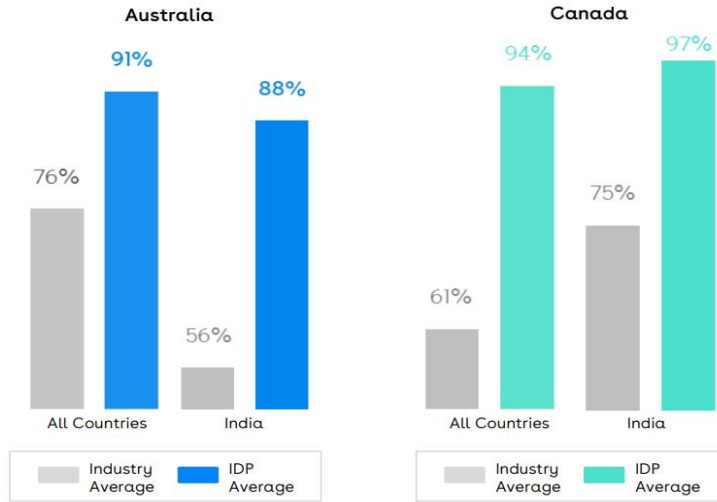
We have finally taken the plunge and introduced English–Language testing company, **IDP Education (IEL)** to the portfolio midway through the month. IEL is a name we have patiently been monitoring for some time. Its share price had recently collapsed from levels of \$32 reached back in February 2023 (and a far cry from the dizzy heights of \$39.55 achieved back in late 2021) for a number of reasons, namely : it's business heading into a period of restrictive government policy, the expected MSCI Index deletion which occurred on 30<sup>th</sup> May 2024, ongoing IELTS market share losses in India, the potential negative impact of the UK review of the Graduate Route (with a report from the Migration Advisory Committee's recommendations on post study group rights), expanded short interest and finally, a view that consensus estimates were just too high.

Based on current industry feedback and given the known announced regulatory changes, including the outcome of Australia's Federal Government Budget (encompassing the draft for Australia's International Education and Skills Strategic Framework), post assessing these potential policy outcomes, our conclusion was that FY25 should represent the peak of industry headwinds and hence the trough for student volumes and therefore, FY25 should see a bottoming of the earnings cycle.

The uncertainty associated with the near-term earnings risks in major markets like Canada and the UK, have clearly weighed heavily on the stock and analysts have re-based their earnings lower, with the potential for further downside risk. Yet Canada study permit reductions appear less severe than the headlines might suggest (with approved study permits expected to be down 28% y/y in CY24). While the headline reduction is substantial, Ontario (the key province for IEL) confirmed that 96% of its allocated study permit applications will go to public colleges and universities (which account for >90% of IDP's Student Placement volumes), providing a fair degree of protection to IDP. In the UK, following the strong uplift in UK student visa issuances in FY22 and FY23, recent regulatory tightening saw visa numbers drop off sharply, with 2Q24 volumes down 37% y/y. While the recommendations of the Migration Advisory Committee (MAC) were made clear on the 14<sup>th</sup> of May, which was to retain policy in its current form, political pressures have heightened the possibility of Rishi Sunak's Government overruling the review's "status quo" recommendations (a UK election looming also clouds the picture). In the market's eyes, this was the final downside risk on the horizon for IEL. The review also noted an increased focus and scrutiny on international recruitment agents, including mandatory registrations, a positive for higher-quality agents like IEL.

In the meantime, the company has strengthened its position within an industry that continues to attract negative press and sentiment. International student education is a long term structurally growing market supported by a rapidly emerging middle class in the developing world (e.g. the likes of India) that is aspirational, but simply doesn't have an internationally competitive domestic education sector. IEL's position as a trusted and reliable operator is illustrated in their market leading visa approval rates, as called out by the company at their 1H result:

Average Student Visa Approval Rates (H1 FY24)\*

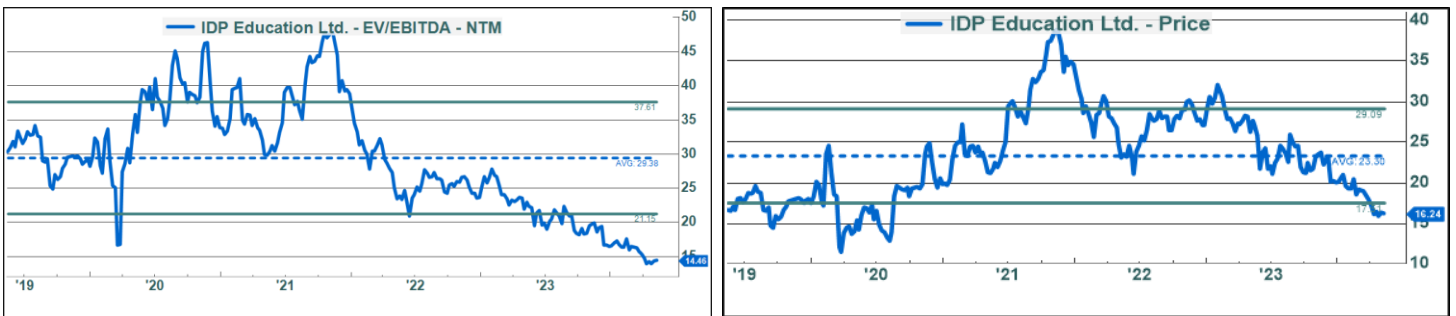


Source: Morgan Stanley

Universities Australia, the peak body for the tertiary sector, sector, said "certainty, stability and growth" were needed in future policy. It said international education contributed \$48bn to the economy last year – more than half of Australia's economic growth.

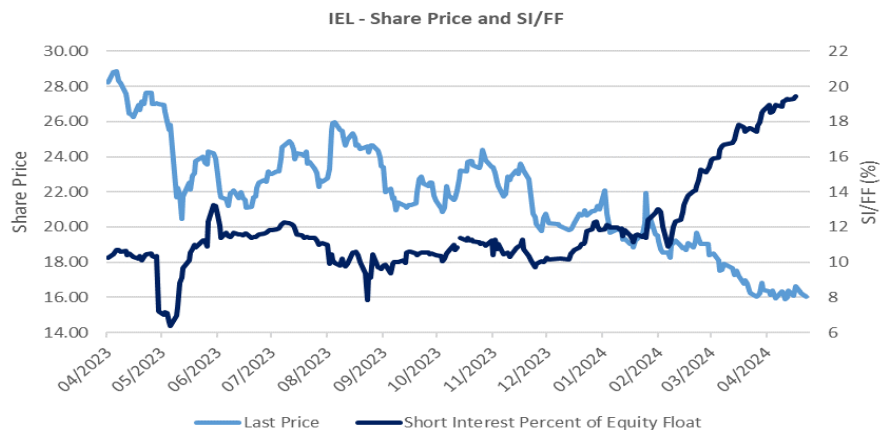
IEL should emerge stronger when global migration and education reverts in the medium-term. We are attracted to the company's capital light model, strong balance sheet and IEL's Student Placement's (SP) quality focus, coupled with SP/IELTS pricing tailwinds which should support longer term earnings growth. As we are nearing the base for FY25 earnings, the market is now capitalising what we feel are trough earnings/growth at a historically low multiple. IEL currently trades well below its historical average EV/EBITDA multiple of 15.0x today vs its 20x pre-covid average and well below its historical premium of 215% vs the ASX200.

IEL's structural long-term growth outlook and business quality remain solid and IEL should outperform its peers during a broader market decline. It is our contention that current trading levels present an attractive entry point, but acknowledge that shorter dated cyclical factors could drive the share price lower.



Source: FactSet

IEL short interest has continued to push higher to 45m shares, the second most shorted stock on the ASX.

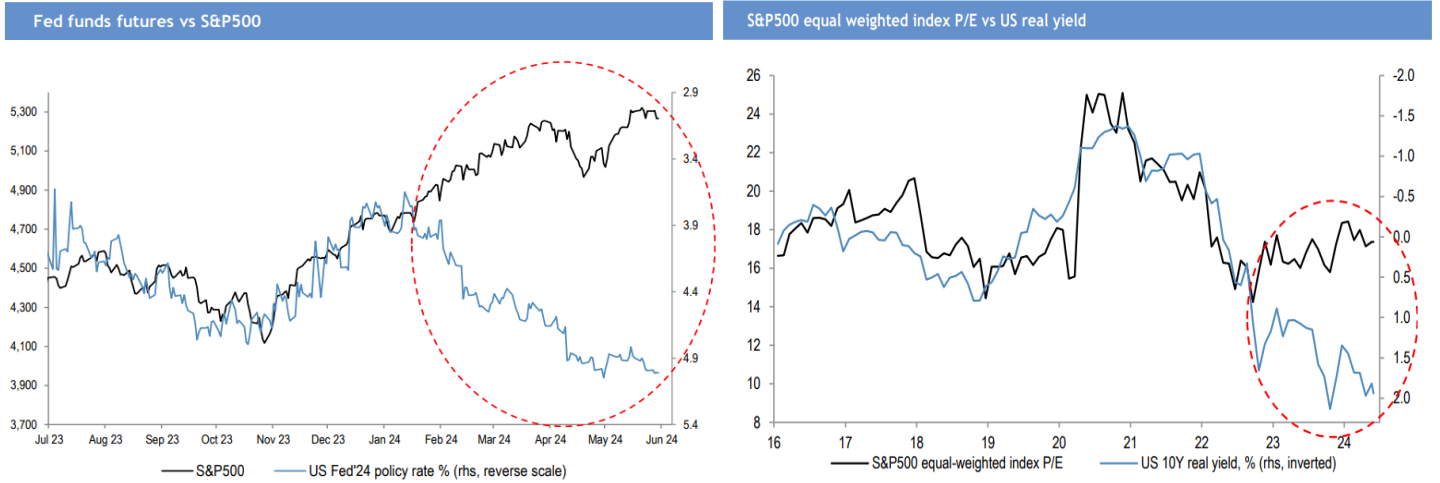


Source: Morgan Stanley

# FUND STRATEGY AND OUTLOOK

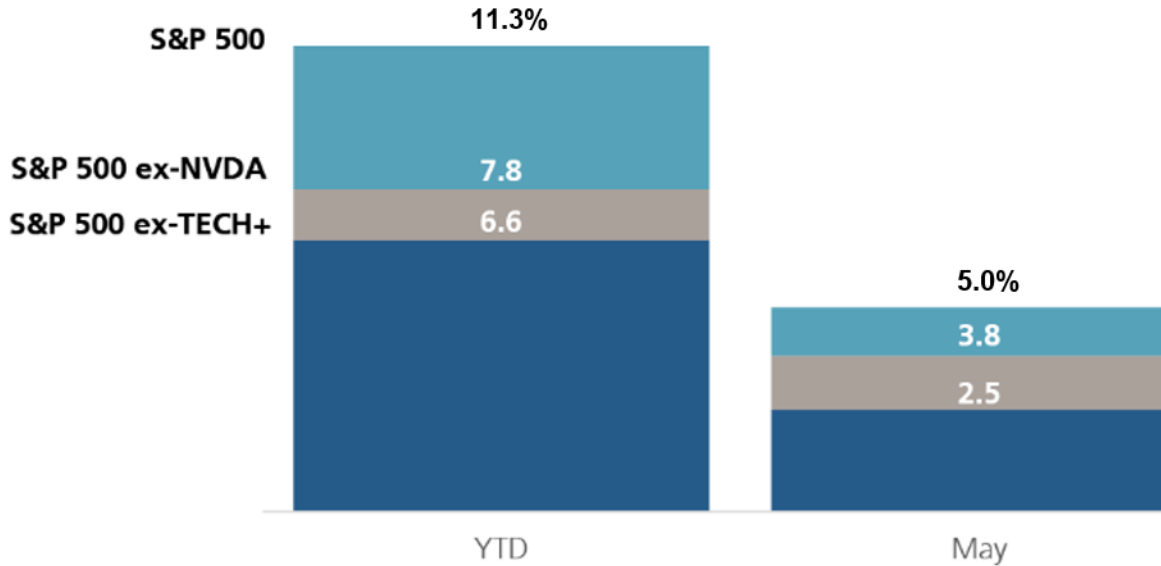
Equity markets rebounded in May following the re-pricing of inflation risks, interest rate and central bank policy. The US economy was showing signs of slowing growth momentum during the month, as weaker data points and Fed speak suggested a reduced risk of any Fed hikes. This saw bond yields fall and the AI juggernaut propel the global IT sector further. The Fed left rates unchanged, with Chair Powell suggesting either softer inflation data or weaker labour markets would provoke a cut. Our view domestically is that the RBA will likely stay on hold through 2024, with easing starting in early 2025.

In the US a large gap has opened up this CYTD between the S&P500 and the Fed futures. As equities decoupled from the Fed, the market was implicitly making the assumption of a growth acceleration coming up, which looks unlikely to materialize. Also, current equity market valuations do not offer a cushion versus bond yields and the question remains, will AI growth be enough?



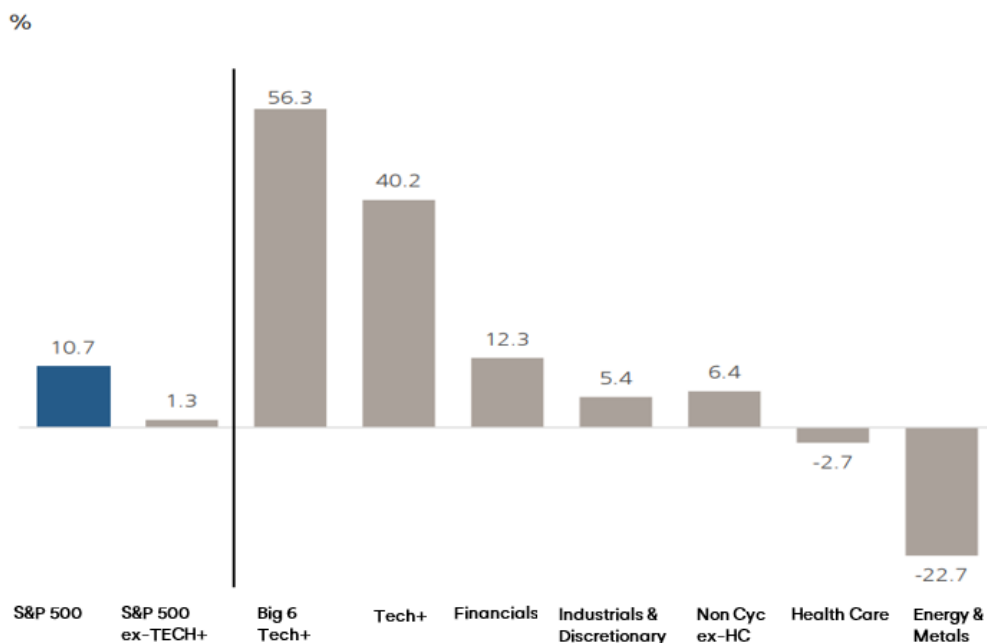
Source: J.P. Morgan

If we look at the total return for the S&P500 for May (+5.0%) and the CYTD (11.3%) it is extraordinary that NVIDIA contributed 1.2% and 3.5% of the total return, respectively.



Source: UBS

US 1Q earnings was another strong quarter, with 3.8% revenue and EPS growth of 10.7% versus 4Q 2023 at 10.5%. However, earnings drivers among groupings varied significantly, as shown in the chart below. What particularly stands out is that whilst the S&P 500 delivered EPS growth of 10.7%, this masks the fact that TECH+ EPS growth was 40.2% (Big 6 TECH+ 56.3%) versus 1.3% for the rest of the market. The second chart below highlights that Big 6 TECH+ returns for 2024 so far have been predominately driven by spectacular earnings growth and less PER expansion than one would expect. This is certainly not the case with Australian tech stocks.



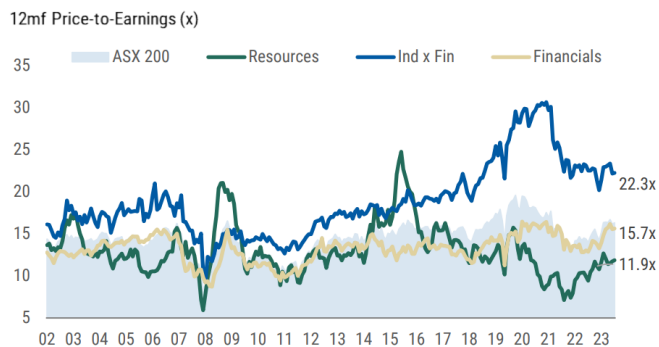
Source: UBS

YTD	EPS	P/E	Price Return (Local)	Total Return (USD)
S&P 500	6.0	4.3	10.6	11.3
Big 6 TECH+	18.6	5.1	24.7	24.9
Russell 1000 Value	2.5	4.0	6.7	7.6
Russell 1000 Growth	11.0	1.6	12.7	13.1
Russell 2000	3.6	-1.4	2.1	2.7
MSCI Pacific	4.5	7.5	12.2	4.9

Source: Standard & Poor's, Russell, MSCI, FactSet, UBSNote

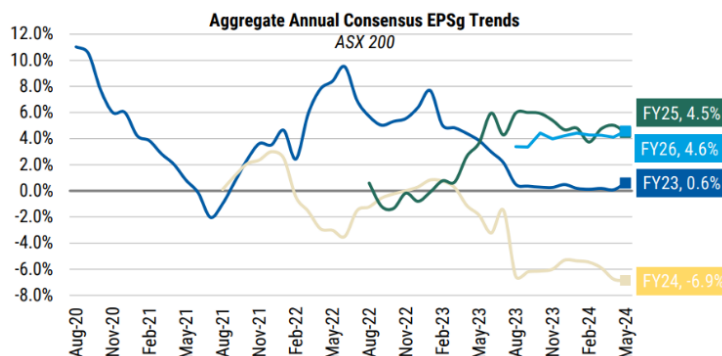
In terms of Valuations, the domestic market 12MF P/E currently stands at 16.3x. Outer year earnings growth forecasts remain fairly anchored in very low-single-digit territory.

**The 12M forward PE of the Industrials ex- Financials has Fallen from 30.2x to 22.3x**



Source: Morgan Stanley

**Annual Consensus EPS Growth Trends FY23-26**



To summarise your portfolio's current positioning:

### 1. Quality Franchises, Growth at Reasonable, Attractive Valuations

Solid companies with strong/leading market positions and credible management with good balance sheets.

Amcor, Ampol, Atlas Arteria, GrainCorp, IDP Education, IPH, James Hardie, Liberty Group and Origin.

### 2. Businesses that are highly cyclical or seasonal in nature, that have faced headwinds

Heavily discounted companies with strong market positions and strategic assets, but very sensitive to economic conditions/seasonality/weather.

Bega Cheese, Challenger, Kelsian, Orora and Seven West Media.

### 3. Turnarounds

Sound businesses that have historically generated poor returns, have been badly managed, resulting in poor execution of strategy and have under-earned versus their potential. These stocks are in a transition phase, and we think earnings/returns will improve over the medium term. Out of favour with the market, somewhat contrarian positions.

Bapcor, Insignia Financial, IRESS and Perpetual.

### 4. Deeper Value Resource Plays

Stocks trading at discounts to NPVs, where much of the heavy lifting has been done (cost out, self-help, deleveraging). The cycle and thematics are still positive and any demand pick up will challenge balanced supply.

BHP Group, IGO, Iluka Resources and Metals Acquisition.

We are truly grateful for, and always appreciate your continued support.



Warmest Regards,

Chris Kourtis

Portfolio Manager

## About Ellerston Overlay ASF

The investment objective of the Fund is to provide investors with a return that outperforms the Benchmark whilst delivering additional income through option strategies over time.

The Fund aims to achieve this by investing in a concentrated portfolio comprising of no more than 30 Australian Listed Securities and where possible, enhancing income through the use of Derivatives and shorter term trading strategies.

The Fund aims to be invested with a minimum of 90% in physical Securities at all times and must maintain a net exposure of 50% or greater. At least 75% of the Fund will be aligned to the portfolio of the Ellerston Australian Share Fund (EASF). The Fund may invest in REITS.

<b>STRATEGY FUNDS UNDER MANAGEMENT</b>	\$ 196,477,847
<b>FUNDS UNDER MANAGEMENT – OASF UNIT TRUST</b>	\$7,625,733
<b>APPLICATION PRICE</b>	\$1.1014
<b>REDEMPTION PRICE</b>	\$1.0960
<b>NUMBER OF STOCKS</b>	24
<b>INCEPTION DATE</b>	1-Jul-11

Source: Ellerston Capital.

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### 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](mailto:info@ellerstoncapital.com) or visit us at [ellerstoncapital.com](http://ellerstoncapital.com).

All holding enquiries should be directed to our register, Automic Group on 1300 101 595 or [ellerstonfunds@automicgroup.com.au](mailto:ellerstonfunds@automicgroup.com.au).

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