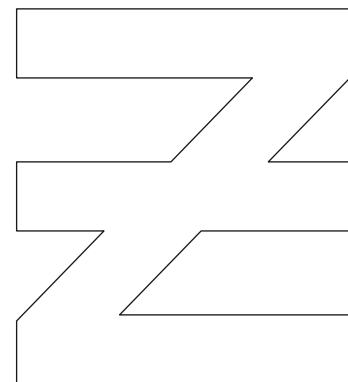


# Ellerston Asian Investments Limited (ASX: EAI)



Monthly Newsletter, October 2022

## Key Information

Listing Date <sup>^^</sup>	4 September 2015
NTA (before tax)*	\$0.7767
NTA (after realised tax) <sup>^</sup>	\$0.7767
NTA (after tax)**	\$0.7923
Share Price at 31/10/2022	\$0.655
EAI Market Capitalisation	\$81.4 Million
Average Management Fee	0.82%
Performance Fee	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 a Tax Asset of 1.16 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 <sup>^^</sup> (p.a.)
Net <sup>^</sup>	-6.53%	-11.68%	-17.68%	-27.88%	-5.85%	-2.01%	1.17%
Benchmark*	-5.62%	-11.02%	-15.22%	-24.22%	-4.38%	-1.92%	2.46%
Alpha	-0.91%	-0.67%	-2.46%	-3.67%	-1.47%	-0.09%	-1.30%

Ellerston Asian Investments (EAI) was down 6.5% (net) in October versus the MSCI Asia ex Japan (MXASJ) Index which was down 5.6%.

EAI aims to have a sustainable dividend policy based on multiple years of profit reserves. The dividend profit reserve as at the end of October 2022 was approximately 11.0 cents per share.

It was an extremely volatile month for Asian markets with the MXASJ rising as much as 3.8% (in AUD terms) in early October on the back of positive global sentiment, before finishing down 5.6% on further negative events out of China.

## China Volatility

The China/HK markets underperformed during October with the CSI300 and HSI Indices down 15% and 8% respectively. A major trigger for the underperformance was the outcome of the 20<sup>th</sup> National Congress where President Xi was elected for an unprecedented third term and filled the seven member Standing Committee with loyalists. This led to concerns that future policy decisions may lack checks and balances, thus increasing the likelihood of future policy mistakes. Although investors had wanted some more progressive politicians elected into the Standing Committee, the reality is not entirely surprising given President Xi has spent much of the past two terms consolidating power. A Standing Committee containing politicians that President Xi trusts does however send a message of unity at the top. Furthermore, policy execution is likely to be enhanced given the more concentrated political structure. It should be noted that one of the key takeaways from the commentary coming out of the Congress was the importance placed on economic growth and we expect a renewed focus on this area now that the 'election' is over.

The most powerful way for the government to reignite economic growth is to ease its suppressive zero-COVID policy. Indeed, we have started to see signs of a potential shift on this policy in recent weeks. Firstly, China has resumed hosting key events over the past month such as the visits by German Chancellor Olaf Scholz and Vietnamese leader Nguyen Phu Trong to Beijing, the running of the Beijing Marathon and the successful staging of the Hong Kong Sevens tournament. Secondly on the vaccine front, China has reportedly agreed to offer BioNTech COVID shots to expatriates living in the country. Further, the rollout of Cansino's inhaled COVID treatment and the imminent Emergency Use Authorisation (EUA) approvals of domestic mRNA based vaccines are likely to help facilitate a reopening. Thirdly, we have seen a number of regional rail stations drop the requirement for proof of negative COVID test results before traveling.

Finally, we have started to see a shift in the government propaganda around COVID. Local governments such as Zhengzhou and Guangzhou have recently tried to downplay the impact of the latest Omicron strain in order to ease public concerns. There has also been a notable decline in the mentions of COVID in official government mouthpieces and on social media since the conclusion of the Party Congress.

All these factors suggest that it is likely a matter of 'when' not 'if' before a China reopening. The spillover effects from China's zero COVID policy has been evident in economic data, which has been improving in a non-linear trajectory. Ultimately, we believe that a sputtering economy characterized by high unemployment, weak domestic demand and property sector distress is inconsistent with President Xi's 'common prosperity' ideology. Whilst a China reopening is likely in the coming months, we however do not expect a big bang announcement. Any reopening will likely be a gradual transition to living with COVID and it appears that the Government is beginning to lay the groundwork for this to happen.

Despite the weakness in Chinese equities during October, we have maintained our overweight on China as we believe the issues facing domestic companies are mostly cyclical rather than structural. We continue to take a diversified approach to investing in China with a preference for high quality companies that are either supported by government policies or operating in policy neutral sectors. We also own companies that are regulated by the Government but strategically important to the economy such as the Chinese internet names.

### **Portfolio Performance Summary**

Indonesia and Singapore were the largest contributors to alpha during the month. Whilst, China and South Korea were the largest detractors. At a sector level, Energy and Communications Services were the biggest contributor to relative performance. Meanwhile, Consumer Staples and Consumer Discretionary were the worst performers.

At a company level, Reliance Industries, Bank of Mandiri and Samsung Electronics were the biggest contributors to relative performance during the month. The Reliance share price was boosted by a rebound in refining margins during October. Bank of Mandiri meanwhile reported strong 3Q22 results with net interest income and pre-provision operating profit up 22% and 26% respectively. Finally, Samsung Electronics bounced as memory peers such as SK Hynix and Micron announced capex cuts which could help to stabilize memory prices earlier than expected.

Moutai, Mengniu and China Merchants Bank (CMB) were the biggest drags on alpha. Moutai was sold off during the month on concerns that the Chinese Government could look to ban baijiu consumption for government officials. We note however that government related baijiu sales account for less than 10% of Moutai revenues. Moutai meanwhile reported solid 3Q results during the month with revenue and profit grow up 15%yoy and 16%yoy respectively. Mengniu's share price was impacted by negative read-throughs from its competitor Yili, which reported a weaker than expected 3Q result. Mengniu management has subsequently confirmed that drivers of Yili's earnings miss such as decelerating liquid milk sales and high operating costs are idiosyncratic. Our channel checks meanwhile suggests that Mengniu has likely gained market share in the liquid milk segment and expanded margins marginally during the quarter. Finally, CMB corrected during the month on news that ex-President Tian Huiyu was expelled from the Communist Party on corruption violations. We believe that CMB has been overpenalised on this event as the violations are related to individual rather than institutional misconduct. CMB has historically demonstrated a cautious risk management culture characterized by low non-performing loan ratio of 0.95%, high provision coverage of 456% and Tier 1 capital ratio of 14.9%. As such, we believe CMB is unlikely to deviate from its more market focused business strategy and is therefore fundamentally undervalued at P/B of 0.8x vs ROE of 16.5%.

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](mailto:info@ellerstoncapital.com).

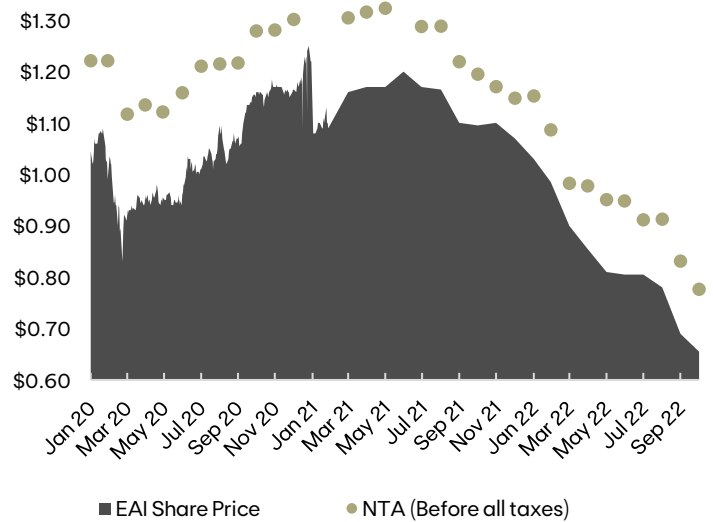
Kind Regards,  
Fredy Hoh

## PORTFOLIO CHARACTERISTICS

### TOP 10 HOLDINGS

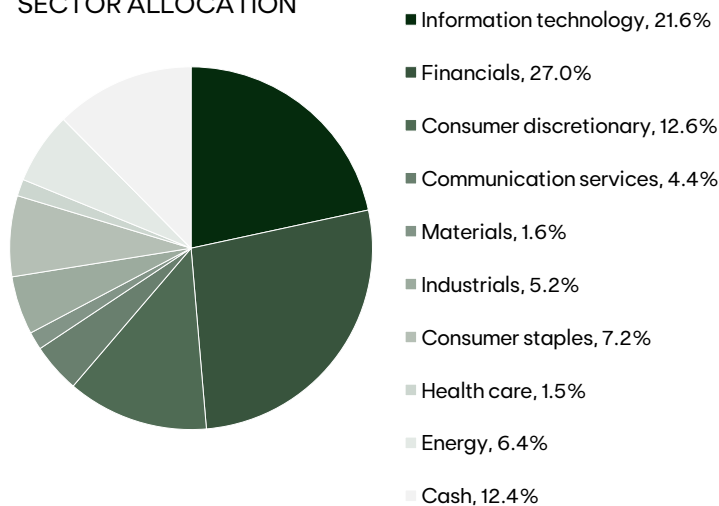
TSMC	8.4%
Samsung Electronics	7.0%
Reliance Industries	6.4%
DBS Group Holdings	5.0%
ICICI Bank	4.4%
Tencent	4.4%
AIA Group	4.4%
Alibaba Group Holding	3.8%
PT Bank Mandiri	3.5%
China Mengniu Dairy	3.0%

### EAI SHARE PRICE VS NTA



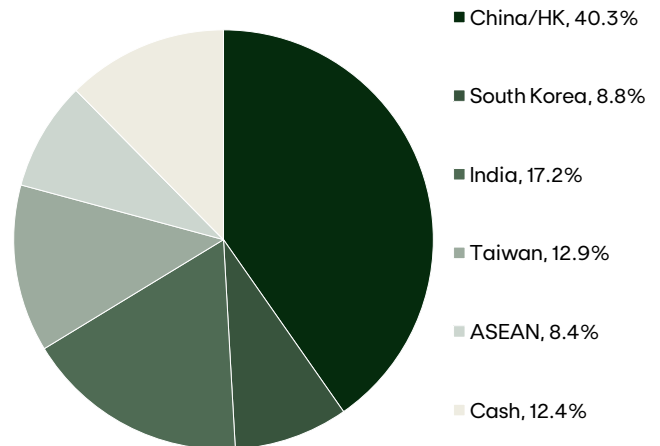
Source: Ellerston Capital.

### 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](mailto:info@ellerstoncapital.com) or visit us at [ellerstoncapital.com](http://ellerstoncapital.com)

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