APIR Code: ECL1411AU

Ellerston Asia Growth Fund

Monthly Newsletter, August 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	$1.0582
Net Asset Value	$1.0556
Redemption Price	$1.0530
Liquidity	Daily
No Stocks	1 Month
Management Fee	1.00%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	3 Years (p.a.)	Since Inception^^ (p.a.)
Net^	0.00%	-2.71%	-2.32%	11.69%	11.85%	8.11%	10.04%
Benchmark*	2.67%	-0.69%	0.01%	16.97%	12.60%	7.56%	10.59%
Alpha	-2.67%	-2.01%	-2.33%	-5.28%	-0.75%	0.55%	-0.55%

^ 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)

Commentary

August was a difficult month characterised by significant volatility due to the ongoing regulatory crackdown in China. Ellerston Asian Growth Fund (EAGF) was flat in August versus the MSCI Asia ex Japan Index which was up 2.67% after being down as much as 4.6% during the month.

China Regulatory Risk

The main event dominating Asia market performance was the rapidly evolving regulatory landscape in China. The quantum of regulatory announcements accelerated throughout the month and broadened to include online gaming, video streaming and other parts of the economy such as healthcare, auto, alcohol, property and high net worth individuals. Importantly, the Chinese Government also provided some clarity on its long term policy 'end game' which is to promote 'common prosperity' and prevent the 'disorderly expansion of capital'. We take this to mean that improving inequality, lowering household/social burden and reducing systemic risks such as monopolistic behaviour and misuse of data will be the key priorities for China's policymakers going forward. The measures announced over the past few weeks have been consistent with this and we expect further regulations to be implemented in the coming weeks.

The broadening of regulatory oversight contributed too much of our relative underperformance during the month as we held Chinese internet companies such as Tencent, Netease and Alibaba heading into August. As it became increasingly clear that regulatory risk would remain elevated for some time, we further reduced our China internet exposure during the month. Some of the proceeds were reallocated towards companies operating in industries supported by Chinese Government policies such as Li Ning (sportswear), China Mengniu (dairy products) and BYD (electric vehicles). This reallocation has meant that almost two thirds of EAI's China portfolio is now invested in companies more aligned with China's long term goals. Alibaba is our only major overweight in the China internet space. We believe this diversified approach is the most sensible way to invest in China at this point in time.

Despite our increasingly cautious positioning towards the China internet space, we continue to believe that many of these companies will play an important role in the development of China's economy. The digital economy, which includes the internet companies, currently accounts for just under 40% of China's GDP and is a major driver of innovation for the country. The industry employs over 200 million people and serves over 1 billion mobile and internet users in China. Given the size and reach of the digital economy, supporting its healthy development should therefore remain a policy priority for the Chinese Government. Indeed, the digital economy was listed as a strategically important sector within China's 14th Five Year Plan (covering the 2021-2025 period). As such, we see recent regulations as creating a framework for long term sustainable growth for the industry, which is ultimately a good thing for the overall economy.

For investors into China's largest internet companies however, it's worth noting that there will likely be a higher cost of policy compliance going forward. Firstly, there is the prospect of higher costs associated with self-rectification measures such as tweaks to business practices. Although there may be some margin impact, we do not expect this to be materially negative to long term valuations. Secondly, there is a risk that firms will need to pay a perpetual 'social tax'. For instance, Alibaba, Tencent and Pinduoduo have recently pledged a combined RMB210bn (A$44bn) over the next few years towards 'common prosperity' causes such as scientific research, rural development and clean energy initiatives. We note that the contributions announced so far represent only a small fraction of the free cash flow that many of these companies generate and again do not materially impact valuations. More importantly though, we believe the ongoing payment of this 'social tax' represents a commitment by China's internet giants to be onside with the government, which should ultimately help lower the risk that they will be permanently impaired or 'shut down'. This in turn, should provide investors greater comfort that the long term value of these internet companies will remain intact, albeit with a slightly higher risk premium.

Despite our optimism around the long term value of China's internet companies, we remain wary of near term regulatory risks and prefer to stay diversified within our China portfolio. In order for us to add back more meaningfully into the internet sector, we would like to see positive actions (not just words) from the Government that help restore investor confidence. Specifically, we are looking for events such as the resumption of IPOs either domestically or offshore, M&A activity, new online games approvals and a lull in new regulatory announcements to confirm that the investment backdrop for these internet companies have tangibly improved.

COVID-19 Update

The regulatory crackdown in China have largely overshadowed improvements in the COVID-19 situation for many Asian countries. Over the past month, China, Indonesia, Thailand and Taiwan have all seen declining case numbers. Vaccination rates have also increased across the region. Taiwan is now the only country we track in Asia where less than 10% of its population is fully vaccinated. Despite the improving COVID-19 trend, the risk of further disruptions remains high. That's because almost all countries in Asia have a zero tolerance approach to COVID-19 and vaccine penetration remains some way off the 'herd immunity' levels. As such, we remain cautious in adding reopening beneficiaries into the portfolio and continue to prefer high quality names with structural growth stories that are less impacted by COVID-19.

Portfolio Performance

Hong Kong was the largest contributor to alpha during August. Whilst, China and India were the largest detractors. At a sector level, Healthcare was the largest contributor to alpha. Meanwhile, Communication Services and Consumer Discretionary were the worst performers. At a stock level, Techtronic and Li Ning were the biggest positive contributors to performance as both reported better than expected 2QFY21 results. China Merchants Bank and HDFC also contributed positively. Conversely, Alibaba and NetEase were the biggest drags on performance.

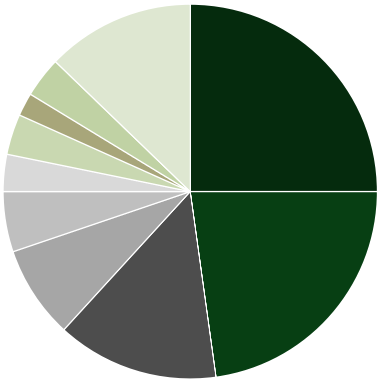
As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

Kind Regards,

Fredy Hoh

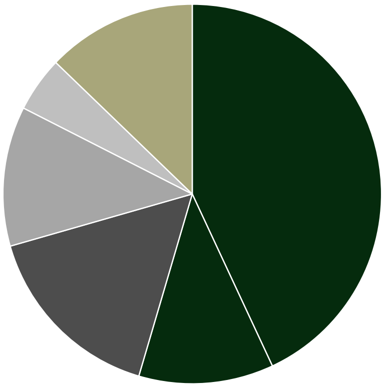
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Sector	Weight
TSMC	Information Technology	10.2%
Alibaba	Consumer Discretionary	6.1%
Tencent	Communication Services	5.6%
Samsung Electronics	Information Technology	5.4%
DBS Group	Financials	3.7%
Reliance Industries	Energy	3.2%
Hong Kong Exchanges & Clearing	Financials	2.9%
AIA Group	Financials	2.9%
Naver	Communication Services	2.4%
MediaTek	Information Technology	2.3%

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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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