Ellerston Fixed Income Target Return Fund

Monthly Report as at 30 November 2024

APIR Code: ECL4489AU

Ellerston Capital

Fixed Income Target Return strategy with strong focus on generating returns throughout the market cycle.

Targets a low correlation to growth assets (and credit returns) though the cycle, but aims to increase protection during times of market weakness.

Dynamic risk allocation framework balances trade-offs between alpha sources and defensiveness.
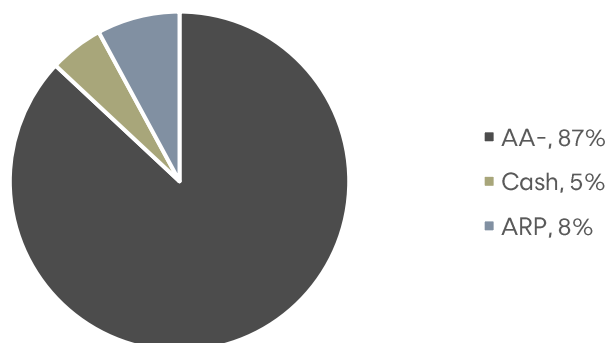
Performance Summary

Performance	1 Month	Since Inception ^^
Gross	0.24%	0.09%
Net ^	0.20%	-0.02%
Benchmark*	0.28%	0.86%
Alpha **	-0.08%	-0.88%

^ The net return figure is calculated after fees & expenses, assuming all distributions are reinvested. Past performance is not a reliable indication of future performance.
* Benchmark: RBA 6m TD Index. ^^Inception date 30 August 2024 **Alpha is return generated from Net returns comparatively to the Benchmark
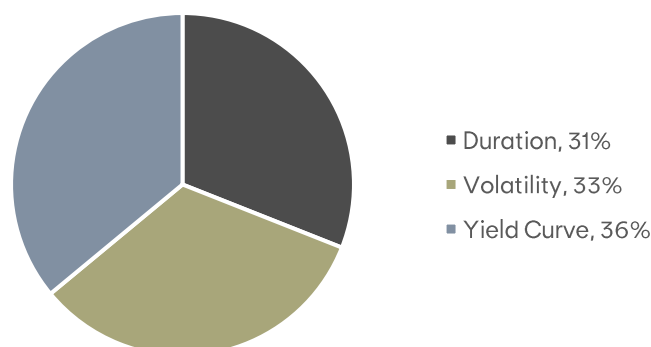
Key Information

Portfolio Manager(s)	Vimal Gor & Thomas Ciszewski
Investment Objective	The investment objective of the Fund is to generate a 2.5% (net) return over the Reserve Bank of Australia (RBA) 6m Term Deposit (TD) Index over the medium to long term.
Benchmark	RBA 6m TD Index
Liquidity	Daily
Minimum Investment	Initial investment – $50,000 Additional investment – $10,000
Distribution Frequency	Aims to distribute quarterly.
Management Fee	0.45% p.a. of the Net Asset Value of the relevant class of the Fund.
Buy/Sell Spread	0.10%/0.10%

Portfolio Characteristics

Yield to Maturity/Call	4.57%
Running Yield	5.22%
Modified Duration	0.19
Weighted Average Maturity (Years)	2.99
S&P Credit Rating	AA-
Number of Securities	12

Source: Ellerston Capital.

Fund Positioning of Portfolio

- AA-, 87%
- Cash, 5%
- ARP, 8%

Source: Ellerston Capital.

Fund Positioning of ARP Overlays

- Duration, 31%
- Volatility, 33%
- Yield Curve, 36%

Source: Ellerston Capital.

COMMENTARY

Portfolio changes

The Ellerston Fixed Income Target Return Fund base portfolio is comprised of Australian major bank FRN's maturing in 2-5 years, rated AA-. The base portfolio was held constant with no changes over November. The base portfolio current yield increased slightly to ~5.22% (from ~5.20%) toward the end of the month after new AUD issuance pushed credit spreads slightly wider.

The quantitative fixed income investment strategies were reduced before the US election to take advantage of favourable pricing. The risk premia portfolio is designed to manage the portfolio's duration risk, rate movements in the easing cycle, movements across the yield curve and hedge against sudden changes in central bank policy through long volatility strategies.

Interest Rate movements

The US Federal Reserve cut interest rates as expected at their November policy meeting. However, 1- and 2-year US yields still moved higher over the month. Heading into the 2024 US presidential election, financial and betting markets were predicting a Trump victory even though the polls were showing the race as tied. The election event risk of an unpredictable result was unlike 2016. Markets were prepared for a Trump victory and the main source of market concern was a contested or unknown outcome that would provide uncertainty for weeks as in 2000. Trump's clear victory was a catalyst for growth assets to continue their multi-year rally. Bonds continued their October selloff on the premise that Trump 2.0 regime policies would be inflationary and slow the speed of the Fed's future rate cuts.

The 10-year US Treasury peaked at a ~4.49% yield in mid-November and then fell back to ~4.22% after Trump's nominated economic team was viewed positively, and in particular, as cognizant of the inflationary consequences of his proposed policies. Economic data showed that growth was at the Fed's policy goal and the probability of an additional Fed cut in December was above 50% by month end.

The changes in US implied policy rates over November are shown below.
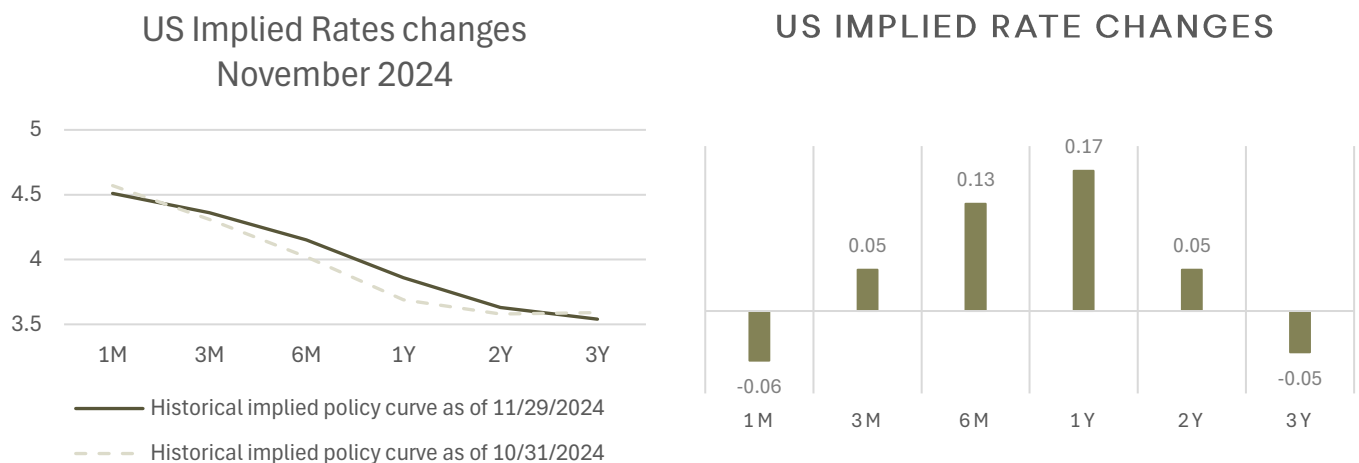
Source: Bloomberg, Ellerston Capital

Rate Curve Movements

The US rate curve experienced a bull flattening during November: 10year US Treasury yields declined over the month while 2year yields remained relatively steady, causing the spread between them (10year rate minus 2year rate) to narrow from approximately 17 bps to 1 bp. Yields across the curve remain well below the highs reached in the first half of 2024, prior to the onset of central bank easing.
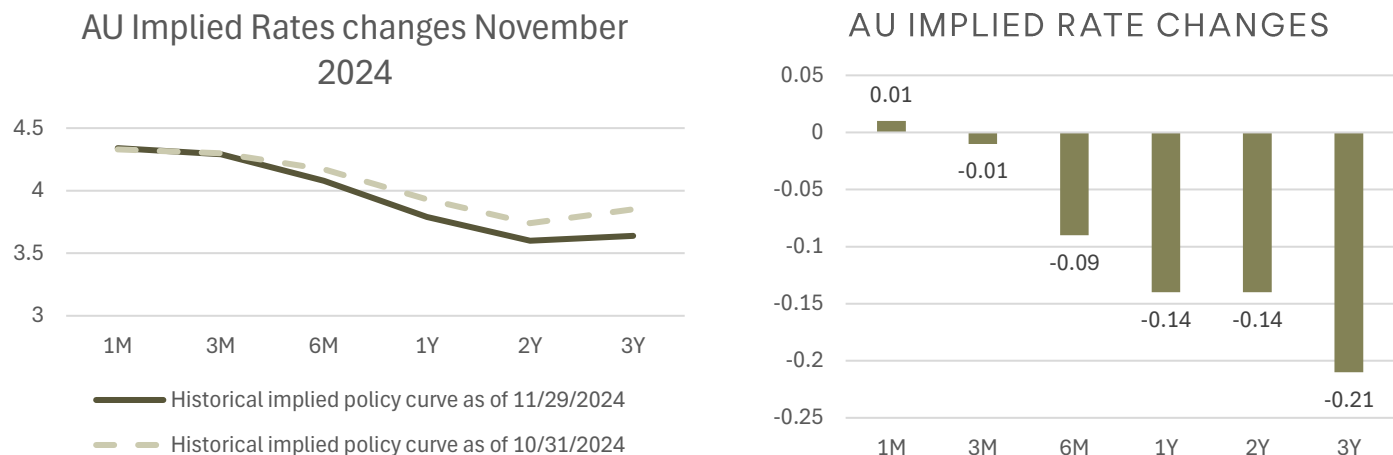
Forward Policy Outlook

The key question for future rate policy is whether the new Trump administration's tariffs and policies will prompt the Fed to not only pause rate cuts but potentially reverse course and hike rates to combat inflation. However, this scenario is viewed as unlikely because it would require substantial inflationary policy measures, which may not align with the goals of Trump and his economic team.

It is more likely that the Fed will maintain its easing trajectory, with an additional 100 bps of cuts anticipated between now and the end of 2025.

Australia

Recent Australian economic data indicates inflation is a secondary concern to the slowing jobs market. The November releases for unemployment and CPI were weaker than expected and the unemployment rate is now expected to increase when released in December.   The RBA is thus expected to start its easing cycle in the first half of 2025. Below are the changes in Australia's implied rates surface over the month.

AU Implied Rates changes November 2024

Legend:
— Historical implied policy curve as of 11/29/2024
- - - Historical implied policy curve as of 10/31/2024

AU IMPLIED RATE CHANGES

	1M	3M	6M	1Y	2Y	3Y
Value	0.01	-0.01	-0.09	-0.14	-0.14	-0.21

Source: Bloomberg, Ellerston Capital

Portfolio Profile

Policy meetings by the Fed, ECB, and BoC are all expected to deliver cuts in December. The RBA and other central banks are not expected to take action but will indicate the pace of their 2025 cuts. The rate cutting cycle is expected to remain steady in the next quarter and volatility to remain relatively subdued in the near term.

The investment team believes positioning the porfolio in high quality Australian IG bank FRNs offers the highest risk adjusted returns. We also prefer the high liquidity profile of these bonds versus lower ranking assets.

The curve steepening profile in G3 rates has been maintained through alternative risk premia total return swaps. These strategies are set up to perform positively in an economic downturn or if rate curves normalise with term premium priced into the curve. The overall portfolio positioning is defensive and in line with the EFIT mandate.

Find out more:

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 registry, Automic Group on 1300 101 595 or ellerstonfunds@automicgroup.com.au.

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