Equus Point Capital Market Neutral Strategy

Performance Update 31 January 2021

Net Returns	1m	3m	6m	1Yr	2yr pa	Incept pa
Equus Point Capital	0.67%	-1.31%	0.92%	1.81%	1.21%	1.83%
S&P/ASX 200 Accum	0.32%	11.89%	12.99%	-3.11%	9.93%	10.96%
Cash	0.01%	0.03%	0.09%	0.27%	0.69%	0.75%
Excess v Cash	0.66%	-1.34%	0.83%	1.54%	0.52%	1.08%

Risk Characteristics	
Volatility	8.1%
Beta	0.10
Correlation to S&P/ASX 200	0.25
Sharpe Ratio	0.14

Commentary

The Strategy returned 0.67% after fees for the month. Please note that with the Fund closed during May, the results for December are simulated returns.

On a gross basis stock selection generated 0.78% alpha for the month, with long exposures contributing 0.48% alpha and a modest short exposure contributing 0.29% alpha. Our beta positioning contributed 0.00% alpha.

The volatility of returns since inception is 8.1% annualized versus 19.9% for the S&P/ASX 200 Accumulation Index.

Positive alpha contributions from stock positions included:

- Consumer Discretionary (+0.85%)
  - ARB Corporation +0.30%
  - Harvey Norman +0.30%
  - Breville Group +0.24%
  - Dominos +0.13% and
  - JB Hi-Fi +0.13%
- Healthcare (+0.20%)
  - Pro Medicus +0.46%
- Communication Services (+0.19%)
  - Chorus Group +0.13%

Negative alpha contributions included:

- Energy (-0.38%)
  - Soul Pattinson -0.33%
- Materials (-0.13%)
  - Mineral Resources -0.20%
  - Sims Group -0.17%
  - Hardie (James) -0.12%
  - Bluescope Steel -0.09%

The portfolio has been largely retained with a positive beta position and modest levels of gearing.

A Long Only Portfolio

Periodically we have been asked how the Strategy might have performed as a long only portfolio. To some degree this is a naturally question as investors are more familiar with, and anchored to, a standard exposure to the equity market. In addition, the underlying exposure for the Strategy is Australian equities, so to a degree you do get incorrectly measured against an equity index, whereas being a market neutral based strategy the impact of the market is largely removed and the benchmark is officially cash.

As a market neutral strategy we will have both long and short equity positions which on average tends to resemble something like a 130/30 long short exposure. We then apply futures to remove the residual impact of the portfolios beta to achieve a market neutral, or largely beta neutral, exposure.

To be measured purely as a long only strategy we need to firstly remove the impact of any leverage (as long only strategies are not permitted to be any more than 100% invested), secondly exclude any impact of short positions, and lastly readjust our beta exposure to one (as the return stream from long only strategies tend to very closely match that of index returns). With daily data extending more than twenty years we can run the numbers to get a sense of how we would have performed against the S&P/ASX 200 Accumulation Index.

	Long Only	XJOAI
Return	1308.4%	370.1%
Return pa	13.8%	7.8%
Volatility	14.2%	13.4%
Reward to Risk	0.97	0.58
Sharpe Ratio	0.70	0.30
Draw Down	-45.3%	-47.2%
Hit Rate	67%	63%
Up Market	3.2%	3.0%
Down Market	-2.3%	-3.2%
Beta	0.90	
Correlation	0.85	
Tracking Error	7.5%	
Information Ratio	0.79	
Up Capture	1.27	
Down Capture	0.93	
Capture Ratio	1.36	

The results indicate the return and risk outcomes over the long term would have been very attractive. Naturally there will be periods when the strategy would have done worse than the index and other times significantly better than the index, but on balance, over the long term the results are compelling.

The returns extend from June 2000 to December 2020 and are gross of any fees. However, even with a modest fee being applied the returns would have comfortably out-performed the index and produced superior risk adjusted outcomes.

We can also compare the results to the Morningstar universe of diversified equity funds that extends ten years to December 2020. Over that time frame the strategy would have ranked in the top 20 out of some 500 products.

A Recipe for Bubbles

The other discussion point that is worth raising has been the Reddit fueled frenzy around the trading in the US based GameStop. It has been the talk of the markets and it would be difficult to not at least make a comment. However, much has already been written about GameStop, and we do not intend to repeat those comments. Rather we will focus on some of the drivers for stock price mania.

William Quinn and John Turner in their book 'Boom and Bust: A Global History of Financial Bubbles' (2020) proposed that there are three requirements for a bubble to exist.

Firstly, a security needs a degree of marketability. In a sense marketability provides the oxygen for a bubble to exist. It provides the environment for the rapid execution of trades.

For example, the US based Robinhood has allowed what is essentially the democratization of trading by providing commission free execution. Retail traders can for the first time participate in the market in a way that was not previously available. A trader can send orders with a simple click of an iPhone instantly. Robinhood also introduced the ability to trade a fraction of a share, making share ownership more accessible for the small trader. So rather than not being able to afford a share in Amazon at $3,300, they can acquire, for example, 1/10th of a share for $330.

The second requirement is the availability of cheap funding and credit.

Cheap money forces investors into riskier assets and the availability of credit allows increased leverage. For example, the US housing bubble was largely fueled by low interest rates, the availability of credit and the relaxation of credit standards. With the more recent GameStop example we have near record low interest rates which has allowed investors to participate with minimal cost through margin accounts.

Lastly there needs to be a degree of speculation. The likes of Reddit and other message boards have allowed for greater speculation, where ideas and concepts (we might also add conspiracies) can be easily and rapidly disseminated to a broad audience.

Clearly one individual will not be able to change the market, but a collective, such those that have participated through Reddit, and trade through Robinhood by way of fractional shares at zero cost, can clearly move stock prices.

We might also add that the level of short interest in GameStop was at one stage 120% of the 69m shares on issue. With average daily volumes prior to recent events of less than 6m shares per day, a little bit of research, the rapid dissemination of information, commission free trading, leverage on near zero interest rates, in hindsight one might understand how the conditions were right for a short squeeze in GameStop. A lack of liquidity and short covering by hedge funds that were forced to exit due to margin calls from prime brokers led, in part, to rapid price appreciation. That rapid price appreciation attracted further buyers and forced further short covering, adding further fuel to the price frenzy.

Now knowing the broad ingredients for a bubble, you could not imagine it would be GameStop or AMC, but you can see how the stars were aligned for a bubble to occur.

We might also add that history has demonstrated that these bubbles to not end well.

Finally, by way of comparison, the largest short position on the Australian Stock Exchange is Webjet with 14% of shares on issue being shorted. Could such a short squeeze occur locally? In theory, yes, and you do from time to time see bouts of increased trading around a short squeeze. But the degree of shorting and the liquidity conditions are not akin to what has been witnessed recently in the US.

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Gross Monthly Performance

Asset	Positions	Weight	Contrib	Alpha
Long	75	93.9%	0.49%	0.48%
Short	29	-19.7%	0.38%	0.29%
Futures		-48.3%	-0.08%	0.00%
Cash		25.8%	0.00%	0.00%
		100.0%	0.78%	0.78%
Cash				0.01%
Excess				0.77%

Exposure and Gross Monthly Alpha

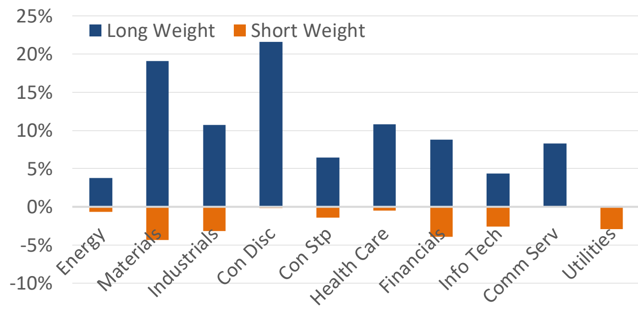
Sector Name	Long Weight	Short Weight	Active Weight	Alpha Contrib
Energy	3.77%	-0.68%	3.09%	-0.38%
Materials	19.07%	-4.31%	14.76%	-0.13%
Industrials	10.68%	-3.18%	7.50%	0.02%
Cons Disc	21.56%	-0.14%	21.43%	0.85%
Cons Staples	6.48%	-1.41%	5.07%	0.01%
Health Care	10.80%	-0.52%	10.29%	0.20%
Financials	8.80%	-3.93%	4.87%	-0.04%
Info Tech	4.34%	-2.58%	1.76%	-0.04%
Comm Serv	8.33%	-0.08%	8.24%	0.19%
Utilities	0.08%	-2.91%	-2.83%	0.12%
Stock Total	93.92%	-19.74%	74.17%	0.77%
Futures			-48.27%	0.00%
Cash			25.83%	0.00%
Total			100.00%	0.78%

Net exposure including futures	25.9%
Gross exposure excluding futures	113.7%
Gross exposure including futures	161.9%

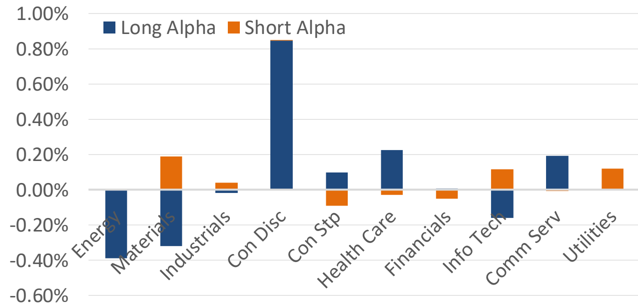
Major Alpha Contributors

Name	Weight	Contrib	Alpha
Top Five Contributors			
Pro Medicus	1.82%	0.46%	0.46%
Lynas Corporation	2.34%	0.44%	0.45%
ARB Corp Ltd	2.16%	0.30%	0.30%
Harvey Norman	2.23%	0.30%	0.30%
Breville Group Ltd	2.02%	0.24%	0.24%
Bottom Five Contributors			
Sims Group Limited	1.30%	-0.18%	-0.17%
Charter Hall Group	2.37%	-0.18%	-0.18%
Mineral Resources	2.88%	-0.19%	-0.20%
Soul Pattinson & Co	3.32%	-0.33%	-0.33%
Polynovo	1.40%	-0.48%	-0.49%

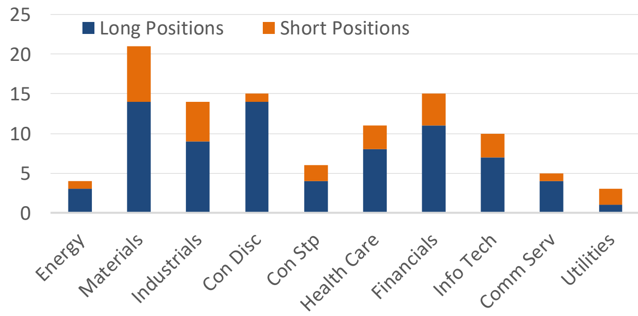
Sector Exposure



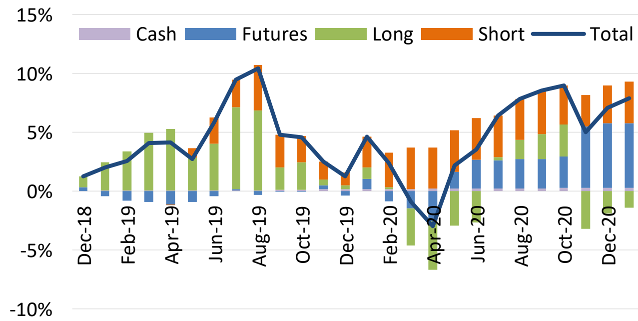
Sector Alpha



Positions



Total Alpha Contributions



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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 behavioral 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 behavioral 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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