Australian Small Caps Systematic Alpha Fund (Wholesale)

December Quarter Performance Report as at 31 December 2020

Fund performance

As at 31 December 2020	3 Month	6 Month	1 Year	Since Inception (Annualised)[2]
Blue Orbit Australian Small Cap Systematic Alpha Fund[1]	11.38%	18.21%	0.29%	0.02%
Benchmark[3]	13.83%	20.28%	9.21%	9.17%
Excess Return	-2.45%	-2.08%	-8.92%	-9.15%

1. Returns shown are Net of Fees. Returns shown for the Lead Series (October 2019).
2. Inception Date is 11 October 2019.
3. Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

The *Blue Orbit* Australian Small Caps Systematic Alpha Fund returned a healthy 11.4% in the December quarter. This return was unfortunately insufficient to match its Benchmark's return, the S&P/ASX Small Ordinaries (Accumulation) Index, of 13.8%. The catalyst for the strong returns was the announcement in November of multiple successful COVID-19 vaccine trials, and the subsequent approvals for their use; thereby offering investors hope that the COVID-19 pandemic would come to an end and normality would return. In addition, a market friendly outcome in the US Presidential election and further global fiscal and monetary stimulus added to investor optimism.

A Benchmark return of over 10% in a quarter would usually satisfy most investors. However, by the end of the quarter investors were somewhat shell-shocked by the divergences in returns across, and within, global markets. The driving force behind the divergence and the speed of the change were the COVID-19 vaccine announcements. This news saw previously unloved stocks skyrocket and winners rapidly decline. While the November rotation was broadly classified as a traditional growth to value rotation, within it was an element of investors switching from those stocks that had appeared to benefit from the pandemic (for example, online retailers, IT stocks, and healthcare stocks) to those badly affected but with renewed hope (for example, travel stocks and retail property trusts). Also notable was the speed of the rotation with a bulk of the changes occurring over a 5-day period. An example of rapid transition in investor sentiment was the outperformance of the MSCI Australia Value Index over the MSCI Australia Value Growth Index by a huge 11.7% (15.8% vs 4.1%) during November alone.

The search for value also saw major dispersions in returns based on the country and the market capitalisation of the stock. Indeed, emerging and some European markets were able to outpace the major large cap USA indexes. For example, during for the quarter the S&P 500 returned 12% compared to a 19.8% return for the MSCI Emerging Markets Index (in USD). French and Italian markets closed 15.8% and 17% higher respectively, while Germany (7.5%) and Switzerland (4.82%) lagged (in EUR).

Regarding market capitalisation, in the US where the Russell 2000 index (representative of the US small cap market) returned 31.4% against only 13.7% for the larger Russell 1000 index. This rally followed several quarters of underperformance though, with both indices ending the year with roughly equal gains in the region of +20%. Globally, the MSCI World Index (USD) returned +14.1% in the December quarter, while the MSCI World Small Cap Index (USD) was 24% higher. In Australia, both small and large stocks (represented by the S&P ASX Small Ordinaries and the S&P ASX 100) returned 13.83% for the quarter. However, on a full year basis, Australian Small caps returned 9.2%, versus a 0.80% return for the ASX 100.

GICS Sector Attribution: December Quarter

Sector Attribution	ASX Small Systematic			S&P/ ASX Small Ordinaries			Attribution		
	Average Weight	Total Return	Contribution To Return	Average Weight	Total Return	Contribution To Return	Allocation	Selection + Interaction	Total
Consumer Discretionary	19.33%	6.30%	1.36%	17.00%	11.04%	1.98%	-0.03%	-0.92%	-0.96%
Industrials	10.25%	27.29%	2.52%	8.70%	17.21%	1.50%	0.06%	0.86%	0.92%
Health Care	5.82%	2.89%	0.07%	6.81%	3.88%	0.21%	0.05%	-0.11%	-0.07%
Consumer Staples	5.00%	4.36%	0.20%	6.88%	8.18%	0.59%	0.08%	-0.17%	-0.09%
Energy	0.63%	62.49%	0.21%	2.33%	26.30%	0.55%	-0.21%	0.09%	-0.12%
Communication Services	5.88%	15.83%	0.87%	5.68%	9.98%	0.61%	-0.05%	0.34%	0.28%
Utilities	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Financials	11.26%	21.08%	2.37%	12.05%	23.54%	2.67%	-0.12%	-0.15%	-0.27%
Materials	20.40%	15.30%	2.96%	21.42%	19.67%	4.09%	-0.08%	-0.82%	-0.91%
Real Estate	11.08%	12.76%	1.45%	12.25%	10.78%	1.38%	0.02%	0.21%	0.23%
Information Technology	9.47%	-3.25%	-0.20%	6.89%	3.33%	0.25%	-0.23%	-0.64%	-0.87%
Cash	0.88%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.16%	0.00%	-0.16%
Total	**100%**	**11.81%**	**11.81%**	**100%**	**13.83%**	**13.83%**	**-0.66%**	**-1.33%**	**-2.02%**

While the Fund posted impressive capital growth for the quarter, sector and stock allocation detracted versus its Benchmark. The chief offender was poor selection in the Consumer Discretionary, Materials and IT sectors. Offsetting some of the selection issues were high performing choices in the Industrials and Communication Services sectors.

As mentioned earlier, the December quarter saw a significant rotation to value stocks. The performance of the Energy sector (23.7%) was the clearest example of this trend. The Fund was underweight to this sector, which contributed a significant proportion of the allocation underperformance for the quarter. The Fund's overweight to the poorly performing IT sector also detracted.

Highlighting the effect of investors switching away from retail stocks that had performed well during the pandemic was the Fund's overweight holdings in the underperforming Super Retail Group (0.1%), Collins Food (-.03%) and Harvey Norman (0.1%). These positions generated a significant portion of the Fund's underperformance for the quarter, yet over the full year they had all performed strongly. Within the Materials sector, the Fund was negatively affected by underweight positions in Pilbara Resources (187.6%) and Sims Metal (77.4%) and overweight gold producers Regis Resources (-25.4%) and Ramelius Resources (-18.7%), which were hit with a softening gold price over the quarter. Offsetting some of this under performance was the Fund's overweight positions in Champion Iron (63.8%) and Mineral Resources (33.7%). Also contributing positively were the Fund's selections in the Industrial sector, with overweights Macmillan Shakespeare (43.8%) and NRW Holding (35.0%) performing strongly during the quarter.

Alpha Signal Attribution

The Blue Orbit Systematic Alpha process combines four individual Alpha Signals – Quality, Trend, Defensive and Value developed using proprietary internal quantitative research processes. The four individual Signals are well diversified with low to negative correlations, and designed to outperform in differing market environments.

The Diversified Alpha Signal is the combination of the individual underlying Alpha Signals, and forms the main input into the formation of the Systematic Alpha Model. In turn, the Fund trades towards the model portfolio provided by the Systematic Alpha Model. This model is a theoretical target, and its returns do not include fees or transaction costs.

Alpha Signal Returns	3 Months Return	3 Months Excess
S&P/ASX Small Ordinaries - Total Return	13.83%	
Blue Orbit Alpha Signal Returns [1]		
Quality Alpha Signal	13.98%	0.15%
Trend Alpha Signal	13.40%	-0.43%
Defensive Alpha Signal	16.14%	2.32%
Value Alpha Signal [2]	17.19%	3.36%
Diversified Alpha Signal	14.94%	1.11%
Systematic Alpha Portfolio (Model)	11.69%	-2.14%

1. Returns shown are for theoretical, calculated Signal and factor portfolios, and are not live or investible products. Returns are calculated using FactSet, and do not include any fees or transaction costs.

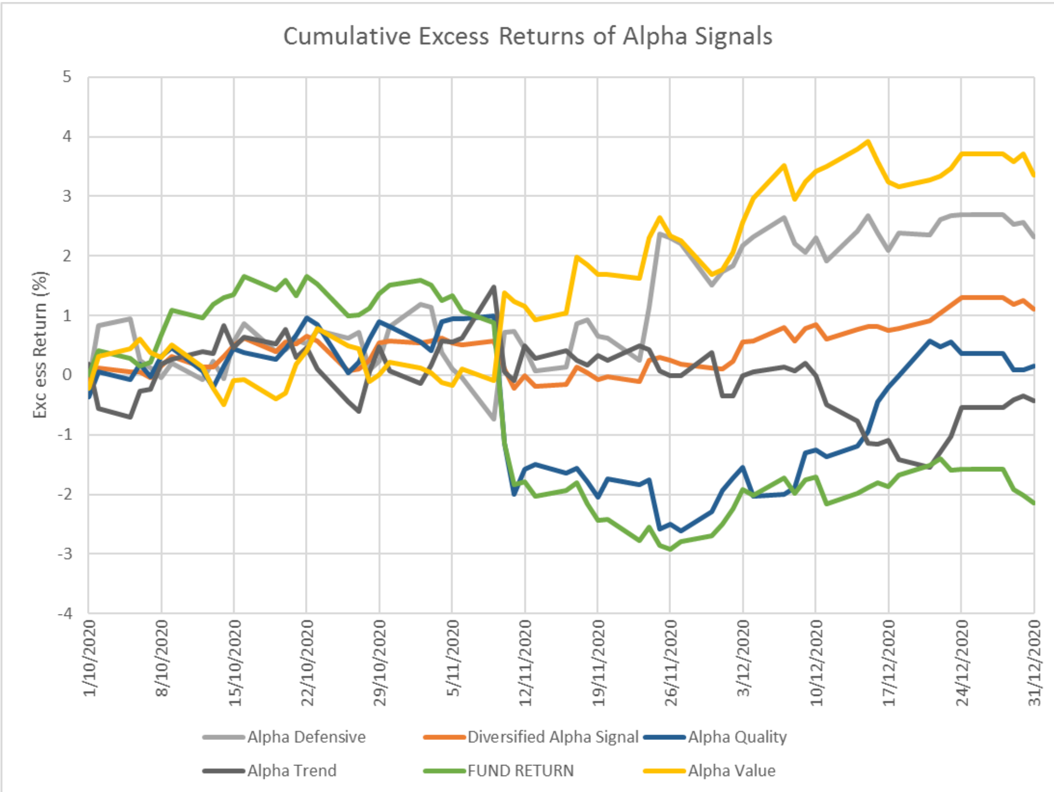
Given the design principle of the Fund, regardless of the market conditions the expectation is that a majority of Alpha Signals will outperform, thereby minimising the effects of any underperforming Signal(s). The justification of this approach was evident in the December quarter with, despite the violent value-growth rotation in November, three Signals outperforming the Benchmark. Significantly, at the start of November the Value Alpha Signal was integrated into the Fund's live portfolio construction process. This enabled the Fund to capture some of the subsequent outperformance of the value stocks as the rotation occurred in mid-November. For the quarter, the Value Signal returned 17.3%, 3% over the Benchmark.

The Defensive Signal returned a very healthy 16.1% for the quarter. At face value, this result seems at odds with the intent of the Signal, which is to provide downside protection. However, this view overlooks the construction process of the Signal, which targets stocks with strong dividends funded from positive operating cash flows. The Signal typically favours Financial, Energy and Real Estate stocks. Value stocks generally align with these characteristics, hence when the value rotation finally occurred, the Signal benefitted through its overweight positions.

While the positioning of the Quality Signal is aligned to growth stocks, it was still able to outperform the Benchmark during the quarter. This is due to the Signal targeting stocks that have high cash returns on their invested capital. The signal did underperform in November, however the strong performance in both October and December offset this underperformance. A factor that harmed the Signal's performance was the strong performance of mid-tier miners and explorers, who rallied in November and beyond. The Signal is underweight these stocks given their lack of positive cash flows. On the positive side, over the quarter the Signal was well positioned in the Healthcare sector, where it avoided Mesoblast (-55.7%) and was overweight Pro Medicus (26.2%) and Nanosonic (41.4%). In addition, some of the Signal's selections in the Consumer Discretionary sector performed well, namely Eagers Automotive (45.3%), Accent (40.4%) and City Chic (40.2%).

The activation of the Value Alpha signal within the process came as our timing indicators clearly indicated that it was appropriate to gradually increase the Fund's value positioning from early November. What was unexpected was the rapid market factor reversal that occurred in November, an outcome that contributed to the Signal returning 17.2% for the quarter. The chief contributor to the performance was the Signal's positioning in the Consumer Discretionary and Communication Services sectors. Within these sectors, the Signal was overweight strong outperformers Eagers Automotive, Accent Group, Lovisa Holding (36.8%) and oOh Media (37.2%). The Signal's outperformance was diminished by overweight positions in Hansen Technologies (-3.9%) and Data#3 (-14.5%), and an underweight allocation to the Financials sector. Regarding the underweight to the traditionally value oriented Financials sector, investors should be aware that within the Small caps universe the sector does include many Fintech companies, which are more growth oriented.

The one Signal to underperform for the quarter was the Trend Signal. Given the rapid transitions in the markets during November where many trend underperformers suddenly became outperformers, and vice versa for outperformers, this result is unsurprising. The Signal's construction methodology demonstrated its value add with a significant outperformance over a naïve momentum strategy during the large factor rotation event that occurred in November. While naïve momentum saw an 8.5% underperformance against the Benchmark for the quarter, the Alpha Trend Signal underperformed by only 0.43% - an 8% performance differential.

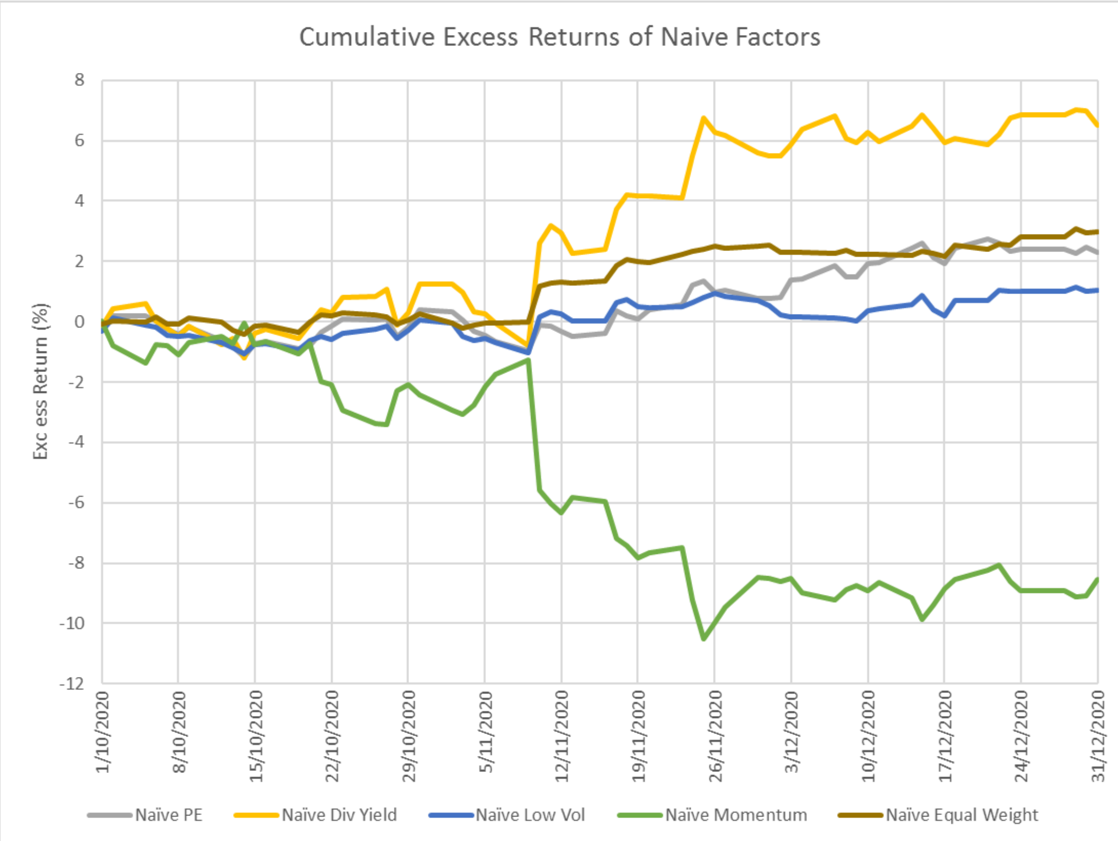


Source: Blue Orbit. FactSet

Naïve Factor Returns

Naïve Factor Returns	3 Months Return	3 Months Excess
S&P/ASX Small Ordinaries - Total Return	13.83%	
Naïve Factor Returns [1]		
Naïve Dividend Yield Factor	20.33%	6.50%
Naïve Equal Weight	16.81%	2.98%
Naïve Low Volatility Factor	14.86%	1.03%
Naïve Momentum Factor	5.28%	-8.55%
Naïve PE Factor	16.14%	2.31%

1. Returns shown are for theoretical, calculated Signal and factor portfolios, and are not live or investible products. Returns are calculated using FactSet, and do not include any fees or transaction costs.



Source: Blue Orbit. FactSet

The returns of the naïve factor strategies exhibited the effects of the value rotation that occurred during the quarter. Most effected, by some margin, was the naïve Momentum strategy that, while already underperforming from the start of the quarter, saw its underperformance accelerate as the value rotation took hold. Directionally the mirror image of the Momentum strategy's performance was the Dividend Yield strategy, a classic value Signal. This strategy had dramatic outperformance in November and continued through December as investors sought yield, as the Reserve Bank of Australia lowered rates during the quarter. The naïve PE and Low volatility strategies, both of which tend to favour value stocks, also outperformed across the quarter. However notably, the outperformances of value strategies were smaller in magnitude than the drawdown in Momentum. This aligned with our observations in November that within small caps, a portion of the reversal was from 'winners' into 'losers'— stocks that had heavily oversold, but could not be characterised as traditional value stocks or cheap due to lack of current or near term earnings or dividends.

Highlighting the volatile nature of the quarter's rally was the performance of the Equal Weighted strategy. This naïve strategy had the second highest return for the quarter as investor sought value in the smaller capitalisation stocks, which was a function of their previous underperformance and the lofty valuation metrics of some larger cap stocks.

Conclusion

Remarkably, given the events of 2020 investors in the Australian small cap market finished the year in positive territory, and the outlook for 2021 remains positive. This outcome was possible due to the unprecedented amount of stimulus deployed into the economy and the financial markets by governments and central banks; and the discovery in record time of multiple COVID-19 vaccines. Despite the solid returns for the year, significant variability in returns across sectors occurred - especially late in the year, with the anti-momentum rotation trimming many of the excessively priced growth stocks and rising commodity prices fuelling a boom in mid-tier mining stocks. Whether this rotation has fully played out and if, and when, the economy returns to a resemblance of normality are the two biggest questions facing investors at the commencement of 2021. Additionally, investors will need to cast their minds forward to whether inflation reappears and how central banks begin to unwind their expanded balance sheets.

Regardless of the outlook for the market, *Blue Orbit* Australian Small Caps Systematic Alpha Fund investors should be comfortable knowing that the investment process design is such that it can successfully accommodate a wide variety of market conditions. Further, the learnings from one of the most turbulent years in financial market history have been utilised as a valuable crisis data set to test and enhance the portfolio construction process.