Ellerston Global Mid Small Cap Fund

Ellerston Capital

Monthly Report as at 30 June 2024

APIR Code: ECL3306AU, ECL8388AU | ARSN 609 725 868

Concentrated portfolio of global mid small cap securities, built through a contrarian, high conviction, and benchmark independent approach.

Targets companies which the Portfolio Manager feels are in a period of "price discovery" and which offer an attractive risk/reward dynamic.

Aims to outperform the benchmark with a focus on risk management and capital growth.

Performance Summary - Class A

Performance	1 Month	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.)^^
Net^	-0.67%	-5.99%	0.31%	-1.10%	8.87%	9.92%
Benchmark*	-1.97%	-5.42%	10.44%	4.34%	8.30%	9.55%
Alpha	1.30%	-0.57%	-10.13%	-5.44%	0.57%	0.37%

Performance Summary – Class B

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception (p.a.)^^
Net^	-0.72%	-6.03%	3.20%	0.23%	-0.84%	6.95%
Benchmark*	-1.97%	-5.42%	5.60%	10.44%	4.34%	9.82%
Alpha	1.25%	-0.61%	-2.40%	-10.21%	-5.18%	-2.87%

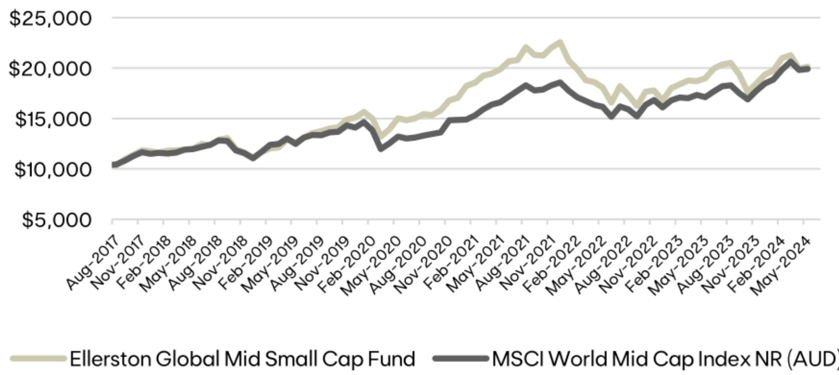
*^ The net return figure is calculated after fees & expenses, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance. * MSCI World Mid Cap Index NR (AUD). ^^Class A inception is 28 February 2017. Class B inception is 18 August 2020.*

Key Information

Portfolio Manager(s)	Bill Pridham
Investment Objective	To outperform the benchmark by 3% over a 5-year rolling period.
Benchmark	MSCI World Mid Cap Index NR (AUD)
Liquidity	Daily
Target Number of Holdings	20-40
Number of Holdings at Month End	35
Minimum Investment	Initial investment - $25,000 Additional investment - $10,000
Distribution Frequency	Half-Yearly (where available)
Management Fee	0.75% p.a.
Performance Fee[1]	10.00%
Buy/Sell Spread	0.25% / 0.25%
Class A Unit Prices & Fund Size	Application – $1.4096 Net Asset Value – $1.4061 Redemption – $1.4026 Fund Size – $40,742,315
Class B Unit Prices & Fund Size	Net Asset Value – $1.1916 Redemption – $1.1886 Fund Size – $47,995,736

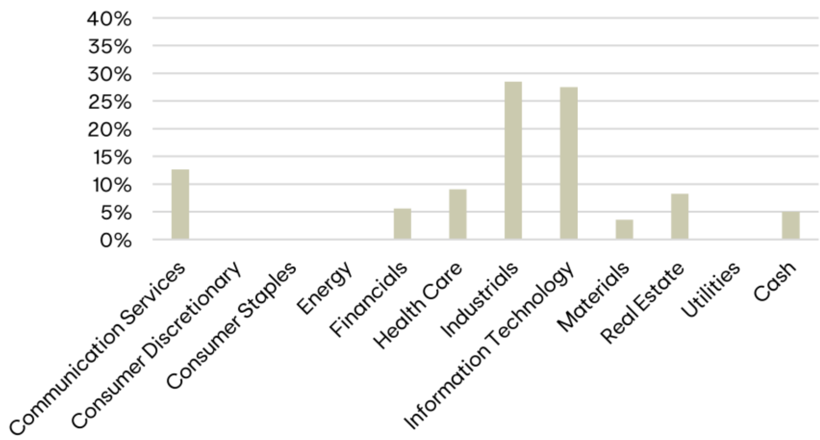
[1]Of the investment return above the benchmark, after recovering any underperformance in past periods.

Growth of $10,000 Investment



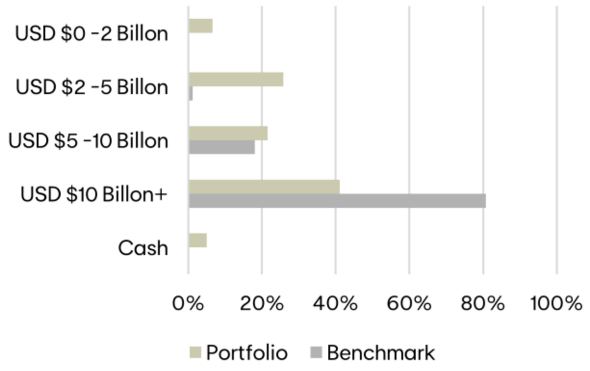
Source: Ellerston Capital.
Performance shown are for Class A Units and net of fees, assuming all distributions are reinvested.
Past performance is not a reliable indication of future performance.

Sector Allocation



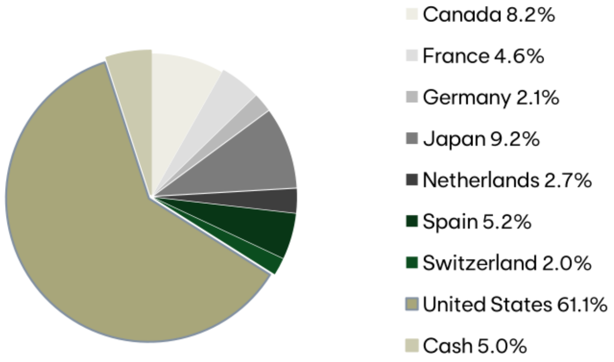
Source: Ellerston Capital.

Market Capitalisation Exposure



Source: Ellerston Capital.

Regional Exposure



Source: Ellerston Capital.

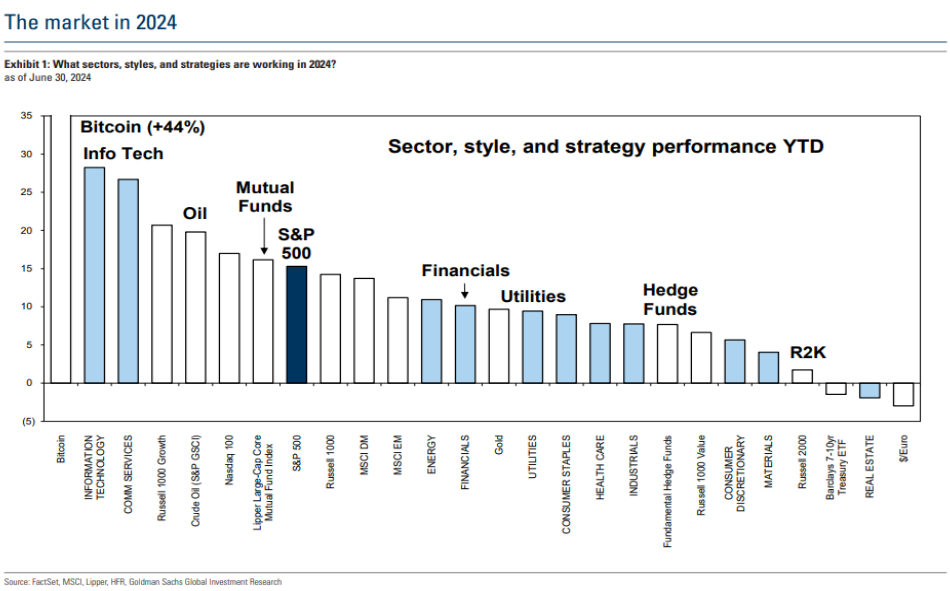
Top Holdings

Company	Sector	Country	Portfolio Weight
GFL Environmental Inc	Industrials	Canada	6.5%
Cellnex Telecom S.A.	Communication Services	Spain	5.2%
GXO Logistics	Industrials	United States	4.2%
Option Care Health	Health Care	United States	4.1%
PTC	Information Technology	United States	3.8%
Webster Financial	Financials	United States	3.6%
Bureau Veritas SA	Industrials	France	3.3%
Zillow Group	Real Estate	United States	3.3%
OBIC Business Consultants	Information Technology	Japan	3.2%
Chart Industries	Industrials	United States	3.0%

Source: Ellerston Capital.

MARKET COMMENTARY

The S&P 500 was very strong during the first half of calendar year 2024, with the largest stocks (MSFT, NVDA, AAPL, GOOG, AMZN and META) contributing over 60% of total returns, which according to Goldman Sachs represented 10% outperformance, relative to the equal weighted S&P 500. The markets continue to be driven by a small number of stocks as concentration in the large meg-caps remains the investment strategy of choice.



The tech outperformance is clearly being driven by the secular theme associated with AI, as the potential economic and earnings impact associated with its adoption remains a north star for the sector. The capex buildout required for expanding AI infrastructure is maintaining its momentum, however, we will need to see some real time consumer and enterprise use cases to drive the next phase of adoption.

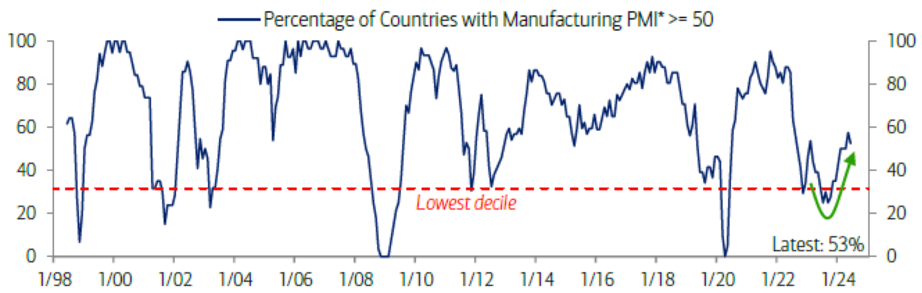
The carrot associated with the spending boom in AI capabilities lies in next generation applications which should drive a rebound in productivity, similar to what was experienced with other "disruptive technologies" such as the use of steam engines, which morphed into electricity enabled mass production and more recently, the internet.

Outside of AI, the rest of the economy continues to come in mixed with notable weaknesses in consumer names including Walgreens, Nike, Levi Strauss and General Mills to name a few. The common thread here is particular weakness in the low-end consumer which remains under pressure from the sustained high cost of living and depletion of pandemic induced cash infusions.

The manufacturing economy seems to be stabilising and improving from recent levels as inventory de-stocking seems to have generally run its course and supply chains are becoming more predictable. When attending a recent conference, the common feedback around the current operating environment was that after a few quarters of weakening, conditions today appear to be steady, however it is too early to call whether the next move inflects up or down.

We can see this in the following chart where global PMI's had been trending down for some time, however, now look to be picking up. The key will be a continuation of this trend for a broadening out of earnings growth beyond just the technology sector.

Exhibit 1: Breadth of manufacturing PMIs in expansion has rebounded from 25% in September-2023 to 53% now
Based on 40 countries as of today



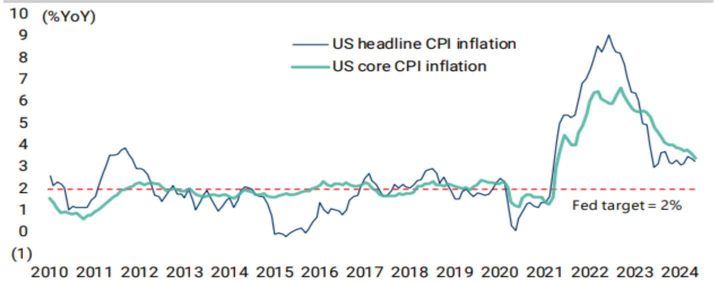
Source: BofA Predictive Analytics, S&P Global, Haver. ***Notes**: In the absence of manufacturing PMIs, whole economy PMIs are used. June data is available for 30 countries, May data is used for the remaining 10.

BofA GLOBAL RESEARCH

While earnings growth traditionally drives medium to long term equity performance, the market right now is really being driven by the aforementioned top 6 meg-cap stocks and expectations around inflation/interest rates. While inflation is clearly trending down, the market remains laser focused on the monthly CPI prints as this dictates the timing of the first rate cut out of a data dependent Fed.

Although US inflation data came in better-than-expected last month, it remains above the Fed's 2.0% target (not sure if it ever gets there outside of a significant slowdown). That said, Chairman Powell has maintained the view that the next move will be down as the economy and price pressures continue to moderate. There is currently a very strong correlation between stocks and bonds (which is not typically the case) as the market is predominately focused on inflation to determine the next move in asset prices.

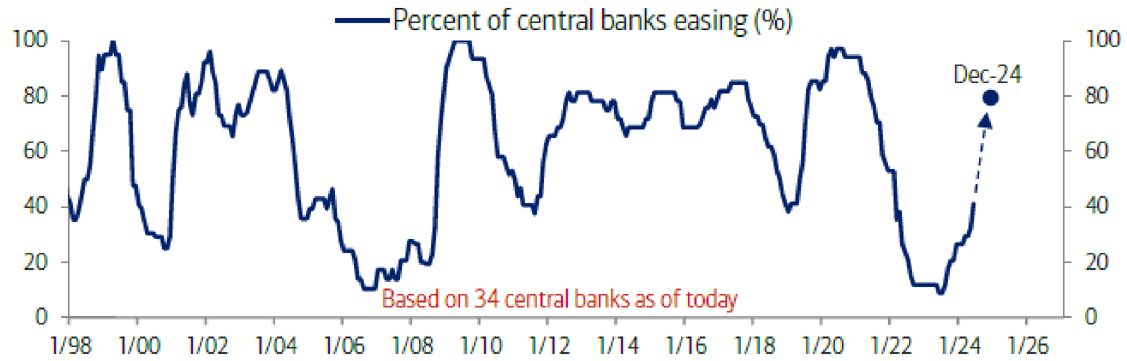
US headline and core CPI inflation



Source: Bureau of Labor Statistics

With expectations for a Fed cut in its meeting in November, it will join a growing list of central banks which are already in easing mode. According to Ned Davis Research, the disinflation momentum has resulted in an interest rate easing synchronization globally, with 42% of the 34 global central banks in easing mode, compared with 10% this time last year (clearly there are outliers including the RBA here in Australia) which is expected to increase to almost 80% by year end.

Exhibit 13: 80% of global central banks are expected to be in easing mode by the end of 2024 vs only 10% in July 2023
Percent of central banks in easing mode



Source: Ned Davis Research. Notes: December-expectation based on Bloomberg consensus.

BofA GLOBAL RESEARCH

So to sum up, we continue to see returns very concentrated in a small number of large Megacap stocks, and this is not surprising given the generational investment opportunity they are exposed to. However, going forward, we do expect returns to broaden out as the productivity benefits associated with the spend around AI proliferates through the ecosystem – this will not be evenly spread or come in a straight line as corporates are in AI "learning mode". There doesn't seem to be a more apt time to use the William Gibson phrase "the future is already here; it's just not very evenly distributed" as the AI learning engines currently reside in a select few hands.

Economic conditions remain mixed, however seem to be stabilising to improving from recent levels (outside of consumer pockets), inflation appears to be under control and the bias of central banks is toward easing conditions, not tightening. While we remain mindful of continuing geopolitical risks and the potential for inflation to reverse course, which would clearly be market negative, the investment backdrop of lower rates, steady growth and expanding market breadth bodes well for the global mid small cap space.

Shifting to June global equity performance, markets were quite mixed as election news (specifically in Europe) drove regional volatility. The NASDAQ composite increased 6%, followed by the S&P500 which was up 3.6% with both highlighting the preference for large cap stocks as the Russell 2000 was down almost 1%. Global markets outside US were generally weak with the French CAC index down 6.2%, Germany's DAX and FTSE 100 lower by over 1.0%, although Japan had a good month, with the Nikkei 225 up c3.0%.

REGIONAL DISCUSSION

As discussed earlier, the S&P 500 achieved a return of 3.6%, driven by strong corporate earnings and positive economic data. Technology giants continued to lead the market. However, the Russell 2000, representing small-cap stocks, declined by 0.93%. This decline was primarily due to economic concerns, profit-taking, and higher volatility, particularly within the industrial and utilities sectors. Despite these mixed results, overall market sentiment remained cautiously optimistic as investors balanced strong corporate performances against economic uncertainties.

European markets, on the other hand, faced a more challenging environment in June. Persistent inflation concerns and uncertainty over energy supplies, exacerbated by ongoing geopolitical tensions, weighed on investor sentiment. The French stock market struggled due to weak economic data and uncertainty surrounding upcoming elections. The Spanish market also saw a decline over the month, driven by investor concerns about economic stability and the impact of inflation.

Japan's stock market performed positively, driven by strong corporate earnings and favourable economic policies. Investor sentiment was buoyed by solid performance in high-tech stocks, particularly in the semiconductor sector. The Bank of Japan's continued accommodative monetary policies also supported market growth. Overall, the Japanese equity market showed resilience and growth amid broader economic uncertainties.

SECTOR DISCUSSION

In June, the Information Technology sector performed well across both large-cap and small-cap stocks. The sector's robust performance was driven by continued advancements in artificial intelligence and significant progress in semiconductor production. The substantial investments in AI infrastructure and the ongoing digital transformation across industries played a crucial role in driving the sector's growth. Small-cap IT stocks also performed well, driven by innovation and niche market opportunities.

The Communication Services sector performed well in global markets, bolstered by digital advertising, AI advancements, and growing demand for digital connectivity. Investments in AI and digital advertising efficiency helped communication services companies maintain strong growth trajectories, even amidst broader economic challenges. Market opinion remained optimistic, as investors continued to see significant growth potential in the sector due to its pivotal role in the ongoing digital transformation.

The Materials sector faced significant challenges in June. Persistent inflation concerns, reduced demand, and economic uncertainties were the primary drivers of this decline. Higher input costs and lower-than-expected demand particularly impacted major chemical and construction material producers. Broader economic uncertainty also led to cautious investor sentiment, further weighing down the sector's performance.

Utilities also underperformed due to persistently high interest rates and inflation. Higher interest rates increased the cost of borrowing, negatively impacting capital-intensive utilities companies that rely on debt to finance their operations and infrastructure projects. Additionally, inflationary pressures elevated operating costs, further squeezing profit margins.

PORTFOLIO COMMENTARY

The Ellerston Global Mid Small Cap Fund (Fund) declined 0.67% net during the month compared to the MSCI World Mid Cap (AUD) Index which was down by 1.97% over the same period. The stronger Aussie dollar was a material drag on returns due to the unhedged nature of the portfolio.

The portfolio's top three contributors GFL Environmental, Advantest and Iron Mountain added 230bps to performance while Cellnex Telecom, Sig Group and Option Care Health detracted 119 bps during the month.

GFL Environmental (+1.48%) is the fourth largest diversified environmental services company in North America, providing a comprehensive line of solid waste management, liquid waste management and soil remediation service in Canada and in more than half of the U.S. states. GFL was upgraded by a significant brokerage based on its strategic investments and M&A activities, which are expected to expand margins and double free cash flow over the next three years. There was also increasing speculation of a potential asset sale regarding its Environmental Services business which would significantly deleverage the company.

Advantest Corp (+0.44%) operates in the duopolistic System on Chip (SoC) testing market within the back-end supply chain of semiconductor production. It has a strong position within Android and high-performance computing which are leading these technology transitions. Advantest released its 2024 to 2026 Mid-/Long-term Management Policy in June, projecting revenue growth and efficiency improvements. The market reacted positively to this announcement, reflecting confidence in Advantest's strategic initiatives and growth potential, especially as this is predominately driven by the demand for AI chips.

Iron Mountain (+0.37%) is a global leader in information management services, offering digital transformation, data centres, secure records storage, information management, asset lifecycle management, secure destruction and art storage and logistics. Iron Mountain reported its first quarter results in May with stronger-than-expected earnings and robust earnings growth, driving positive sentiment and contributing to a strong stock performance. Iron Mountain is developing one of the only self-funded data center platforms which operates on a global scale – it is a beneficiary of the AI demand for data centers.

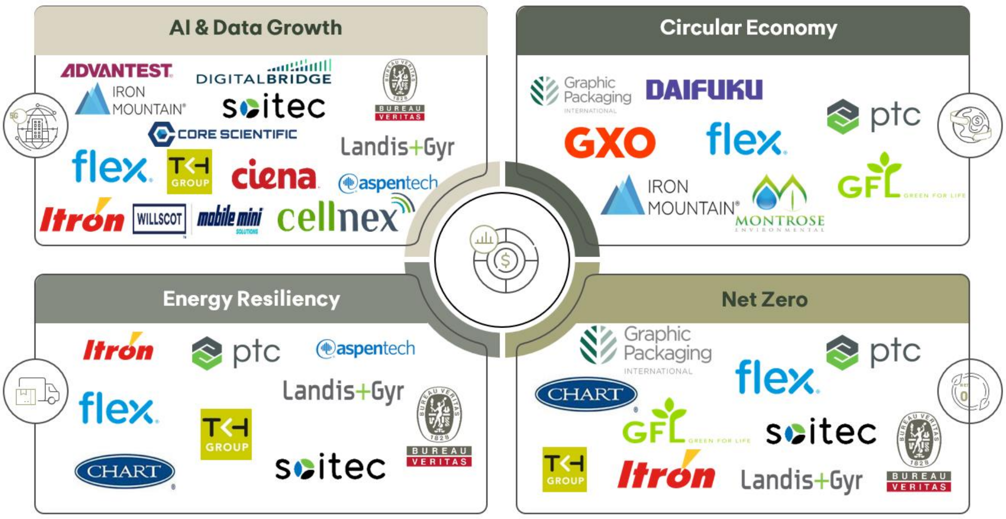
Cellnex Telecom (-0.53%) is a leading independent mobile tower company in Europe with over 130,000 sites across Spain, France, Italy, UK, Portugal, Poland and more. Cellnex was upgraded by a global independent investment banking advisory firm in June, citing the potential for increased cash returns over time following the sale of its Austrian unit. However, this positive news was offset by Criteria Caixa selling a stake in the company at a discount.

Option Care Health (-0.33%) is the largest independent provider of home and alternate site infusion services in the U.S., operating in all 50 states. Management reaffirmed their commitment to expanding their product portfolio and increasing market share at a global healthcare conference in June. Aside from this, there was no material company-specific news.

SIG Combibloc (-0.33%) operates in a global duopoly in the aseptic packaging market alongside market leader, Tetra Pak. With continued weakness in consumer end markets there is increasing concern around margins and organic growth in the business. As such, we decided to exit the position and concentrate exposure where we have higher conviction on earnings and subsequent share price performance.

During the month, we trimmed our position in GFL Environmental to take advantage of the c24% share price move (still remains our largest position), while also taking some profits in Radnet and Iron Mountain. Conversely, we added to Cellnex Telecom, Ciena and Aspen Technology to take advantage of short-term price weakness. A new shift during the month was a concerted move into strategic content plays as in a recent conference in the US, it was clear that first party, user generated, and unique content will become increasingly valuable as AI generated "spam" becomes more prolific. As such we initiated positions in TKO Group and Warner Music – both are must have content plays in sports entertainment and music listening respectively. With the proliferation of AI data center spending, there is growing concern around the availability of power to operate these facilities. We already have positions in electricity resilience plays such as AspenTech, Itron and Landis+Gyr and have added Core Scientific which controls 1.2GW of power, of which a material portion can be repurposed to power AI data infrastructure. We funded the positions by exiting SIG Combibloc and Nextracker – SIG due to growth and margin concerns and Nextracker due to reaching full valuation.

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



Source: Ellerston Capital

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

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

Regulatory Guide (RG240) Fund Disclosure Benchmark – Periodic Reporting (monthly)

- **Net Asset Value of the Fund and Redemption Price of Units**

Please refer to details on page one.

- **Any changes to key service providers including any change in related party status.**

There have been no changes to key service providers, including any change in related party status.

- **Net returns after fees, costs and relevant taxes**

Please refer to details on page one.

- **Any material changes to the Fund's risk profile and strategy**

There have been no changes to the Fund's risk profile and strategy.

- **Any material changes related to the primary investment personnel responsible for managing the Fund.**

There have been no changes to the primary investment personnel responsible for managing the Fund.

Contact Us

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Find out more:

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

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