Ellerston Asia Growth Fund

Monthly Newsletter, December 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	$1.0046
Net Asset Value	$1.0021
Redemption Price	$0.9996
Liquidity	Daily
No Stocks	32
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^	-2.02%	-2.05%	-10.11%	-3.20%	4.19%	9.90%	8.21%
Benchmark*	-1.30%	-2.12%	-8.39%	-0.62%	5.30%	8.61%	8.67%
Alpha	-0.72%	0.06%	-1.72%	-2.58%	-1.11%	1.30%	-0.46%

^ 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

Ellerston Asia Growth Fund (EAGF) was down 2.02% (net) in December versus the MSCI Asia ex Japan Index which was down 1.30%.

December was yet another volatile month for financial markets driven by the spread of the Omicron COVID variant and the repricing of US monetary policy expectations. We discuss these factors below along with a quick update on the developments out of China.

Omicron Concerns

The new Omicron COVID variant has spread rapidly around the world since it first emerged in early November. Evidence from South Africa, where the latest variant originated, suggests that Omicron is more infectious, but less deadly than previous mutations. New daily cases in South Africa have already peaked. Meanwhile, daily deaths (case fatality rate of ~0.5%) and the hospitalization rate (~1.7% of cases) are a fraction of the levels seen during the first three waves. The UK also appears to be exhibiting a very similar infection, mortality and hospitalization profile. As such, the read-through from the South Africa and UK examples is that COVID is likely following the path of the Spanish Flu by getting less lethal over time.

Despite the reduced virulence of Omicron, financial markets continue to be impacted by COVID related headlines. That's because Government policies to contain COVID have not adjusted to the reality that this pandemic is turning endemic. This is most notable within Asia, where China continues to persevere with a COVID zero policy. Meanwhile, most other Asian countries have either tightened border controls or implemented stricter restrictions such as mask wearing, social distancing or curfews over the past month. We however expect these restrictions to be much shorter in duration and have less economic impact than previous episodes. We will therefore opportunistically look to add to our existing core positions on any COVID-related pullbacks.

Mini Taper Tantrum

Last month, we highlighted the hawkish pivot by the US Federal Reserve towards a faster pace of quantitative tapering. This has coincided with financial markets pricing in the prospects of a first interest rate hike by March 2022 and a total of 4 hikes in 2022. The US 10 year bond yield has climbed from a low of 1.34% in early December to 1.74% in early January. This has fuelled strong performances in rate sensitive stocks, including DBS (+9% during December) and DGB Financial (+5% during the month) in the EAGF portfolio. Conversely, unprofitable and expensive Technology and Healthcare stocks were sold off heavily throughout December. The 2013 Taper Tantrum showed that the policy transition phase can result in a short and sharp sell-off in equities as investors adjust to a 'new normal' of lower liquidity and higher rates. We are starting to see this play out again, particularly in the parts of the market with high valuations.

As our investors know, Ellerston Asia's core philosophy is to own quality growth companies. Our strategy doesn't change to suit different market conditions as we strongly believe that investing in businesses with high and structural growth is a sustainable long term strategy for generating positive absolute and relative returns. Factor rotations such as the one we're currently experiencing can therefore have a temporary adverse effect on performance. We note that the portfolio weighted average PE of EAGF is currently ~21x and the weighted average earnings growth is ~19% for a PEG ratio of 1.1x. We are therefore paying an appropriate price for growth at this point in the cycle.

We remain comfortable with our portfolio positioning, where we are overweight secular growth sectors such as Technology and also beneficiaries of rising interest rates such as Financials. This barbell approach reflects two considerations. Firstly, US inflation is likely to remain strong until April, when a high base effect kicks-in. 1Q2022 meanwhile will likely see above trend inflation prints, which will add fuel to the monetary tightening narrative. This should be a supportive environment for Financials. The second consideration is the fact that whenever the Fed does decide to raise interest rates, it will be rising from a historically low base. After adjusting for inflation, real interest rates are likely to remain close to zero or even negative. This interest rate backdrop should also be supportive for equities and technology/growth stocks in particular. Furthermore, COVID highlighted the importance of technology to the way that we work, communicate and interact. These behavioural changes should persist even after COVID. As such, we believe the underlying demand and earnings outlook for many technology companies is likely to remain strong irrespective of the monetary policy environment.

China Update

There were two developments with regards to China during December. The first was the 50bps cut in the Reserve Requirement Ratio (RRR) by the PBOC. This incremental easing was in response to the notable slowdown in the Chinese economy due to continued COVID related lockdowns and troubles in the property sector. We expect further minor easing measures to be announced in the coming months.

The second development was the re-escalation of US/China geopolitical tension. Specifically, the US finalized the rules within the Holding Foreign Companies Accountable Act. This could see Chinese companies that fail to comply with US auditing requirements being delisted from US exchanges within 3 years, which would be sooner than what the market had expected. China is understandably looking for a compromise on this issue. But we do not believe the Chinese Government wants domestic companies making additional disclosures given the country's increased focus on 'data security'. Similarly, we do not expect the US to concede in the near term given China remains one of the few topics that receives bi-partisan political support. As such, we believe this delisting issue could remain an overhang on Chinese American Depository Receipts (ADRs) throughout 2022. We are underweight ADRs as a group and overweight Hong Kong Exchange as it will be the natural beneficiary of Chinese ADRs re-listing back home.

Despite these aforementioned concerns and the challenges encountered over the past 12 months, China's economy is still forecast to grow by ~5.2% in 2022, which is faster than any developed market in the world. Heading into 2022, we are becoming more constructive on China's domestic demand story in light of the incremental easing that is expected in the coming months. Within our China portfolio, we are currently overweight the consumer sector.

Portfolio Performance Summary

Taiwan and India were the largest contributors to alpha during December. Whilst, South Korea and Thailand were the largest detractors. At a sector level, Information Technology and Materials were the biggest contributors to performance. Meanwhile, Industrials and Consumer Discretionary were the worst performers.

At a company level, Tech Mahindra and Mediatek were the main alpha generators for the portfolio. Tech Mahindra was helped by positive read-throughs from the Accenture 1QFY22 results which showed a strong demand environment for outsourced IT services. Meanwhile, Mediatek was boosted by company comments confirming mid to high teens revenue CAGR over the next three years and also reports that the company could be working with Apple on some artificial intelligence related chipsets.

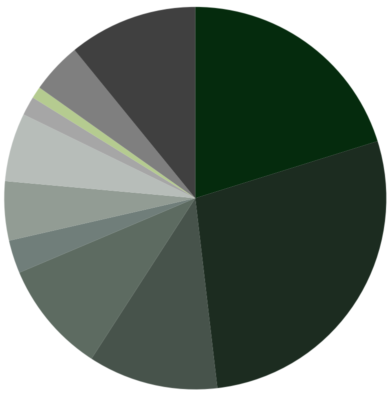
Conversely, JD.com and CATL were the biggest drags on performance. The JD.com share price was negatively affected by Tencent's decision to reduce its stake in the company from 17% to 2.3%. We view this as a disappointing development for JD.com as it creates uncertainty on whether the current strategic the partnership between the two companies is maintained going forward. We have subsequently trimmed our overweight in JD.com. The weakness in CATL meanwhile, reflected a broad based pullback in China's EV supply chain stocks despite continued strong new energy vehicle sell-through numbers (+121%YoY in November and +114%YoY in December). We remain positive on China's EV industry.

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

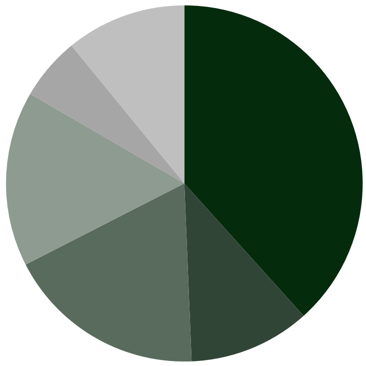
SECTOR ALLOCATION



- Financials, 20.2%
- Information technology, 28.0%
- Consumer discretionary, 11.0%
- Communication services, 9.5%
- Materials, 2.8%
- Energy, 5.0%
- Consumer staples, 5.8%
- Health care, 1.6%
- Real estate, 1.0%
- Industrials, 4.3%
- Cash, 10.9%

Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



- China/HK, 38.3%
- South Korea, 11.0%
- Taiwan, 18.1%
- India, 15.9%
- ASEAN, 5.7%
- Cash, 10.9%

Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Sector	Weight
TSMC	Taiwan	11.30%
Samsung Electronics Co.	Korea	7.00%
Tencent Holdings	China	5.90%
Reliance Industries	India	4.96%
DBS Group Holdings	Singapore	4.29%
Alibaba Group Holdings	China	3.99%
China Mengniu Dairy Co.	China	3.37%
MediaTek Inc.	Taiwan	3.22%
Tech Mahindra	India	2.86%
AIA Group Limited	Hong Kong	2.75%

Contact Us

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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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