

Ellerston Fixed Income Target Return Fund

Monthly Report as at 31 December 2024

APIR Code: ECL4489AU



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

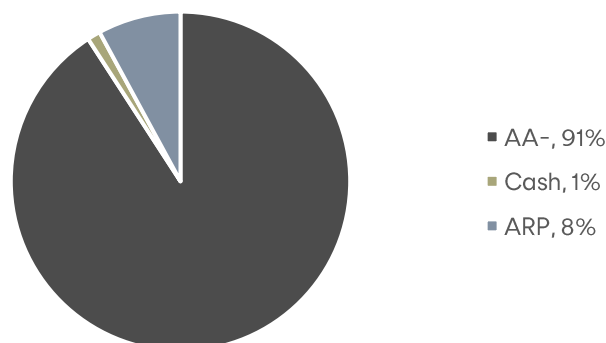
Performance	1 Month	3 Months	Since Inception ^^
Gross	0.45%	0.20%	0.54%
Net ^	0.41%	0.08%	0.38%
Benchmark*	0.29%	0.87%	1.16%
Alpha **	0.12%	-0.79%	-0.78%

^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

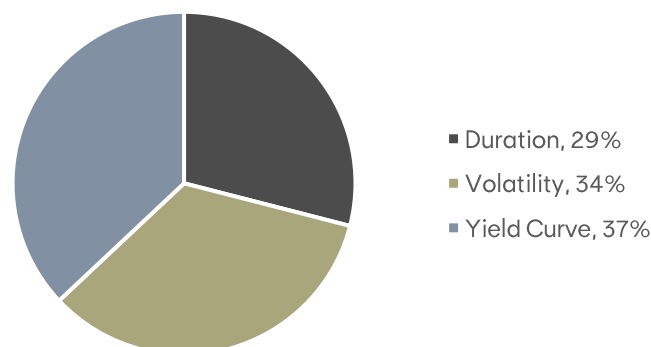
Portfolio Manager(s)	Vimal Gor & Thomas Ciszewski
Investment Objective	The investment objective of the Fund is to generate a 2.5% (net) return over the Reserve Bank of Australia (RBA) 6m Term Deposit (TD) Index over the medium to long term.
Benchmark	RBA 6m TD Index
Liquidity	Daily
Minimum Investment	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%

Fund Positioning of Portfolio



Source: Ellerston Capital.

Fund Positioning of ARP Overlays



Source: Ellerston Capital.

Portfolio Characteristics

Yield to Maturity/Call	4.50%
Running Yield	5.23%
Modified Duration	0.20
Weighted Average Maturity (Years)	2.99
S&P Credit Rating	AA-
Number of Securities	12

Source: Ellerston Capital.

COMMENTARY

Portfolio changes

The EFIT base portfolio is comprised of Australian major bank FRNs maturing in 2–5 years, rated AA-. The base portfolio added to a FRN position in December but no other adjustments were made. The base portfolio current yield is ~5.23%.

The quantitative fixed income investment strategies were held constant over December. 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 U.S. Federal Reserve cut interest rates again, as expected, at the December policy meeting, reducing the benchmark interest rate by 100 basis points over the last four months of 2024. Hawkish commentary by Chairman Powell following the decision indicated that the Fed would slow the pace of further cuts in 2025, leading the market to price in just two additional cuts for next year. At the end of September, the cutting cycle was projected to continue until the Federal funds rate reached 2.75%; however, by the end of December, the market had reduced easing expectations and was pricing in a terminal rate of 3.75%.

Asset prices surged following President Trump's election victory, driven by his perceived pro-growth policies, which were expected to extend the multi-year rally in growth assets. December saw a pause in some of the bullish momentum, with the MSCI World Equity Index, gold and digital assets posting modest declines for the month. The potentially inflationary consequences of Trump's policies pushed 10-year Treasury yields up by 40 basis points over the month. Since September, 10-year yields have risen by 100 basis points, returning to the highest levels seen since early 2024 before there was clarity on when the rate-easing cycle would begin. Below is a chart of 2-year and 10-year yields over 2024.



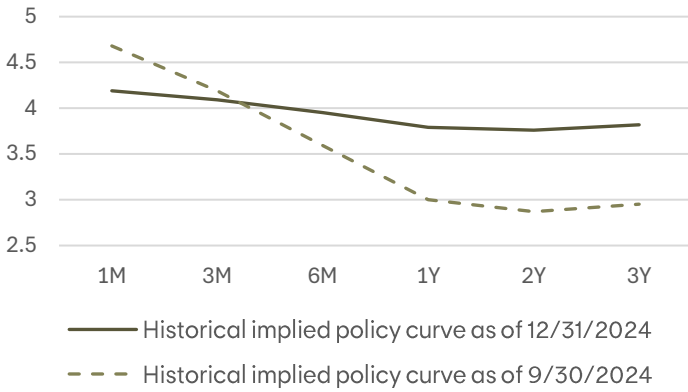
Source: Bloomberg, Ellerstion Capital

Economic data will remain crucial for pending interest rate decisions in 2025Q1. If inflation remains contained but the unemployment rate starts to climb, the Fed may resume cuts at a more aggressive pace. The benchmark rate could return to approximately 3% under both hard- and soft-landing scenarios.

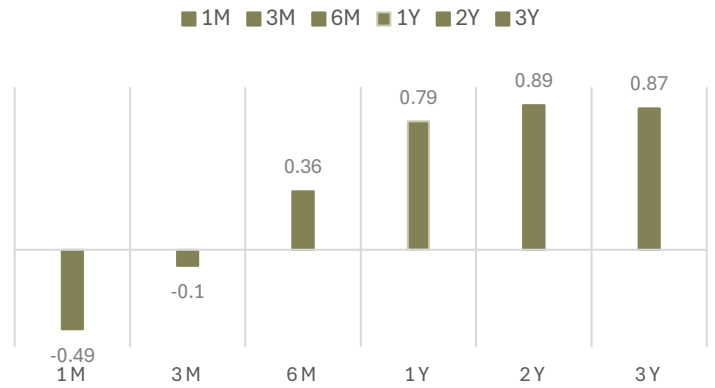
The new administration's fiscal policy goals face narrow majorities in Congress, complicating the passage of legislation. During Trump's first term, many of his policies were derailed by his own Republican Party, raising questions about whether his legislative agenda will be more successful this time. Additionally, some market strategists argue that his tariff rhetoric may not align with actual implementation or may not be as inflationary as some economists have forecast. As a result, the data-dependent Fed may cut rates closer to the levels estimated in September 2024 rather than those currently priced into the U.S. yield curve.

The changes in US implied policy rates between September and December are shown below.

US Implied Rates changes Sep-Dec 2024



US IMPLIED RATE CHANGES



Source: Bloomberg, Ellerstion Capital

Yield Curve Movements

The U.S. yield curve experienced bear steepening in December: yields across the U.S. Treasury curve rose, but 10-year Treasury yields increased more than 2-year yields. This caused the spread between the two (10-year rate minus 2-year rate) to widen from approximately 2 basis points to 32 basis points. The increase in yields across tenors from 1 to 30 years has reintroduced term premiums into the U.S. yield curve. The bond selloff, occurring during an easing cycle, can largely be attributed to the "normalization" of the yield curve shape with the return of some term premium.

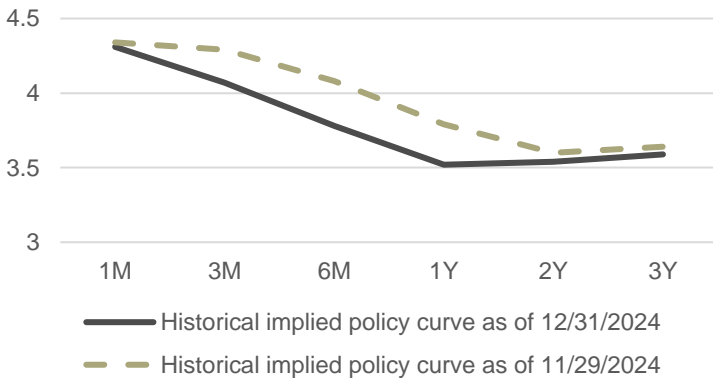
Forward Policy Outlook

The first Federal Open Market Committee (FOMC) meeting of 2025 is scheduled for the end of January, with no changes currently priced into the yield curve or expected by the market. Only a 40% chance of a rate cut is currently priced in for the March 2025 meeting.

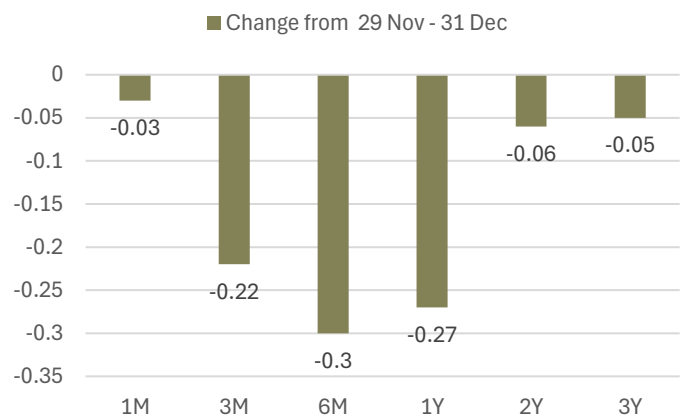
Australia

Australian economic data continues to indicate inflation is slowing. Markets are now pricing in two rate cuts by the RBA in the first half of 2025 with the easing cycle commencing at the February policy meeting. Below are the changes in Australia's implied rates surface over the month.

AU Implied Rates changes December 2024



AU IMPLIED RATE CHANGES



Source: Bloomberg, Ellerstion Capital

Portfolio Profile

Central banks around the globe are expected to continue the easing cycle in 2025. However, the depth of the easing cycle and the ability of governments to fund expansionary fiscal programs are being scrutinized by market participants. The investment team believes that rates markets will remain range-bound in the first half of 2025, with short-term rates likely to ease more than what is currently priced into rate curves. Additionally, we anticipate that 5- to 30-year yields will remain relatively sticky, with term premiums in yield curves increasing over the year.

The investment team believes that positioning the portfolio in high-quality Australian investment-grade (IG) bank floating rate notes (FRNs) offers the highest risk-adjusted returns. We also value the high liquidity profile of these bonds compared to lower-ranking assets.

The curve steepening profile in G3 rates has been maintained through alternative risk premia total return swaps. These strategies are designed to perform positively in the event of an economic downturn or if rate curves continue to normalize with term premiums being priced in. The overall portfolio positioning remains defensive and aligned with the EFIT mandate.

Find out more:

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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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