

Performance Overview

After the wild fluctuations of January, equity markets commenced February in a positive manner, bouncing back 4.6% in the first few days. Supporting the recovery in Australian stocks was a generally positive start to the February reporting season. Australian investors were especially encouraged by the return of healthy dividends (previously suspended or reduced due to the initial COVID-19 outbreaks) and the trend of analysts upgrading future growth and profit estimates. However, the joy was not to last as simmering tensions in global bond markets boiled over in the second half of the month, sending equities markets sharply lower. While the S&P/ASX Small Ordinaries Accumulation Index managed to finish the month with a 1.55% gain, this was a 3.6% fall from its mid-month highs. Amongst the volatility, the Blue Orbit Australian Small Caps Systematic Alpha Fund underperformed its Benchmark with a total return of +0.80% for the month.

Bond yields rose sharply during the month, as lingering inflationary fears gathered sufficient momentum. Stoking the market's fears were the next round of US fiscal stimulus, the underlying strength of the global economic recovery, and ongoing rises in commodity and real asset prices. The US and Australian central banks were both forced to increase bond purchases and talk down inflationary fears as the speed, and extent, of the bond selloff caught many by surprise. A further ramification for equity markets of the rising yields was a rotation away from the high growth and the bond proxy sectors, such as Utilities and Real Estate Trusts.

Within the Australian small cap space, the sell-off and the February reporting season combined to generate a divergent range of return outcomes. There were 25 (16) stocks with a return greater (less) than 1.5%, with the highest (lowest) being 43% (-39%). The dispersion in stock outcomes was also replicated at the sector level, with the difference between the best and worst sector total returns over 15% for the month. Financials (+6.8%) was the best performing sector, mainly driven by the performance of Zip (+43.1%), and Virgin Money UK (+39.5%). Also recording strong returns were the Communication Services (+6.9%) and Consumer Staples (+3.7%) sectors. The Industrials (-8.3%) and Real Estate Investment Trusts (REIT) (-1.8%) sectors were the laggards for the month, with NRW Holdings (-30.7%) and Service Stream (-39.6%) the worst performers within Industrials. Other trends of note for the month were the strengthening of domestic travel names at the expense of retailers (following the commencement of the local COVID-19 vaccine roll-out); and the continued rise of copper and rare earth miners.

Blue Orbit Systematic Alpha Fund Performance

The Blue Orbit Australian Small Caps Systematic Alpha Fund posted a total return of 0.80% for February, underperforming its Benchmark by 0.75%.

As at 28 February 2021	1 Month	3 Month	6 Months	FYTD	1 Year	Since Inception (Annualised) ²
Blue Orbit Australian Small Cap Systematic Alpha Fund ¹	0.80%	5.25%	10.17%	20.53%	10.32%	1.43%
Benchmark ³	1.55%	4.08%	12.05%	21.84%	17.18%	9.06%
Excess Return	-0.75%	1.16%	-1.88%	-1.31%	-6.86%	-7.63%

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.

Portfolio Facts

Fund Details	
Fund Valuation (AUD)	\$2,163,524
NAV unit price (Mid)	\$1.0074
Inception date	11 October 2019
Performance benchmark	S&P/ASX Small Ordinaries Accumulation Index
Buy/sell spread	0.20% / -0.20%
Distributions	Annually

Portfolio Characteristics

Characteristics	Portfolio	Benchmark
Number of securities	116	200
Market Capitalization	3,157	2,402
Active Share	48.6	0.0
Dividend Yield	2.8	2.2
Price/Earnings	13.5	15.3
P/E using FY1 Est	14.8	18.0
Price/Cash Flow	9.5	11.3
Price/Book	1.9	1.9
ROE	13.8	5.0
LT Debt to Capital	28.8	25.9

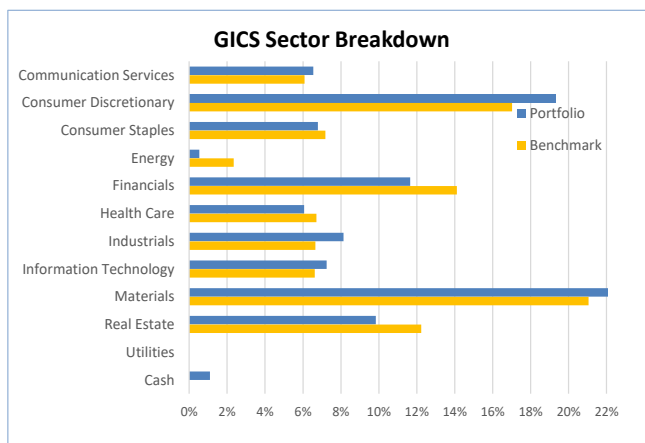
Top Ten Holdings	Portfolio	Benchmark
Harvey Norman Holdings Ltd	3.86%	1.50%
Codan Limited	2.99%	0.75%
Eagers Automotive Limi	2.67%	0.95%
Champion Iron Ltd.	2.66%	0.72%
Pro Medicus Limited	2.54%	0.89%
Janus Henderson Group	2.48%	0.54%
Inghams Group Ltd.	2.39%	0.55%
News Corporation	2.25%	0.67%
Spark New Zealand Limited	1.99%	0.46%
Iluka Resources Limited	1.88%	1.31%

Five Largest Overweight Positions

Security	Portfolio	Benchmark	Active
Harvey Norman Holdings	3.86%	1.50%	2.35%
Codan Limited	2.99%	0.75%	2.24%
Champion Iron Ltd.	2.66%	0.72%	1.94%
Janus Henderson Group	2.48%	0.54%	1.93%
Inghams Group Ltd.	2.39%	0.55%	1.84%

Five Largest Underweight Positions

Security	Portfolio	Benchmark	Active
Breville Group Limited	0.20%	1.10%	-0.90%
Sims Ltd.	0.00%	0.94%	-0.94%
Bapcor Ltd	0.00%	0.97%	-0.97%
Chorus Limited	0.00%	1.38%	-1.38%
Steadfast Group Limited	0.00%	1.45%	-1.45%



Performance Attribution

The Fund underperformed the Benchmark by a modest margin in February, with underperformance in three of its underlying Alpha Signals largely offset by strong outperformance in its 4th Signal. On a sector attribution basis, both sector allocation and stock selection detracted over the month. An overweight position to the Industrials sector and an underweight allocation to the Financials sectors were the main detractors on a sector allocation basis. However, the Fund's positioning in the Materials (3.0%) and Information Technology (IT) (2.2%) sectors added some value. Within stock selection, the Fund's largest gains came from overweight positions in Sandfire Resources (27.6%), Mineral Resources (13.4%), IGO Ltd (9.5%), and the overweight position in IT stock Codan (25.9%). However, the gains from these stocks were not sufficient to overcome the strong performance from a host of underweight Financials positions, including Zip Ltd (43.0%) and Virgin Money UK (39.5%). Further, overweight positions in Netwealth (-18.5%) and Janus Henderson (-9.0%) added to the underperformance. Also detracting from performance was a number of the Fund's overweight positions in the Industrials sector, primarily the overweight positions in NRW Holdings (-29.7%), Cimic (-13.7%) and Monadelphous (-10.6%).

Australian Small Caps Systematic Alpha Fund (Wholesale)

Monthly Performance Report as at 28 February 2021



Sector Attribution

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
Materials	22.27%	6.15%	1.32%	20.84%	2.99%	0.65%	0.02%	0.67%	0.68%
Information Technology	7.35%	6.91%	0.48%	6.60%	2.20%	0.13%	0.00%	0.32%	0.32%
Communication Services	6.98%	10.78%	0.72%	5.90%	6.94%	0.38%	0.06%	0.25%	0.31%
Consumer Staples	6.73%	5.20%	0.33%	7.00%	3.68%	0.25%	0.00%	0.09%	0.08%
Health Care	5.87%	-0.25%	-0.02%	6.82%	-0.58%	-0.03%	0.02%	0.01%	0.04%
Utilities	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Energy	0.83%	-2.60%	-0.02%	2.32%	1.01%	0.02%	0.01%	-0.03%	-0.02%
Real Estate	9.71%	-3.47%	-0.34%	12.17%	-1.83%	-0.21%	0.08%	-0.17%	-0.09%
Consumer Discretionary	18.44%	-0.87%	-0.21%	17.23%	0.42%	0.06%	-0.03%	-0.23%	-0.26%
Industrials	9.94%	-12.54%	-1.20%	7.00%	-8.33%	-0.58%	-0.32%	-0.40%	-0.72%
Financials	10.99%	-1.20%	-0.21%	14.12%	6.80%	0.87%	-0.17%	-0.85%	-1.02%
Cash	0.87%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	100%	0.86%	0.86%	100%	1.55%	1.55%	-0.34%	-0.35%	-0.69%

Size Attribution

Size 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	Total
Total	100.00	0.86	0.86	100.00	1.55	1.55	0.09	-0.78	-0.69
Market Cap Quintile 1 (Large)	44.03	0.28	0.06	37.48	3.21	1.18	0.10	-1.26	-1.16
Market Cap Quintile 2	20.35	5.38	1.05	26.47	1.22	0.32	0.03	0.80	0.83
Market Cap Quintile 3	18.31	-4.31	-0.74	17.05	1.90	0.32	-0.03	-1.11	-1.13
Market Cap Quintile 4	12.23	2.73	0.33	11.60	-2.45	-0.27	-0.03	0.62	0.59
Market Cap Quintile 5 (Small)	4.21	3.57	0.15	7.13	-0.08	-0.01	0.03	0.16	0.19
Cash	0.87	0.00	0.00	--	--	--	0.00	--	0.00

Stock Attribution

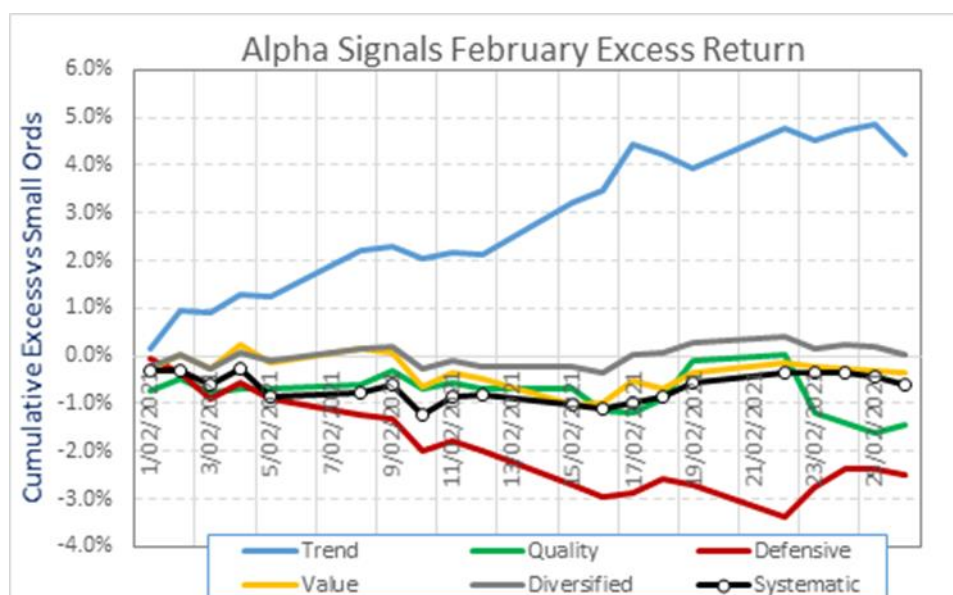
Stock Attribution	ASX Small Systematic			S&P/ ASX Small Ordinaries			Attribution
	Average Weight	Total Return	Contribution To Return	Average Weight	Total Return	Contribution To Return	Total Effect
Top 5							
Codan Limited	2.72%	25.93%	0.63%	0.65%	25.92%	0.15%	0.46%
Sandfire Resources Limited	1.70%	27.58%	0.43%	0.38%	27.62%	0.10%	0.32%
News Corporation	2.36%	18.26%	0.37%	0.65%	18.27%	0.10%	0.25%
Mineral Resources Limited	1.56%	14.54%	0.23%	0.00%	0.00%	0.00%	0.19%
IGO Limited	1.36%	9.52%	0.12%	0.19%	0.93%	0.02%	0.15%
Bottom 5							
Janus Henderson Group	2.44%	-8.99%	-0.23%	0.56%	-9.00%	-0.05%	-0.21%
Netwealth Group Ltd.	1.64%	-18.45%	-0.30%	0.60%	-18.45%	-0.11%	-0.22%
Virgin Money UK PLC Shs Chess Depository	0.06%	-3.13%	-0.01%	1.11%	39.48%	0.34%	-0.34%
Zip Co Ltd.	0.85%	26.88%	0.04%	1.63%	43.05%	0.48%	-0.41%
NRW Holdings Limited	2.09%	-29.75%	-0.66%	0.48%	-29.72%	-0.15%	-0.55%

Alpha Signal Attribution

The Blue *Orbit's* Systematic Alpha construction process combines four individual underlying Alpha signals – Defensive, Quality, Trend, and Value developed using our proprietary internal quantitative research processes. The design intention of the four signals is to insure they will outperform in a variety of market environments through their diversified nature and low to negative correlations between each other. The Diversified Alpha Signal is the combination of the individual underlying Alpha Signals, and is the primary alpha input in the construction of the final portfolio, namely the Systematic Alpha Model. This model is the target model portfolio and determines the strategy underlying the implemented portfolio, that is, the Fund. The model is a theoretical target, and its returns do not include fees or transaction costs.

Alpha Signal	1 Month Return	1 Month Excess	2 Year Annualised Excess Return	2 Year Annualized Tracking Error	2 Year Information Ratio
Small Ordinaries	1.55%				
Defensive Alpha Signal	-0.93%	-2.48%	-2.46%	6.22%	-0.40
Quality Alpha Signal	0.08%	-1.47%	4.32%	6.57%	0.66
Trend Alpha Signal	5.78%	4.23%	4.24%	7.10%	0.60
Value Alpha Signal	1.17%	-0.38%	1.41%	7.70%	0.18
Diversified Alpha Signal	1.54%	-0.01%	0.60%	2.88%	0.21
Systematic Alpha Portfolio (Model)	0.68%	-0.87%	-5.13%	5.56%	-0.92
Blue Orbit Australian Small Caps Systematic Alpha Fund*	0.86%	-0.68%	N/A	N/A	N/A

*Fund Returns in this table are shown Gross of Fees.



The preceding chart plots the cumulative relative returns for each of the Alpha Signals and the Fund against the Benchmark for February. Despite the late month sell off, the Trend Signal displayed exceptional performance throughout the month as investors continued to back recent winners with only a mild concern regarding their financial position. Apart from the Defensive Signal (which lagged as investors still exhibited a preference for outright growth over yield); the other Signals were generally in line with the Benchmark. With the various Alpha Signals forming the inputs into the construction of the final portfolio, many of the stock selection and performance themes for the Fund were present within the individual Alpha Signals.

Performance Commentary

Defensive Alpha Signal

Underperforming for the month, despite the late month market correction, was the Defensive Alpha Signal (-0.93%). A majority of the underperformance came from poor stock selection, with the Signal's sector allocation a minor drag on performance. The main contributor to the Signal's selection underperformance, as also seen in the Fund's overall performance, was the combination of being underweight to the strongly performing Zip and Virgin Money UK within Financials, while being overweight to Janus Henderson. In the REIT space, the Signal's overweight to Unibail-Rodamco-Westfield (-13.8%) was a major detractor, along with the overall overweight allocation to the sector. Compounding the Signal's underperformance was stock selection in the Consumer Discretionary (0.4%) space. The Signal was underweight the rebounding travel stocks, Flight Centre (18.0%) and Corporate Travel (21.7%), while also being overweight Harvey Norman (-1.9%). The underperformance was partly offset by underweight holdings in PointsBet (-9.5%) and Temple & Webster (-18.7%). On a sector basis, the main driver was the Signal's overweight position to the underperforming Industrial and Real Estate sectors, albeit an underweight to Healthcare (-0.7%) added some value.

Quality Alpha Signal

The Quality Signal's role is to target companies generating strong free cash flow returns. However, during February the market appeared more focussed on the recent price trend, hence the Quality Signal (0.08%) underperformed for the month. The underperformance was evenly attributable to sector allocation and stock selection. Similar to the Defensive Signal, an overweight to the Industrials sector was the main cause of the sector allocation underperformance. An underweight position to Financials was also damaging, with an underweight to the REIT sector offsetting some of the underperformance. The main source of stock selection performance was again being underweight Zip and Virgin Money UK, with an overweight to Netwealth (-18.5%) also detracting. However, the Signal was underweight to Asset Managers Janus Henderson, Perpetual Trustees (-5%) and Pandal (-3.9%), thereby reclaiming some positive performance. Stock selection in the Consumer Discretionary space suffered as investors rotated away from brick and mortar retailers (the Signal was overweight Temple and Webster (-18.7%) and Kogan (-22.3%)) and moved towards travel stocks. This effect was somewhat offset by the Signal being overweight Lovisa Holdings (36.3%) and underweight PointsBet. Finally, overweights in the Consumer Staples (0.3%) stocks Inghams (6.7%) and Asaleo Care (9.2%) added positively to performance.

Trend Alpha Signal

February was an outstanding month for the Trend Alpha Signal (5.8%) as investors continued to follow recent market outperformers. Indeed the Signal's outperformance almost came entirely from stock selection. The primary selection gains came from the Materials sector, driven by the overweight positions in Mineral Resources (18.9%) and Lynas Rare Earths (25.1%) coupled with an underweight to gold miner Regis Resources (-13.7%). Tapering some of the outperformance was the underweight position in Iluka Resources (15.4%) and an overweight to Bellevue Gold (-28.0%). In the Consumer Discretionary sector, the Signal was overweight the recovering travel stocks – Corporate Travel (21.7%) and Sea Link (32.6%) – and IDP Education (23.6%), adding to the outperformance. Further outperformance came from selection in the Financials sector, where the Signal was overweight Zip and Virgin Money UK, thereby reversing the negative effect seen in the other Signals.

The superior construction of the Alpha Trend signal was clearly on display in February, as the Naïve momentum factor (based on simple 12 month price momentum) returned only 0.64% for the month- underperforming our Alpha Trend signal by over 5% for the month.

Value Alpha Signal

The Value Signal (1.2%) underperformed the market by a small margin in February. At a headline level, the lost performance came from the Signal's overweight allocation to Industrials, and underweight allocation to Financials. While stock selection performance was broadly flat, there was a large discrepancy with the gains from the Materials sector cancelled by the positioning in the Financial sector. The positioning in the Materials sector that delivered the outperformance included overweights in Sandfire Resources, Pact Group (38.3%) and IGO Limited (9.5%) and an underweight to Regis Resources. The Financial sector underperformance came from the underweight positions in Zip, Virgin Money UK, and Pinnacle Investments (24.2%) and an overweight in Janus Henderson. The Signal also had some poorly performing selections in the Industrials sector, namely NRW Holdings and Service Stream (-39.6%) but these were offset by the following overweight selections from the Communication Services sector, NewsCorp (18.3%) and OohMedia (10.4%).

Despite the global rotation to Value seen in overseas markets in February, this did not carry over into Australian Small cap stocks. Our Value Alpha Signal saw mild underperformance over the month in this environment, however still significantly outperformed naïve value factors – Dividend yield returned only 0.06%, and Naïve P/E was down -1%.

Diversified Alpha Signal

The Diversified Alpha Signal (1.5%) performed in line with the Benchmark in February, with the underperformance from its sector allocation offset by selection gains. An overweight to the Industrial sector and underweight to the Financial sector were the main drivers of the poor allocation effect, with no offsetting allocation gains. The Signal's main source of selection gains came from the Materials sector, where the Signal was overweight Mineral Resources, Sandfire Resources, and IGO Limited. Negating some of these gains were an overweight in SSR Mining (-17.3%) and underweights in Lynas Rare Earths and Iluka Resources. The Signal derived meaningful outperformance from its overweight holding in NewsCorp and underweight to Chorus (-6.1%). The constant theme from the other Signals of being on the wrong side of Virgin Money, Zip, Pinnacle, Janus Henderson and Netwealth trade meant negative selection performance from the Financials sector.

Conclusion

While Australian companies delivered robust financial reports throughout February, equity markets gave investors a gentle reminder that they tend to be forward looking and do interact with other asset classes. While it is not Blue Orbit's position to make a definitive forecast regarding the future direction of interest rates, we are cognisant that central banks remain united in their goal of ensuring that businesses continue to have access to cheap credit for the foreseeable future, to ensure that the global economy continues its recovery from the depth of its 2020 lows. Further, the governments of the largest global economies, the US and China, show no signs of reducing their fiscal stimulus programs. Therefore, Australian investors should be comfortable in maintaining a high degree of confidence that equity markets will provide sufficient investment opportunities throughout the year.

The divergence of the Australian small cap market from global style and factor trends, and underperformance of naïve factor approaches in this market, shows clearly the importance of an investment process specifically tailored to this market segment. The ability of the Blue Orbit investment process to extract alpha by applying our tailored Alpha Signals and adapting to a range of differing market environments leaves us strongly positioned for performance into 2021.

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