APIR Code: ECL0339AU

Ellerston India Fund

Monthly Newsletter, September 2023

Investment Objective

To outperform the MSCI India Net Return Index (AUD) with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio with exposure to Indian companies using the Manager's high growth, high conviction, benchmark independent investment approach. The Fund has identified a number of core thematics that will drive returns in the Indian market in the medium term. The focus is on investing in Indian companies that benefit from these fundamental drivers.

Key Information

Strategy Inception^^	4-May-17
Portfolio Manager	Fredy Hoh
Application Price	$1.2966
Net Asset Value	$1.2934
Redemption Price	$1.2902
Liquidity	Daily
No Stocks	29
Management Fee	1.10% p.a.
Performance Fee**	15.00%
Buy/Sell Spread	0.25% on application 0.25% on redemption
Minimum Investment	$10,000
Minimum Additional Investment	$5,000
Distribution Frequency	Half Yearly (i.e. June & December)

**** Of the investment return above the benchmark, after recovering any underperformance in past periods**

Performance Summary

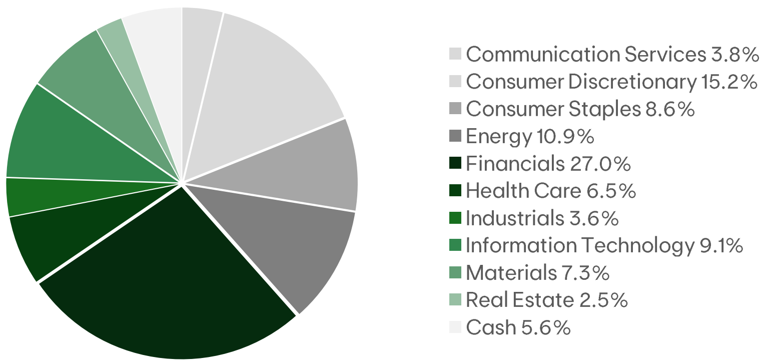
Period	Gross+	Net Before Tax*	MSCI India Net Pre Tax	Net After Tax^
1 Month	1.1%	1.0%	2.0%	0.8%
6 Months	14.9%	14.3%	19.6%	12.5%
1 Year	11.9%	10.7%	9.7%	10.0%
3 Years (cumulative)	49.9%	45.1%	68.6%	40.0%
Since Inception^^ (cumulative)	82.3%	68.5%	91.2%	62.6%
Since Inception^^ (p.a.)	9.8%	8.5%	10.6%	7.9%

^ The net return figure is calculated after fees, expenses and taxes. Past performance is not a reliable indication of future performance.
+References to the gross fee and pre-tax contribution to the total Net After Tax and Fee return.
*Net return figure is calculated after fees and expenses.
All returns shown in AUD

Portfolio Characteristics

Company	Sector	Portfolio Weight
Reliance Industries Limited	Energy	10.9%
ICICI Bank Limited	Financials	8.8%
HDFC Bank Limited	Financials	8.2%
Infosys Limited	Information Technology	6.4%
Maruti Suzuki India Limited	Consumer Discretionary	4.7%
Varun Beverages Ltd.	Consumer Staples	3.8%
Bharti Airtel Limited	Communication Services	3.8%
Bajaj Finance Limited	Financials	3.3%
Sun Pharmaceutical Industries Limited	Health Care	3.2%
Max Healthcare Institute Ltd	Health Care	3.2%

Sector Allocation



Commentary

The Ellerston India Fund (EIF) was up 0.8% (net) in September, versus the MSCI India Index (MXIN) which was up 2.0%.

Global markets pulled back during September on concerns that central banks, most notably the US Federal Reserve (Fed), may raise interest rates further. Although the Fed kept policy rates on hold at 22 year highs of 5.25-5.50% during September, it left the door open for another rate hike later this year. Fed officials also indicated that rates could stay higher for longer throughout 2024 than they had previously anticipated. Confirmation of potential further upside in interest rates led to a spike in US 10-year yields, to a 17 year high of 4.8%. The USD also rallied by ~2.5% during the month. Historically, a stronger USD has been negative for flows into Emerging Markets (EM) and indeed this was a headwind throughout September. All Asian markets, with the exception of India and Philippines (+2.4%) were down last month.

The Indian market performance is notable given it has outperformed most major indices over the past 3 months, despite a ~30% rally in the oil price. India imports ~80% of its oil requirements, so a higher price is typically negative for the current account balance and a potential headwind for economic growth. As we have previously highlighted, the resilience of Indian equities however has been driven by a number of idiosyncratic factors. First is robust domestic demand, with indicators such as PMI (60.9 in September) and credit growth (+15%yoy in September) pointing to a healthy economic environment. The second is India's ability to purchase cheap Russian oil, albeit this discount has narrowed in recent weeks. This, along with solid tax collections (+12%yoy in the past 12 months) has helped fund a lift in government capex (+48%yoy in FY24YTD). The third is the stability of the currency, which has been driven by the Reserve Bank of India's (RBI) willingness to defend the currency and strong inflows from foreigners. Indeed, over the past 3 months the RBI has reduced its foreign exchanges reserves by ~US$22bn. Meanwhile, over the past 6 months, foreign institutional investors have net bought ~US$19bn of Indian equities, which is the fastest pace in 3 years. For foreign investors, India remains one of the very few countries globally that offer both a structural growth story and near term-economic tailwinds. As such, despite the Indian market trading at an optically high multiple of 20x forward PE, earnings growth is expected to be robust (i.e. high teens) over the coming year. Within India, we are positioned in sectors such as financials (HDFC Bank, ICICI Bank), consumer (Maruti Suzuki, Phoenix Mills), healthcare (Max Health) and industrials (Reliance Industries) that leverage India's domestic demand and infrastructure buildout tailwinds.

An important development during the month was the inclusion of India into the JP Morgan EM Bond Index. It is estimated that this will lead to US$20-30bn incremental inflows from investors from June 2024 onwards. This development could pave the way for India to be included into other EM or Global bond indices, which could add a further ~US$10-20bn of additional inflows. Whilst this event is not directly linked to equities from a flow perspective, Indian financial institutions could benefit from a potential reduction in wholesale funding costs. Overall, we view this as another major step in increasing the relevance of India as an investment destination.

Other developments to watch in the coming weeks are the outcome of five state elections, namely Madhya Pradesh, Chhattisgarh, Rajasthan, Telangana and Mizoram. The results will provide some read-through on voters' thinking going into the General Election in 2024. The other is India's agricultural production given monsoon rainfalls in 2023 have been running at a five-year low due to an El Nino weather pattern. Both events will determine the likelihood of additional populist measures over the coming months.

Portfolio Performance

Performance over the past 6 months for the fund has been disappointing and can be attributed to:

- The underperformance of large portfolio positions such as Reliance Industries and HDFC Bank. Reliance has been sold off following the listing of its Jio Financial Services business in late August, likely driven by adjustments to portfolio weightings towards the Reliance group of companies by institutional and ETF investors. HDFC Bank meanwhile has also been negatively impacted by selling post its merger with HDFC. We view both as temporary liquidity events.
- Underweight positions in sectors such as IT services, utilities and Industrials. Our positioning in IT services reflect concerns over the worsening near term demand environment, which is likely to lead to further earnings cuts. Meanwhile within the Utilities and Industrial sectors, not owning names such as Larsen and Toubro and the Adani Group of companies have been a material drag on relative performance. We note however these names do no pass our strict ESG criteria, but not owning them have nonetheless been a source of tracking error;
- As mentioned in previous newsletters, there has been a currency hedge in place for a portion of the EIF portfolio in order to help mitigate against the currency related volatility. The INR however has appreciated against the AUD by ~2% since the end of March and this has resulted in a negative contribution to portfolio performance from the currency forward.
- Cash held by the fund has averaged ~6% over this period. The Indian market meanwhile has increased by ~16% since the end of March. Our cash holding along with recognition of withholding tax from unrealised capital gains has therefore been a headwind for fund performance.

We however believe many of the factors outlined above are temporary in nature. In particular, our conviction level on HDFC Bank, Reliance Industries and the underweight in IT services remain high. Meanwhile, we are actively looking to address our cash situation by increasing our exposure to companies with near term earnings momentum trading at reasonable valuations. It is also worth highlighting that EIF takes a patient and disciplined investment approach. All of our investments are based on extensive bottom-up research and where the risk-reward is favourable. This means we sometimes invest in good companies that may be temporarily out of favour for whatever reason and this can create short term volatility for portfolio performance. We however believe that over time, the share prices for our investments will converge to the valuations that we ascribe to them once our thesis for these names plays out.

Turning to September performance, Consumer Staples and Consumer Discretionary were the key alpha contributors. Meanwhile, Industrials and Energy were the key detractors for the month.

At a company level, **Maruti Suzuki, Varun Beverages** and **Nykaa** were the biggest contributors to relative performance during the month adding a combined 35bps to alpha. Meanwhile **HDFC Bank, Max Healthcare** and not owning **Larsen & Toubro** detracted 56bps to relative performance.

Maruti Suzuki was up 6% during the month on positive channel checks which showed strong order momentum, particularly for its newly launched SUV models. This will help improve the product mix which is the key driver for its ASP and margin improvement, leading to strong earnings momentum.

Varun Beverages is benefiting from a continuation of positive consumptions trends which could accelerate in the coming weeks due to the upcoming festive season and international events such as the cricket World Cup.

Nykaa's management team has been out and about presenting a positive outlook for both the company and the domestic ecommerce space, which has helped turn around the sentiment on the stock. In early October, Nykaa provided a positive trading update which showed that net sales value for both its Beauty and Fashion segments grew ~20%yoy and 'early 30%yoy' respectively in 2QFY24.

HDFC Bank held an analyst meeting during the month to help guide on developments following its merger with HDFC. Within this meeting, management guided to a 5% drop in book value from consolidation and a 25bps headwind to near term net interest margins, due to higher liquidity requirements. We believe these are conservative actions taken by management to better drive mid-teens loan growth and improving ROAs.

Max Healthcare has continued to experience significant share price volatility over the past 2 months following a broker downgrade report. Channel checks however suggest that the company remains on track to deliver on its network expansion and profitability per bed improvement goals.

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

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**

Please refer to details on page one; there have been no changes to the primary investment personnel responsible for managing the Fund.

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, Automic Group on **1300 101 595** or ellerstonfunds@automicgroup.com.au

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