

S&P Dow Jones Indices

A Division of **S&P Global**

TalkingPoints

Introducing the S&P/TSX SmallCap Select Index



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Could incorporating earnings quality and liquidity improve risk/return in Canadian small-cap equities?

1. Why is the S&P/TSX SmallCap Select being introduced now?

Prior research has demonstrated that profitability matters for small-cap companies in the U.S.¹ For example, the S&P SmallCap 600[®]—which includes earnings eligibility criteria—has outperformed the broader Russell 2000 Index (with lower volatility) throughout its 25-year live track record. Our new S&P/TSX SmallCap Select Index extends this phenomenon to Canadian equity markets, where we have found that a similar effect exists. Simply put, small-cap companies without a track record of generating earnings have performed poorly relative to their profitable peers and have thus been a drag on broad small-cap indices.

2. How does the S&P/TSX SmallCap Select Index work?

The index is a part of the S&P Global SmallCap Select Index Series. In order to be eligible for index inclusion, companies must post two consecutive years of positive earnings per share. As a buffer, companies are dropped from the index after posting two consecutive years of negative earnings. In order to improve replicability of the index, we also eliminate the 20% smallest and 20% least liquid companies. The index is weighted by float market cap and is rebalanced semiannually in June and December.

3. What additional indices are offered within the S&P Global SmallCap Select Index Series?

The S&P/TSX SmallCap Select Index follows the same index methodology framework utilized in our S&P Global SmallCap Select Index Series. We currently offer several regional and country indices within the S&P Global SmallCap Select Series, including those in Exhibit 1.

¹ Brzenk, Phillip and Soe, Aye M., "A Tale of Two Small-Cap Benchmarks: 10 Years Later," S&P Dow Jones Indices.

Gunzberg, Jodie and Glawe, Garrett, "Big Things Come in Small Packages," S&P Dow Jones Indices.

Exhibit 1: Regional Indices in the S&P Global SmallCap Select Index Series

Global	S&P Global SmallCap Select Index
Global Excluding the U.S.	S&P Global Ex-U.S. SmallCap Select Index
Developed Markets Excluding the U.S.	S&P Developed Ex-U.S. SmallCap Select Index
Developed Markets Excluding the U.S. and Canada	S&P EPAC SmallCap Select
Emerging Markets	S&P Emerging SmallCap Select Index
Australia	S&P/ASX Small Ordinaries Select Index
United Kingdom	S&P United Kingdom SmallCap Select

Source: S&P Dow Jones Indices LLC. Data as of November 2019. Table is provided for illustrative purposes.

4. How can the S&P/TSX SmallCap Select Index be used?

The index can be used to support index-linked investment products or serve as a better benchmark for active Canadian small-cap strategies. The S&P/TSX SmallCap Select Index can provide the following benefits.

- Relative to traditional small-cap indices:
 - Improved risk-adjusted returns
 - Moderate tracking error
 - Enhanced liquidity
- Relative to active strategies:
 - Lower cost
 - Broader exposure to the asset class, resulting in diversification benefits
 - Increased transparency

Many active managers may screen out unprofitable companies as part of their investment process. The index serves as an improved benchmark for such strategies.

5. How has the S&P/TSX SmallCap Select Index performed?

Exhibits 2-4 demonstrate the performance and volatility advantages of the S&P/TSX SmallCap Select Index.

Exhibit 2: Risk/Return Comparison

Period	S&P/TSX SmallCap Select Index (CAD)	S&P/TSX SmallCap (CAD)
Annualized Total Return (%)		
1-Year	-1.83	-6.62
3-Year	3.45	-1.84
5-Year	3.08	0.10
10-Year	7.33	3.73
15-Year	5.14	2.77
Since Dec. 21, 2001	5.88	3.99
Annualized Volatility (%)		
1-Year	14.03	15.30
3-Year	10.10	10.74
5-Year	10.32	13.68
10-Year	12.08	14.77
15-Year	15.13	17.48
Since Dec. 21, 2001	14.66	16.93

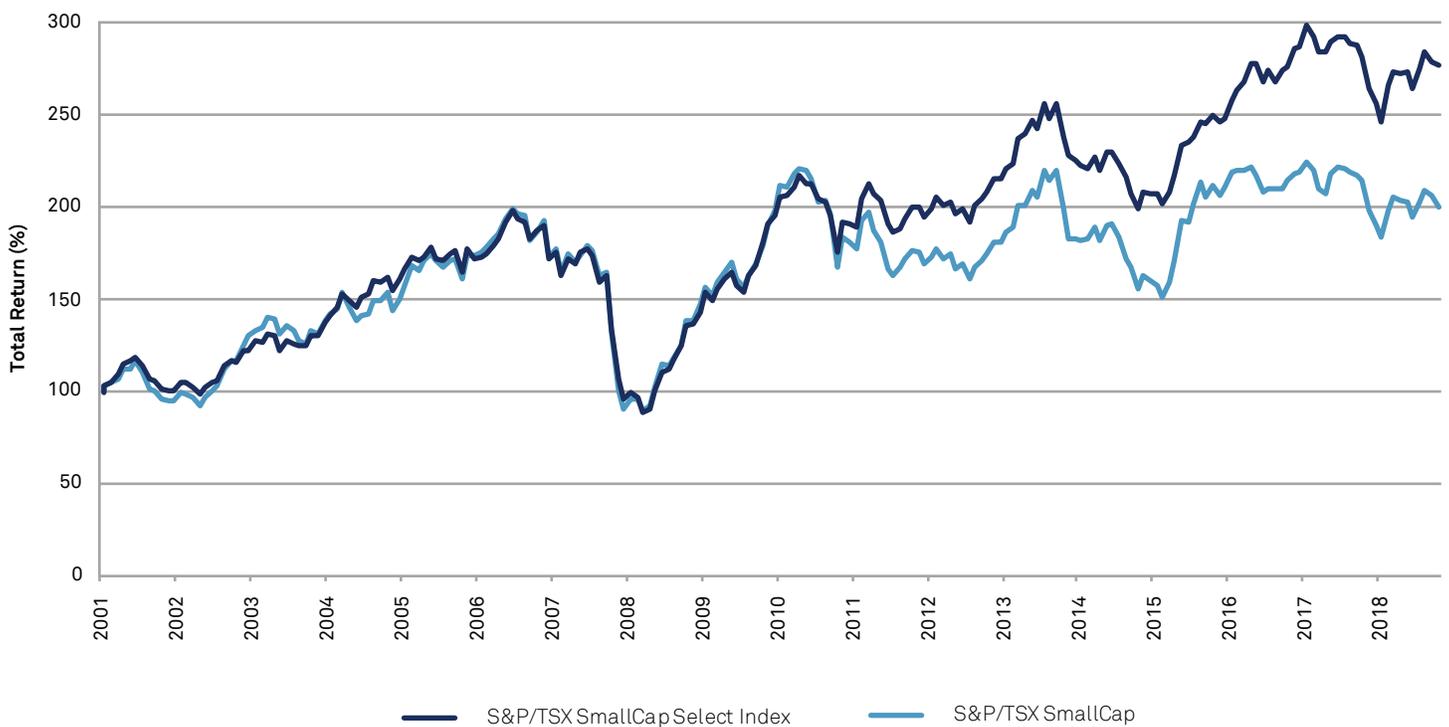
Source: S&P Dow Jones Indices LLC. Data from Dec. 21, 2001, to Sep. 30, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Annualized volatility and risk statistics calculated based on monthly total returns, with the exception of maximum drawdown. Maximum drawdown calculated based on daily total returns over the period. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Exhibit 2: Risk/Return Comparison (cont.)

Period	S&P/TSX SmallCap Select Index (CAD)	S&P/TSX SmallCap (CAD)
Return/Risk		
1-Year	-0.13	-0.43
3-Year	0.34	-0.17
5-Year	0.30	0.01
10-Year	0.61	0.25
15-Year	0.34	0.16
Since Dec. 21, 2001	0.40	0.24
Risk Statistics (Since Dec. 21, 2001)		
Maximum Drawdown (%)	-55.31	-54.85
Beta With Benchmark	0.83	-
Correlation With Benchmark	0.96	-
Monthly Tracking Error (%)	1.50	-
Sharpe Ratio	0.11	0.07

Source: S&P Dow Jones Indices LLC. Data from Dec. 21, 2001, to Sep. 30, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Annualized volatility and risk statistics calculated based on monthly total returns, with the exception of maximum drawdown. Maximum drawdown calculated based on daily total returns over the period. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Exhibit 3: Cumulative Return Comparison



Source: S&P Dow Jones Indices LLC. Data from Dec. 21, 2001, to Sep. 30, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Annualized volatility and risk statistics calculated based on monthly total returns, with the exception of maximum drawdown. Maximum drawdown calculated based on daily total returns over the period. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Exhibit 4: Up and Down Market Comparison

Period	S&P/TSX SmallCap Select Index
Hit Rate: % of Months the Index Outperformed the Benchmark	
All Months	53.52
Up Months	41.18
Down Months	69.15
Average Monthly Excess Return Versus Benchmark (%)	
All Months	0.12
Up Months	-0.40
Down Months	0.78
Market Capture Ratios (%)	
Up Months	88.79
Down Months	79.42

Source: S&P Dow Jones Indices LLC. Data from Dec. 21, 2001, to Sep. 30, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

6. What are the key benefits of the S&P/TSX SmallCap Select Index?

Improved Long-Term Total Returns: The S&P/TSX SmallCap Select Index has typically outperformed in down cycles and underperformed slightly in up cycles, leading to outperformance of the S&P/TSX SmallCap over the long run.

Reduced Risk: Excluding companies without a track record of positive earnings has historically provided a smoother ride in Canadian small caps. Volatility and beta have been meaningfully lower compared to the S&P/TSX SmallCap.

Enhanced Liquidity: The index liquidity profile is improved by removing the 20% least liquid and 20% smallest securities.

Moderate Tracking Error: The index has historically had moderate tracking error relative to the S&P/TSX SmallCap.

Performance Disclosure

The S&P/TSX SmallCap Select Index was launched November 18, 2019. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at www.spdji.com. Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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