Ellerston Fixed Income Target Return Fund – Class A Units

Ellerston Capital

Monthly Report as at 28 February 2025

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

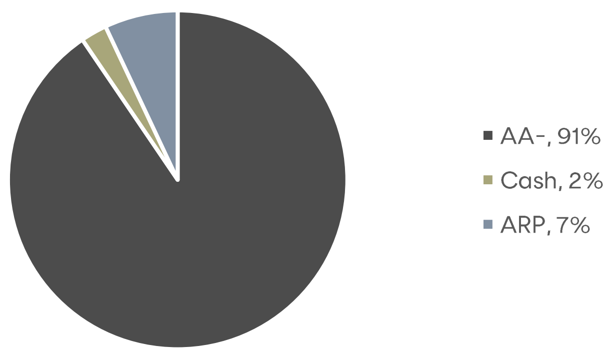
Performance	1 Month	3 Months	Since Inception ^^
Gross	0.10%	1.03%	1.12%
Net ^	0.06%	0.91%	0.88%
Benchmark*	0.26%	0.85%	1.72%
Alpha **	-0.20%	0.06%	-0.84%

^ 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

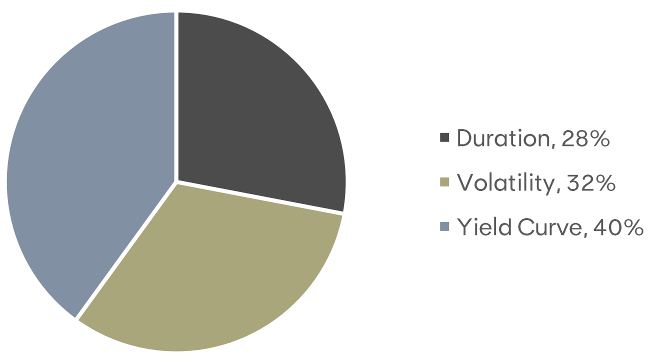
Portfolio Manager(s)	Vimal Gor & Thomas Ciszewski
Investment Objective	The investment objective of the Fund is to generate a 2.5% (net) return over the Reserve Bank of Australia (RBA) 6m Term Deposit (TD) Index over the medium to long term.
Benchmark	RBA 6m TD Index
Liquidity	Daily
Minimum Investment	Initial investment - $10,000 Additional investment - $5,000
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%
Class A Unit Prices & Fund Size	Application – 10.0122 Net Asset Value – 10.0022 Redemption –9.9922 Fund Size – $38,900,767.52

Fund Positioning of Portfolio



Source: Ellerston Capital.

Fund Positioning of ARP Overlays



Source: Ellerston Capital.

Portfolio Characteristics

Yield to Maturity/Call	4.36%
Running Yield	5.12%
Modified Duration	0.20
Weighted Average Maturity (Years)	2.84
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 was largely held constant in February. The base portfolio current yield is ~5.12%.

The quantitative fixed income investment strategies exposures were adjusted in February, largely in response to the changes in levels of the yield curve. 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

Before Trump's inauguration, the prevailing view was that his economic policies—centred on tariffs, tax cuts, and increased defence spending—would drive inflation higher and expand the deficit. Anticipating this, bond markets reacted sharply in early January, with 10-year and 30-year yields surging to their highest levels since 2023, signalling expectations of a brief and limited easing cycle. However, this spike was short-lived, as yields reversed course later in January and continued falling into February.

During the frantic first 45 days of the Trump administration, its immediate focus has been to halt government spending through the DOGE initiative, threaten tariffs against the U.S.'s closest allies and trading partners, and realign foreign policy toward a transactional approach. These moves have introduced the risk of a major fiscal shock, one that could drag the U.S. economy into a sharp slowdown and force the Federal Reserve into deeper rate cuts.

While public sector job cuts have dominated headlines, private sector layoffs are also mounting. Consumer sentiment is deteriorating, though partisan divisions remain stark. Treasury Secretary Scott Bessent has conceded that short-term economic pain is an unavoidable trade-off for the administration's broader goals—a smaller government, reduced spending, and lower taxes.

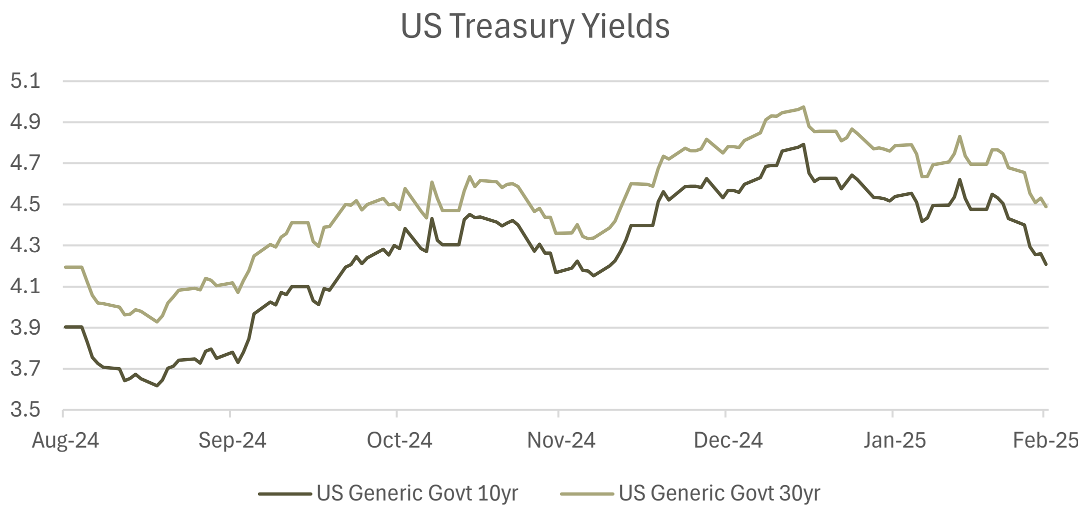
A key pillar of Trump's trade and tariff policy is repatriating manufacturing jobs, but even if successful, job growth will take time to materialise. In the meantime, rising unemployment and sinking consumer confidence are likely to weigh heavily on the economy, increasing the risk of a deeper slowdown.

Some strategists, including our investment team, are questioning whether the Trump administration is willing to tolerate a near-term recession to achieve its economic objectives. With unprecedented control over his party, Trump faces little risk of Republican resistance, making an economic slowdown—or even a recession—a potential tool to justify aggressive Federal Reserve intervention.

Using political power to force such dramatic structural changes is rare, but Secretary Bessent has already hinted at targeting lower 10-year yields to prepare for refinancing the national debt. Speculation is growing over a potential "Mar-a-Lago Accord", a proposal to issue very long-term debt at low interest rates.

The success of these proposals remains uncertain, and the political fallout from a recession could be severe. However, the sharp decline in 10-year yields suggests that markets are taking these policies seriously. If the unemployment rate rises above 4.5%, the Fed may be compelled to cut the benchmark U.S. Fed Funds rate towards 3%. The prevailing narrative of a "soft landing" or "no landing" has now shifted toward the belief that a hard landing may be necessary to achieve the Trump administration's long-term economic objectives.

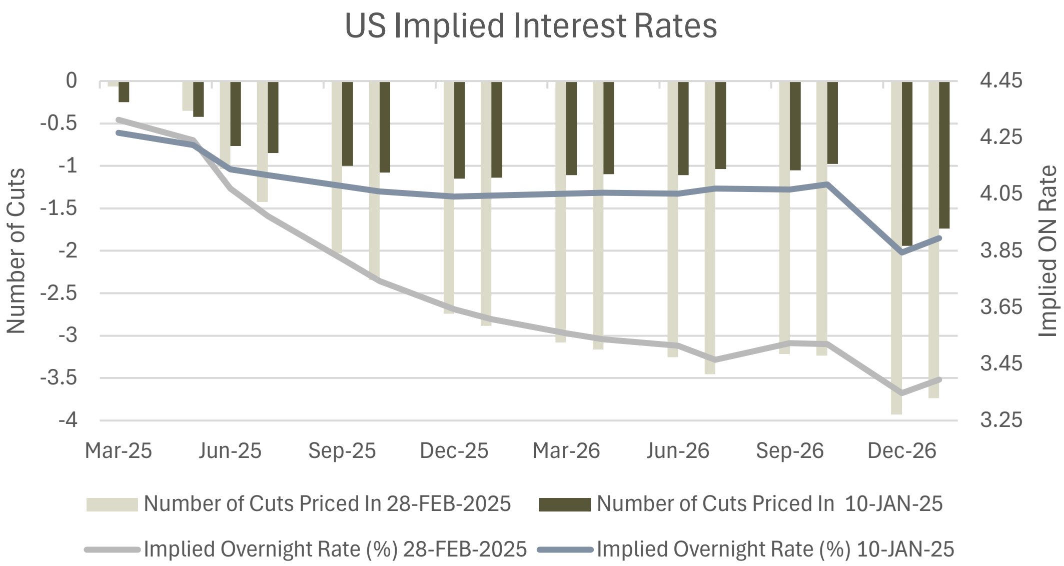
Below is a chart of the 10- and 30-year yields over the last six months.



Source: Bloomberg, Ellerston Capital

The U.S. implied yield curve has shifted rapidly, moving from pricing in two rate cuts through 2026 to now expecting four over the same period. The pace at which market expectations have adjusted since the Trump administration took office has been striking. Unlike his first term, Trump's rhetoric now embraces short-term economic pain as a necessary step toward achieving long-term objectives—a stark contrast to his previous focus on immediate economic stimulus.

The below chart shows the changes in implied US interest rates and number of cuts by the policy dates.



Source: Bloomberg, Ellerston Capital

Yield Curve Movements

The U.S. yield curve continued to bull flatten over February as the 10- and 30-year yields declined faster than nearer dated yields. Secretary Bessent comments that the administration is focused on bringing 10- year yields lower is explanatory of the move.

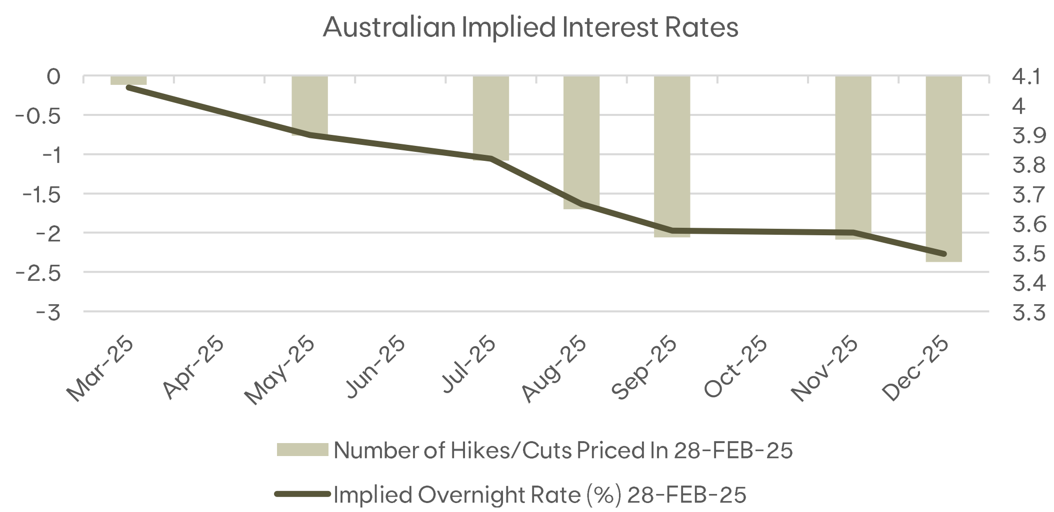
Forward Policy Outlook

The next Federal Open Market Committee (FOMC) meeting is set for mid-March, with only a minimal 4% chance of a cut currently priced into the yield curve. While we believe a move at this meeting remains unlikely, the probability is higher than what markets are currently factoring in.

Australia

The Reserve Bank of Australia (RBA) cut interest rates in February, marking its first reduction since 2020. Markets are currently pricing in additional cuts in June and September, with a 50% probability of another cut in December. With the Federal election expected in May, markets do not anticipate any rate adjustments before the vote.

The below chart shows the changes in implied Australian implied interest rates and number of cuts by the policy dates.



Source: Bloomberg, Ellerston Capital

Portfolio Profile

The rapid shifts in U.S. policy are fuelling greater market uncertainty and volatility, with expectations and economic trends reversing over increasingly shorter timeframes. The negative correlation between bonds and equities has re-emerged, alongside growing confidence that the Federal Reserve will respond to an economic downturn with aggressive rate cuts.

The investment team believes that positioning the portfolio in high-quality Australian investment-grade (IG) bank floating rate notes (FRNs) offers compelling 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 will generate positive performance in an economic downturn or if yield curves normalize as term premiums are repriced higher. The overall portfolio positioning remains defensive, fully aligned with the EFIT mandate.

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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