

TalkingPoints

Introducing the S&P/ASX Small Ordinaries Select Index



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

1. Why is the S&P/ASX Small Ordinaries 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) for more than 20 years. Our new S&P/ASX Small Ordinaries Select Index extends this phenomenon to Australian 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/ASX Small Ordinaries 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. The index is weighted by float market cap and is rebalanced semiannually in March and September.

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

The S&P/ASX Small Ordinaries Select Index follows the same index methodology framework utilized in our S&P Global SmallCap Select Index Series. We currently offer the following regional indices within the S&P Global SmallCap Select Series (see below).

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

S&P Global SmallCap Select Index
S&P Global Ex-U.S. SmallCap Select Index
S&P Developed Ex-U.S. SmallCap Select Index
S&P Emerging SmallCap Select Index

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

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

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

4. How can the S&P/ASX Small Ordinaries Select Index be used?

The S&P/ASX Small Ordinaries Select Index is suitable for use as a performance benchmark for actively managed Australian small-cap funds or as the basis for index-linked investment products. We expect the index to be used as an alternative to core Australian small-cap indices, given its simple and intuitive framework. Because the index excludes a relatively small portion of the small-cap universe over most time periods and is float-market-cap weighted, it tends to have a moderate tracking error compared with the S&P/ASX Small Ordinaries.

5. How has the S&P/ASX Small Ordinaries Select Index performed?

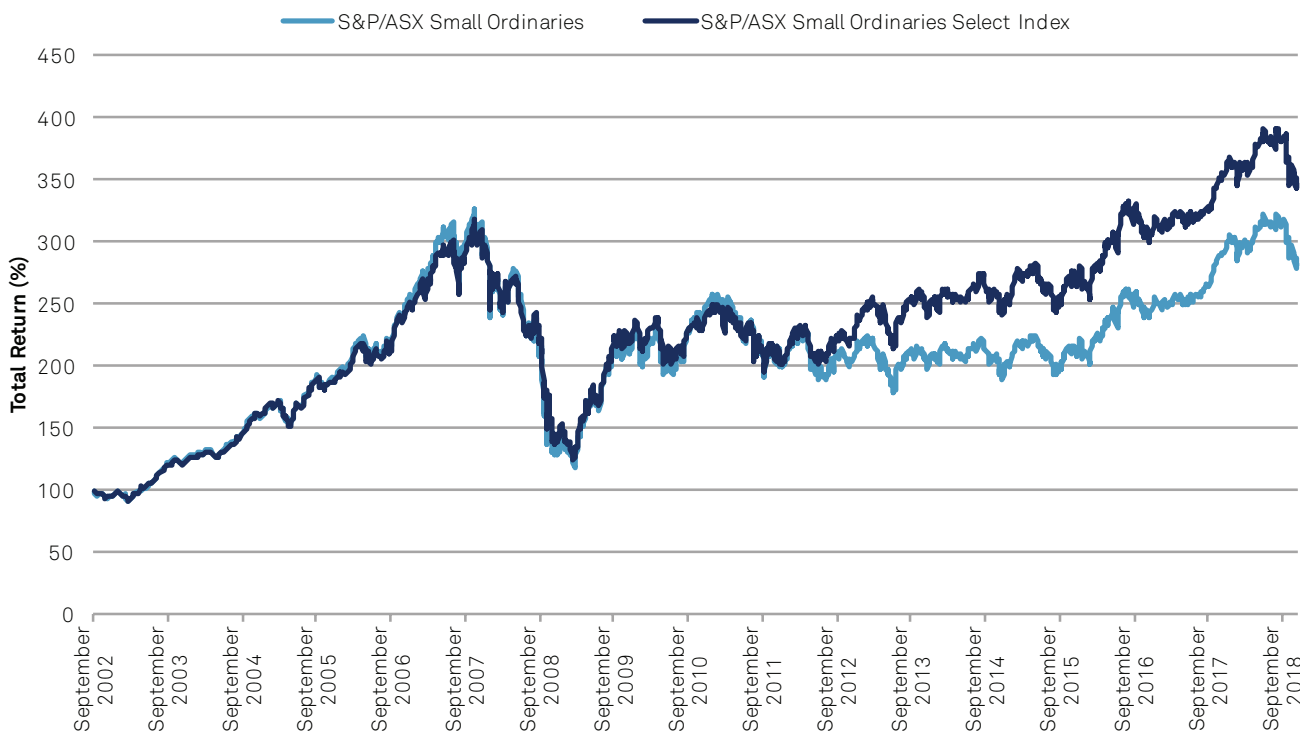
Exhibits 2–4 demonstrate the performance and volatility advantages of the S&P/ASX Small Ordinaries Select Index.

Exhibit 2: Risk/Return Comparison

Period	S&P/ASX Small Ordinaries Select Index (AUD)	S&P/ASX Small Ordinaries (AUD)
Annualized Total Return (%)		
1-Year	-1.38	-1.63
3-Year	8.84	10.39
5-Year	7.17	7.07
10-Year	9.20	7.77
15-Year	7.33	5.82
Since Sept. 20, 2002	8.19	6.93
Annualized Volatility (%)		
3-Year	11.81	11.83
5-Year	12.08	12.36
10-Year	14.90	15.78
15-Year	16.31	17.30
Since Sept. 20, 2002	15.96	16.93
Return/Risk		
3-Year	0.75	0.88
5-Year	0.59	0.57
10-Year	0.62	0.49
15-Year	0.45	0.34
Since Sept. 20, 2002	0.51	0.41
Risk Statistics (Since Sept. 20, 2002)		
Maximum Drawdown (%)	-61.79	-63.86
Beta With Benchmark	0.92	-
Correlation With Benchmark	0.98	-
Monthly Tracking Error (%)	3.25	-
Sharpe Ratio	0.36	0.32

Source: S&P Dow Jones Indices LLC. Data from Sept. 20, 2002, to Nov. 30, 2018. 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 Sept. 20, 2002, to Nov. 30, 2018. Past performance is no guarantee of future results. Chart 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.

Exhibit 4: Up and Down Market Comparison

Period	S&P/ASX Small Ordinaries Select Index
Hit Rate: % of Months the Index Outperformed the Benchmark	
All Months	52.06
Up Months	47.11
Down Months	60.27
Average Monthly Excess Return Versus Benchmark (%)	
All Months	0.09
Up Months	0.06
Down Months	0.34
Market Capture Ratios (%)	
Up Months	95.48
Down Months	87.88

Source: S&P Dow Jones Indices LLC. Data from Sept. 20, 2002, to Nov. 30, 2018. 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/ASX Small Ordinaries Select Index?

Reduced risk: Excluding companies without a track record of positive earnings has historically provided a smoother ride in Australian small caps. Volatility, beta, and drawdowns have been lower relative to the S&P/ASX Small Ordinaries.

Improved long-term total returns: The S&P/ASX Small Ordinaries Select Index has typically outperformed in down cycles and underperformed slightly in up cycles, leading to outperformance of the S&P/ASX Small Ordinaries over the long run.

Moderate tracking error: The index has historically had moderate tracking error relative to the S&P/ASX Small Ordinaries.

Performance Disclosure

The S&P/ASX Small Ordinaries Select Index was launched December 21, 2018. 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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