Equus Point Capital Market Neutral Strategy

Performance Update 31 May 2021

Net Returns	1m	3m	6m	1Yr	2yr pa	Incept pa
Equus Point Capital	-0.86%	3.65%	9.23%	11.58%	4.17%	4.09%
S&P/ASX 200 Accum	2.34%	8.48%	11.74%	28.23%	9.38%	13.73%
Cash	0.01%	0.03%	0.05%	0.17%	0.46%	0.67%
Excess v Cash	-0.87%	3.63%	9.18%	11.41%	3.71%	3.43%

Risk Characteristics	
Volatility	7.93%
Beta	0.11
Correlation to S&P/ASX 200	0.26
Sharpe Ratio	0.43

Commentary

The Strategy returned -0.86% after fees for the month. Please note that with the Fund closed during May 2020, the results for the month are simulated returns.

On a gross basis stock selection generated -1.45% alpha for the month, with long exposures contributing -2.46% alpha and a modest short exposure contributing 1.01% alpha. Our beta positioning contributed 0.51% alpha.

The volatility of returns since inception is 7.9% annualized versus 18.6% for the S&P/ASX 200 Accumulation Index.

Positive alpha contributions from stock positions included:

- Utilities (+0.33%)
  - AGL (short position) +0.32%
- Industrials (+0.17%)
  - ALS +0.18%
  - Nearmap (short position) +0.11%

Negative alpha contributions included:

- Materials (-0.82%)
  - Mineral Resources -0.17%
  - Bluescope -0.13%
  - Champion Iron -0.11%
  - Incitec Pivot -0.10%
  - Sims Group -0.10%
  - Resolute Mining (short position) -0.15%
- Consumer Staples (-0.65%)
  - Costa Group -0.60%
- Information & Technology (-0.61%)
  - EML Payments -0.75%
  - Wisetech Global -0.19%

The largest contributors to the negative performance for the month were:

- EML Payments (-0.75%) on the back of money laundering and counter terrorism financing concerns by the Central Bank of Ireland with regards to EML's Irish operations.
- Costa Group (-0.60%) on the back of disappointing earnings guidance.

In prior months we have demonstrated how alpha can be attributed across volatility and beta. To recap, low volatility stocks tend to provide superior risk adjusted returns than high volatility stocks. Similarly, low beta stocks tend to provide superior risk adjusted returns than high beta stocks. Both anomalies are well documented in academic literature and have been featured in a range of professional papers. A portfolio that is constructed to take advantage of these anomalies can provide investors with incrementally superior risk adjusted returns.

We also demonstrated that at Equus Point our portfolios tend to have a natural skew towards lower volatility and lower beta names, consistent with this anomaly.

This month we delve into how returns are generated across the S&P/ASX 200 Index.

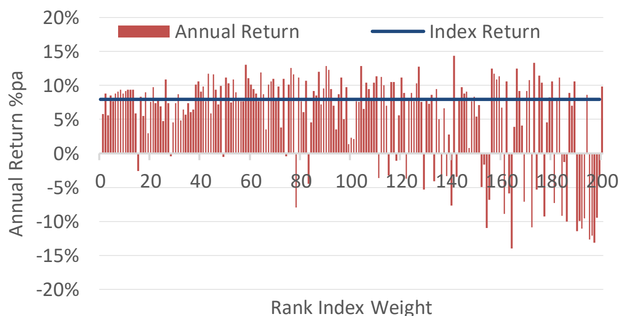
We ask, do large caps provide superior risk adjusted returns? Or to phrase it another way, large caps provide the largest contribution to index returns, but do they represent the best return outcomes on a nominal and risk adjusted basis, or are investors better served by focusing on a part of the Index that provides a better risk/return trade-off?

Invariably we view Index returns through the prism of the largest contributors to total return (i.e. the four banks and the largest resource companies). These stocks naturally provide the greatest contribution to the total return of the Index. Conversely, the smaller the weighting of a stock in the Index, the smaller the incremental contribution to the total Index return.

In the following charts we break down the average annual return for each stock ranked by index weight at the end of each month in the S&P/ASX 200. We can then determine the incremental contribution each ranking makes to the total Index return. The analysis period was from June 2000 to April 2021 and has been conducted on a nominal basis and on an alpha basis (or risk adjusted basis where each stocks return is adjusted to reflect its beta and the market return).

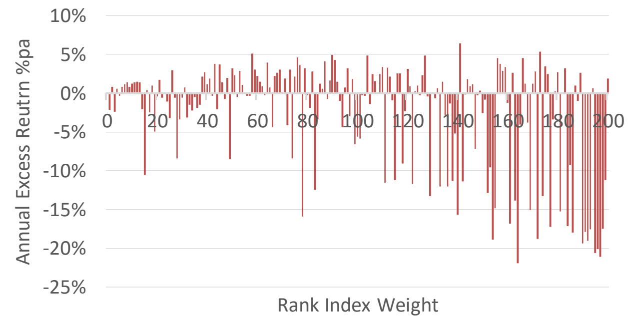
Note that stock rankings will naturally change over time as index weights adjust to changes in price, free float, inclusion and exclusion etc. The analysis is not designed

to highlight that any individual rank provides superior/inferior returns. Rather, it is designed to highlight that there are broad inefficiencies that exist in the Index (akin to low volatility and low beta providing superior risk adjusted returns). Given the portfolio construction for many long only portfolios is designed around taking small positional differences around Index weights, investors may wish to consider the risk/reward for such index wedded strategies.



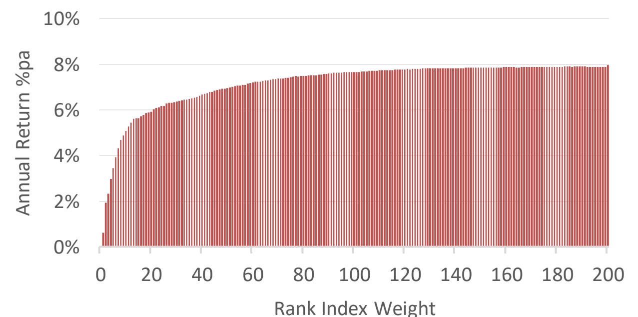
Being viewed through the prism of excess returns:

- Negative returns from those constituents ranked towards the bottom of the S&P/ASX 200 Index is pronounced. Anecdotally one might suggest that this negative return outcome is partly a function smaller stocks being prone to possible index exclusion (due to size and liquidity), being sold down. And as managers have increasing funds under management, the illiquidity of small caps requires managers to seek greater liquidity from large caps.
- At the other end of the spectrum the small variance in excess returns for the largest ranked stocks reflects their dominance in the Index and how they act as a proxy for a broad exposure, especially for international fund flow where immediate exposure and liquidity can be achieved with minimal market impact.
- Midcaps on balance provide greater opportunity for potential excess returns.



To reinforce the impact the large caps have to the total Index return, we can apply the index weight of each stock over the analysis period to determine the incremental contribution to total return. The following chart represents the accumulated total as one adds additional stocks and moves from largest to smallest ranked stocks in the Index.

Over the analysis period the S&P/ASX 200 Accumulation Index has returned 7.92% per annum. Note, some 75% (or 6%) of this return has been a function of the weight of the largest 30 ranked constituents with the remaining 2% a function of the residual 170 ranked constituents.



Now let’s turn our attention to viewing returns through the lens of risk adjusted returns.

To recap, we define alpha as the risk adjusted return for any given stock, taking into account that stock’s beta and the movement in the broader market. This is a better reflection of recognizing a stocks genuine return independent of any market movement and that stocks inherent sensitivity to those market movements.

We define alpha as: $a = R_s - (\beta_s * R_m)$

Where:
R_s = stock return
β_s = stock beta
R_m = market return

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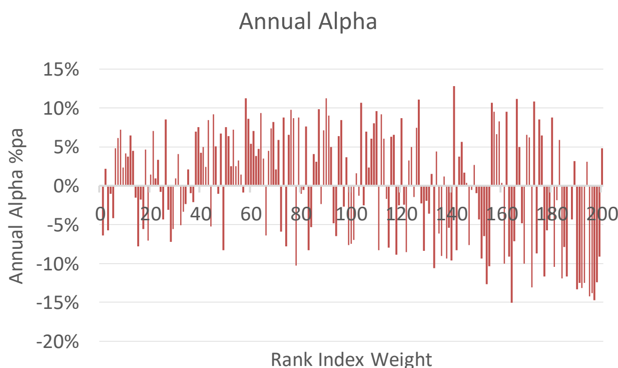
For example, consider the following table that includes two stocks and an index return. At first glance stock A has out-performed both the index and stock B. However, when adjusted for each stocks beta it is apparent that the 'alpha' of stock B is superior to stock that of stock A.

	Return	Beta	Expected Return	Alpha
Stock A	30%	2.0	40%	-10%
Stock B	15%	0.5	10%	+5%
Index	20%			-

On an alpha basis we witness a more pronounced under-performance of small cap stocks. The largest stocks by index ranking tend to have negative alpha. And mid-caps tend to provide, on balance, a more consistent alpha return.

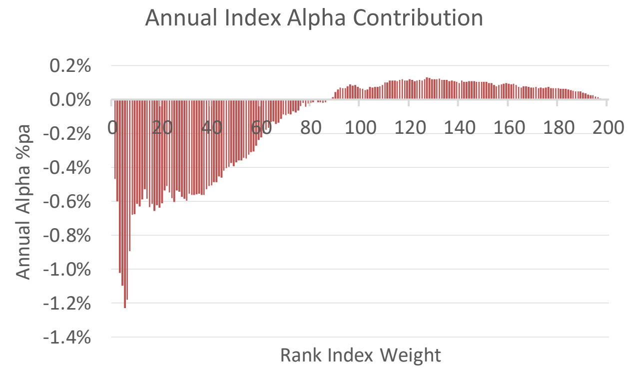


Note, in the chart immediately following, we subtract from each stock's nominal return the stocks beta multiplied by the Index return to determine alpha. We then multiply its alpha by each stocks index weight. As a result, the total alpha contribution across the Index will sum to zero.

What the analysis highlights is that on a risk adjusted basis we have the large cap stocks producing a negative alpha contribution. Stocks ranked between 40 and 120 tend to provide a positive risk adjusted contribution. And finally, stocks ranked greater than 120 tend to provide a negative risk adjusted contribution.

Why is this important?

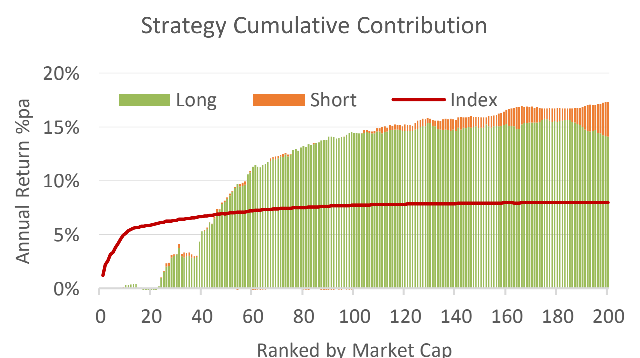
It gets back to the concept of constructing a portfolio that takes advantage of the best risk adjusted returns available from Index constituents.



A typical long only portfolio will invariably have an exposure to large caps. The larger the portfolio size the greater the need of the manager to seek exposure to the large caps for liquidity purposes, and the portfolio increasingly resembles index like behaviour and returns (i.e. the portfolio resembles index hugging). However, investors should ask if such an exposure is being rewarded for the given level of risk? The analysis suggests investors may be better served with a greater exposure to mid-caps where over the long-term, results demonstrate a better return for the level of risk being undertaken.

With Equus Point Capital the bulk of the returns are generated from the long book with the focus being those stocks with index rank between 40 and 100, consistent with the positive alpha contribution of the previous analysis. The short book derives its returns from an exposure to smaller ranked stocks. This is consistent with higher ranked, or small cap stocks, providing negative risk adjusted returns.

In essence, the portfolio is constructed in such a way to harvest the best risk adjusted returns from index constituents, without being a slave to index weights or index hugging.



In summary being able to focus on the underlying drivers of meaningful risk adjusted returns allows us to understand where and how returns – and risk – are generated across the portfolio.

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Net Monthly Performance

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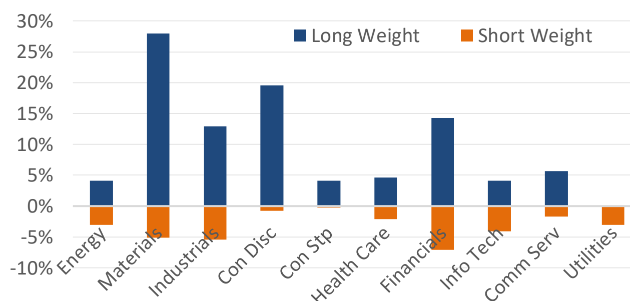
Gross Monthly Performance

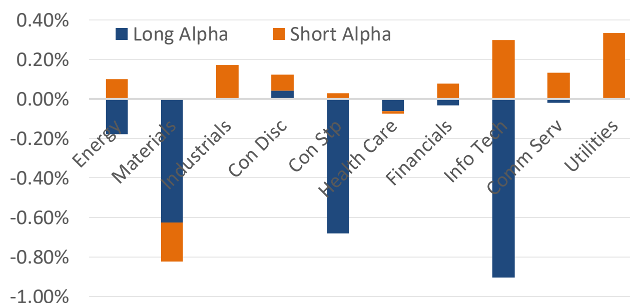
Asset	Positions	Weight	Contrib	Alpha
Long	78	97.2%	-0.10%	-2.46%
Short	31	-32.6%	0.23%	1.01%
Futures		-47.2%	-1.07%	0.51%
Cash		35.3%	0.00%	0.00%
		100.0%	-0.94%	-0.94%
Cash				0.01%
Excess				-0.95%

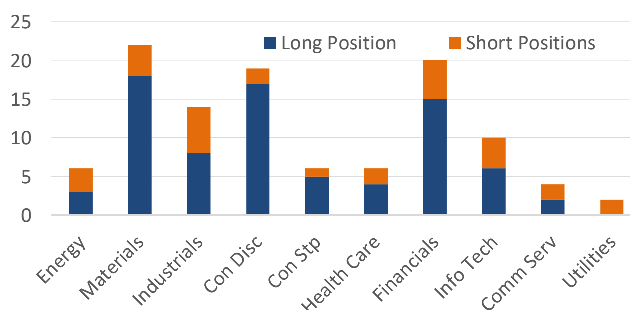


Exposure and Gross Monthly Alpha

Sector Name	Long Weight	Short Weight	Active Weight	Alpha Contrib
Energy	4.07%	-3.03%	1.03%	-0.08%
Materials	27.91%	-5.12%	22.79%	-0.82%
Industrials	12.89%	-5.48%	7.41%	0.17%
Cons Disc	19.57%	-0.77%	18.80%	0.12%
Cons Staples	4.14%	-0.20%	3.94%	-0.65%
Health Care	4.59%	-2.15%	2.44%	-0.07%
Financials	14.29%	-7.05%	7.23%	0.04%
Info Tech	4.11%	-4.08%	0.02%	-0.61%
Comm Serv	5.68%	-1.64%	4.03%	0.11%
Utilities	0.00%	-3.04%	-3.04%	0.33%
Stock Total	97.24%	-32.57%	64.67%	-1.45%
Futures			-47.16%	0.51%
Cash			35.33%	0.00%
Total			100.00%	-0.94%

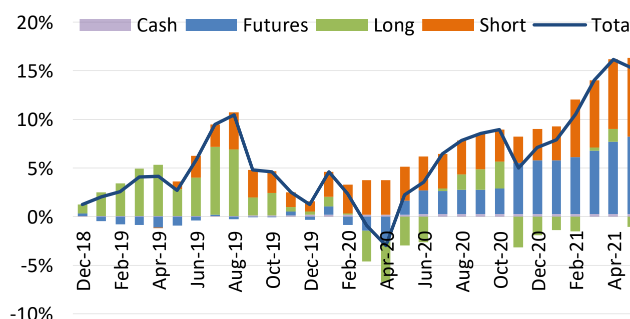
Net exposure including futures	17.5%
Gross exposure excluding futures	129.8%
Gross exposure including futures	177.0%





Major Alpha Contributors

Name	Weight	Contrib	Alpha
Top Five Contributors			
AGL Energy	-2.86%	0.27%	0.32%
Appen Limited	-1.33%	0.17%	0.21%
ALS Ltd	1.35%	0.21%	0.18%
ARB Corp Ltd	2.40%	0.22%	0.16%
Boral Limited	2.89%	0.24%	0.16%
Bottom Five Contributors			
Soul Pattinson & Co.	3.72%	-0.08%	-0.16%
Mineral Resources	2.33%	-0.12%	-0.17%
Wisetech Global	0.51%	-0.18%	-0.19%
Costa Group	1.93%	-0.57%	-0.60%
EML Payments	1.18%	-0.72%	-0.75%



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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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