Equus Point Capital Market Neutral Strategy

Performance Update 31 July 2020

Net Returns	1m	3m	6m	1yr	Incept pa
Equus Point Capital	2.85%	9.12%	0.58%	-3.50%	1.65%
S&P/ASX 200 Accum	0.50%	7.62%	-14.25%	-9.87%	6.43%
Cash	0.02%	0.06%	0.18%	0.60%	0.92%
Excess v Cash	2.83%	9.06%	0.40%	-4.10%	0.72%

Risk Characteristics	
Volatility	8.6%
Beta	-0.02
Correlation to S&P/ASX 200	-0.06
Sharpe Ratio	0.1

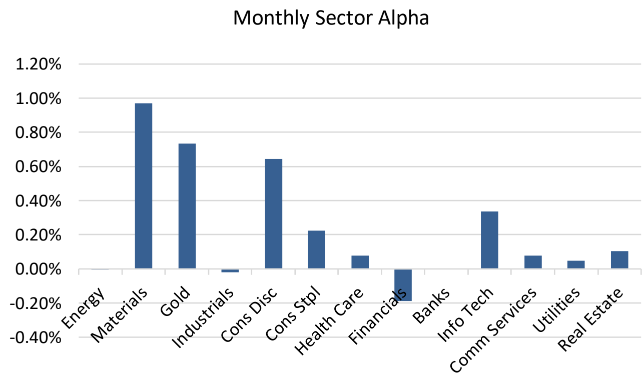
Commentary

The Strategy returned 2.85% after fees for the month. Please note that with the Fund closed during May, the results for July are simulated returns.

Stock selection generated 3.00% alpha for the month, the result of long exposures with direct shorts having been closed out in favour of futures during March. Our beta positioning contributed -0.06% alpha.

Alpha from stock selection has been primarily sourced from exposures to themes that have benefited through the last four months of COVID lockdowns and associated impacts:

- Materials: 7.97% weight contributing 0.97% alpha, with key positions being Iluka, James Hardie, Mineral Resources and OZ Minerals. Commodity prices have held up nicely given China managed to exit the worst of COVID related shutdowns and Brazil has seen a gradual closure of mines due to a failure to control virus infection rates.
- Gold: 8.25% weight contributing 0.73% alpha, with key positions being Gold Road, Perseus Mining, Regis, Saracens, St. Barbara and Silver Lake. Gold in particular has benefited from a resurgent gold price (now firmly ensconced above $2,000 USD an ounce) on the back of a weakening US dollar and general fears around virus, elections, trade tensions and longer-term inflationary fears. Historically one of the headwinds gold has faced is the fact that it does not provide an income or yield. However, in an environment of low or negative bonds yields, golds lack of a yield becomes less of an issue.
- Consumer discretionary: 9.25% weight contributing 0.64% alpha, with key positions being Breville Group, Dominos, JB HiFi and REA Group.
- Information Technology: 10.5% weight contributing 0.34% alpha, with key positions being data solutions firm Appen, data centre operators Megaport and NextDC, business software Technology One and cloud-based accountancy software firm Xero.



Given the market draw down and partial recovery it is perhaps prudent to review how the strategy has performed through these events.

We have always stated the aim of the strategy was to provide absolute returns in excess of the official cash rate, uncorrelated to and with lower volatility than the equities market, and preserve capital during times of market stress. The following table summarizes these key points for the period from Nov 2018 to July 2020.

Whilst the headline return has been modest versus our historical numbers, the volatility of the return stream, correlation and beta versus the equities market and the lower draw down all point towards the strategy results consistent with its objectives.

	Strategy	XJOAI	Cash
Return Net	2.76%	10.95%	1.55%
Return Annual	1.65%	6.43%	0.92%
Volatility	8.6%	23.6%	
Reward to Risk	0.2	0.3	
Sharpe Ratio	0.1	0.2	
Draw Down	-13.4%	-35.9%	
Beta	-0.02		
Correlation	-0.06		

The recent bout of volatility is a firm reminder that seeking returns from the equity market is not without risk. The higher the return, the higher the potential risks and volatility of those returns.

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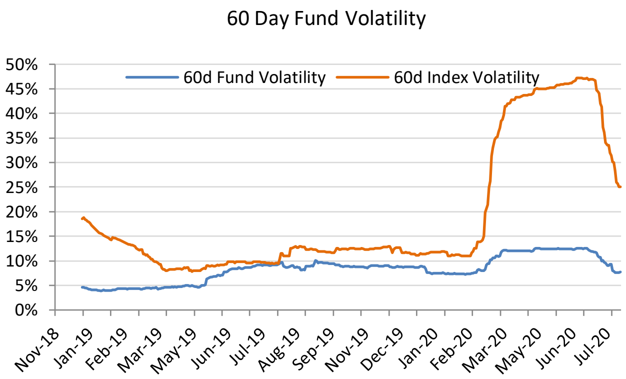
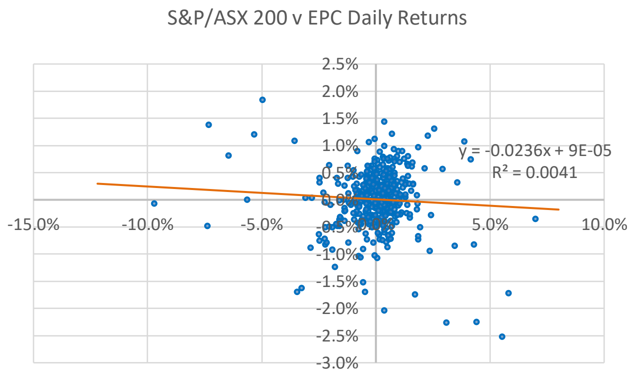




But history tells us that bouts of extreme volatility occur more frequently than normal probability distributions would have us believe. The most wildly recognized measure of volatility is the VIX, often referred to as the 'fear index' as the VIX tends to increase in response to market fears and stress. When markets are generally positive the VIX tends to be in low. But the VIX can also rapidly increase when markets turn negative and are under stress.

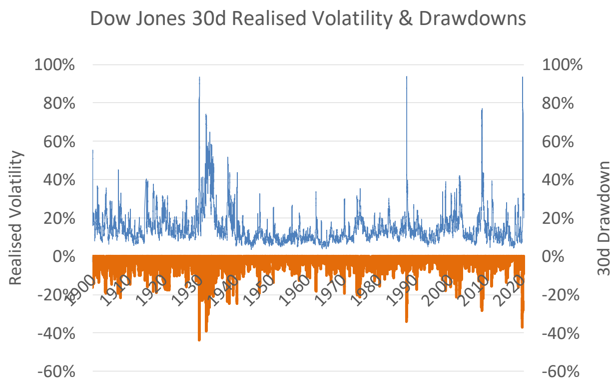
The VIX index is calculated to reflect the 'implied' volatility of exchange traded options over the S&P 500 with expiries between 23 and 37 days. It is a gauge of expected future one month volatility. The original VIX index was launched by the Chicago Board Options Exchange (CBOE) back in 1993 based on S&P 100 options. This evolved to be based on the S&P 500 in 2003 following a revision and changes to the methodology to a more robust and relevant approach for traders and hedging.

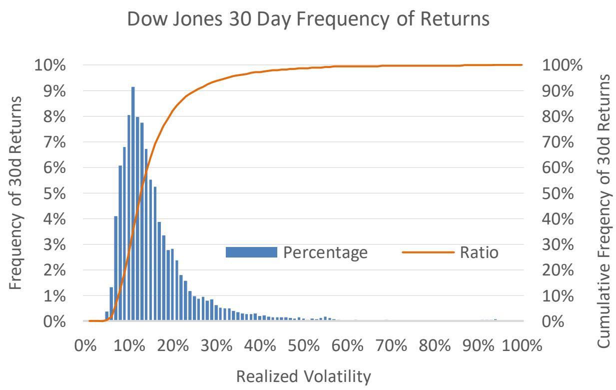
The VIX is also a mean reverting index, unlike most other indices which are trending in nature, albeit with periods of negative returns and drawdowns. Note also that implied volatility will typically be higher, on average, than realized volatility. This difference is called the 'volatility risk premium'.

Given the VIX is based on S&P 500 options we can use the realized volatility of the S&P 500 index to get a sense of the longer term context for volatility expectations.

However, whilst the S&P 500 extends back to 1957 we can use the Dow Jones Industrial Average as gauge for a longer term history of volatility, again based around realized volatility rather than implied volatility. Given the strong correlation between the Dow Jones and the S&P 500, such a comparison, whilst not perfect, acts as a reasonable proxy.

The following chart details the realized 30 day volatility for the Dow Jones Industrial Average and its related 30 day drawdown, since 1900.





With the long-term average for realized volatility around 15%, some 90% of realized volatility for the Dow Jones is less than 25%. However, the long right tail skew indicates the potential for volatility spikes which in turn typically reflect periods of large drawdowns in equity markets.

In summary, volatility defining characteristic of equity markets and volatility spikes occur with greater frequency than normal distribution curves would suggest. And this plays out in an environment at present that exhibits a number of potential risks to equity markets.

On the negative side (and this is by no means exhaustive) we have:

- Concentration risks skewing the US market where the likes of Apple, Amazon, Facebook,

Microsoft, Netflix and Google now present more than the entire Japanese market;
- Sowing the seeds of uncertainty around the Trump administration acceptance of the November elections;
- The US economy has experienced the greatest quarterly setback in history
- Social divisions in the US across race, religion, politics, health and class;
- Politicization of public health with the virus firmly entrenched in the US and unlikely to be fully contained without a full lockdown (something the Trump administration has firmly resisted) or a vaccine is fast tracked;
- An escalation of the US-China trade war and concerns over intellectual property;
- Cyber warfare from state actors interfering in the US November elections, intellectual property and infrastructure; and
- South China Sea disputes.

On the positive side we have:

- Unprecedented central bank intervention and government fiscal support propping up economies, with the US Federal Reserve and Treasury apparently willing to provide support and stimulus well into the future;
- Government decision making in Europe designed to minimize the spread of COVID-19;
- Multiple agencies and researchers seeking a vaccine, with fast track approval, rapid manufacture and a concerted distribution (Goldman Sachs recently indicated they expected a vaccine will be approved by years end and with distribution in the first quarter of 2021). Vaccine approval will rapidly reshape expectations of economic recovery; and
- Closer to home, infection rates that are gradually coming under control in Victoria, albeit NSW remains on edge.

Legendary investors have also sounded the alarm and have taken more conservative positions in the face of a rising equity market and declining economic environment:

- Warren Buffet has raised to $130b within Berkshire Hathaway;
- Howard Marks of Oaktree Capital has been raising concerns about the equity market recovery and valuations in his regular memo’s;
- Jeremy Grantham raised the prospect that he was witnessing the “fourth major stock market bubble” of his 40-plus year investment career, with “US valuations in the top 10% of its history” and the US economy in the “worst 10%, perhaps even the worst 1%” of its history. To quote Grantham in his 1Q 2020 newsletter, “markets have historically loved fat margins, low inflation, stability and, by inference, low levels of uncertainty. This is apparently one of the most impressive mismatches in history”.

In an environment where there are multiple risks that may, or may not play a role in volatility expectations going forward, investors should be cognizant that volatility spikes will need to be navigated.

Having an exposure to liquid alternatives such as a market neutral strategy can mitigate the impact of severe volatility episodes. The benefits of this alternative exposure to standard long only strategies is that by removing the impact of beta from the portfolio one can also reduce the volatility of the return stream and preserve capital when markets are under stress.

Whilst we have gradually increased exposure to the long equities portfolio we remain cautious in the current environment.

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Net Monthly Performance

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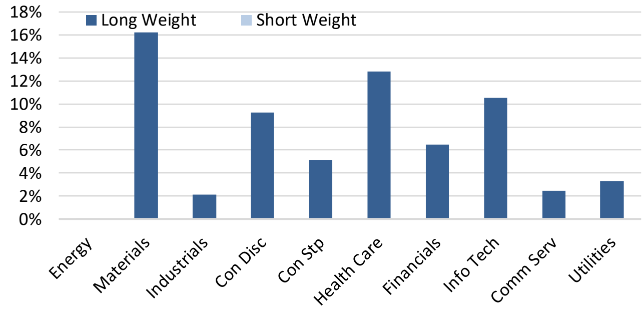
Gross Monthly Performance

Asset	Positions	Weight	Contrib	Alpha
Long	47	68.4%	2.50%	3.00%
Short	0	0.0%	0.00%	0.00%
Futures		-31.7%	0.45%	-0.05%
Cash		31.6%	0.01%	0.01%
	47	100.00%	2.96%	2.96%
Cash				0.02%
Excess				2.94%

Sector Exposure

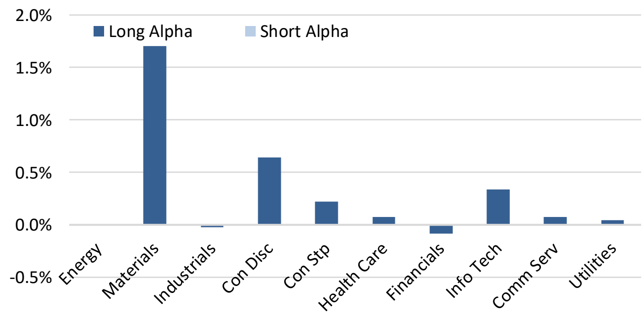


Exposure and Gross Monthly Alpha

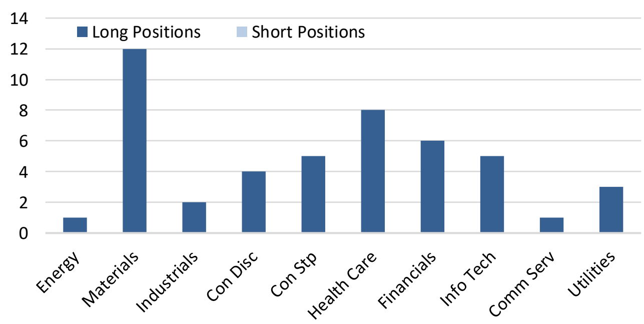
Sector Name	Long Weight	Short Weight	Active Weight	Alpha Contrib
Energy	0.1%	0.0%	0.1%	-0.01%
Materials	16.2%	0.0%	16.2%	1.71%
Industrials	2.1%	0.0%	2.1%	-0.02%
Cons Disc	9.2%	0.0%	9.2%	0.64%
Cons Staples	5.1%	0.0%	5.1%	0.22%
Health Care	12.8%	0.0%	12.8%	0.08%
Financials	6.5%	0.0%	6.5%	-0.08%
Info Tech	10.5%	0.0%	10.5%	0.34%
Comm Serv	2.5%	0.0%	2.5%	0.08%
Utilities	3.3%	0.0%	3.3%	0.05%
Stock Total	68.4%	0.0%	68.4%	3.00%
Futures			-31.7%	-0.05%
Cash			31.6%	0.01%
Total	68.4%	0.0%	100.0%	2.96%

Net Exposure	36.7%
Gross Exposure excluding Futures	68.4%
Gross Exposure including Futures	100.1%

Sector Alpha



Positions



Major Alpha Contributors

Name	Weight	Contrib	Alpha
Top Five Contributors			
Mineral Resources	3.14%	0.52%	0.56%
Oz Minerals Limited	2.16%	0.39%	0.41%
Nextdc	2.77%	0.33%	0.34%
Breville Group Ltd	2.25%	0.23%	0.25%
Silver Lake Resources	1.68%	0.22%	0.23%
Bottom Five Contributors			
Nanosonics	0.98%	-0.17%	-0.18%
Adelaide Brighton	0.20%	-0.13%	-0.14%
Aust. Stock Exchange	3.34%	-0.12%	-0.10%
Technology One	2.31%	-0.09%	-0.08%
AMP Limited	0.29%	-0.08%	-0.07%

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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.

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.

Strategy 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 Strategy 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 Strategy

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.

Further information: www.equuspointcapital.com
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