

# Ellerston Asian Investments Limited (ASX:EAI)

Performance Report | April 2020

## PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year	Since Inception (p.a.)
Net <sup>^</sup>	1.24%	-5.61%	1.47%	2.56%	1.63%	6.15%
Benchmark*	1.81%	-5.12%	-0.54%	-2.94%	-1.22%	6.72%
Alpha	-0.57%	-0.49%	2.01%	5.50%	2.85%	-0.57%

Source: Ellerston Capital

<sup>^</sup> The net return figure is calculated before all tax provisions, after fees & expenses, includes the effects of the share buyback, and excluding the effects of option exercise dilution. Past performance is not a reliable indication of future performance

\*MSCI Asia ex Japan (non-accumulation) (AUD)

## PORTFOLIO COMMENTARY

April saw a continuation of the global market rally that started on March 23, 2020. Since then the S&P 500 is up an incredible 30.1% and MSCI World is up 28.1%. Asian markets have lagged with MSCI Asia ex Japan up 20.1% in local terms but only 8.3% in AUD terms.

Ellerston Asian Investments was up 1.2% during April but underperformed the benchmark by 0.6% (net), primarily due to our high cash position (15.8%). AUD strength was a headwind for absolute returns in April. Year to date in calendar 2020, EAI is down 4.5% and has outperformed the benchmark by 0.4% (net). The monthly pre-tax NTA as of April 30, 2020 was \$1.1353, and the most recent daily pre-tax NTA (as of May 12) was \$ 1.1295.

## MARKET OUTLOOK

We have received a lot of questions from investors about whether March was the bottom for equity markets in Asia. Our view is that markets have rallied too far too fast and markets are now completely disconnected from the underlying economies both in developed markets (DM) and Emerging Markets (EM). As such, we anticipate staying relatively high cash either until markets correct (most likely) or the underlying economies recover significantly (less likely in the short term).

There are numerous reasons why we feel that global markets have gotten ahead of fundamentals. First of all, valuations have become very expensive given the degree of uncertainty. Looking at P/E ratios at this point in the cycle is not meaningful, so we focus on Price to Book (P/B) multiples. Asia is trading at 1.3x P/B which is still inexpensive, but MSCI World is trading at 2.2x and the S&P 500 is trading at 3.2x. For the S&P, this is more than 25% above its long term average.

Secondly, technical indicators are creeping towards overbought territory and strong resistance levels. The 3,000 level for the S&P 500 presents strong resistance. The NASDAQ, almost unbelievably, is only about 5% from its all-time high. In Asia, despite being oversold just a few weeks ago, the TAIEX and CSI 300 have RSI (Relative Strength Index) levels above 60. A continued upward trajectory for markets will get harder from here.

Finally, the strong rally in equities is not being confirmed by other asset classes. In the bond market for example, Fed fund futures are implying that US rates will turn negative by the end of the year, US 2 Year and 5 Year yields remain near record lows and the whole yield curve remains under 1%.

In sovereign credit, CDS spreads remain severely elevated despite market rallies. In India for example, the 5 Year CDS spread is currently around 200bps, which is triple what it was prior to the onset of COVID yet the market has rallied 23% from the March low. In commodities, oil is still below \$25, copper is off the lows but still depressed at a price of ~\$240 and gold is above \$1700. It appears that equities are the odd asset class out in terms of its optimism.

Given the above, we remain high cash with a cash balance of 15.8% as of April 30. What will be the catalyst for equity markets to correct from current levels? We consider 4 possibilities:

**A Second Wave of COVID** Markets have generally cheered news of economic reopening. This is indeed positive news, but it also increases the risk of a resurgence in COVID cases. Certain countries like China (Jilin, Wuhan) and Korea (nightclub cluster) have recently experienced this phenomenon. While these incidents have not led to a resurgence of community transmission on a larger scale, this trend needs to be watched in economies that are being re-opened when the total number of active cases is still very high (i.e. the US).

### Key Facts

<b>Listing Date</b>	4 September 2015
<b>NTA (before tax)*</b>	\$1.1353
<b>NTA (after realised tax)<sup>^</sup></b>	\$1.1353
<b>NTA (after tax)**</b>	\$1.1192
<b>Share Price at 30/04/20</b>	0.96
<b>EAI Market Capitalisation</b>	\$127.3 Million
<b>Average Management Fee</b>	0.83%
<b>Performance Fee</b>	15%

\* NTA (before tax) – Includes taxes that have been paid.

<sup>^</sup> NTA (after realised tax) - Includes a provision for tax on realised gains from the Company's Investment Portfolio.

\*\* NTA (after tax) - Includes any tax on unrealised gains and deferred tax.

**Diminishing Returns to Policy Stimulus** Since the onset of COVID, there has been over \$14 trillion of stimulus globally. This “policy put” has undoubtedly been one of the main reasons for the sharp recovery in equities since the last week in March. However, it is important to highlight that there are diminishing returns to policy stimulus, both monetary and fiscal.

On the monetary side, at the last Fed press conference Powell said that “we are going to see economic data for the second quarter that is worse than any data we have seen for the economy,” yet rates are already at zero and he announced no new facilities or bond buying programs at that time. In Asia, most central banks cut early on but have held off on any additional rate cuts. Even if they reduce rates further, policy makers fear that the transmission mechanism may be less effective going forward given that the labour market, lending market and consumer confidence have all been severely disrupted due to COVID.

On the fiscal side, investors need to be aware that some of the emergency stimulus measures announced to soften the blow of lockdown and quarantines will start to get rolled back as economies reopen. The Jobkeeper wage subsidy in Australia is an example. This means that marginal businesses that hung on through COVID due to government support may start to falter once these emergency facilities are withdrawn. In summary, the policy environment has been massively stimulative but central banks and government stimulus going forward will likely have diminishing returns.

**Resurgence of US-China Tensions** We fully expect a re-escalation of US-China relations due to COVID and have positioned the portfolio for this sort of environment. We consider 3 main avenues for backlash against China: economic (trade war resurgence, crackdown on Huawei/ZTE), markets (increased scrutiny of Chinese ADRs, banning US government pension funds from investing in China) and diplomatic (increased engagement with Taiwan, military presence in the South China seas, support of Hong Kong protesters). Our China portfolio is primarily domestic demand stocks. We expect the underlying tensions to become exacerbated as the US Presidential election gets closer.

**June Quarter Earnings** In April, news of COVID curves flattening globally, the number of deaths falling, lockdowns being lifted, and Gilead’s treatment hopes all served to boost markets and sentiment with increasingly less focus on company earnings and guidance (or lack thereof). The earnings that have been released were for the March quarter but in most developed markets (ex-Italy) the brunt of the epidemic economic pain started in April. Since companies are generally not giving any guidance and have very little visibility, there is decent chance that June quarter will hold negative surprises for investors.

While investors (including us) are willing to look through one or two quarters of COVID depressed earnings, we do not think that the medium term economic reality of COVID has been factored into valuations or forecasts. According to Bloomberg consensus for example, the MSCI World Index is expected to have earnings growth this year of only negative 6% before rebounded by 26% the following year. This seems increasingly unrealistic.

For these four reasons, we’re staying high cash.

## PERFORMANCE

In April, the top performing sectors were IT and Health Care. From a country perspective, the largest contributor to alpha was Indonesia while Korea was the largest detractor. The stocks that contributed the most to alpha were Sun Pharma and Anhui Conch and the largest detractors from alpha were HDFC and Sunac.

Throughout all the COVID noise and extreme volatility, our strategy remains staunchly the same – high growth, high quality, large cap, benchmark unaware with a strong commitment to ESG.

As always, if you have any questions regarding any aspect of EAI or the portfolio, please feel free to contact us at [info@ellerstoncapital.com](mailto:info@ellerstoncapital.com). We are hosting an update conference call on May 19 at 10am AEST for Ellerston Asia investors for which you can register [here](#).

Kind regards,

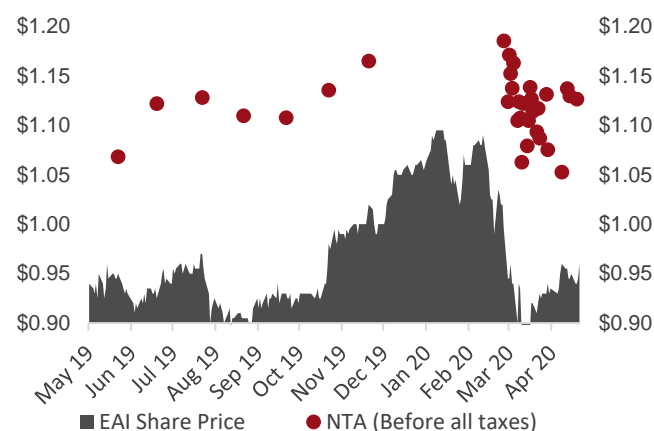
Mary Manning – Portfolio Manager

## PORTFOLIO CHARACTERISTICS

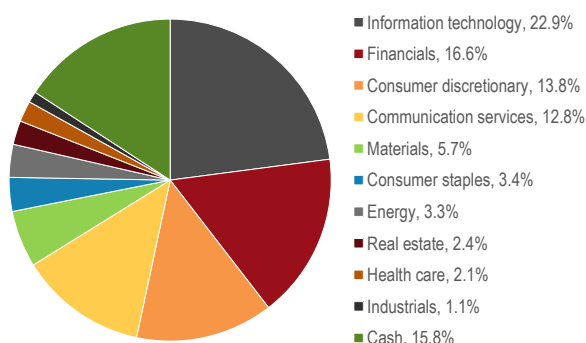
### HOLDINGS

Top 10 holdings	%
TSMC	9.5%
Tencent Holdings Ltd	8.2%
Samsung Electronics	7.7%
Alibaba Group Holding Ltd.	7.7%
Anhui Conch Cement Company Limited	4.6%
Ping An Insurance	4.0%
China Merchants Bank Co. Ltd.	3.2%
Hong Kong Exchanges & Clearing Ltd	2.9%
JD.com	2.7%
AIA Group Limited	2.5%

### EAI SHARE PRICE VS NTA

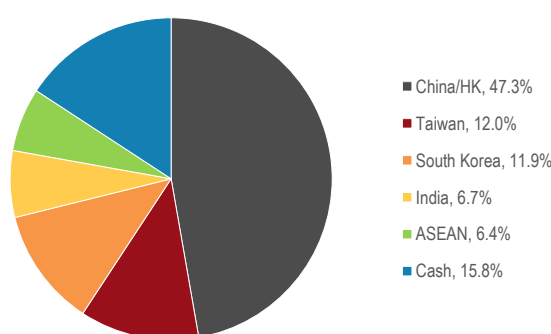


### SECTOR ALLOCATION



Source: Ellerston Capital

### GEOGRAPHIC ALLOCATION



All holding enquiries should be directed to our share registrar, **Link Market Services** on 1300 551 627 or [EAI@linkmarketservices.com.au](mailto:EAI@linkmarketservices.com.au)

Should investors have any questions or queries regarding the company, please contact our **Investor Relations team** on 02 9021 7701 or [info@ellerstoncapital.com](mailto:info@ellerstoncapital.com) or visit us at <https://ellerstoncapital.com/>

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