APIR Code: ECL1411AU

Ellerston Asia Growth Fund

Monthly Newsletter, April 2022

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	$0.8845
Net Asset Value	$0.8823
Redemption Price	$0.8801
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^	-0.27%	-12.31%	-12.17%	-18.16%	-0.01%	0.50%	5.13%
Benchmark*	0.15%	-10.99%	-10.61%	-15.63%	1.82%	0.21%	5.76%
Alpha	-0.42%	-1.33%	-1.56%	-2.53%	-1.83%	0.29%	-0.63%

^ 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 0.27% (net) in April versus the MSCI Asia ex Japan Index which was up 0.15%.

April 2022 was another turbulent month for equity markets with macro factors such as inflation, interest rates and slowing growth continuing to take centre stage. Meanwhile, mixed signals coming out of China also contributed to market volatility. We discuss these two factors below.

Global Stagflation Concerns

During the month, investors grew increasingly worried that persistently high inflation will force central banks around the world, most notably the US Federal Reserve (Fed) to lift interest rates aggressively and subsequently cause an economic recession. Indeed, the Fed lifted its key policy rate by 50bps in early May and the fixed income market is now pricing in a further ~180bps increase by the end of 2022. Additionally, the Fed will start reducing its US$8.9tn balance sheet from June by up to US$95bn/month. The concurrent tightening of monetary and quantitative policies have only occurred once in recent history (in 2018). Investors are therefore nervous about the impact that higher rates and the withdrawal of liquidity will have on the economy and financial markets. In theory, a tightening of financial conditions is not ideal for economic growth and therefore growth stocks. We note however that the real Fed funds rate remains deeply negative, with the latest US CPI print of 8.3% significantly higher than the policy rate of 0.75-1.00%. Negative real rates should still provide a constructive backdrop for growth equities, particularly those with pricing power, strong balance sheets and positive free cash flows.

EAGF's core philosophy is to own quality growth companies that trade at reasonable valuations over a long investment horizon. Our portfolio currently does not contain any unprofitable or expensive growth companies. We believe this selective approach should allow the portfolio to perform resiliently in volatile markets. As at the end of April, the weighted average PE ratio of EAGF was 18x and the weighted average forward earnings growth was ~19% for a PEG ratio of <1.0x. Average ROE of the portfolio was 18% and all our portfolio companies are free cash flow positive.

China Update

Another factor weighing on global markets has been the COVID situation in China. Over 40 cities in China are still under some form of localized restrictions and the Government again reiterated its zero-COVID policy during the month citing the need to protect human lives. This will remain a drag on domestic demand, exports and global growth in the near term. We however continue to believe that policymakers will reassess its hardline COVID policy given the disease is becoming progressively more contagious, but less virulent. Whilst zero-COVID worked remarkably well during the initial outbreak in 2020, the increased transmissibility of subsequent variants have made this strategy impractical to enforce. Improvements in testing protocols and continued rollout of new COVID vaccines and antiviral pills should reduce the human impact of the virus and allow the Government to confidently shift towards a 'COVID light' model throughout this year. We see a refinement of the COVID policy as a pivotal step for China to achieve its 5.5% GDP growth target for 2022.

Despite the near term COVID related headwinds, a Politburo meeting in late April provided the strongest signal yet about the Government's intention to stimulate the domestic economy. Specifically, the meeting called for an acceleration in infrastructure spending, relaxation of property restrictions, increased fiscal stimulus and support for the platform companies. The Government has so far disappointed the market with the lack of stimulus and supportive policy action. We however believe it is only matter of time before further easing measures will be announced.

Expectations around COVID relaxation and stimulus are currently low and investor sentiment towards China is poor. The Hang Seng Index and CSI300 are both in bear market territory with a number of market participants having concluded that China is 'uninvestible'. We believe this is a backdrop where excellent long term buying opportunities can be found. Indeed, we have increased our exposure to China/HK over the past couple of months. Given the current bearish sentiment, any tangible policy action in the coming weeks could be a significant inflection point for a sustained rally in China/HK markets.

Portfolio Performance Summary

Indonesia and Singapore were the largest contributors to alpha during the month. Whilst, Taiwan and Hong Kong were the largest detractors. At a sector level, Energy and Consumer Staples were the biggest contributors to performance. Meanwhile, Industrials and Information Technology were the worst performers.

At a company level, Reliance Industries, Kweichow Moutai and Bank of Mandiri were the main alpha generators for the portfolio. The positive moves in Reliance Industries reflects earnings tailwinds from rising refining margins and tariff hikes in its Jio telecom business. Moutai's share price strength during the month reflected better than expected 1Q2022 numbers where sales and net profit grew 18% and 24% respectively. Bank of Mandiri meanwhile also reported very strong 1Q22 numbers with loan growth of +9YoY, NIM expansion (to 5.3%) and lower provisions driving operating profit growth of +57%YoY.

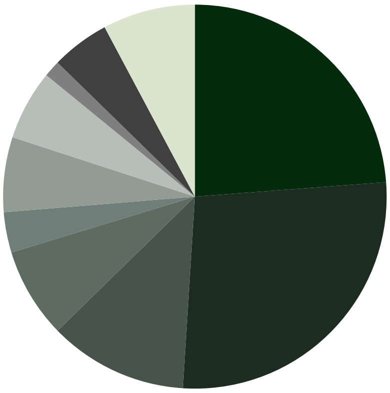
China Merchants Bank (CMB), CATL and Unimicron were the biggest drags on performance. CMB's share price was dragged down by the sudden removal of its President Tian Huiyu due to an investigation on potential legal violations. Our channel checks suggest the investigation could be related to other recent anti-corruption investigations into Tian's former colleagues at China Construction Bank. Whilst this unexpected senior management change is negative for sentiment, we believe this to be an isolated incident rather than an institutional issue. CMB has historically demonstrated a cautious risk management culture characterized by low non-performing loan ratio of 0.94%, high provision coverage of 463% and Tier 1 capital ratio of 14.9%. Furthermore, we believe the potential appointment of current CFO Wang Liang to President could give the market confidence that CMB's strategy to drive high quality growth and ROE will remain unchanged. CATL's share price was negatively impacted by expectations that surging lithium and nickel prices would be major headwind to margins. Unimicron's share price weakness meanwhile reflected concerns over a potential slowdown in semiconductor related demand and COVID-related disruptions to the company's Kunshan factory (3-4% of sales). Unimicron however reported very strong 1Q21 results during the month with revenues and operating profit up 41% and 482% respectively. This reaffirms our belief that Unimicron is likely to be the biggest beneficiary of the secular supply shortage situation in the ABF substrate market.

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

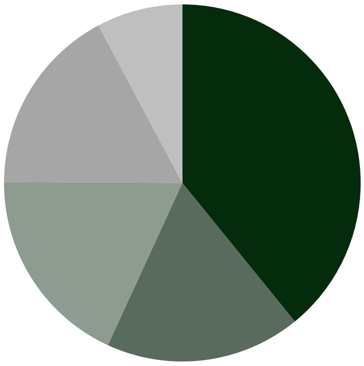
PORTFOLIO CHARACTERISTICS

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

TOP 10 HOLDINGS

Company	Country	Weight
TSMC	Taiwan	10.4%
Samsung Electronics	Korea	7.5%
Reliance Industries	India	6.3%
Tencent Holdings	China	6.2%
DBS Group	Singapore	4.5%
AIA Group	Hong Kong	4.0%
Alibaba Group	China	3.9%
China Mengniu Dairy	China	3.5%
ICICI Bank	India	3.3%
Unimicron Technology	Taiwan	2.9%

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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