Sunbird Portfolios™
QUALITY LISTED PORTFOLIOS

Investment Philosophy

Updated: March 2022

Sunbird has developed an investment philosophy over the past 15 years that has a proven track record of generating excess returns (alpha), whilst also reducing portfolio risk (beta). This philosophy combines three investment criteria or factors: **Quality, Value** and **Momentum**.

Quality drives alpha and reduces risk because quality companies are more likely to generate sustainable growth and high returns, without the downside risks from high leverage, low profitability or volatile earnings.

Value drives alpha and reduces risk because the lower the price paid, the more likely an investor will generate an acceptable return and protect their downside risk. The higher the price paid, the less likely an investor will meet their return objectives and the greater the downside risk, if market expectations are not met.

Momentum is only used after the Quality and Value filters are applied and is used mainly as a timing tool to identify BUY and SELL signals. If a stock meets our Quality and Value criteria but is in downtrend, we prefer to wait for some positive momentum before investing. We describe this as "getting on at the station" rather than "standing in front of the train and hoping it will stop in front of us!" Alternatively, if a Sunbird stock starts to break down from a medium-term uptrend, then this is a trigger to reassess the position.

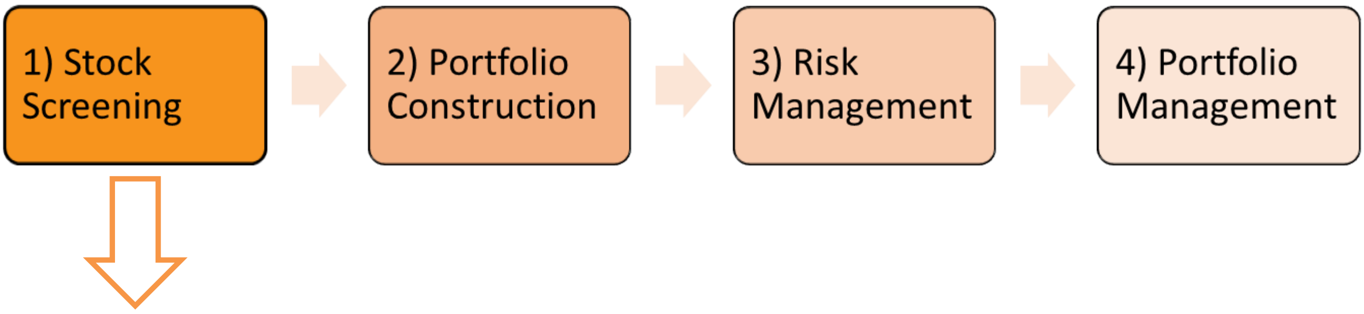
What we don't want are quality companies that are expensive or poor-quality companies that are cheap. This is EXACTLY where most investors go wrong. All our focus is on assessing each company for Quality, Value and Momentum. Those that pass our process are the 'little gems' of the market and become candidates for the Sunbird portfolios.

Portfolio capital protection is built into the investment process

While the Sunbird portfolios will always be correlated to the Australian equity market, we aim to reduce capital downside with the following in-built capital protection measures:

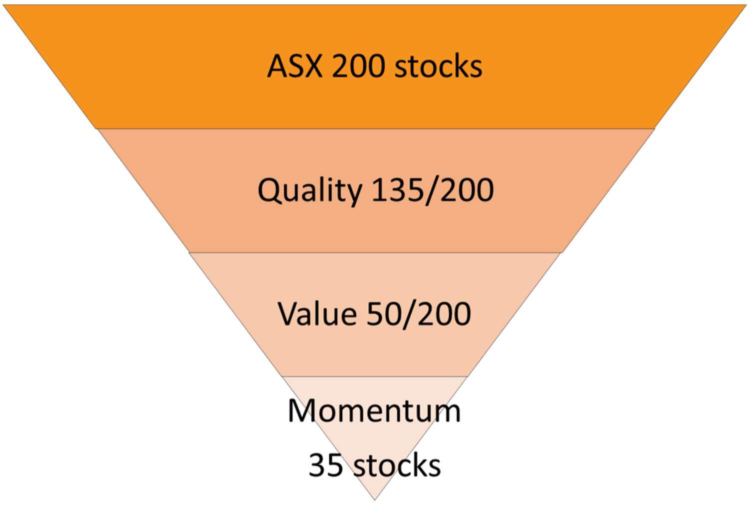
1) **Quality and Value investment philosophy and process –** this process seeks to reduce risk by only investing in quality companies that are showing value, this investment philosophy tends to reduce downside risk;
2) **Portfolio diversification –** each portfolio is diversified across GICS sectors and portfolio weights are based on a number of inputs that seek to maximise returns without adding additional risk vs the market (in fact we aim to lower portfolio risk);
3) **High defensive exposure –** each portfolio tends to have high weightings to defensive stocks that have lower volatility than the market;
4) **Gold hedge up to 10% –** the growth portfolios will tend to holds some gold equity exposure when the US market and US Federal Reserve hiking cycle seems to be peaking. Gold will outperform in volatile market conditions and when US interest rates are falling; and
5) **Cash weighting up to 10% -** in highly volatile and uncertain financial markets, the portfolios can go to 10% cash to help protect capital. That said, our policy is to generally remain 100% invested in Australian Equities and let the adviser choose when to adjust their exposure to cash via their own strategic asset allocation.

4-Step Investment Process



1) Stock Screening

Sunbird runs three screens across the S&P/ASX 200 universe. Firstly, a **Quality** screen which assesses each company across 9 quality factors. A company needs to score 70% or above to meet our definition of quality. This screen typically reduces the universe by one third to around 135 stocks.
These 135 stocks are then assessed for **Value**. To determine value, a company must be able to deliver an expected return greater than its minimum required return. This process typically reduces the universe down to 50 stocks or 25% of the original universe.
Our final screen, seeks to eliminate stocks that are in down-trend or underperforming, we prefer to see some positive **Momentum** before investing. This screen further reduces the sample size down to 35 stocks or 18% of the original universe.



Quality Assessment

Sunbird assesses and scores every company in the S&P/ASX 200 across 9 quality factors. Companies need to score a minimum of 56/80 or 70% to meet our definition of quality.

Industry /10	Macro drivers, Market size, Growth rate, Life-cycle, Industry profitability, Industry structure, Barriers to entry, Competition intensity, Government regulation and taxes
Competitive Advantages /10	Product, Price, Distribution, Location, Marketing, Brands, Service, Reputation, Patents, Licenses, Market share, Assets, Productivity, Technology, Management, Corporate culture, Scale, Capital strength
Profitability /10	Profit margins, ROE, ROA, ROCE
Earnings quality /10	Track record, Volatility of revenue & earnings, EBITDA cash conversion, Sustainability of revenue, Key customer risk, Contract risk
Sustainable Growth /10	Past growth, guided growth, consensus growth, theoretical growth rate (ROE x retention rate), industry/peer growth
Gearing /10	Net Debt/EBITDA, Net Debt/ND+E, Net debt/market cap, Interest cover
ESG /5	Refinitiv Environmental, Social, Governance score, converted to a score out of 5
Volatility /5	Lower vol = higher score, Short term volatility and long-term beta scores combined and converted to a score out of 5
Company risk /10	Lower risk = higher score Macro risks, Industry risks, Regulatory risks, Company-specific risks

Every stock in the ASX 250 is assessed and given a quality score which is updated with any major announcement. Quality scores change slowly with company developments over time. As of March 2022, Sunbird has rated 256 stocks with a Quality distribution as follows:

(90-100%) 0%	0% of the universe has a quality score >90%
(80-90%) 4%	4% of the universe has a quality score between 80-90%
(70-80%) 53%	53% of the universe has a quality score between 70-80%
(<70%) 43%	43% of the universe has a quality score less than 70%, i.e. 43% of the universe are not viewed as quality companies

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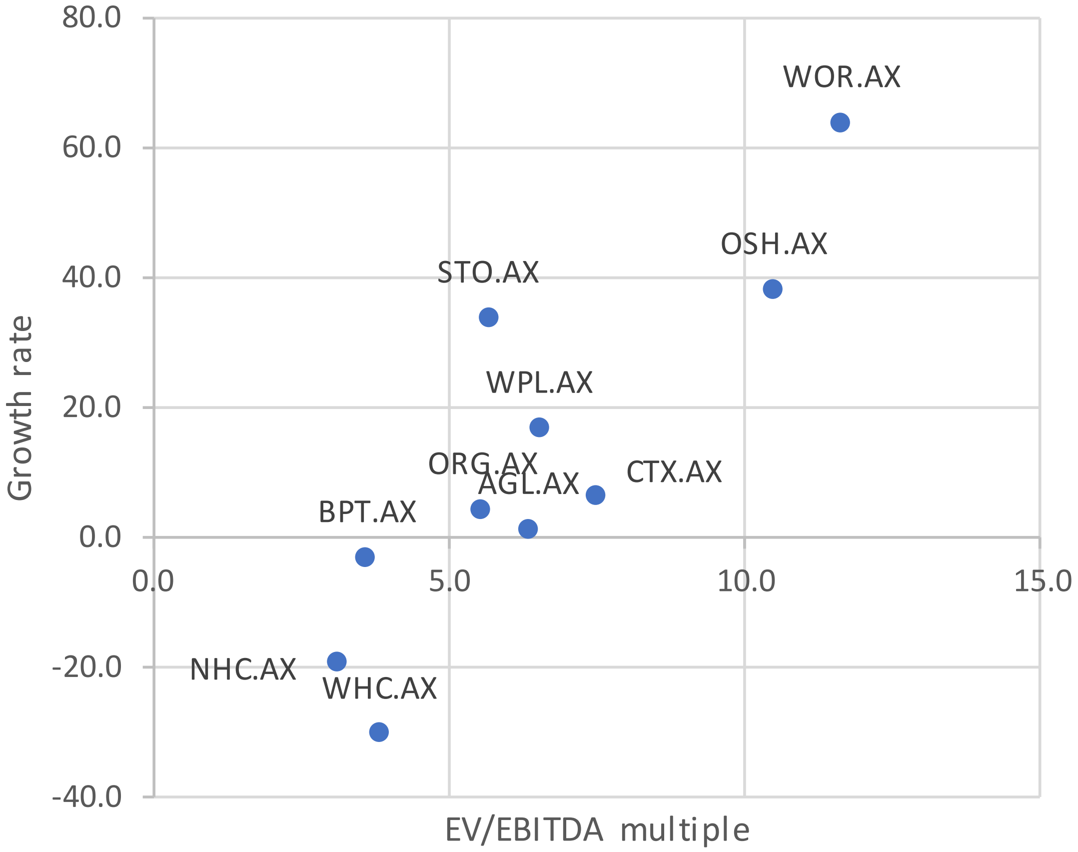
Value Assessment – Screen 1

Sunbird assesses the stocks in each GICS sector by growth vs trading multiple to identify high ranking quality stocks that seem to offer good value. We have built a scatterplot for each GICS sector (x11 sectors).

Example: Energy sector scatterplot



Value assessment – Screen 2

Once we identify a potential target, we then conduct a detailed quality and value analysis and produce a company research report. In the detailed analysis, we build an internal rate of return (IRR) model to assess whether the expected return of the stock exceeds it minimum required return.

Expected Return (IRR) = the sum of future dividends and capital growth, over a 10-year holding period, divided over the entry price and expressed as an Internal Rate of Return (IRR).

Required Return (R) = the stock's risk factor x the expected market return.

We view this as a practical approach as it replicates the actual investor experience of buying a stock (negative cashflow) and receiving dividends (positive cashflow) and the exit price (positive cashflow) as their investment return. Effectively, we are assessing whether the stock has a reasonable chance of generating a minimum required return, over a 10-year holding period.

The outcomes will be as follows:

IRR>R = undervalued

IRR=R = fair value

IRR<R = overvalued

Example: Seek (SEK)

SEK.AX	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
EPS	0.59	0.65	0.72	0.81	0.90	1.01	1.12	1.23	1.36	1.48	1.60
DPS	0.46	0.51	0.57	0.64	0.72	0.81	0.90	1.00	1.11	1.22	1.32
Payout ratio	78%	78%	79%	79%	80%	80%	81%	81%	82%	82%	83%
EPS growth		10.0%	11.0%	12.0%	12.0%	12.0%	11.0%	10.0%	10.0%	9.0%	8.0%
Share price	17.81										38.19
P/E	30.2										23.9

IRR at current price			Assumptions		
Purchase Price	- 17.81		EPS 10-year CAGR	10.5%	
Dividends Yr 1-10	8.79		Payout ratio increase p.a.	0.5%	
Capital Price Yr10	38.19		Year 10 growth rate	8.0%	
IRR	11.3%		Year 10 P/E ratio	23.9	
Required Return	9.0%		Required return	9.0%	
Fair Value (IRR=R)			**Required return calculation**		
Purchase Price	- 21.34		10-year bond yield	3.0%	
Dividends Yr 1-10	8.79		Equity Risk Premium	6.0%	
Capital Price Yr10	38.19		Equity market expected return	9.0%	
IRR	9.0%		Stock risk factor (from Quality analysis) (x)	1.0	see table on page 2
Required Return	9.0%		Required return	9.0%	

SEK purchase price $17.81

IRR at that price: 11.3% p.a.

Required return: 9.0% p.a.

IRR>R hence the stock offers value

Fair value of SEK: $21.34 (the price where the IRR = R)

At a purchase price of $17.81, SEK's expected return (IRR) is 11.3% which is greater than its required return of 9.0%. The stock is undervalued at $17.81/share, based on the assumptions above right. Further, SEK offers value up to $21.34, which is the point where its expected return (IRR) of 9.0% = its required return of 9.0%.

The required return is calculated by multiplying SEK's risk factor x the expected market return. In this case, SEK's risk factor is 1.0 which is calculated by reference to its volatility and risk score in our Quality analysis. Each stock will have a risk factor of 0.9, 1.0 or 1.1 depending on how risky it is relative to the market. The expected market return is calculated as the risk-free rate (10-year bond yield) + a premium for equity risk (Equity Risk Premium). Investors will note this method is similar to the Capital Asset Pricing Model except we substitute our own risk factor for beta, given beta is often an unreliable figure that changes wildly with the timeframe measured. The result is every stock will have a required return of either 8.1%, 9.0% or 9.9%, depending on its risk factor, which we believe is a reasonable and practical approach. Our expected market return inputs will be reviewed annually with market conditions while risk factors will change slowly with the quality analysis outcomes.

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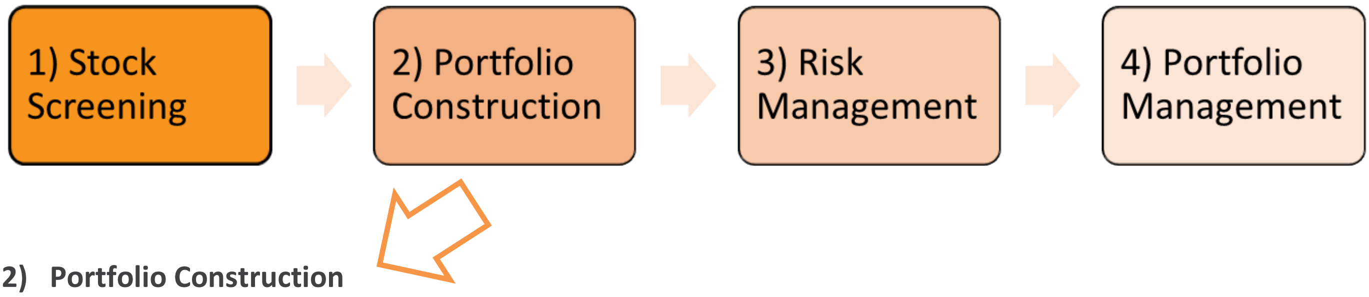
Momentum Assessment

The last filter is a momentum filter where we look for positive momentum as a BUY trigger or negative momentum as a SELL signal. This is mainly to reduce downside risk as we prefer to "get on at the station" rather than "hoping the train will stop in front of us". Here we observe short, medium and long-term price trends, as well as relative performance vs the ASX 200. We are typically looking for an up-trend and stock outperformance before investing.

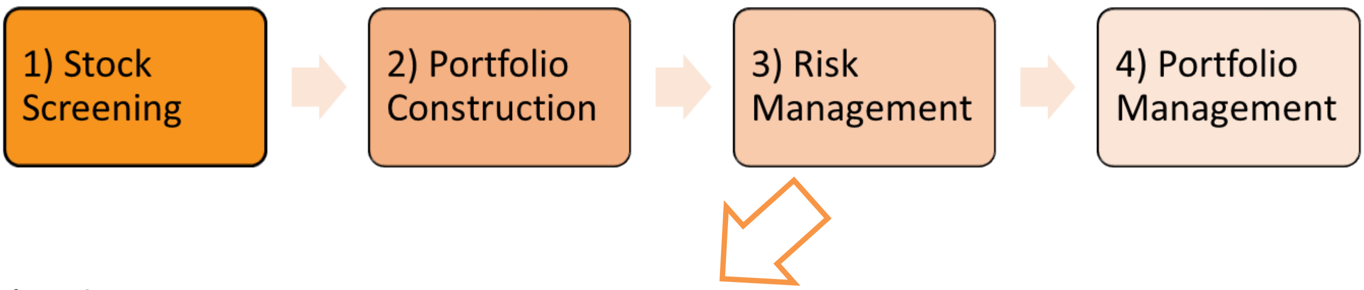
Example: Brambles (BXB)

We use BXB as an example because it ranks as a quality stock offering value (as at September 2018). The stock was in downtrend but has recently broken out of this downtrend. The stock has regained momentum and is now outperforming the ASX 200. This is exactly the sort of investment opportunity that we look for.



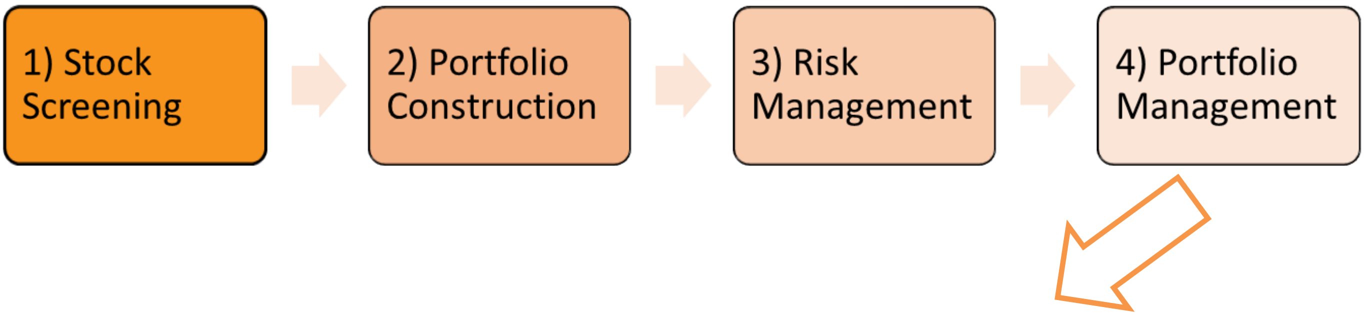
2) Portfolio Construction

- Portfolio objective
- Portfolio strategy (asset allocation, rules, constraints)
- Top-down inputs (20%)
    - Macro-economic conditions (stable or unstable)
    - Big-picture investment themes e.g. low inflation/interest rates, regulatory interference, technology changes, globalization and population change, sustainability
- Bottom-up inputs (80%)
    - Quality, Value, Momentum stock screens
- Portfolio weighting considerations
    - Portfolio expected return
    - Portfolio yield
    - Portfolio expected risk
    - Portfolio correlations/portfolio optimiser results
    - Portfolio defensiveness in a bear scenario
    - Diversification across industries
    - Quality, Risk, Value and Momentum results for each stock
    - Growth vs income qualities of each stock
    - Portfolio manager conviction in each stock
    - Market weights, market cap, liquidity



3) Risk Management

- Portfolio strategy/rules/constraints (sets the portfolio boundaries and risk limits)
- Top-down inputs (unstable macro conditions trigger gold exposure, defensive positions, overweight cash)
- Bottom-up inputs (focus on stocks meeting quality, value and momentum screens acts to mitigate downside risks)
- Portfolio weighting considerations (additional overlay to portfolio strategy rules)
- Risk measurement (measurement of key risk statistics to inform portfolio manager about portfolio risks)
- Sell discipline (removal of stocks as soon as they do not meet quality, value or momentum requirements)



4) Portfolio Management

- Monitor portfolio returns
- Monitor portfolio risk metrics
- Review top-down inputs
- Review bottom-up inputs
- Identify potential SELLS
- Identify potential BUYS
- Report to Investment Committee regularly
- Report to Investors regularly
- Identify adjustments to the Investment Process (above) that maybe required to maximise risk-adjusted returns

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