Ellerston Asia Growth Fund (Hedge Fund)

Ellerston Capital

Monthly Report as at 30 September 2024

APIR Code: ECL1411AU | ARSN 626 690 686

Portfolio of 20-50 Asian Companies built through a distinctive high conviction and benchmark independent investment approach.

Focus on high quality companies with superior growth characteristics, sustainable earnings, and quality management.

Aims to outperform the Benchmark with a focus on capital growth and downside protection.

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	Since Inception (p.a.)^^
Net^	6.7%	4.1%	11.2%	19.7%	13.4%
Benchmark*	5.8%	5.4%	9.5%	17.3%	11.2%
Alpha	0.9%	-1.3%	1.7%	2.4%	2.2%

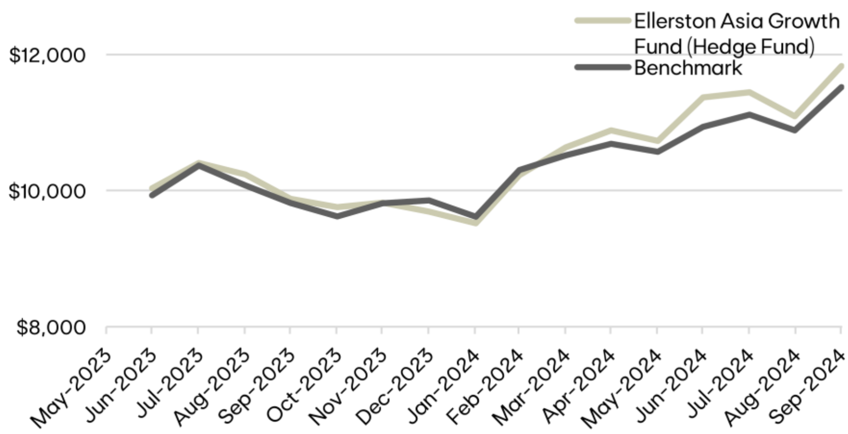
^ The net return figure is calculated after fees & expenses, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance.
** MSCI Asia Ex Japan (non-accumulation) Index in AUD.*
^^ Inception Date is 01/06/2023. The Ellerston Asia Growth Fund (Hedge Fund) was formerly known as the Ellerston Asia Growth Fund, with a strategy inception date of 04/01/2017. The performance was reset following a restructure of the fund into an exchange traded managed fund which took effect on 01/06/2023.

Key Information

Investment Objective	To outperform the Benchmark on a net of fees basis, with a focus on capital growth and downside protection.
Benchmark	MSCI Asia Ex Japan (non-accumulation) Index in AUD.
Liquidity	Daily
Target Number of Holdings	20-50
Number of Holdings at Month End	49
Minimum Investment for Applications Direct with Unit Registry[1]	Initial investment - $10,000
Distribution Frequency	Half-Yearly (where available)
Management Fee	0.75% p.a.
Performance Fee[2]	10%
Buy/Sell Spread[3]	0.25% / 0.25%
Unit Prices	Application – $7.1655 Net Asset Value – $7.1476 Redemption – $7.1297
Fund Size	$ 38,826,738.56

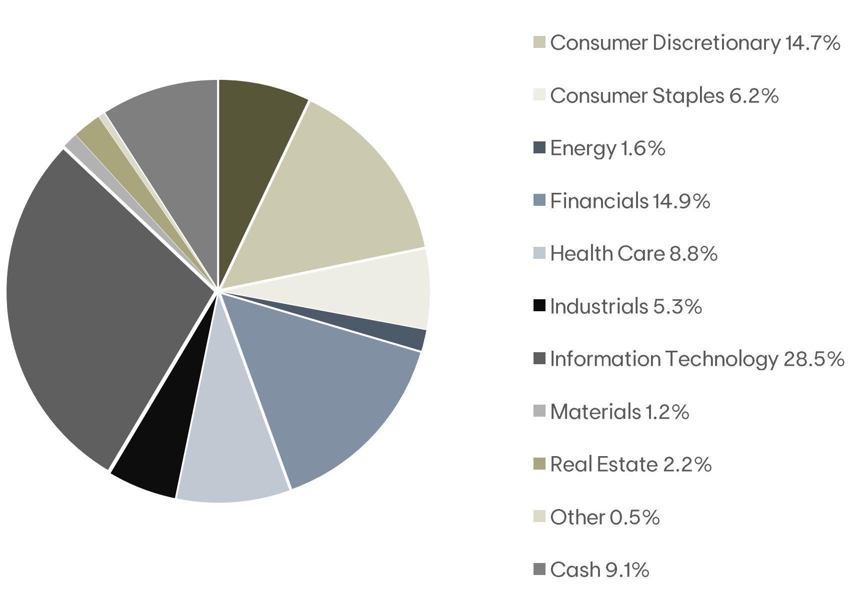
[1] Minimum number of units required for purchases made via the ASX will be dependent on each stockbroker.
[2] Of the investment return above the Benchmark after recovering any underperformance in past periods.
[3] Applicable only to investors buying and selling directly with the manager.

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.

Sector Allocation



Geographic Allocation

Source: Ellerston Capital.

Top Holdings

Company	Sector	Portfolio Weight	Benchmark Weight
Taiwan Semiconductor Manufacturing Company Limited	Information Technology	11.3%	10.2%
Tencent Holdings Limited	Communication Services	7.1%	5.2%
Samsung Electronics Co., Ltd.	Information Technology	5.8%	3.1%
Alibaba Group Holding Limited	Consumer Discretionary	3.4%	3.0%
ICICI Bank Limited	Financials	3.3%	1.1%
Wuliangye Yibin Co., Ltd. Class A	Consumer Staples	2.9%	0.1%
Tokyo Electron Limited	Information Technology	2.5%	0.0%
Hong Kong Exchanges and Clearing Limited	Financials	2.5%	0.7%
AIA Group Limited	Financials	2.4%	1.4%
DBS Group Holdings Ltd	Financials	2.3%	0.8%

Source: Ellerston Capital.

MARKET COMMENTARY

The Ellerston Asia Growth Fund (Hedge Fund) (EAFZ) was up by 6.7% (net) in September, compared to the MSCI Asia ex Japan (non-accumulation) (AUD) (MXASJ) Index, which was up by 5.8%.

Market Summary

Global equity markets demonstrated resilience in September 2024, with major indices posting gains across regions. The S&P 500 (net) advanced 2.1%, bringing its year-to-date return to 21.7%, while the Dow Jones Industrial Average rose 1.9% to reach new all-time highs. European markets also performed well, with the Stoxx Europe 50 Index hitting a record high and posting a 14.6% year-to-date return. The positive market performance was largely driven by central bank actions, with the U.S. Federal Reserve cutting interest rates by 50 basis points and the European Central Bank reducing its benchmark rate by 25 basis points. These moves signalled the beginning of an easing cycle and boosted investor confidence. Sector-wise, consumer discretionary, materials, and utilities outperformed globally, while energy and healthcare stocks lagged in the U.S. market. Despite historical trends of poor performance in September, investor sentiment remained optimistic, with the VIX index staying relatively low. As markets enter the final quarter of 2024, they appear poised for continued growth, although potential economic slowdowns and geopolitical risks remain factors to watch.

Asia outperformed the global market in September, with the MSCI Asia ex-Japan Index (net) up 7.1% in local currency, ahead of the MSCI World Index, which gained 1.5%. However, performance within the index was mixed. China and Hong Kong markets surged, dramatically outperforming global equities, while Japan, Korea, and India underperformed. China's SSE rose 19.2%, and the Hang Seng gained 18.7% (driven by property-related names), followed by India's SENSEX, which was up 2.4%. In contrast, Japan's Nikkei, still affected by the unwinding of the carry trade, and Korea's KOSPI were both negative at -1.4% and -3.0%, respectively.

In late September, China suddenly unveiled new supportive measures amid persistent economic pressures, including cuts to interest rates, the Reserve Requirement Ratio for banks, mortgage rates on existing loans, and the down payment requirement for second mortgages. A few days later, Beijing held its first-ever Politburo economic meeting in September (a month earlier than usual), signalling an even more supportive and coordinated policy approach, including "counter-cyclical fiscal policy" that still needs to be formalized. It appears that President Xi is no longer willing to tolerate further economic deceleration in the name of deleveraging. These events drove the largest weekly rally in the Chinese stock market in a decade. While it is too early to call it a China's "whatever it takes moment," it suggests that Chinese policymakers are shifting their approach to deflation, forming a market bottom as any further economic deterioration will likely lead to an even stronger policy response.

<u>A case study of the Chinese stock market</u>

The Chinese stock market is known for its volatility but also for rewarding patient, long-term investors. Prior to COVID-19, the annualized return over 15 years was approximately 9.2% per annum, making it one of the best-performing markets globally. The underperformance observed over a 20-year horizon is almost entirely attributable to the past three years, during which COVID-19 and geopolitical tensions have impacted the market.

This recent period is somewhat reminiscent of 2000-2009, when China faced several challenges, including deflationary pressure (2000-2002), the SARS outbreak (2002-2004), and heightened tensions with Taiwan (2000-2008). During that time, the MSCI China Index declined by approximately 9.0% per annum over the first five years but subsequently delivered a remarkable 17.5% per annum return after the market bottomed out. Some might argue that China's entry into the WTO in 2001 was the rerating catalyst—a situation unlikely to be repeated now. However, it's important to note that the MSCI China Index continued falling for another four years after 2001. The true rerating catalyst emerged in 2005 when China introduced the split-share structure reform, aligning the interests of government and private owners. Government agents of state-owned enterprises (SOEs) began to be rewarded or punished based on their firm's market performance.

This is similar to what is happening now with the latest round of SOE reforms. We are seeing many SOE companies transferring ownership from government agencies (typically state-owned assets supervision and administration commissions) to government-controlled investment platforms, where shareholder returns and share price performance are the key performance indicators. As policymakers begin to act, we believe the Chinese market will start generating superior returns as economic fundamentals improve.

MSCI China performance (2020-2024 vs. 2000-2009)

Source: Factset

PERFORMANCE SUMMARY

At the country level, **China** was the largest contributor to alpha, while **Japan** and **South Korea** were the relative underperformers. Despite being underweight in China for most of the year, we significantly increased our exposure (from Underweight to Overweight) just days before the market rally. While we didn't know what would happen later in the month, we were initially surprised by the resilience of the Hong Kong market in the early part of September, despite waves of bad news (i.e., both industrial output and retail sales slowing more than expected). We asked ourselves, "How bad can it get from here?" We concluded that China would need more stimulus and needed to act quickly. Once that stimulus plan was announced, shorts would need to be covered. This tactical call worked out far better than we anticipated, as the policy pivot was extremely well-received by the market.

On the sector level, **Healthcare** made the biggest contributions to relative performance, whereas **Information Technology** and **Consumer Discretionary** were the relative underperformers. The negative surprise to us was the continued weakness of global technology sector for which the correction last longer than expected.

At a company level, **KE Holdings**, **Wuliangye Yibin** and **Hong Kong Exchanges & Clearing** were the largest contributors to alpha, adding a combined 136 bps. Meanwhile, **SK Hynix**, **Samsung Electronics**, and **not owing PDD** detracted 141 bps from alpha during the month.

The China "pivot moment" is a significant re-rating catalyst for sectors severely impacted by the persistent economic downturn, particularly property and consumer. Two stocks in our portfolio, **KE Holding** and **Wuliangye Yibin**, benefitted the most from this theme. **KE Holding** operates the largest online-offline integrated home transaction platform in China by gross transaction value (GTV). **Wuliangye Yibin** is one of the most premium liquor brands in China, known for its unique aroma and taste. Its classic bottle, "Pu Wu", is selling for $284 at Dan Murphy's. Wuliangye is a type of "nongxiang" (i.e., strong aroma) Chinese liquor that is sweet-tasting and mellow. The 16 ancient fermentation pits, built in the Ming Dynasty and still in use today, are considered "living cultural relics" and are a key factor behind Wuliangye's inimitable quality. Premium liquor brands such as Wuliangye and Moutai are among the best China growth assets, typically the first to respond to a broader market rally. **Hong Kong Exchanges & Clearing**, which operates Hong Kong's stock and futures exchange, also benefitted from the strong market rally. **Samsung Electronics** and **SK Hynix** were the detractors of the month. **Samsung Electronics** is the global leader in smartphones, home appliances, display panels, and the production of memory chips. **SK Hynix** is a key supplier of high-end memory (including high bandwidth memory, which is essential for generative AI development) chips to server/data centre customers. Both stocks were affected by a broker downgrade, citing a belief that the memory cycle had peaked. We are of the view that the current valuation level has already priced in a recession scenario, however, given the cautious near-term outlook, we reduced our sector exposure from over-weight to equal-weight.

The Fund had an active month, responding to unprecedented volatility in the Chinese market. In China, we introduced **Hangzhou Tigermed**, **Shenzhen Mindray Bio-Medical Electronics** and **KE Holding** (which subsequently became the best performer of the month) and exited **MINISO** and **Yangtze Power**. Hangzhou Tigermed, a leading contract research organization (CRO) in China, benefits from the structural trend of outsourcing clinical services. We believe the company has passed its trough, with a stronger-than-expected 2H turnaround likely. The company is also one of the biggest investors in China's CRO space and hence highly leveraged to a broader market rally. Shenzhen Mindray Bio-Medical Electronics is one of China's largest medical device manufacturers, with a growing global presence and a focus on AI and workflow integration solutions. We rotated out of Yangtze Power, China's largest hydropower company, as we expect defensive stocks to underperform in a market rally. Yangtze Power has been one of the best performers for the Fund in the past six months. **MINISO** is a Chinese retailer and variety store chain that specializes in household and consumer goods. While we still like MINISO's structural growth opportunities, its 1H results, with margins below expectations despite strong revenue growth, were disappointing. Our main concern was management's optimistic outlook in a challenging macro environment, which could lead to a misstep in the company's growth strategy. The stock fell 40% after our exit, following an acquisition deal that was poorly received by the market. We also initiated a position in I**ndofood**, a market leader in Indonesia instant noodles market, and **Samsung Biologics**, the global No.1 CDMO (contract development manufacturing organisation) in terms of capacity.

As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

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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