VanEck®
Access the opportunities.

YOUR GUIDE TO

Exchange Traded Funds

ISSUE FIVE

Smarter strategies to fortify your portfolio

Investing for the new world regime

> This guide is focused on smart beta and how you can use ETFs as a tool to access those asset classes you cannot access by yourself.

Dear Investor,

Welcome to the fifth edition of our *Guide to Exchange Traded Funds* (ETFs).

Market volatility has undoubtedly plagued this year as we moved into a new regime of rising rates. While central banks do all they can to fight inflation, astute investors are looking for pockets of opportunities. Beneath the surface, dispersion within asset class returns across sectors and styles remains high.

Unfazed by a fall in markets this year, the booming exchange traded products industry has continued to strengthen over the course of 2022. In the 12 months to September, the industry has grown to over $129 billion. By the end of the year we expect that figure could reach $145 billion. Australians are increasingly turning to ETFs as a long-term wealth creation and preservation strategy, with ETFs being the 'go-to' investment tool in portfolio construction.

Since 1955 VanEck has offered its investors strategies that are designed to provide unequalled access to markets, sectors and investment ideas. VanEck is one of the largest issuers of ETFs globally and in Australia, managing in excess of US$65 billion for our investors. With over 30 listed on the ASX, our range of ETFs offer access to a range of asset classes and outcomes to help all types of investors meet their investment objectives.

ETFs are an efficient, transparent and cost effective way of investing in Australian and international shares, fixed income, credit and other assets such as infrastructure and property, and have become one of the world's most popular ways to invest. They are opening up opportunities for investors and importantly offering full price discovery and transparency. Factor and smart beta strategies which were once the domain of institutional investors are now readily available for all investors via ETFs with intelligent portfolio construction techniques enabling targeted outcomes.

Smart beta is the term given to ETFs that take a “smarter” approach. They track an index that differs from the traditional market capitalisation approach, which simply weights assets such as shares by their size.

Smart beta’s popularity in the investment community is due to their ability to target investment outcomes, and better match desired investment objectives. Recently we completed our 7th annual Australian Smart Beta Survey where over 70 per cent of financial advisers said smart beta investments represent good value for money. Over 77 per cent of advisers said they are using smart beta ETFs for international equities, while 70 per cent are using it for Australian equities.

With this in mind, this guide is focused on smart beta and how you can use ETFs as a tool to access those asset classes you cannot access by yourself.

We hope you find this guide useful and implore you to speak to your financial adviser or stock broker in assessing which ETFs are right for you. If you have any other questions please contact us on 02 8038 3300 or via info@vaneck.com.au

Sincerely,

Arian Neiron
CEO & Managing Director
Asia Pacific, VanEck

ETF FAST FACTS

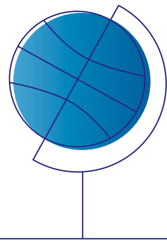
The ETF market in Australia is expected to reach

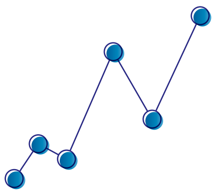
$145 billion

by the end of 2022

The most popular smart beta ETF on ASX by flows is

QUAL





Total funds invested in ETFs listed in Australia is

$129.9 billion

As at 31 August 2022 there were:

281

ETFs listed in Australia

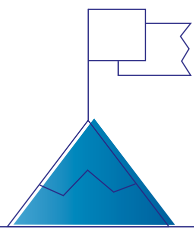
and more than

30

VanEck ETFs listed on ASX

99%

of financial advisers are satisfied with their smart beta ETF investments[1]



Two in three

financial professionals have increased usage of ETFs over the last 12 to 18 months[1]

Source: ASX, data to 31 August 2022.
1. 2022 VanEck Australian Smart Beta Survey.

Smart beta 101

Smart beta refers to ETFs which take a "smarter" approach in the way companies or other assets are included in the fund.

Smart beta strategies have grown exponentially in popularity over the last five years. In 2018 there were 27 ETFs offered in this space in Australia, today there are 57, that's an increase of almost 200 per cent. The trend reflects a broader global movement, with over 1,000 smart beta products now offered worldwide.

To understand smart beta it's helpful to first understand the 'beta' part of the term. Beta refers to the performance of the market, represented by an index. For example, in Australia the standard market benchmark, and therefore the standard measure of beta, is the S&P/ASX 200 Index. In the US, it is the S&P 500 Index.

These standard benchmarks typically follow 'market capitalisation' indices. That means companies are included based on their size and value.

For the Australian beta, the S&P/ASX 200, this means the 200 companies included, and their percentage representation within that index, is determined by their size. In Australia, BHP is the largest company on the ASX and represents around 10 per cent of the index.

A smart beta index is constructed using a methodology different than the size of the company. The 'smart' description denotes that thought has gone into constructing the index, with an investment outcome in mind that differs from the standard market return (or beta).

That outcome could be a focus on dividends, e.g. the index only includes companies that pay relatively high dividends, or a focus on cheaper companies to achieve positive returns, e.g. the index includes companies perceived to be undervalued based on fundamentals such as their price relative to their earnings. Other popular approaches focus on the weighting of companies in the index. This can include capping the weight of constituents, which has been used to ensure one or more companies don't dominate the portfolio, or applying an equal weight methodology which means all constituents have same importance in the portfolio.

A smart beta index is constructed using a methodology different than the size of the company. The 'smart' description denotes that thought has gone into constructing the index, with an investment outcome in mind that differs from the standard market return (or beta).

Smart beta is often described as combining the best of active and passive investing: targeting investment outcomes, such as potential out-performance, while being rules-based, transparent and cost effective.

We believe smart beta ETFs are still in a phase of rapid growth. 20 years into the movement, investors are still finding opportunities in the smart beta space. In the year to September almost $500 million flowed into smart beta ETFs in Australia, more than thematic and ESG focused ETFs combined.

The local moves reflect a broader global industry trend.

In the US, smart beta ETFs now make up over US$1 trillion of the US$7 trillion-dollar ETF market. Since the start of 2021, smart beta ETFs have taken in US$250 billion, five times more than thematic ETFs and six times more than ESG ETFs, according to Bloomberg's Eric Balchunas.

The popularity of smart beta strategies means this sub-sector is growing at a faster rate than both the broader ETF market and the active asset management industry. ■

The next generation of investing

The explosion of the ETF market has democratised investing. Up until recently, investors had to rely on active fund managers to achieve their investment objectives.

Active fund managers have often utilised 'factors' as a key part of their investment process, as a means to identify companies worthy of investment. Nowadays, all investors can utilise the tools that were once only the domain of large institutions and investment professionals.

The exchange traded product market has revolutionised factor investing. There are now many low cost smart beta ETFs which deliver the 'factor' (or 'smart') returns beyond the market benchmark (or 'beta'). They do this by tracking smart beta indices which are specifically designed with targeted investment outcomes in mind.

Nowadays, all investors can utilise the tools that were once only the domain of large institutions and investment professionals.

In recent years more and more investors have started to question their reliance on active managers and are seeking passive alternatives. Apart from active management being more expensive than passive investing, active management also introduces other risks such as key man risk and investment process risk.

To understand this innovation of smart beta, it is worth understanding where it has evolved from.

Prior to the 1960s the abilities of a professional investor or an active manager were compared only to other active manager's returns. Whoever had the highest return was the most skillful.

Toward the end of the 60's, as research by famed economists Harry Markowitz and William Sharpe emerged, market capitalisation indices became the standard measure of the stock market. It was against these barometers in which active managers' returns, and the standard deviation of those returns, were compared. The Greek alphabet became the lexicon for this.

'Alpha' is the term commonly used to describe performance above a given benchmark. The benchmark is typically a market capitilsation weighted index. 'Beta' refers to the performance of the market represented by that index. For example, in global equities the standard market benchmark, and therefore the standard measure of beta, is the MSCI World Index. In Australia it is the S&P/ASX 200.

This means active managers in the 70s were evaluated on their 'alpha' - the returns they achieved that were in excess of the standard market benchmark return, or beta.

In the 80s and 90s, following more empirical research and analysis of portfolios, stock pickers were described as: value managers, growth managers or GARP (Growth at a Reasonable Price) managers – which is a combination of value and growth.

Value managers were those that focused on identifying stocks which were trading, at what they believed, was a discount to their fair value. One way to identify value stocks is to pick those with a low price-to-book value.

Growth stocks, on the other hand, were identified as companies whose earnings were expected to increase at an above average rate. These are often smaller companies.

In the 80s and 90s, a fund manager's returns could be attributable to a combination of:

- market beta;
- the style of the portfolio, e.g. value or growth; and
- alpha.

Value investing, in particular, had significant support during this time. A lot of value managers point to the work of Benjamin Graham, regarded by many to be the father of value investing, to support their long-term approach.

Graham's student Warren Buffett and his investing partner, Charlie Munger, are strong advocates of this approach. According to commentary in the 2003 edition of Graham's *Intelligent Investor*, at the time, prominent value advocate and active manager Peter Lynch had the best 20-year return of any mutual fund ever.

Investors were now recognising, beyond beta, performance was attributable to the manager's skill and their style. Lynch's portfolio benefitted from its exposure to value and the skill of the manager.

In the 80s and 90s, the portion attributable to alpha was getting smaller. Finding a manager with this skill was becoming more difficult.

Into the new century, more sophisticated research into the persistent drivers of stock returns saw the rise of identifiable 'factors' beyond value and growth as well as factor indifferent approaches such as equally weighting a portfolio.

Active managers can no longer afford to ignore the popularity of smart beta ETFs, which have continued to innovate while showing resilience during market volatility.

According to index provider MSCI, there are six main equity style factors: quality, size, value, momentum, dividend yield and volatility.

Technological advances and the dramatic increase in the availability of data or "big data", as it is referred, has seen more active stock-pickers' returns attributed to these factors.

The result is a further reduction in the part of the return attributed to the manager's skill, or alpha. Active managers now need to be able to demonstrate that their individual skill is generating sufficient alpha, if they can at all, to justify their fees.

The rise of index-tracking passive investments such as ETFs have put further pressure on active managers.

New index design innovations that include factors, such as value, are now being tracked by passive ETFs. These ETFs have been delivering targeted outcomes while retaining the low costs of index investing. These are known as smart beta ETFs.

One way of thinking about smart beta is "R2D2 with the head of Peter Lynch", according to Bloomberg's Eric Balchanus. Smart beta provides an important component of active management via simple, transparent, rules-based portfolios delivered at lower fees.

Smart beta has been identified as "a disruptive financial innovation with the potential to significantly affect the business of traditional active management."[1]

Over time more investors have shown a willingness to track indices beyond those based on market capitalisation as a means of targeting investment outcomes.

The increased sophistication in identifying drivers of stock returns and measuring manager skill has coincided with allowing investors to access those returns.

Smart beta ETFs have become an accepted and growing part of investors' toolkits by allowing them to buy and sell exposures to targeted outcomes in a single trade on an exchange.

Active managers can no longer afford to ignore the popularity of smart beta ETFs, which have continued to innovate while showing resilience during market volatility.

Over 56 per cent of financial professionals surveyed in the 2022 VanEck Australian Smart Beta Survey said they use smart beta as a replacement or substitute for active management.

Individual investors are also becoming more aware of the value of smart beta both as an alternative to active managers and to traditional market capitalisation indices.

Today smart beta is an established part of portfolios for the world's largest investors.

According to Bloomberg Intelligence's Athanasios Psarofagis, "Smart beta is a pretty interesting category, 70 per cent of the category is beating the market this year. So that's pretty impressive and the smart beta category in itself is so large – it's over a trillion in assets."

The recent Australian Smart Beta Survey also showed that 46 per cent of financial professionals currently use smart beta strategies.

The survey reveals very high levels of satisfaction among smart beta users, with almost 99 per cent of advisors using smart beta strategies very satisfied or extremely satisfied with their smart beta investments.

Half of these advisors are planning to increase their smart beta allocation over the next year. ■

For more information on smart beta visit **vaneck.com.au/smartbeta**

1. Kahn and Lemmon, Financial Analysts Journal, 2016.

Taking a smarter approach to Australian equities

Among the most popular smart beta strategies in Australia is the VanEck Australian Equal Weight ETF (ASX: MVW).

The S&P/ASX 200 index is one of the most concentrated by stock and sector in the world, this is problematic for a number of reasons. The top 10 companies represent over 45 per cent of the S&P/ASX 200 index.

A concentrated market means that the lion's share of performance is attributed to mega caps, limiting stock diversification and performance attribution to companies smaller than these mega-caps.

Since the BHP unification earlier in 2022, we have one company that represents around 10 per cent of the S&P/ASX 200. This skews the performance of the overall sharemarket with cyclicality becoming more pronounced.

The Australian equity market is also extremely concentrated by sector; financials and resources dominate. Combined, financials and resource companies account for more than 50 per cent of S&P/ASX 200 exposure. High stock concentration and the small universe in Australia reduces the breadth of unique coverage.

This makes it hard for active managers to add value. The near stagnant nature of the mega-caps that dominant the local sharemarket doesn't help. If we look back at the last 20 years, there has been little variability in the top 10. Looking at changes year-on-year, there has been very little variability over each calendar year.

Equal weighting seeks to address inefficiencies created by the market-capitalisation weighted benchmark S&P/ASX 200. It offers an alternative to the highly concentrated index by selecting only the most liquid stocks then weighting them equally. This results in a portfolio of around 86 companies with reduced exposure to concentrated sectors such as financials and resources. The targeted outcome is to reduce concentration risk at both a stock and sector level.

MVW has outperformed the S&P/ASX 200 by 1.71% per annum since its inception in March 2014 (data as at 31 August 2022, Bloomberg). Please note that past performance is not indicative of future performance.

Given the particularly high concentration of the Australian share market, this simple smart beta approach is an alternative to both the standard market capitalisation approach and actively managed funds, that may hug the benchmark rather than manage inherent risks and, therefore, struggle to outperform.

The Australian equities universe is stock and sector concentrated by market capitalisation but when you equal weight, these biases disappear.

MVW is a way to access an Australian equity portfolio with active outcomes, while retaining transparency, liquidity and ease of trading for investors. ■

New opportunities in the race to net zero...

Harnessing a global megatrend for your portfolio

Australia is finally getting serious about global warming and investors are in a unique position to capitalise on the transformation.

Following a number of climate related disasters in recent years, one topic dominated the Federal election in 2022. Climate change. Australians returned the opposition Labor party to power, with incoming Prime Minister Anthony Albanese vowing to "end the climate wars" and turn Australia into a "renewable energy superpower."

And with the recent change in Australia's federal government, there has also been a legislated shift in the nation's position on climate change.

Australia's parliament has passed Labor's climate change legislation. The new law pledges to cut carbon emissions by 43 per cent by 2030, with a goal of net zero by 2050.

The recent moves in Australia mirror a broader shift in global climate policy. In the US, the Inflation Reduction Act will inject US$369 billion into the US clean energy economy. This is the largest investment in the nation's history to slow the pace of climate change. The bill increases the tax credit for permanent carbon removal from $50 to $180 per ton. With the legislation, companies have room to develop environmentally sustainable technologies at lower costs and work towards gigaton scale removal of carbon.

Clean energy stocks rallied since the Act was passed and the sector is being buoyed by other tailwinds which include easing supply chain bottlenecks, as well as backlogs in retail orders due to increased demand.

Wind energy stocks have also done well recently due to a fall in the European steel prices to €1,500 at 30 June 2022 from €1,850 in March 2022. Steel is a major cost for wind energy production and its price could continue to fall as global growth slows amid fears of recession. Costs have also been reduced on the shipping side.

Investing in companies related to global clean energy production, technology and equipment offers a long-term growth opportunity and an investment in the global energy supply of the future, which is transitioning to infinite clean energy away from finite fossil fuels.

While climate change policies in Australia and around the world may differ, more than 190 countries are unified in commitment to The Paris Agreement, limiting global warming to 2 degrees by 2050. With carbon emissions responsible for the lion's share of global warming, the focus is on decarbonisation.

One of the ways some governments are achieving their goals is via a carbon price. Many economists agree that introducing a carbon price is the single most effective way for countries to reduce carbon emissions.

This has created an opportunity for savvy investors.

Carbon pricing requires companies and other entities to pay for the CO_2 they release into the atmosphere.

There are two main forms of carbon pricing: Carbon taxes; and Cap-and-trade programs.

A carbon tax is a charge placed on greenhouse gas pollution, mainly from the burning of fossil fuels. The tax is in effect the carbon price. In this instance, the government sets it and generally, the price increases over time.

A cap-and-trade program is designed to limit, or cap, the amount of CO_2 a company can emit. Those that exceed the limit are required to buy carbon 'credits' that are equivalent to CO_2 excess emissions. The carbon credits, also known as emissions allowances, are official permits that allow a company to produce a certain amount of carbon emissions. These can be traded if the full allowance is not used, hence the 'trade' part of 'cap-and-trade'.

Carbon credits have now become a liquid and investable asset class, with the value of the global carbon market achieving a compound annual growth rate (CAGR) of 60% from 2018 to 2021.[1]

The four most actively traded carbon futures markets in the world are the EU Emissions Trading Scheme, UK Emissions Trading Scheme, California's Western Climate Initiative and the Regional Greenhouse Gas Initiative also in the US. Individual investors can gain access to these markets via ETFs.

Estimates forecast global carbon prices need to be higher for countries to meet their emissions target. Immense growth opportunities abound. ■

1. Source: Refinitiv.

Popular Australian & international ETFs – in – 2022

MVW

VanEck Australian Equal Weight ETF

- An award-winning core Australian equities strategy that is backed by empirical evidence.
- Delivers three times more diversification[1] than the S&P/ASX 200, meaning significantly less concentration risk.
- Research has shown that equal weighted portfolios outperform their market capitalisation counterparts over the long term.

QUAL

VanEck MSCI International Quality ETF

- The most awarded ETF on ASX, QUAL is Australia's largest and most popular smart beta ETF by funds under management (FUM).
- Access 300 of the world's highest quality companies based on high return on equity, stable annual earnings growth and low financial leverage.
- Quality companies have demonstrated outperformance during periods of economic slowdown and over the long term.

QSML

VanEck MSCI International Small Companies Quality ETF

- QSML offers access to 150 of the world's highest quality small companies based on high return on equity, stable annual earnings growth and low financial leverage.
- Investments focusing on quality small companies have delivered outperformance over the long term relative to other global small companies benchmarks and also relative to large- and mid-cap benchmarks.
- QSML is the only smart beta ETF focused on international small companies on ASX.

IFRA

VanEck FTSE Global Infrastructure (Hedged) ETF

- Offers a diversified portfolio of global infrastructure securities, with returns hedged into AUD.
- First global infrastructure ETF on the ASX and the largest smart beta ETF focused on infrastructure.
- IFRA is the most cost effective hedged global infrastructure offering in the Australian market.
- Infrastructure assets have inflation linked cash flows often mandated by government regulation.

Key Risks: An investment in the ETF carries risks associated with: ASX trading time differences, financial markets generally, individual company management, industry sectors, foreign currency, country or sector concentration, hedging, political, regulatory and tax risks, fund operations and tracking an index. While it is not possible to identify every risk relevant to your investment, we have provided details of the risks that may affect your investment in the relevant product disclosure statement (PDS). Past performance is not indicative of future performance. See PDS for details.

The awards are determined using proprietary methodologies. The awards are solely statements of opinion and do not represent recommendations to make investment decisions.

Any views expressed are opinions of the author at the time of writing and is not a recommendation to act.

VanEck Investments Limited (ACN 146 596 116 AFSL 416755) (VanEck) is the issuer and responsible entity of all VanEck exchange trades funds (Funds) listed on the ASX. This is general advice only and does not take into account any person's financial objectives, situation or needs. The product disclosure statement (PDS) and the target market determination (TMD) for all Funds are available at vaneck.com.au. You should consider whether or not an investment in any Fund is appropriate for you. Investments in a Fund involve risks associated with financial markets. These risks vary depending on a Fund's investment objective. Refer to the applicable PDS and TMD for more details on risks. Investment returns and capital are not guaranteed.

1. As measured by the Herfindahl index.

Global listed private equity

Invest with the smart money and gain access to start-ups, buy-outs and project financing.

ASX CODE: GPEQ

VanEck Global Listed Private Equity ETF

Learn more at vaneck.com.au/GPEQ
or speak to your financial adviser or stock broker today.

VanEck®

Access the opportunities.