

# Equus Point Capital Market Neutral Fund

## Performance Update 31 January 2020



Net Returns	1m	3m	6m	1yr	Incept pa	Risk Characteristics	
Equus Point Capital	3.32%	-0.30%	-4.58%	0.61%	1.85%	Volatility	7.43%
Cash	0.06%	0.19%	0.42%	1.11%	1.17%	Beta	0.10
Excess	3.25%	-0.49%	-5.00%	-0.50%	0.68%	Correlation to S&P/ASX 200	0.15
						Sharpe Ratio	0.10

### Commentary

The Fund returned +3.32% after fees for the month.

Stock selection generated +2.16% alpha for the month, with longs returning +0.68% alpha and shorts +1.48% alpha, whilst our beta positioning contributed +1.20% alpha.

Pleasingly the alpha generated over the month was broad based in nature. In particular the short exposure, which is always a constrained exposure, contributed significant alpha on the back of short positions in:

- Energy
  - Soul Pattinson +0.16%
  - Viva Energy +0.17%
  - Whitehaven Coal +0.23%
- Information Technology
  - Nearmap +0.53%

Key sector alpha drivers for the long exposure included:

- Healthcare
  - Polynovo +0.17%
  - Resmed +0.27%
- Financials (ex-Banks and REIT's)
  - Credit Corp +0.28%
  - Magellan Financial Group +0.23%
- Information Technology
  - EML Payments +0.19%

Negative alpha contributions included:

- Western Areas -0.35%
- Super Cheap -0.27%
- Independence Group -0.24%
- Vocus Group -0.21%
- Sydney Airport -0.20%

In our monthly reports we often take the opportunity to peel back the layers on our strategy and the key differences between a traditional long only portfolio and a market neutral strategy. This month we focus on the limitations that exist within a long only portfolio for a manager and how a market neutral strategy can take advantage of alpha generating opportunities, both long and short.

With a long only portfolio active returns are derived from that portion of the portfolio exposure that deviates

from benchmark weight. We can break this down into a standard long only portfolio being a composite of each stock's index weight, plus or minus the manager's active tilt.

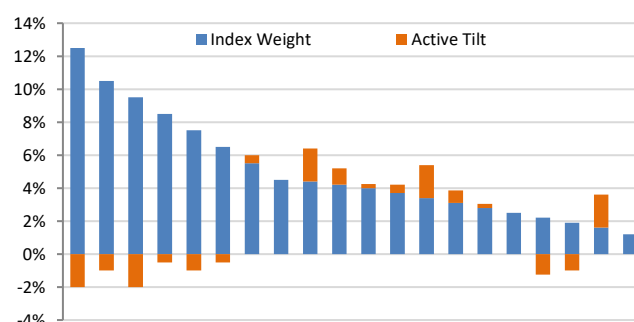
An active manager is ultimately seeking to over-weight stocks they believe have the potential to out-perform the index, and either under-weight or exclude stocks that they expect to under-perform the index. A manager's active return comes directly from these positive and negative active positions. Importantly, while there is essentially no limit to the magnitude of an overweight position and managers are free to express their views, the same cannot be said of underweight positions. The maximum underweight position to a stock is limited to its index weight.

The impact on returns from a long only manager's negative view on a stock is limited to avoiding the impact of that stock's negative return impact in the event the stock under-performs the index. For example, a manager has a negative view on BHP and excludes the stock from the portfolio. If the manager is correct and BHP under performs, then the impact on returns is avoided. Conversely, if BHP out-performs the index the manager incurs an opportunity cost of not having that exposure.

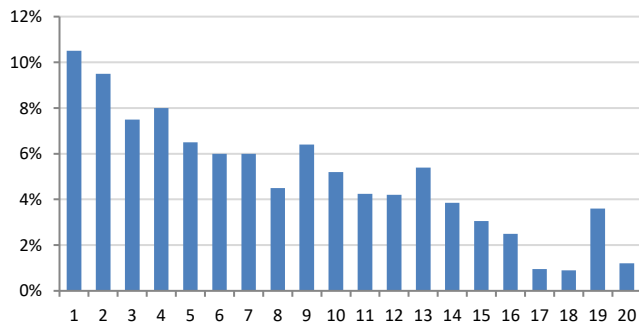
Importantly the manager's ability to maximize an active exposure is limited to a stock's weight in the index, and for the majority of index constituents this weight is relatively small.

In the following illustration we break down the exposure for a long only portfolio into its passive component (index weights) and its active component (or tilts).

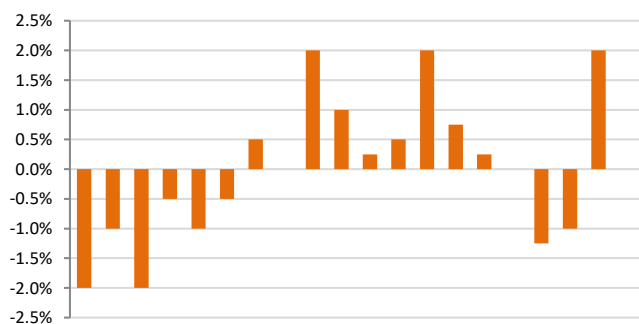
Index Weight and Active Weight



**Long Only Portfolio**



**Long Only Portfolio Active Positions**



The median weight for a stock in the S&P/ASX 200 is 0.17% (and an average weight of 0.50%). Consequently, with a long only portfolio, underweighting a stock in the index to zero weight has only a marginal impact on the overall portfolio. In contrast, the same stock can be significantly over-weighted and have a much larger impact on portfolio returns. This may explain the focus on winners in research and stock selection. With a long short or market neutral strategy, this constraint on being able to underweight through the use of shorting is removed allowing the manager to fully exploit the opportunity set to derive alpha.

Finally, long only managers are commonly constrained by tracking error, or the volatility of excess returns. The greater the deviation from index weight (i.e. the greater the number and degree of active positions) the larger the potential tracking error. Conversely a manager that is seeking to minimize tracking error would have fewer and smaller active positioning, but this runs the risk of investors receiving index-like return outcomes.

Of course there is a fine balance between introducing tracking error and active share to produce meaningful excess returns, a manager's capacity and the manager's skill. Something we addressed in November 2019 under

**Finding Alpha – the intersection between active share, capacity and manager skill.**

By removing the need to be tied to an index and the underlying index weights of its constituents, a market neutral strategy is better able to target stocks that present the most opportunity. Positioning is unrelated to index weight.

Traditional market neutral strategies tend to be pairs based, where each long position is offset by a short position, and often with stocks derived from the same sector. Short positions do not necessarily have to decline to contribute a positive portfolio outcome, provided the offsetting long position out-performs, and conversely for long positions.

At Equus Point Capital our stock selection is not based on a pairs based strategy and we construct the portfolio differently to standard market neutral pairs-based portfolios.

Firstly, our stock selection is based on inherent behavioural biases that exist amongst market participants. That is stocks with positive historical returns tend to continue to produce positive returns and stocks with negative historical returns tend to continue to produce negative returns.

Secondly, we recognize the opportunity to derive high quality alpha from a short exposure is more limited in nature. In addition shorts tend to be more volatile in nature and without robust risk management, short positions can in theory negatively impact returns should they go against you. Accordingly our short positions tend to be constrained to reflect these risks.

Thirdly, our longs positions are totally independent of our short positions. Unlike a traditional pairs base market neutral strategy where a long position is offset by a related short position (for example, long BHP and short RIO), our stock positioning is totally independent.

Lastly, we employ futures to achieve an overall market neutral exposure. This is encompassed within robust risk management framework to manage exposure, leverage and residual beta.

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### Net Monthly Performance

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### Gross Monthly Performance

Asset	Positions	Weight	Return	Alpha
Long	70	110.42%	5.68%	0.68%
Short	28	-26.95%	0.23%	1.48%
Futures		-53.12%	5.12%	1.20%
Cash		16.53%	0.06%	0.01%
	98	126.95%	3.36%	3.36%
Cash				0.00%
Excess				3.36%

### Exposure and Gross Monthly Alpha

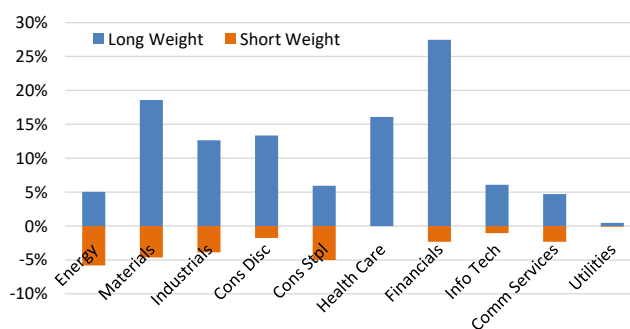
Sector Name	Long Weight	Short Weight	Active Weight	Alpha Contrib
Energy	5.0%	-5.8%	-0.8%	0.38%
Materials	18.6%	-4.7%	13.9%	0.29%
Industrials	12.6%	-3.9%	8.7%	0.02%
Cons Disc	13.4%	-1.7%	11.6%	-0.27%
Cons Staples	6.0%	-5.0%	0.9%	0.09%
Health Care	16.1%	0.0%	16.1%	0.63%
Financials	27.5%	-2.4%	25.1%	0.69%
Info Tech	6.1%	-1.1%	5.1%	0.55%
Comm Serv	4.7%	-2.3%	2.4%	-0.22%
Utilities	0.5%	-0.1%	0.4%	-0.02%
Stock Total	110.4%	-26.9%	83.5%	2.14%
Futures			-53.1%	1.20%
Cash			16.5%	0.01%
Total			100.0%	3.35%

Net Exposure	30.4%
Gross Exposure excluding Futures	137.4%
Gross Exposure including Futures	190.5%

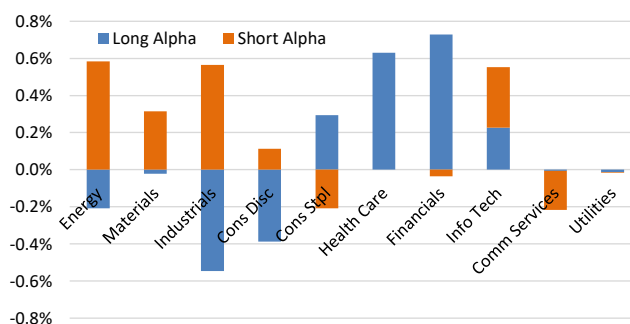
### Major Alpha Contributors

Name	Weight	Contrib	Alpha
<b>Top Five Contributors</b>			
Cimic Group Ltd	-2.54%	0.43%	0.53%
Nearmap Ltd	-0.53%	0.27%	0.34%
Sandfire Resources	-2.40%	0.19%	0.33%
Silver Lake Resource	1.99%	0.33%	0.33%
James Hardie Industries	4.07%	0.51%	0.33%
<b>Bottom Five Contributors</b>			
Sydney Airport	2.31%	-0.09%	-0.20%
Vocus Group Ltd	-2.32%	-0.33%	-0.21%
Independence Group	2.77%	-0.05%	-0.24%
Super Retail Ltd	2.59%	-0.22%	-0.27%
Western Areas Ltd	1.44%	-0.26%	-0.35%

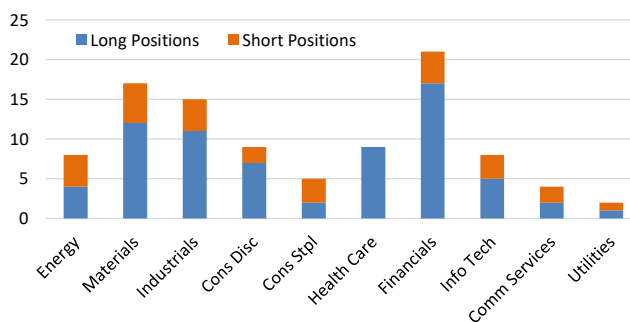
### Sector Exposure



### Sector Alpha



### Positions



# Equus Point Capital Market Neutral Fund

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### Investment Manager

Equus Point Capital is a boutique fund manager focused on producing meaningful risk adjusted returns from the Australian equities market. Equus Point was founded in 2017 in partnership with Prodigy Investment Partners.

Equus Point's investment process is systematic, designed to produce a return stream irrespective of market direction over the long term, with low volatility and uncorrelated to traditional asset classes.

### Fund Objective

To deliver absolute returns above the RBA Official Cash Rate over a rolling five-year period, with low volatility and a low correlation to traditional asset classes.

### Investment Philosophy

Equus Point uses a systematic approach to investing, seeking to harvest meaningful risk adjusted returns from behavioural biases in the Australian equities market. The strategy uses both long and short positions coupled with index futures to achieve a market neutral portfolio that seeks to produce positive returns irrespective of equity market direction and uncorrelated to traditional assets. Equus Point's robust risk management approach limits to portfolio's beta positioning, portfolio volatility, individual stock positioning, and long and short portfolio positioning.

The Fund employs a proprietary systematic investment process. The Fund invest exclusively in Australian equities and equity derivatives.

We believe in the following:

- In the short to medium term behavioural biases of investors can influence stock prices leading to both momentum and reversion effects. Momentum is where stocks with positive historical returns tend to be rewarded with a continuation of positive returns, and stocks with negative historical returns tend to underperform with a continuation of negative returns. Reversion is where stock prices initially overshoot before returning to a perceived fair value.
- Meaningful risk adjusted returns can be achieved through a portfolio of both long and short positions seeking to harvest positive and negative momentum.

- Managing the risks of the potential for stock price reversion, stock volatility, portfolio volatility and beta exposure are a core part of the investment process.
- Market neutral positioning between long and short portfolios is ensured through the use of index futures to offset residual beta risks.
- Combining the above dynamics with acceptable leverage delivers a portfolio that is designed to provide superior risk adjusted returns through market cycles.

### Benefits of the Fund

1. A systematic strategy with a disciplined focus on risk management.
2. Attractive risk adjusted returns over the long term.
3. Low volatility return stream uncorrelated to traditional asset classes over a rolling five year time frame.
4. Expected to preserve capital in volatile and negative equity markets.

### Key Attributes

APIR Code	ETL5256AU
Benchmark	RBA Official Cash Rate
Investment Objective	To deliver absolute returns of 5% above the RBA Official Cash Rate over a rolling five year period
Management Fee	1.20%
Performance Fee	20% over benchmark plus Management Fee
Redemption/Liquidity	Daily
Buy/Sell Spread	+/-0.35%
Entry/Exit Fees	Nil
Distributions	Half Yearly
Inception	30 Nov 18
Investment Manager	Prodigy Investment Partners
Sub Investment Manager	Equus Point Capital
Trustee	Equity Trustees Limited
Prime Broker	Morgan Stanley
Administrator	RBC Investor Services

Further information: [www.equuspointcapital.com](http://www.equuspointcapital.com)

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