Ellerston Fixed Income Target Return Fund

- ✓ All weather Fixed Income.
- ✓ 6-months TDs + 2.5% net target.
- ✓ Income focused. Consistency.
- ✓ Low and often negative correlation to credit & high yield.
- ✓ Limited duration. Not reliant on leverage.
- ✓ High capacity and daily liquidity.

Ellerston's Fixed Income Target Return

- The Ellerston Fixed Income Target Return Strategy (EFIT or Fund) launched in September 2024. The fund is designed to address a clear gap in the market and to navigate the structural shifts in the fixed income landscape that have affected traditional alpha generation. We see a substantial opportunity to capitalise on these changes with a strategy that is highly liquid, diversified, and offers low volatility.
- EFIT focuses on a diversified range of 'accrual' or income-based returns, rather than relying on credit beta or leveraged alpha strategies. The portfolio is classified into three buckets: a Base Portfolio of high-quality bonds (50-100%), Alternative Risk Premia (0-50%), and Hedging & Alpha positioning (0-30%).
- This strategy is designed to complement, not replace, existing allocations to global credit and private debt. EFIT offers daily liquidity and targets a net return of 2.5% above 6-month term deposits over rolling 3-year periods, translating to approximately 6-8% today. The approach is intentionally structured to have minimal correlation with other risk markets, such as high yield and equities, while also not relying solely on duration to manage risk.
- EFIT is an all-weather fixed income portfolio, based on a mandate our team previously managed for Australia's Future Fund.

Adapting to Structural Changes in Fixed Interest Markets

- Over the last 5 years global and Australian fixed interest markets have undergone significant – and what we consider to be structural – changes, ultimately requiring different approaches when investing in the asset class. Alpha in this market has largely been arbitraged away or has become increasingly difficult to access, with returns increasingly focused on relative-value opportunities which are dependent on extreme leverage.
- This decline in traditional alpha opportunities partly explains the substantial growth in private debt and the move towards riskier global high yield. Some of these structural changes, both positive and negative, are summarised below:

X The Rise of High-Frequency Trading Funds:

Over the past five years, macro, high-frequency trading and pod-based groups like Two Sigma, BlueCrest, Millennium, and Point72 have significantly infiltrated global fixed income markets. These groups have been highly effective in arbitraging and capturing alpha.

X Higher Interest Rates:

While Central Banks are easing, rates remain at more than decade highs. This raises the cost of borrowing and impacts traditional fixed interest alpha strategies like relative value, which depend on high levels of gross leverage.

X Reduction in Prime Broker Facilities:

The collapse of the Archegos Hedge Fund resulted in a collective loss of around $US10 billion for prime brokers. Consequently, available credit from prime brokers has decreased, and the cost of accessing these lines has risen significantly. This has further reduced access to funding or leverage.

✓ Access to Risk Premia:

Banks' balance sheets today are much different than pre-GFC. Globally banks have shifted from holding and warehousing assets to a more transactional model. This meant rapid growth in areas which help them to manage risk such as Alternative Risk Premia, making them more accessible and cost-effective.

For more information on the Ellerston Fixed Income Target Return Fund, please contact our Investor Relations Team.

Investor Relations
T: +61 9021 7701
E: info@ellerstoncapital.com

www.ellerstoncapital.com
Level 11, 179 Elizabeth Street,
Sydney NSW 2000

Simple, Liquid, & Meeting a Genuine Market Need

- EFIT is designed to be simple and straightforward, with 40-60 expected underlying positions. Leverage, which is a typical characteristic of active fixed interest strategies, is low at approximately 2x (compared to up to 30x-50x for strategies targeting alpha via relative value), and portfolio turnover is expected to be significantly lower.
- The three portfolio buckets are summarised below:

Step 1. Base Portfolio: 50-100%*
Target Return: 4-6%

The Base Portfolio is the core engine of the strategy, focusing on short-dated government bonds and liquid investment-grade credit, primarily from the big four banks.

This allocation includes both fixed and floating bonds, with its composition adjusted based on the interest rate / monetary policy cycle.

The portfolio is expected to be infrequently traded, meaning regular and consistent accrual income will be the primary driver of fund returns.

The number of individual positions in the base portfolio is anticipated to be between 10 and 25.

Example: CBA Senior Fixed Bonds and NAB Floating Rate Notes.

Step 3. Hedging & Alpha: 0-30%*
Target Return: 0-2%.

After constructing the Base Portfolio and Alternative Risk Premia portfolio, the combined allocation is analysed by Premialabs, a third-party market leading risk system. Premialabs provides a comprehensive view of every position in the portfolio and helps identify any unintended themes, positions, or risks.

While hedging and alpha is expected to generate positive returns, the overall portfolio return will primarily rely on accrual from the Base and Alternative Risk Premia portfolios.

Example: The portfolio may have a residual short position in short-term interest rates in the US, which would be hedged/offset if the team's risk regime model and view indicates a positive duration stance.

*Percentages are of total portfolio targeted return and risk

Step 2. Alternative Risk Premia: 0-50%*
Target Return: 0-3%.

Alternative Risk Premia (ARP) is captured through Quantitative Investment Strategies (QIS), providing an additional way to generate accrual income for the portfolio.

QIS allows any 'view' to be efficiently and cost-effectively packaged, covering fixed income factors such as yield-curve, cross-market, momentum, carry, volatility, and credit-index themes.

The objective is to identify structural risk premiums we believe exist, then identify how investment banks structure and execute them, and at what cost. QIS positions can be purchased off the shelf or customised.

The objective is to have 3-5 unrelated factors at play at any one point in time, with 3-4 individual QIS positions representing each factor.

Positions are taken at the index/country level only with no single name exposure. All positions are highly liquid and have set exit cost agreed before opening. All positions are margined daily to minimise counterparty risk.

Example: The team may want to opportunistically invest in sovereign emerging market credit in a period where the US Dollar is expected to depreciate. Typically, when the USD weakens, emerging market currencies and bonds tend to outperform. One risk premia could be an exposure to investment grade emerging market bonds, and this could be expressed through several QIS positions.

EFIT Investment Team

- EFIT is managed by Vimal Gor, the former Head of Pendal Group's Bond, Income & Defensive Strategy Boutique, where he oversaw c.$22 billion. He is joined by Thomas Cizewski (Portfolio Manager) and Ainslie Yuen (Data Scientist) both of whom previously worked with Vimal at Pendal and Trovio Group. The team is supported by the extensive resources at Ellerston, a firm managing over $3 billion in FUM, with more than 35 investment professionals and 30 back-office staff, including compliance, legal, and HR. Ellerston has a proud history of innovation in asset management, and we are excited to have Vimal leading the team, bringing his extensive and successful track record in fixed income investing.

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EFIT Summary

- EFIT has been designed to address a clear gap in the local market – capitalising on structural changes that will likely constrain alpha in traditional fixed interest – while complementing existing exposures to private debt and global credit. EFIT is capacity unconstrained, liquid, easy to explain, and offers an attractive return target of 6-month TDs + 2.5% (net). Importantly, the strategy is expected to show negligible or even negative correlation to other risk markets without having to rely soley on duration. Back-testing of the Core & QIS portfolio indicates minimal drawdowns, typically no greater than -3%, which compares favourably to the double-digit drawdowns seen in traditional bonds over the past five years, and this is before any contribution from the hedging and alpha overlay.

Fund Facts

APIR Code	ECL4489AU
Strategy Inception	September 2024
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 (Benchmark) over the medium to long term.
Benchmark	RBA 6m TD Index
Risk Objective	The Fund's expected volatility is 2–3% p.a. over a rolling 3yr period
Suggest Timeframe	At least three years
Liquidity	Daily
Minimum Initial Investment	AU$50,000
Management Fee	0.45% p.a. of the Net Asset Value of the relevant class of the Fund
Distributions	Aims to distribute Quarterly
Fund Structure	The Fund is an Australian domiciled unit trust and is not registered with ASIC as a managed investment scheme. The Fund may be registered as a managed investment scheme in the future at the discretion of Ellerston Capital.
Investment Universe	Fixed Income Securities (0–100%) Cash and Cash-like-Securities (0–100%) Fixed income securities include but are not limited to government, semi-government, investment grade corporate and short-term money market instruments. The Fund may also use listed and OTC Derivatives to gain access to the above investment exposures and these Derivatives may reference sub-investment grade issuers.

The Team

Vimal Gor
Portfolio Manager & Head of Fixed Income & Multi-Asset

Over 30 years of industry experience.

Thomas Ciszewski
Portfolio Manager

Over 28 years of industry experience.

Ainslie Yuen
Data Scientist

Over 18 years of industry experience.

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How To Invest

Whether you're a first-time investor or an investment professional, you can access Ellerston's investment expertise in the way that best suits your individual needs:

Direct Investment

You can invest directly with Ellerston as an investor or adviser. You can apply online or use our paper application.