Ellerston Asia Growth Fund

Monthly Newsletter, June 2021

Investment Objective

To outperform the MSCI Asia Ex Japan (non-accumulation) (AUD) benchmark on a net of fees basis, with a focus on capital growth and downside protection.

Investment Strategy

The Fund's investment strategy is to provide access to a high quality portfolio of primarily large cap Asian Companies using the Manager's distinctively high growth, high conviction and benchmark independent investment approach.

The Manager believes that the trade-off between risk and potential returns at the portfolio level is improved by implementing highest conviction ideas from a filtered universe of securities that offer the best risk/reward.

Key Information

Strategy Inception	4 January 2017
Portfolio Manager	Fredy Hoh
Application Price	$1.2968
Net Asset Value	$1.2936
Redemption Price	$1.2904
Liquidity	Daily
No Stocks	42
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25% on application / 0.25% on redemption

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception^^ (p.a.)
Net^	2.75%	4.97%	7.68%	23.99%	14.19%	10.72%	11.77%
Benchmark*	2.68%	4.51%	8.48%	25.75%	12.88%	9.21%	11.83%
Alpha	0.07%	0.46%	-0.80%	-1.76%	1.31%	1.51%	-0.06%

^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance
* MSCI Asia ex Japan (non-accumulation) (AUD)

The Ellerston Asian Growth Fund (EAGF) was up 2.75% (net) in June versus the MSCI Asia ex Japan Index which was up 2.68%. In the 2021 financial year, EAGF was up 23.99% compared to the benchmark which was up 25.75%.

COMMENTARY

Asian financial markets again lacked clear direction and conviction during the month with investors oscillating between growth/value and reopening/lockdown plays. We believe this is reflective of continued uncertainty around the evolving COVID -19 situation across the region and the outlook for US monetary policy. We discuss these two topics below.

Ongoing COVID-19 Concerns

There were contrasting COVID-19 developments across Asia during June. South East Asian countries such as Indonesia and Thailand saw escalating COVID-19 cases as the Delta variant took hold. Conversely, India and Taiwan reported significant improvements. Despite the improvements in some countries, we continue to take a cautious view on the COVID-19 situation regionally. This is due to the spread of the highly contagious Delta variant and vaccination rates across Asia remaining low. Specifically on vaccinations, only Hong Kong, Singapore, South Korea and Japan have fully vaccinated more than 10% of their population. This compares to many developed countries such as the US, UK, Germany, Italy and France, where vaccine penetration is already above 30%. Preliminary findings out of the UK suggest that vaccines have been effective in protecting people from the Delta variant. Therefore until we see vaccine penetration improve across most of Asia, the region is susceptible to disruptions from further COVID-19 waves. This could see investors vacillate between reopening and lockdown beneficiaries on a country by country basis depending on their COVID-19 situation.

We currently have no exposure to South East Asian countries outside of Singapore, but have increased our weight in India during June as our channel checks confirmed that the improvement in case numbers has led to increased economic activity.

Taper Tantrum Fears Resurface

The US Federal Reserve (Fed) delivered a hawkish surprise in mid-June by shifting up its dot plot to include two rate hikes in 2023. The reason for the change in outlook was higher core inflation expectations on the back of better than expected improvement in the US economy. This stoked concerns about near term tightening risk and the impact this may have on equities.

The 2013 taper tantrum showed that the policy transition phase can result in a sharp sell-off in equities as investors adjust to a 'new normal' of lower liquidity and higher rates. The episode also showed that post the initial sell-off, equities can continue to perform well, particularly if the pace of tightening is gradual and well communicated.

We believe that a gradual Fed tapering is likely to occur within the next 6-12 months as the US economy regains its strength on the back of a successful vaccine rollout program. We however expect the market reaction to be milder than in 2013, particularly for Asian markets because the economic backdrop is stronger this time around and the external balances for current account deficit countries such as Indonesia, Thailand, India and Philippines are much healthier.

Nonetheless, our portfolio is positioned more defensively than we typically have in the past in order to protect returns against a mild sell-off associated with Fed tapering. As we will discuss in the next section, we are overweight Financials and high quality tech names and have zero or underweight positions in current account deficit countries with volatile currencies.

Positioning and Portfolio Changes

In light of the market uncertainty with regards to COVID-19 and US monetary policy, the EAGF portfolio is positioned for balanced growth with a bias towards high quality Financials and Technology companies.

Specifically within Financials, we hold a number of banks that are beneficiaries of rising inflation and rates such as DBS, OCBC and Shinhan Financial. These banks are also likely to benefit from improved loan growth, stabilized net interest margins and potential tailwinds from write-back of provisions. This should pave the way for higher ROEs and payout ratios.

Within the Technology space, we have significant positions in beneficiaries of the current chip shortage situation such as TSMC and Samsung. Our latest channel checks suggest that there has been some easing of the undersupply of chips to segments such as automotive. As such, global auto makers will progressively see more stabilized production in the coming months. We added Maruti Suzuki into our portfolio during the month as the combination of easing component shortages and improving COVID-19 situation in India should help deliver better sales in the coming months.

During June we also added to our positions in Chinese internet companies such as NetEase, Baidu and Alibaba. Our NetEase position reflects a belief that upcoming new games launches will be a catalyst for potential earnings upgrades. Meanwhile, we see Baidu as one of the most undervalued search companies globally. The company trades on a PEG ratio of less than 1x and at current levels, the core search business is trading on an implied P/E multiple of 11x, which is less than half the multiple that peers such as Google is trading on. Finally, Alibaba is now our second largest position in the portfolio at 7.9%. The stock has been buffeted in recent weeks by regulatory and investment concerns, but we believe these are largely reflected in the share price. The company remains a market leader in the growing China e-commerce space, has a fortress balance sheet, generates positive free cash flow and has a strong track record of value enhancing investments. Yet because of the aforementioned concerns, the stock is currently trading at a trough multiple of 21x PE. On our sum of the parts analysis, the current market cap of the Alibaba suggest that investors are paying only for the core ecommerce and ascribes no value to the Cloud business and other strategic investments. We see Alibaba as a core structural holding within the portfolio and therefore view the recent sell-off as an attractive opportunity to add more.

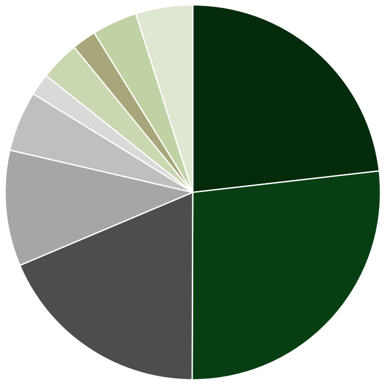
Performance

In June, China and Korea were the largest country contributors to alpha. While Taiwan was the largest detractor primarily due to the surge in share prices for shipping liners such as Evergreen Marine, Yang Ming Marine and Wan Hai. We currently do not hold any of these shippers in our portfolio and see the recent share price appreciation as transitory. At a sector level, Consumer Discretionary and Communication Services were our biggest drivers of performance. Meanwhile, Financials and Information Technology were the key drags. At a stock level, CATL, NIO and Kakeo were our largest contributors to alpha. While China Merchants, Hong Kong Exchanges and Moutai were our biggest detractors.

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.

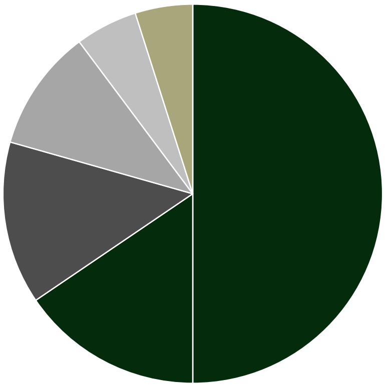
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Sector	Weight
Taiwan Semiconductor Manufacturing	Information Technology	8.87%
Alibaba	Consumer Discretionary	7.93%
Tencent	Communication Services	7.28%
Samsung Electronics	Information Technology	6.23%
DBS Group	Financials	3.85%
China Merchants Bank	Financials	2.85%
Baidu Inc	Communication Services	2.78%
China Construction Bank	Financials	2.70%
NetEase	Communication Services	2.60%
ANTA Sports	Consumer Discretionary	2.50%

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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 register, Link Market Services on **1800 992 149** or **ellerston@linkmarketservices.com.au**

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