Ellerston Asian Investments Limited (ASX: EAI)

Monthly Newsletter, August 2022

Key Information

Listing Date^^	4 September 2015
NTA (before tax)*	$0.9130
NTA (after realised tax)^	$0.9130
NTA (after tax)**	$0.9538
Share Price at 31/08/2022	$0.780
EAI Market Capitalisation	$97.7 Million
Average Management Fee	0.82%
Performance Fee	15%

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

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

** NTA (after tax) - Includes a Tax Asset of 3.679 Cents per share relating to realised and unrealised losses.

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Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)	Since Inception^^ (p.a.)
Net^	0.19%	-3.94%	-13.38%	-22.09%	-0.60%	2.02%	3.04%
Benchmark*	1.57%	-2.52%	-9.10%	-18.44%	1.13%	2.27%	4.48%
Alpha	-1.37%	-1.42%	-4.28%	-3.65%	-1.73%	-0.25%	-1.44%

^ 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)

Ellerston Asian Investments (EAI) was up 0.2% (net) in August versus the MSCI Asia ex Japan (MXASJ) Index which was up 1.6%.

EAI aims to have a sustainable dividend policy based on multiple years of profit reserves. As at the end of August 2022, EAI's dividend profit reserve was approximately 13.92 cents per share.

Portfolio Discussion

China and Hong Kong were the two weakest markets regionally during August, which negatively impacted the fund's performance. As regular readers would know, we recently turned positive on the outlook for Chinese equities driven by expectations of counter-cyclical policy stimulus in the second half of 2022. Indeed there were further supportive policies announced during August including interest rate cuts by the PBOC and a raft of fiscal measures from the State Council and local governments focused on infrastructure construction, property sector stability and consumption.

Despite these stimulus measures, the Chinese economic recovery has thus far been a case of two steps forward, one step back. The reason for this remains China's ongoing zero-COVID policy. Over the past month, a number of major cities such as Shenzhen, Chongqing and Chengdu were placed into localized lockdown. As at early September, the number of cities affected by full or partial lockdown accounted for ~17% of China's GDP (vs <5% in early August). We note however that the number of daily symptomatic cases across China remains quite steady at ~350. This is likely due to a step-up in the timeliness of COVID containment and the frequency of testing. As such, we believe a repeat of the harsh lockdowns seen in April/May is unlikely. Nonetheless, China's COVID suppression policy will remain an overhang on the economy until at least the 20th Party Congress starting on October 16, where President Xi is likely to be re-elected for another term. Our base case remains that China will look to reintegrate with the rest of the world and transition to 'living with COVID' sometime between the Party Congress and the Two Sessions meeting in March 2023. We note that the successful development of a domestic mRNA vaccine by year-end would be a major catalyst for a formal change in COVID policy. There are currently two vaccines undergoing phase 3 clinical trials that could receive approval for emergency use before the end of 2022. The COVID situation in Hong Kong is also worth monitoring given cases in recent weeks have surged to ~10,000 per day, yet there has not been any decision to lock down the city. As such, Hong Kong could be a leading indicator for how mainland China may proceed with its COVID policy in the coming months.

The recent bout of COVID concerns have overshadowed a number of positive developments for Chinese equities. Aside from new fiscal and monetary policy stimulus announcements, the US and China also reached an agreement during the month that would allow audit inspections of Chinese companies listed in the US. This deal represents a significant step in alleviating the risk that Chinese ADRs will be delisted because of non-compliant audits. The potential removal of the ADR delisting overhang in the coming weeks would be a major positive catalyst for the Chinese internet companies that we own such as Alibaba and JD.com. We note that the Chinese internet companies continue to trade at trough valuations despite recent de-escalation in the geopolitical and domestic regulatory environments. Meanwhile, most Chinese internet names managed to beat earnings expectations during the latest reporting season primarily due to effective cost-control measures and a greater focus on free cash flows. These companies therefore are well placed to exhibit significant operating leverage when revenue growth starts to accelerate.

The recent volatility in China/HK has allowed us to add to our China/HK exposure, particularly in the Government promoted areas such as consumption, green energy and factory automation. China/HK continues to be our largest regional weight due to continued policy easing, cheap valuations and low investor sentiment towards the region. The margin of safety for investing in Chinese equities therefore remains attractive and there exists clear near-term catalysts that could lift animal spirits and drive a sustained market rally.

Portfolio Performance Summary

Singapore and India were the largest contributors to alpha during the month. Whilst, China and Taiwan were the largest detractors. At a sector level, Communication Services and Healthcare were the biggest contributors to performance. Meanwhile, Consumer Discretionary and Materials were the worst performers.

At a company level, ICICI Bank, Reliance Industries and DBS were the best contributors to relative performance during the month. ICICI Bank and Reliance mirrored the strength of the Indian market which was up 3.9% in August. The Indian market strength was driven by foreign investor flows (of US$10.6bn) and further evidence of domestic demand resilience despite 140bps of interest rate increases over the past 6 months. India is the second largest regional weight within EAI, with expensive valuations (MSCI India PE of 23x) being the only major reason preventing a larger allocation. DBS meanwhile was boosted by an increase in US interest rate expectations and the release of solid 2Q22 numbers.

Beijing Oriental Yuhong, Zhejiang Shuanghuan Driveline and BYD were the biggest drags on alpha. Yuhong's share price was negatively affected by a weaker-than-expected earnings result driven by COVID-related disruptions. We were disappointed by the company's earnings delivery this quarter, but believe that the worst of the disruptions have likely passed. Furthermore, key raw materials such as bitumen have corrected in recent weeks, which should help support margins in the near term. Longer term, we continue to see the company as a major beneficiary of the regulatory push for improved construction-related standards given its market-leading position in waterproofing materials. Shuanghuan Driveline saw some profit-taking from investors after a 25% gain in the prior month, yet the company's half-year results came in at the top end of guidance with continued market share gains within China's burgeoning EV market. Finally, BYD's share price came under pressure during the month as its largest shareholder (Berkshire Hathaway) disclosed that it had sold down a small stake in the company. There remains prospects of further sell-downs in the near term, which will present a liquidity overhang on the share price. We however remain positive on the business outlook for BYD with earnings forecast to double over the next two years due to strong demand for its mass-market electric vehicles (EV) as well as outsourcing opportunities for its EV batteries. In the near term, the company has 4 months of order backlog and has exhibited commendable pricing power by increasing the selling price of its vehicles twice this year.

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,

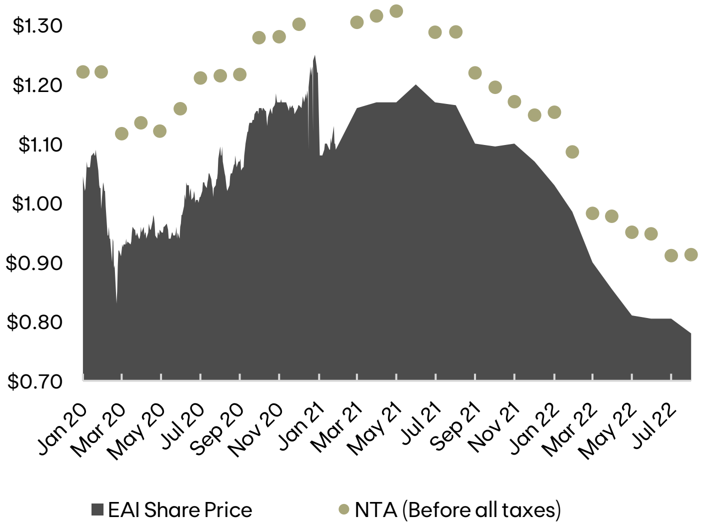
Fredy Hoh
Portfolio Manager

PORTFOLIO CHARACTERISTICS

TOP 10 HOLDINGS

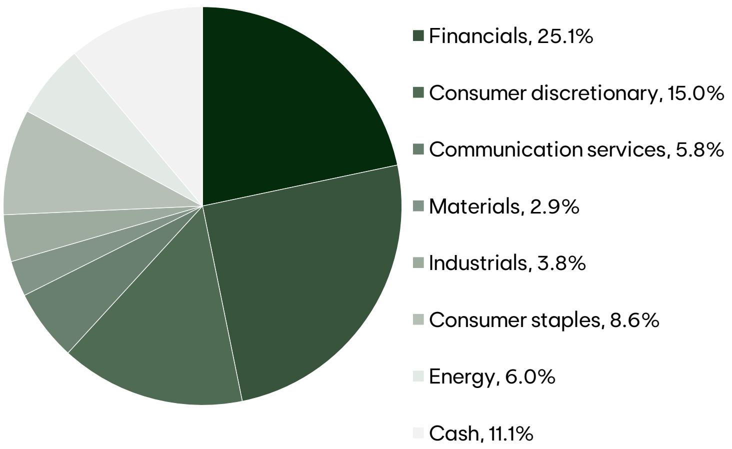
TSMC	9.8%
Reliance Industries	6.0%
Samsung Electronics	5.9%
Tencent	5.8%
Alibaba Group Holding	4.8%
AIA Group	4.5%
China Mengniu Dairy	4.3%
DBS Group Holdings	3.9%
ICICI Bank	3.6%
Kweichow Moutai Co	3.0%

EAI SHARE PRICE VS NTA



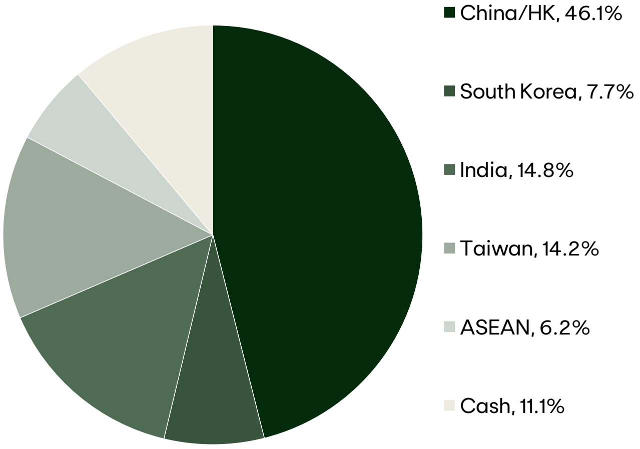
Source: Ellerston Capital.

SECTOR ALLOCATION



Source: Ellerston Capital.

GEOGRAPHIC ALLOCATION



Source: Ellerston Capital.

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Find out more

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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**

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