



# Profitability Screening in Australian Small Caps

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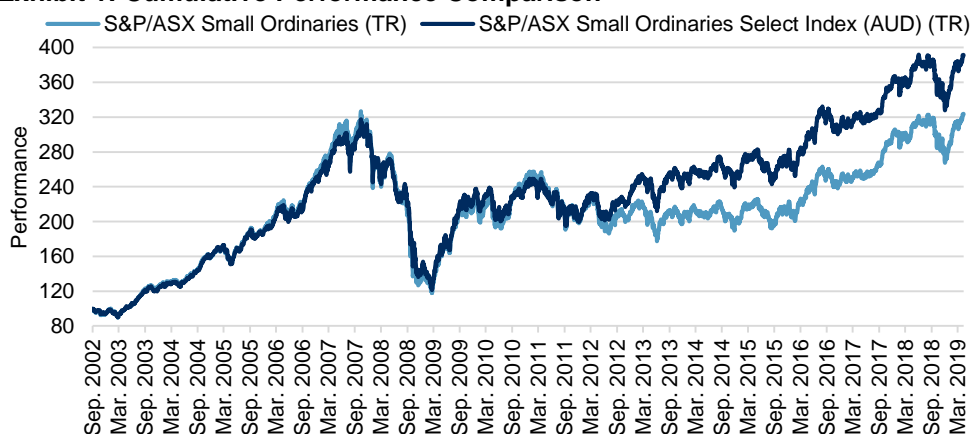
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## EXECUTIVE SUMMARY

This paper examines the effectiveness of a profitability screen on improving return and reducing volatility and drawdown for Australian small-cap stocks. We also demonstrate the benefit of applying a profitability screen to the [S&P/ASX Small Ordinaries](#), the benchmark for small-cap stocks in Australia.

- On average, 28% of companies in the S&P/ASX Small Ordinaries were unprofitable over the period studied, in contrast to 9% in the [S&P/ASX 50](#). Small-cap companies with positive earnings per share (EPS) historically outperformed the unprofitable companies on both absolute and risk-adjusted bases.
- The [S&P/ASX Small Ordinaries Select](#) is designed to track profitable small-cap companies in Australia. The index's addition of a profitability screen helped it to outperform its benchmark by 1.2% per year from Sept. 20, 2002, to Dec. 31, 2019.
- Sector allocation and stock selection effects both contributed to the excess return of the S&P/ASX Small Ordinaries Select, with the sector allocation effect explaining a larger part of it.
- The S&P/ASX Small Ordinaries Select had higher dividend yield and active profitability factor exposures compared with the S&P/ASX Small Ordinaries.

**Exhibit 1: Cumulative Performance Comparison**



Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Index performance based on total return in AUD. 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.

## SMALL-CAP BEHAVIOR IN AUSTRALIA

*Australian small caps had the lowest correlation with Australian bonds, Australian REITs, and international equities.*

In 1992, the capital asset pricing model (CAPM) evolved into the Fama & French three-factor model to include size and value as risk factors in addition to market risk, with the aim to help better explain a portfolio's risk/return characteristics. Inclusion of small-cap companies offers diversification and potential for higher returns.

Exhibit 2 shows the return correlation of various common Australian investment classes. Australian small caps had return correlations of 0.83 and 0.91 with large and mid caps, respectively. Among the three size categories in Australian equities, small caps had the lowest correlation with Australian bonds, Australian REITs, and international equities.

**Exhibit 2: Return Correlation of Various Australian Equity Market Cap Spectrum and Other Asset Classes**

ASSET CLASS	AUSTRALIAN LARGE CAP	AUSTRALIAN MID CAP	AUSTRALIAN SMALL CAP	AUSTRALIAN BONDS	AUSTRALIAN REITS	INTERNATIONAL EQUITIES
AUSTRALIAN LARGE CAP	1.00	0.88	0.83	-0.26	0.64	0.53
AUSTRALIAN MID CAP	0.88	1.00	0.91	-0.26	0.66	0.55
AUSTRALIAN SMALL CAP	0.83	0.91	1.00	-0.34	0.57	0.49
AUSTRALIAN BONDS	-0.26	-0.26	-0.34	1.00	0.10	-0.04
AUSTRALIAN REITS	0.64	0.66	0.57	0.10	1.00	0.45
INTERNATIONAL EQUITIES	0.53	0.55	0.49	-0.04	0.45	1.00

Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Index performance based on total return in AUD. Australian Large Cap is represented by the S&P/ASX 50, Australian Mid Cap by the [S&P/ASX MidCap 50](#), Australian Small Cap by the S&P/ASX Small Ordinaries, Australian Bonds by the [S&P/ASX Australian Fixed Interest Index](#), Australian REITs by the [S&P/ASX 200 A-REIT Index](#), and International Equities by the [S&P Developed Ex-Australia LargeMidCap](#). 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.

Performance leaders and laggards rotated across investment classes over the period studied, though Australian small caps were more volatile with worse drawdown in downturns compared with Australian large and mid caps (see Exhibit 3). This segment was the best performer in 2006, 2009, and 2010, and the worst performer in 2011-2014 and 2018. While including small caps in portfolios can provide diversification benefits and potential to capture growth opportunities, carefully managing volatility and downside risk is important for small-cap investments.

Exhibit 3: Yearly Performance of Various Australian Equity Market Cap Segments and Other Asset Classes						
YEAR	RANK					
	1	2	3	4	5	6
2005	Australian Mid Cap 23.2%	Australian Large Cap 22.7%	Australian Small Cap 19.6%	International Equities 18.2%	Australian REITs 12.5%	Australian Bonds 5.9%
2006	Australian Small Cap 34.2%	Australian REITs 34.0%	Australian Mid Cap 26.0%	Australian Large Cap 23.0%	International Equities 11.5%	Australian Bonds 2.5%
2007	Australian Mid Cap 17.1%	Australian Small Cap 17.1%	Australian Large Cap 16.0%	Australian Bonds 3.1%	International Equities -1.4%	Australian REITs -8.4%
2008	Australian Bonds 17.1%	International Equities -24.7%	Australian Large Cap -35.8%	Australian Mid Cap -45.9%	Australian Small Cap -53.2%	Australian REITs -54.0%
2009	Australian Small Cap 57.4%	Australian Large Cap 36.2%	Australian Mid Cap 36.0%	Australian REITs 7.9%	International Equities 1.4%	Australian Bonds 0.8%
2010	Australian Small Cap 13.1%	Australian Bonds 6.0%	Australian Mid Cap 4.0%	Australian Large Cap 0.4%	Australian REITs -0.4%	International Equities -1.2%
2011	Australian Bonds 12.1%	Australian REITs -1.5%	International Equities -5.1%	Australian Large Cap -9.0%	Australian Mid Cap -16.3%	Australian Small Cap -21.4%
2012	Australian REITs 33.0%	Australian Large Cap 22.0%	International Equities 15.1%	Australian Mid Cap 12.8%	Australian Bonds 7.9%	Australian Small Cap 6.6%
2013	International Equities 47.8%	Australian Large Cap 22.1%	Australian Mid Cap 16.8%	Australian REITs 7.1%	Australian Bonds 1.9%	Australian Small Cap -0.8%
2014	Australian REITs 27.0%	International Equities 15.4%	Australian Mid Cap 13.2%	Australian Bonds 10.5%	Australian Large Cap 5.3%	Australian Small Cap -3.8%
2015	Australian REITs 14.3%	International Equities 12.3%	Australian Mid Cap 11.3%	Australian Small Cap 10.2%	Australian Bonds 2.7%	Australian Large Cap 1.0%
2016	Australian Mid Cap 17.8%	Australian Small Cap 13.2%	Australian REITs 13.2%	Australian Large Cap 10.9%	International Equities 8.5%	Australian Bonds 2.9%
2017	Australian Mid Cap 22.1%	Australian Small Cap 20.0%	International Equities 14.5%	Australian Large Cap 9.5%	Australian REITs 5.7%	Australian Bonds 3.7%
2018	Australian Bonds 4.7%	Australian REITs 2.9%	International Equities 1.8%	Australian Large Cap -1.5%	Australian Mid Cap -7.4%	Australian Small Cap -8.7%
2019	International Equities 28.1%	Australian Large Cap 24.4%	Australian Mid Cap 21.8%	Australian Small Cap 21.4%	Australian REITs 19.4%	Australian Bonds 7.7%

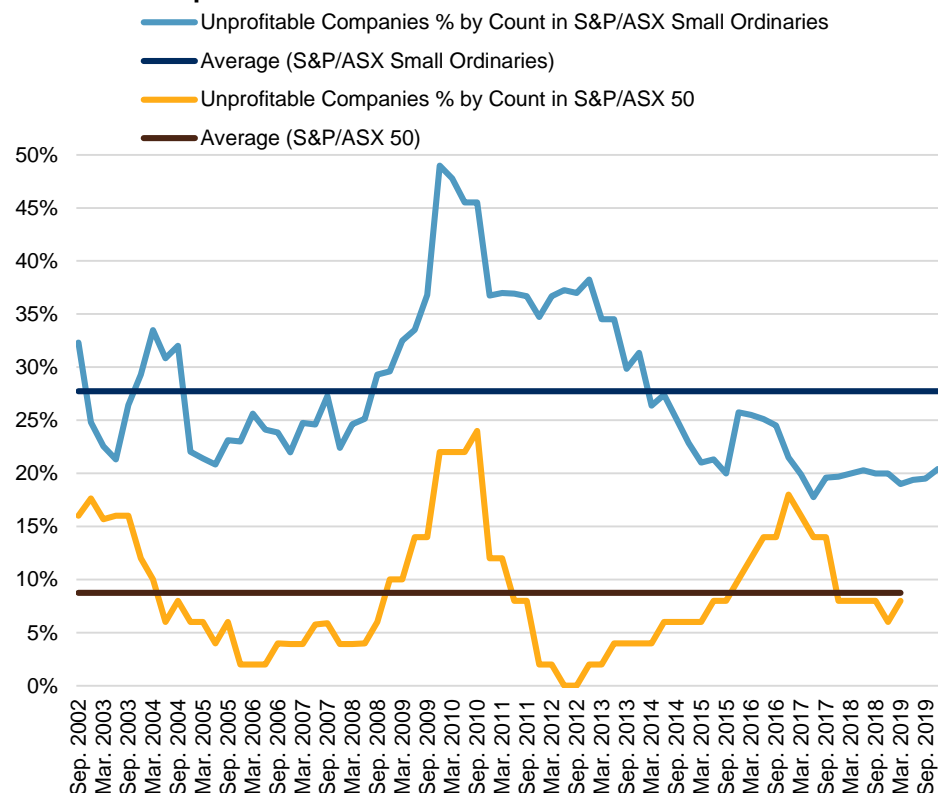
Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Index performance based on total return in AUD. Australian Large Cap is represented by the S&P/ASX 50, Australian Mid Cap by the S&P/ASX MidCap 50, Australian Small Cap by the S&P/ASX Small Ordinaries, Australian Bonds by the S&P/ASX Australian Fixed Interest Index, Australian REITs by the S&P/ASX 200 A-REIT Index, and International Equities by the S&P Developed Ex-Australia LargeMidCap. 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.

*Performance leaders and laggards rotated across investment classes.*

Of companies in the S&P/ASX Small Ordinaries, 28% were unprofitable, in contrast to 9% in the S&P/ASX 50, on average (see Exhibit 4). In the small-cap universe, the percentage of unprofitable companies was highest in the Materials sector (followed by Energy), which was dominant in the small-cap benchmark (see Exhibit 5). The higher percentage of unprofitable companies among small caps resulted in higher volatility and worse drawdown during market downturns, as the analysis later in the paper will showcase.

Research<sup>1</sup> published by S&P Dow Jones Indices suggests that a simple screening (or elimination) of unprofitable companies using EPS could have a positive return impact for small-cap benchmarks tested across different markets. In this paper, we study whether a profitability screen (positive EPS) may improve small-cap performance and reduce volatility and drawdown in Australia.

**Exhibit 4: Percentage of Unprofitable Companies in the S&P/ASX Small Ordinaries compared with the S&P/ASX 50**

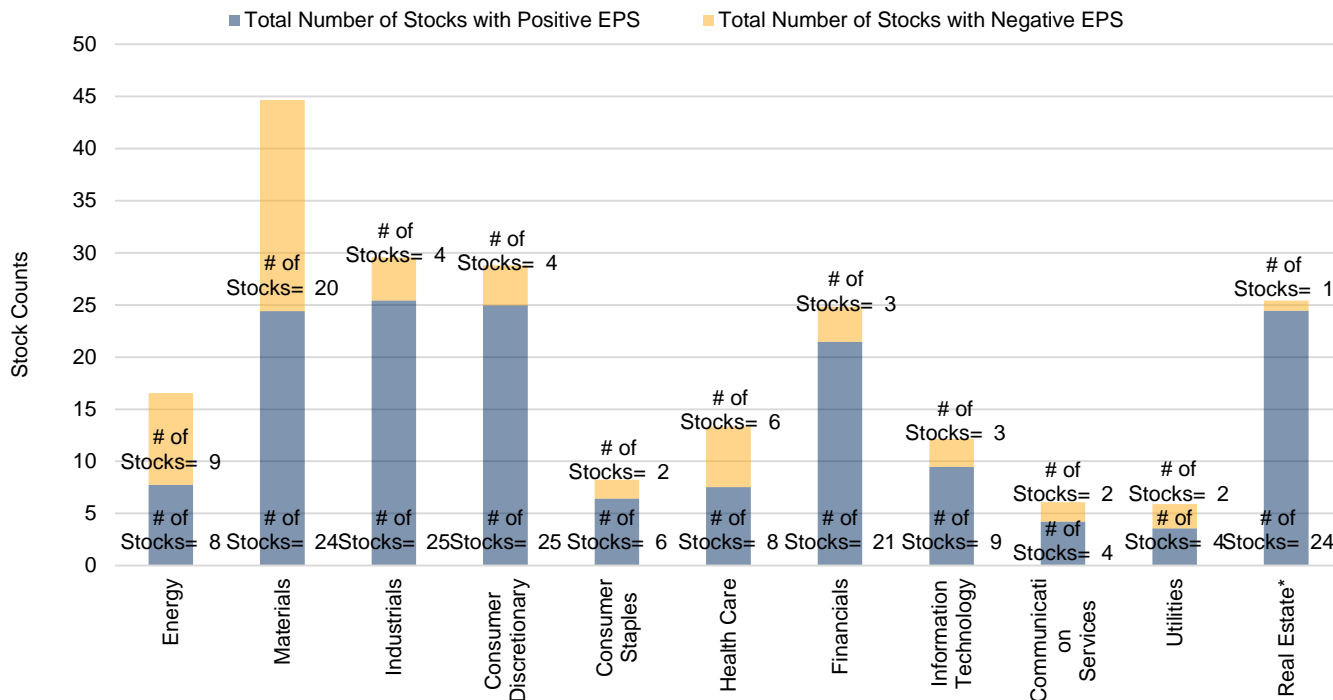


*Australian small caps displayed more volatility and worse drawdown in downturns compared to the Australian large- and mid-cap companies.*

Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 30, 2019. Figures are percentages of companies with negative trailing 12-month EPS in the S&P/ASX Small Ordinaries and S&P/ASX 50. 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.

<sup>1</sup> Brzenk, Phillip and Rachel Du. "Building Better International Small-Cap Benchmarks." S&P Dow Jones Indices. July 2019.

**Exhibit 5: Number of Companies with Positive and Negative EPS in Each Sector**



Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Chart displays average number of companies considered in each sector over the back-tested period. \*The Real Estate sector has a limited history; prior to September 2016, it was part of the Financials sector. 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.

*The portfolio of companies with positive EPS outperformed the unprofitable companies on both absolute and risk-adjusted bases, offering lower return volatility and smaller drawdown.*

## DOES A PROFITABILITY SCREEN IMPROVE SMALL-CAP PERFORMANCE IN AUSTRALIA?

To study whether a profitability screen (positive EPS) enables small-cap performance improvement in Australia, we divided the S&P/ASX Small Ordinaries universe into two hypothetical portfolios based on trailing 12-month (TTM) EPS.<sup>2</sup> One included stocks with positive TTM EPS; the other included stocks with negative TTM EPS. To further substantiate the hypothesis, we examined the performance of float-market-cap- and equal-weighted portfolios (see Exhibit 6).

The portfolio of companies with positive EPS outperformed the unprofitable companies on absolute and risk-adjusted bases, with lower return volatility and smaller return drawdown during the period studied (see Exhibit 6).

This indicates profitability screens can be effective in improving performance and reducing volatility and drawdown of small-cap portfolios in Australia.

<sup>2</sup> TTM EPS is calculated as of the reference date and lagged appropriately by three months to avoid look-ahead bias. The portfolios are rebalanced quarterly as of the third Friday of March, June, September, and December. Reference date is the last trading day of the previous month.

<b>Exhibit 6: Fractile Performance Analysis</b>					
<b>PERIOD</b>	<b>S&amp;P/ASX SMALL ORDINARIES</b>	<b>EQUAL-WEIGHTED</b>		<b>FLOAT-MARKET-CAP WEIGHTED</b>	
		<b>NEGATIVE EPS</b>	<b>POSITIVE EPS</b>	<b>NEGATIVE EPS</b>	<b>POSITIVE EPS</b>
<b>ANNUALIZED RETURN (%)</b>					
1-Year	21.4	20.1	25.5	25.6	22.1
5-Year	10.6	13.4	8.9	14.4	10.4
10-Year	4.1	-3.6	3.5	-0.4	6.4
Since Inception	7.2	2.1	7.7	4.7	9.0
<b>ANNUALIZED VOLATILITY (%)</b>					
1-Year	11.4	13.9	10.4	14.6	11.5
5-Year	12.4	16.2	10.9	17.2	12.0
10-Year	14.9	18.9	13.5	19.4	14.0
Since Inception	16.1	21.6	15.1	21.8	15.3
<b>RISK-ADJUSTED RETURN</b>					
1-Year	1.9	1.5	2.5	1.8	1.9
5-Year	0.9	0.8	0.8	0.8	0.9
10-Year	0.3	-0.2	0.3	0.0	0.5
Since Inception	0.4	0.1	0.5	0.2	0.6
<b>250-DAY MAXIMUM DRAW DOWN (%)</b>					
1-Year	-15.6	-23.1	-13.4	-24.5	-13.8
5-Year	-17.1	-25.9	-15.0	-26.3	-15.2
10-Year	-25.8	-45.7	-23.9	-38.8	-21.6
Since Inception	-60.1	-68.3	-62.7	-71.1	-56.6

*The application of a profitability screen on small-cap companies can be seen in the S&P/ASX Small Ordinaries Select.*

Equal-Weighted and Float-Market-Cap-Weighted portfolios are hypothetical portfolios. Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Index performance based on total return in AUD. 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.

## **THE S&P/ASX SMALL ORDINARIES SELECT**

The application of a profitability screen on small-cap companies can be seen in the S&P/ASX Small Ordinaries Select. This index was launched on Dec. 21, 2018, with the aim of tracking profitable small-cap companies in Australia while minimizing index portfolio turnover and tracking error against the S&P/ASX Small Ordinaries.

The S&P/ASX Small Ordinaries Select is rebalanced semiannually on the third Friday of March and September. At each rebalancing, EPS data from each of the previous two years are reviewed for all companies in the S&P/ASX Small Ordinaries. Existing constituents of the S&P/ASX Small Ordinaries Select are removed from the index if they record two consecutive years of negative EPS. Non-constituent stocks are eligible for inclusion in the S&P/ASX Small Ordinaries Select if they record two

consecutive years of positive EPS. In addition, companies that are removed from the S&P/ASX Small Ordinaries are simultaneously excluded from the S&P/ASX Small Ordinaries Select.<sup>3</sup>

*The S&P/ASX Small Ordinaries Select demonstrated better long-term performance than the S&P/ASX Small Ordinaries...*

The S&P/ASX Small Ordinaries Select demonstrated better long-term performance than the S&P/ASX Small Ordinaries, with an annualized excess return of 1.2%, lower return volatility, and reduced drawdown. The index recorded a small tracking error of 3% versus the S&P/ASX Small Ordinaries, with an information ratio of 0.4 (see Exhibit 7).

The S&P/ASX Small Ordinaries Select had a marginally higher average annualized one-way turnover of 36.4%, compared with 32.9% for the S&P/ASX Small Ordinaries.

**Exhibit 7: Performance Comparison between the S&P/ASX Small Ordinaries and S&P/ASX Small Ordinaries Select**

PERIOD	S&P/ASX SMALL ORDINARIES	S&P/ASX SMALL ORDINARIES SELECT	
		ANNUALIZED RETURN (%)	EXCESS RETURN (%)
1-Year	21.4	20.0	-1.3
5-Year	10.6	9.8	-0.8
10-Year	4.1	5.8	1.7
Since Inception	7.2	8.4	1.2
PERIOD	ANNUALIZED VOLATILITY (%)	TRACKING ERROR (%)	
1-Year	11.4	11.3	1.6
5-Year	12.4	12.1	1.9
10-Year	14.9	13.9	2.7
Since Inception	16.1	15.1	3.0
PERIOD	RISK-ADJUSTED RETURN	INFORMATION RATIO	
1-Year	1.88	1.78	-0.8
5-Year	0.86	0.81	-0.4
10-Year	0.28	0.42	0.6
Since Inception	0.45	0.56	0.4
PERIOD	250-DAY MAXIMUM DRAW DOWN (%)	BETA	
1-Year	-15.6	-15.0	1.0
5-Year	-17.1	-16.3	1.0
10-Year	-25.8	-21.7	0.9
Since Inception	-60.1	-56.4	0.9

*...with an annualized excess return of 1.2%, lower return volatility, and reduced drawdown.*

Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Index performance based on total return in AUD. 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.

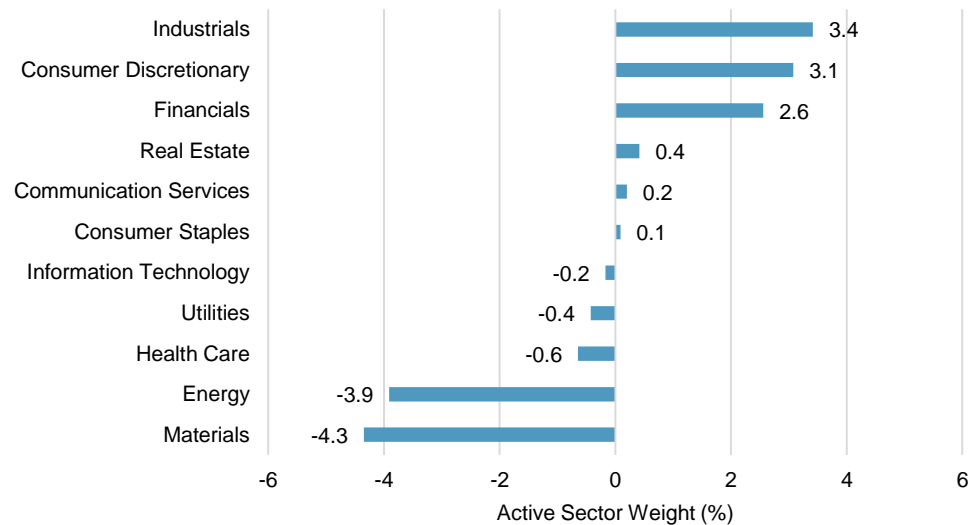
<sup>3</sup> For S&P/ASX Small Ordinaries Select methodology details, please visit <https://spdji.com/documents/methodologies/methodology-sp-asx-australian-indices.pdf/documents/methodologies/methodology-sp-asx-australian-indices.pdf>.

### Sector Allocation

Historically, the S&P/ASX Small Ordinaries Select was overweight in the Industrials, Consumer Discretionary, and Financials sectors (see Exhibit 8). It was underweight in Energy and Materials, which had a high percentage of unprofitable companies (see Exhibit 5).

*Sector allocation and stock selection effects contributed to the excess return of the S&P/ASX Small Ordinaries Select...*

**Exhibit 8: Active Sector Weights of the S&P/ASX Small Ordinaries Select versus Relative Weight in the S&P/ASX Small Ordinaries**



Source: S&P Dow Jones Indices LLC. Data from Sept. 20, 2002, to Dec. 31, 2019. Average active weight calculated with respect to S&P/ASX Small Ordinaries Select. 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.

*...though the sector allocation effect explained a larger part of it.*

### Return Contribution Analysis

Sector allocation and stock selection effects contributed to the excess return of the S&P/ASX Small Ordinaries Select, with the sector allocation effect explaining a larger part of it (see Exhibit 9). The overweight in Financials and underweight in Health Care resulted in positive contributions to excess return. The EPS screen resulted in pronounced positive stock selection effects across most sectors, apart from Industrials, Consumer Discretionary, and Consumer Staples. Therefore, the outperformance of the S&P/ASX Small Ordinaries Select was not simply a manifestation of active sector bets but also driven by the selection effect across sectors.



**Exhibit 9: Allocation and Selection Effect of Positive EPS Overlay on the S&P/ASX Small Ordinaries**

SECTOR	AVERAGE ACTIVE WEIGHT (%)	ALLOCATION EFFECT (%)	SELECTION EFFECT (%)	TOTAL EFFECT (%)
Communication Services	0.2	6.1	3.1	9.2
Consumer Discretionary	3.1	5.7	3.5	9.2
Consumer Staples	0.1	0.1	-3.7	-3.6
Energy	-3.9	-0.4	-4.2	-4.6
Financials	2.6	9.5	6.3	15.8
Health Care	-0.6	7.0	15.2	22.2
Industrials	3.4	2.1	-5.1	-3.0
Information Technology	-0.2	2.2	1.1	3.3
Materials	-4.3	5.2	5.2	10.4
Real Estate	0.4	2.1	2.5	4.5
Utilities	-0.4	0.7	-0.9	-0.3
[Unassigned]	-0.3	3.1	0.6	3.7
<b>Total</b>	-	43.4	23.5	66.9

Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to April 30, 2019. Brinson attribution is used to decompose total return differentials between allocation and selection effects, grouped by sectors. Average active weight is calculated with respect to S&P/ASX Small Ordinaries Select. 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.

### Factor Exposure

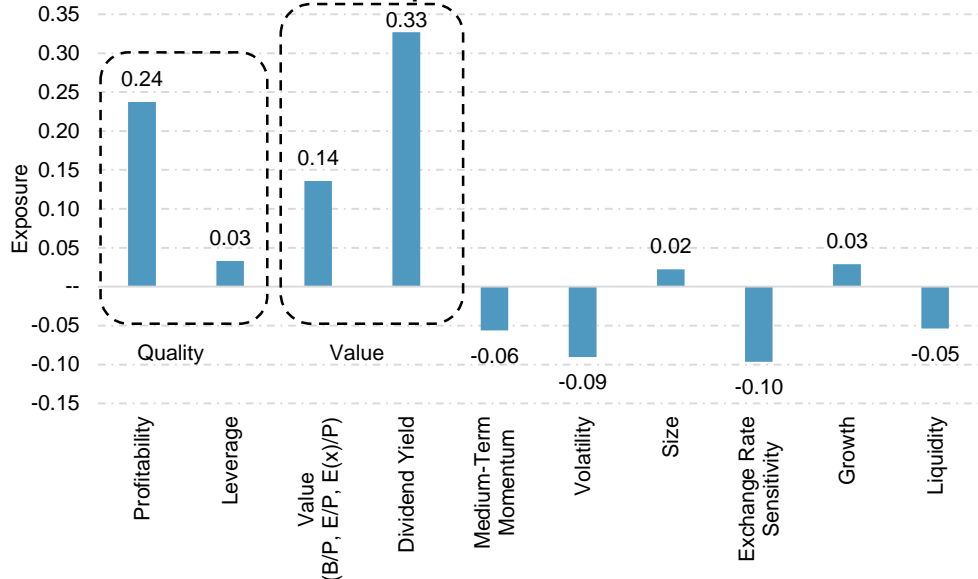
Historically, the S&P/ASX Small Ordinaries Select had higher profitability<sup>4</sup> active factor exposure than the S&P/ASX Small Ordinaries, as well as offering higher dividend yield (see Exhibit 10). Profitable companies are better positioned to maintain sustainable dividends. The S&P/ASX Small Ordinaries Select also offered higher value exposure (measured by book-to-price ratio and earnings yield) and tended to have lower realized volatility and less sensitivity to exchange rates compared with the benchmark (see Exhibit 10).

*The S&P/ASX Small Ordinaries Select had higher active exposure to profitability, dividends, and value ...*

*...and tended to have lower realized volatility with regard to the small-cap benchmark.*

<sup>4</sup> Profitability refers to return on equity, return on assets, cash flow to assets, cash flow to income, gross margin, and sales to assets.

**Exhibit 10: Axioma Style Factor Active Exposure of the S&P/ASX SmallCap Select versus S&P/ASX SmallCap Ordinaries<sup>5</sup>**



Source: S&P Dow Jones Indices LLC, Axioma, and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. The Axioma Australia Fundamental Equity Risk Model MH 4 is used for the comparison of the factor portfolios against the S&P/ASX Small Ordinaries. 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.

**Performance Cyclicity**

*The S&P/ASX Small Ordinaries Select demonstrated its defensive nature in its significant outperformance during down and neutral markets.*

The S&P/ASX Small Ordinaries Select demonstrated its defensive nature with significant outperformance during down and neutral markets. The index recorded monthly excess returns of 0.5% and 0.3% with a win ratio higher than 65% during down and neutral markets, respectively, though it underperformed by 0.2% (monthly average) during up markets (see Exhibit 11).

**Exhibit 11: Performance of S&P/ASX Small Ordinaries Select in Up and Down Market Phases**

TREND	MONTHS	AVERAGE EXCESS MONTHLY RETURN OVER BENCHMARK (%) WITH SIGNIFICANCE LEVEL	% OF MONTHS OUTPERFORMING BENCHMARK
Up	112	-0.2*	40
Down	63	0.5**	65
Neutral	32	0.3*	66
All	207	0.1	52

Source: S&P Dow Jones Indices LLC and FactSet. Data from Sept. 20, 2002, to Dec. 31, 2019. Past performance is no guarantee of future results. Index performance based on total return in AUD. Up and Down markets are defined as months in which the S&P/ASX Small Ordinaries (TR) returned over 1% or 1% or less, respectively. \*\*Represents significance level at 1%. \*Represents significance level at 5%. The rest of the months are classified under Neutral markets. 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.

<sup>5</sup> d'Assier, Olivier. "When Size Matters." Axioma. Pp 12.

## CONCLUSION

*Small-cap companies tend to be more volatile and may suffer higher drawdown during market downturns...*

Inclusion of small-cap companies in portfolios may provide diversification benefits and growth opportunities. Nevertheless, small-cap companies tend to be more volatile and may suffer higher drawdown during market downturns. Thus, managing volatility and downside risk is important for small-cap portfolios.

We observed that the portion of unprofitable companies in Australia has been much higher in the small-cap space than in the large-cap segment. On average, 28% of companies in the S&P/ASX Small Ordinaries were unprofitable, in contrast to 9% in the S&P/ASX 50. We also found small-cap companies with positive EPS historically outperformed the unprofitable companies, with reduced volatility and drawdown. This shows the potential benefit of applying profitability screens to small-cap portfolios in Australia.

Designed to track profitable small-cap companies in Australia, the S&P/ASX Small Ordinaries Select offered better risk/return characteristics while minimizing turnover and tracking error compared with the S&P/ASX Small Ordinaries. The S&P/ASX Small Ordinaries Select demonstrated better long-term performance than its benchmark, with an annualized excess return of 1.2%, lower return volatility, and reduced drawdown.

*...thus, managing volatility and downside risk is important for small-cap portfolios.*

Historically, the S&P/ASX Small Ordinaries Select was overweight in Industrials, Consumer Discretionary, and Financials, while underweight in Energy and Materials, the latter two exhibiting a high percentage of unprofitable companies. Both the sector allocation and stock selection effects contributed to the excess return of the S&P/ASX Small Ordinaries Select, with the sector allocation effect explaining a larger part of it.

The S&P/ASX Small Ordinaries Select also featured higher active exposure to dividend yield and profitability factors compared with the S&P/ASX Small Ordinaries.

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