VanEck®

Access the opportunities.

VanEck Vectors Small Companies Masters ETF (ASX Code: MVS)

The smart way to invest in small companies

June 2019

VanEck has developed a smart beta ETF which tracks an index that has consistently outperformed the S&P/ASX Small Ordinaries Index with reduced volatility.

ASX investors can access this performance via the VanEck Vectors Small Companies Masters ETF (ASX code: MVS).

ETFs

Exchange traded funds are growing in popularity and new ETFs are coming onto the Australian market every month. Much of the growth has been a result of the innovation in index investing known as 'smart beta'.

ETFs are managed funds that are traded on ASX just like shares. Buying an ETF gives you exposure to a portfolio of listed securities in a single trade. They combine the best features of unlisted managed funds and listed shares.

Smart beta

Institutional investors have been using smart beta for years. It is now becoming more widely used and accepted by the rest of the investing community.

As at 31 May 2019 there were over 50 ETFs on ASX that could be described as smart beta. Smart beta ETFs are attractive compared to unlisted actively managed strategies due to:

- cost effectiveness;
- explicit rules based methodology;
- transparency; and
- risk-adjusted performance.

Smart beta is an index methodology that differs from the traditional index method of using market capitalisation as the basis for weighting a portfolio.

There is mounting research that concludes that market capitalisation weighting is not the best method for passive portfolio construction. Institutions such as The University of London's Cass Business School, EDHEC Business School, Goethe University and Australia's own Monash University have demonstrated the long term outperformance and lower volatility of alternate indexing methods. These findings reinforce industry research by index companies.

In Australia the rise of smart beta is a response to investor demand for lower cost outperformance. This demand has emerged due to the disappointing performance of active fund managers.

The SPIVA® Australian scorecard for full-year 2017 reports that over the previous one and three year periods, only 26% and 25% of Australian Small and Mid Cap Equity funds managed to deliver better returns than the benchmark, respectively.

Small company funds

Where active managment once ruled, the SPIVA® scorecard shows a sharp increase in the number of active small-cap managers falling behind the index.

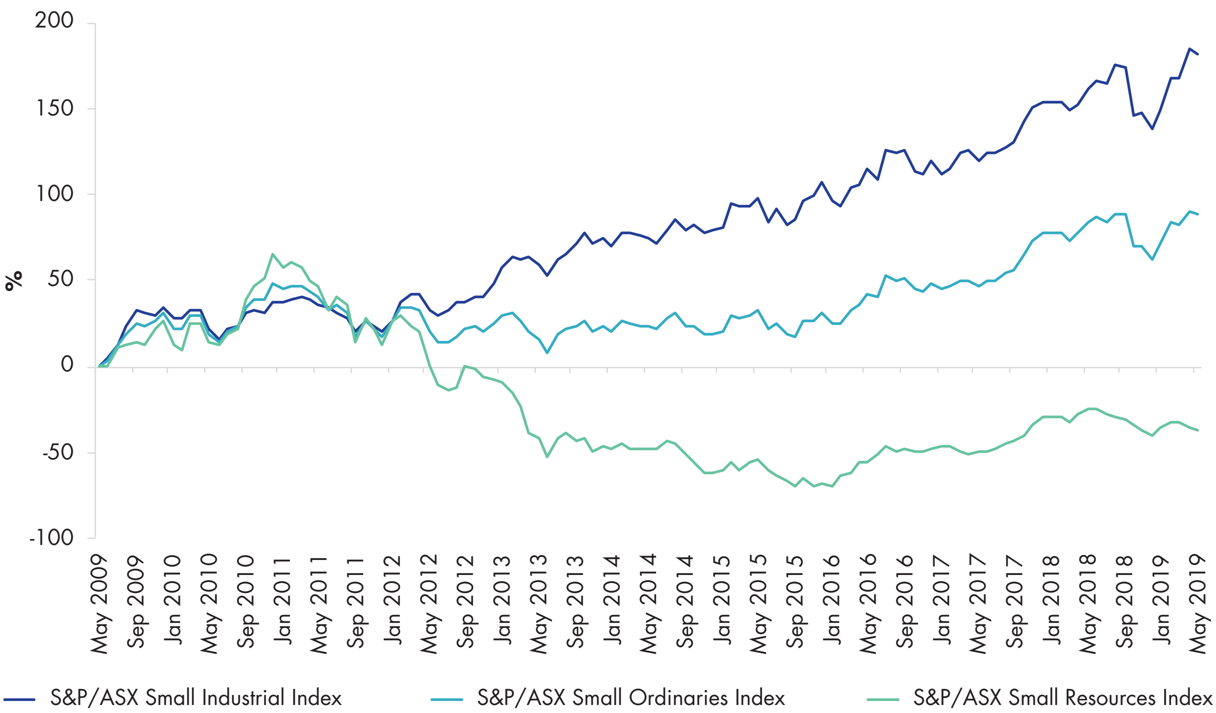
The historically weak performance of the S&P/ASX Small Ordinaries Index is understandable. It is carved out of the S&P/ASX 300 Index by excluding those in S&P/ASX 100 Index. While it is used as a benchmark for small cap Australian equities portfolios, it has shortcomings as an investment portfolio.

The index includes many illiquid stocks. As market capitalisation is the only filter to get into the index it includes miners in exploration phase. As no filter is applied to weed out the 'rats and mice', the tail end of the portfolio experiences high turnover as companies fall in and out of the index.

For individual and institutional investors, investing in small companies is expensive, onerous and risky. For many stocks within the Australian small company universe there is no broker research, information is not readily available and as a result there are more opportunities for mispricing. This mispricing is part of the reason active fund managers have historically been relatively successful in this asset class.

Using their expensive proprietary research, they have been able to analyse under-scrutinised companies, leaving the rats and mice alone and investing only in those companies that have passed their qualitative and quantitative screens. At the beginning of the decade, much of the outperformance of active managers had simply been achieved by avoiding resource companies which fell from representing approximately 40% of the index in 2010, to just 15% at the beginning of 2019. Chart 1 highlights this.

Chart 1 – Ten year performance of Australian small ordinaries indices: May 2009 to May 2019 (%)



Source: Morningstar Direct; as at 31 May 2019

Up to recently, good performance in small cap funds has been limited to non-transparent high cost active funds.

VanEck Vectors Small Companies Masters ETF (ASX Code: MVS)

MVS is a low cost investment vehicle on ASX that gives investors simple access to the growth and dividend potential of ASX listed small companies. MVS breaks new ground, being the first ETF with a smart beta approach to this equity class.

MVS tracks the MVIS Australia Small-Cap Dividend Payers Index (MVS Index) that combines strict liquidity and minimum market capitalisation requirements with a filter to exclude the companies less likely to perform. The filter is a binary dividend rule:

Only companies that pay a dividend are eligible for inclusion in the index.

If a company misses a dividend it is taken out of the index. The MVS Index shows superior risk and returns to the S&P/ASX Small Ordinaries Accumulation Index.

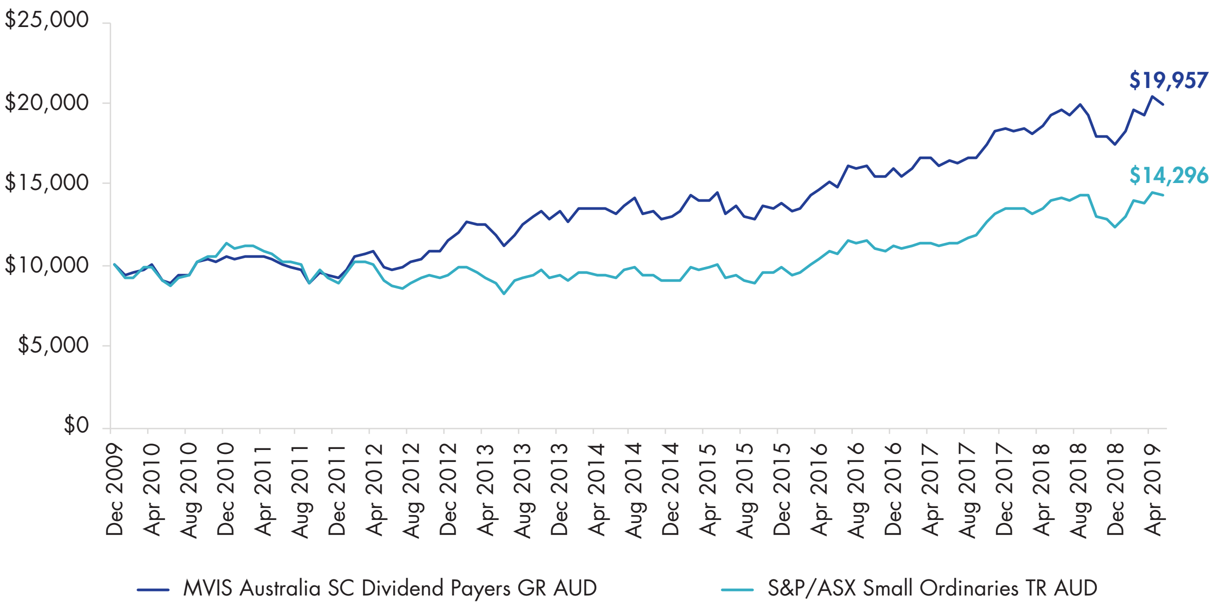
Dividend payers perform

There are many compelling economic and theoretical reasons for using dividend paying as the stock filter:

- Companies with the ability to pay out dividends typically have competitive business models and robust balance sheets with strong cash flows;
- Dividends are empirically linked to determining stock values and future earnings;
- According to Wharton Professor Jeremy Siegel, dividends have provided the majority of the stock market's total return over time and by allocating only to dividend paying stocks Siegel has been able to demonstrate outperformance; [1]
- Dividends are an objective measure of performance;
- Paying dividends indicates that the company is profitable;
- Dividends typically signal the presence of management teams that have a disciplined approach; and
- Investors, especially SMSFs in the drawdown or retirement phase, have an increasing demand for income producing assets.

The MVS Index can demonstrate outperformance with reduced volatility relative to the S&P/ASX Small Ordinaries Index. Chart 2 highlights this.

Chart 2 – Hypothetical growth of a $10,000 investment: December 2009 to May 2019



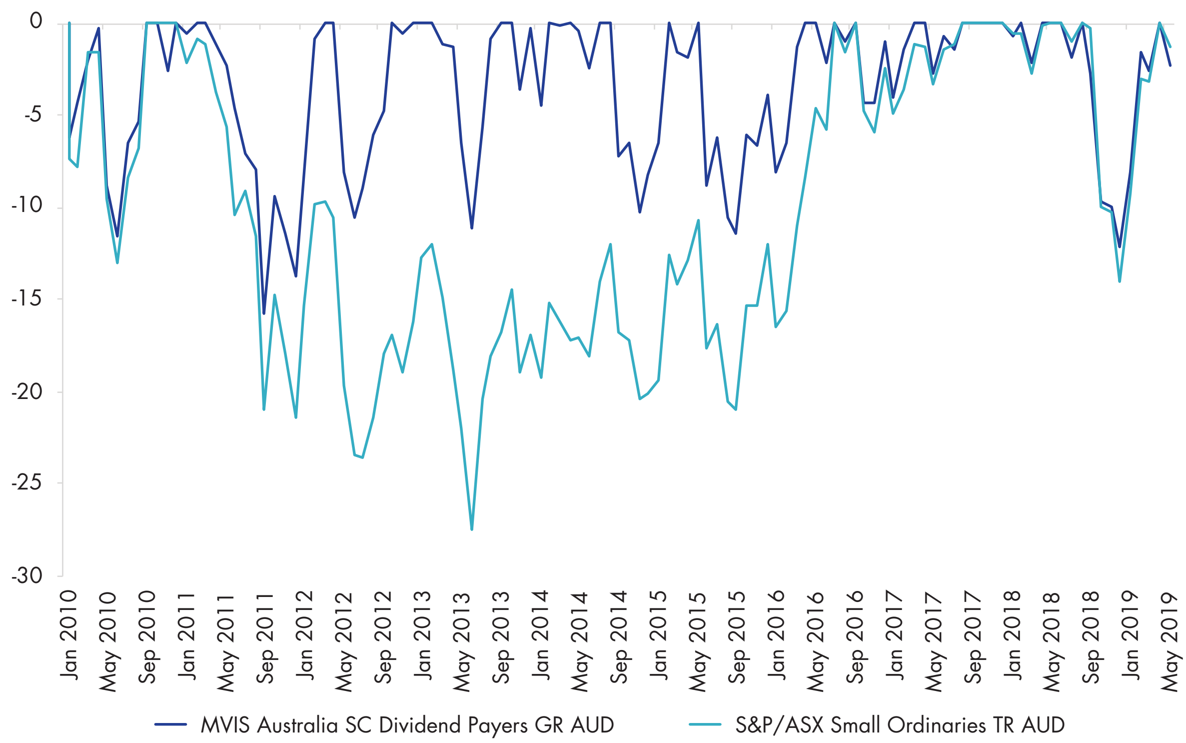
Source: VanEck, Morningstar Direct; as at 31 May 2019. Inception date of MVS Index is 31 of December 2009. The above graph is a hypothetical comparison of performance of a $10,000 investment in the Index and other recognised indices. Results are calculated to the last business day of the month and assume immediate reinvestment of all dividends and exclude costs associated with investing in MVS. You can not invest directly in an index. MVS Index performance shown prior to its Launch Date is simulated based on the current Index methodology. The above performance information is not a reliable indicator of current or future performance of MVS, which may be lower or higher.

Avoiding the perils that can exist in small companies

To mitigate risk within the small companies' universe MV Index Solutions (MVIS) has incorporated liquidity, market capitalisation and dividend screening requirements into the MVS Index rules. This deals with problems at the small end of the S&P/ASX Small Ordinaries index.

The chart and table following illustrate how effective these screening requirements are in shielding investors from volatility and capital loss. The drawdown chart indicates an investment tracking the MVS Index would have spent less time underwater than an investment tracking the S&P/ASX Small Ordinaries Index since December 2009. It also would have recovered losses quicker.

Chart 3 – MVS Index vs S&P/ASX Small Ordinaries Accumulation Index - Drawdown December 2009 to May 2019



Source: VanEck, Morningstar Direct; as at 31 May 2019. Inception date of MVS Index in December 2009. Results are calculated to the last business day of the month and assume immediate reinvestment of all dividends and exclude costs associated with investing in MVS. You cannot invest directly in an index. MVS Index performance shown prior to its Launch Date is simulated based on the current Index methodology. The above performance information is not a reliable indicator of current or future performance of MVS, which may be lower or higher.

[1] Future for Investors, 2005

Table 1 – MVS Index vs S&P/ASX Small Ordinaries Accumulation Index ending May 2019

Risk Metrics	MVIS Australia Small-Cap Dividend Payers Index	S&P/ASX Small Ordinaries Accummulation Index
Std Dev % p.a.	13.61	14.71
Sharpe Ratio	0.36	0.08
Information Ratio	0.66	0.00
Sortino Ratio	0.54	0.11
Beta	0.85	1.00

Source: VanEck, Morningstar Direct; as at 31 May 2019. Inception date of MVS Index in December 2009.
Results are calculated to the last business day of the month and assume immediate reinvestment of all dividends and exclude costs associated with investing in MVS. You cannot invest directly in an index. MVS Index performance shown prior to its Launch Date is simulated based on the current Index methodology. The above performance information is not a reliable indicator of current or future performance of MVS, which may be lower or higher.

The MVS Index rules are as follows:

To be included in the index universe for the MVS Index a security must meet the following assessment:

- Have a full market capitalisation exceeding USD50 million;
- Did not omit their last dividend payment;
- Be a local company incorporated in Australia with an ASX listing or be an offshore company incorporated outside of Australia with an ASX listing but generate at least 50% of their revenues (or, where applicable, have at least 50% of their assets) in Australia.

When MVIS develops and maintains indices, its key focus is on investability. Stringent rules in respect of liquidity are applied when screening potential components for inclusion in the MVS Index. Reviews are carried out every 3 months. The process is summarised on the next page.

Step 1 Index Universe	Step 2 Investable Universe	Step 3 Target Coverage	Step 4 Dividend Eligibility	Step 5 Portfolio Basket
Index universe: Local companies Incorporated in Australia Listed on ASX Full Mcap >$50m Offshore companies Incorporated outside of Australia Listed on ASX Revenue of at least 50% in Australia	**Investable index universe:** Application of screenings Existing / New Market Capitalisation Full $75m/$150m Free-Float (FF) > 5%/10% Liquidity 3mth ADTV >$0.6M/$1M at actual & previous 2 AND At least 200,000/250,000 shares traded per month over the last 6 months at actual and previous 2 reviews	**Coverage:** Ranking by free-float Market Capitalisation 90%-98% qualify Existing companies 85^{th} - 99^{th} qualify	**Dividend eligibility:** Removal of stocks that did not pay their most recent dividend	**Index Basket:** Minimum 25 stock holdings Application of 8% capping (if applicable) Quarterly reviews
624 securities	220 securities	189 securities	82 securities	

Source: MVIS, as at 14 May, 2019

VanEck Vectors Small Cap Dividend Payers ETF

Investors are always looking for better investment opportunities. ETFs provide investors the ability to access markets and investment ideas in a low cost, efficient way.

Investors seeking an allocation to Australian small companies now have a smart low cost passive alternative.
The MVS gives Australian investors access to the most liquid profitable small cap companies listed on ASX.

ASX code:	MVS
Management costs:	0.49% p.a.
Index:	MVIS Australia Small-Cap Dividend Payers Index
Stock Number	82
Distribution frequency	Generally twice a year

Source: VanEck, as at 19 June 2019

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Key Risks

An investment in the Fund carries risks associated with: financial markets generally, individual company management, industry sectors, stock and sector concentration, fund operations and tracking an index. See the PDS for details.