THE CASE FOR EX20

BetaShares Australian Ex-20 Portfolio Diversifier ETF (ASX: EX20)

BetaShares
Exchange Traded Funds

May 2018

More eggs for the basket: the case for investing in the BetaShares Australian Ex-20 Portfolio Diversifier ETF (ASX Code: **EX20**)

Due to the top-heavy nature of the Australian equity market, and the tendency of most investors to directly own only a handful of well-known blue chip stocks, Australian investors' portfolios have long tended to have a heavy bias toward large-cap companies.

This large-cap bias, however, appears to have left many Australian share portfolios with excessive stock and sector specific risk, and also under-exposed to the relatively strong growth in mid to smaller-cap Australian shares ("Ex-20 Shares") in recent years. More generally, there is evidence to suggest that investing in Ex-20 Shares can potentially offer enhanced risk-adjusted returns for portfolios otherwise mainly comprised of mature large-cap stocks.

With this in mind, BetaShares has launched the BetaShares Australian Ex-20 Portfolio Diversifier ETF (ASX Code: EX20) to provide simple, transparent and cost-effective access to Australian mid to smaller-cap companies listed on the Australian stock exchange.

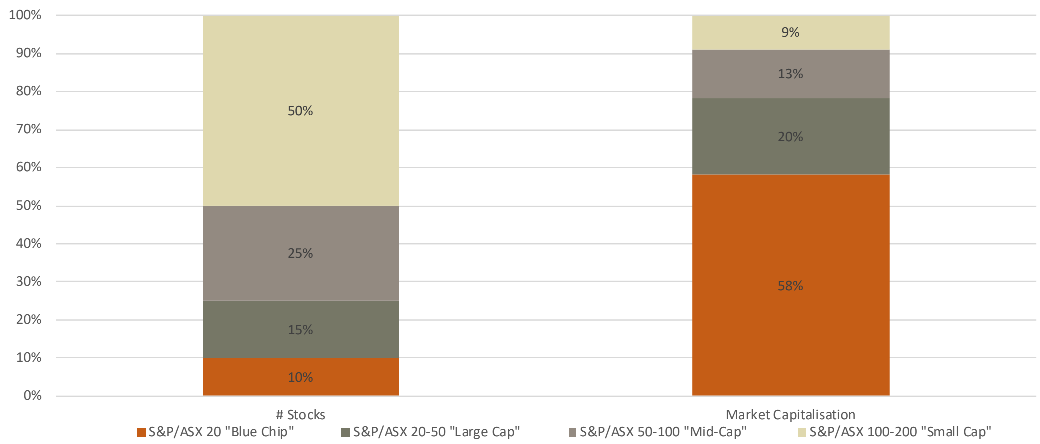
The Index which EX20 aims to track[1] (the "Index") is designed to provide exposure to approximately 180 stocks, ranked from number 21 to 200, based on their market capitalisation. To ensure additional diversification, under the methodology employed no industry sector can have a weight of more than 25% in the Index and no single stock can have a weight of more than 6%.

EX20's Index offers less large-cap stock specific risk

Irrespective of whether they own shares directly or indirectly, Australian investors tend have very top-heavy exposure to large-cap stocks in a select few sectors. As we will show below, those investors that hold stocks directly tend to limit those holdings to a small number, and, to the extent investors are exposed to shares indirectly through managed funds, their typically large-cap bias reflects the very concentrated nature of the investment benchmarks professional fund managers tend to track or measure themselves against.

As seen in the chart below, while accounting for only 10%, by number, of the 200 stocks in the S&P/ASX 200 Index, the top 20 "blue chip" stocks accounted for 58% of the Index's market capitalisation as at 31 May 2018. By contrast, the bottom 180 stocks by market capitalisation accounted for 90% of the 200 stocks in the Index by number, but only 42% of its market capitalisation.

S&P/ASX 200 STOCKS BY NUMBER AND MARKET CAPITALISATION – 31 MAY 2018

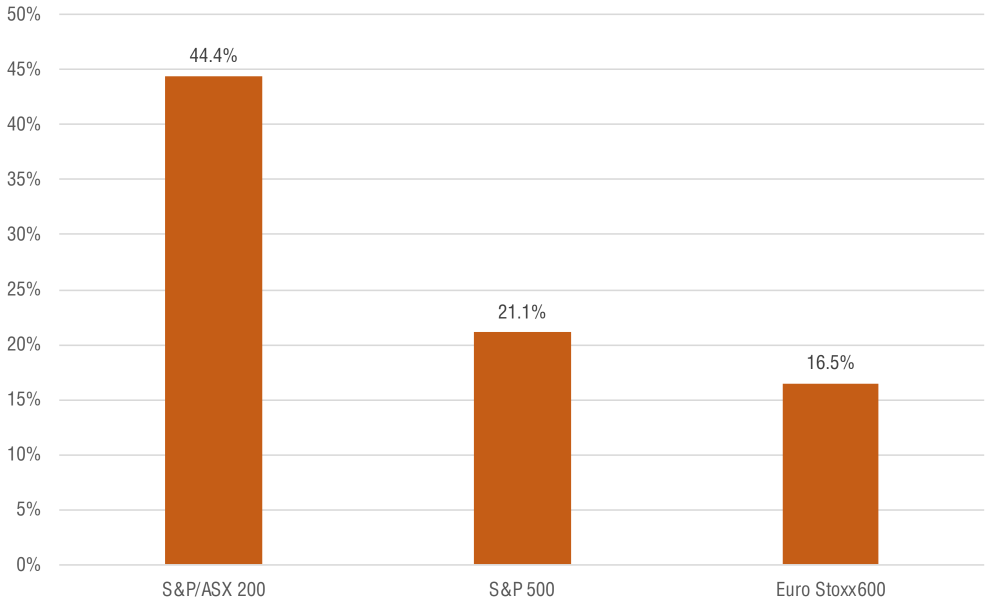


Source: Bloomberg

[1] EX20 aims to track the Nasdaq Australia Completion Cap Index

This large-cap concentration is relatively high by global standards. Indeed, the top ten stocks in the S&P/ASX 200 Index accounted for 44.4% of the Index's market capitalisation at as 31 May 2018. By contrast, the top 10 stocks accounted for only around 21.1% of the market capitalisation of stocks in the United States S&P 500 Index and only around 16.5% in the European STOXX 600 Index.

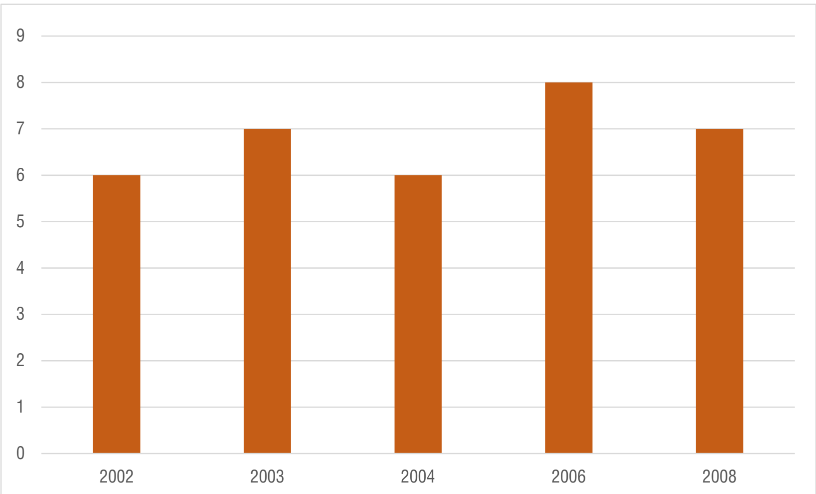
INDEX WEIGHT OF TOP-10 SHAREMARKET CONSTITUENTS – 31 MAY 2018



Source: Bloomberg

This large-cap concentration is even more evident when we consider the evidence on direct share ownership by Australian investors. A consistent finding from the biennial ASX Share Ownership Study is that, among investors that invest directly in the share market, most hold only a handful of (mainly large cap) stocks. According to the latest survey evidence, from the 2008 Survey[2], investors held on average only around 7 stocks in their portfolio – and this average level of holding had not changed much over previous years.

MEDIAN NUMBER OF SHARES HELD IN AUSTRALIAN SHARE PORTFOLIOS - 2002 - 2008



Source: ASX Australian Share Ownership Study, 2002-2008. Note since 2008, ASX has not asked this question in their survey.

By contrast, EX20's Index offers lower large cap concentration and lower stock specific risk. As the chart below shows, the largest 10 companies represented 44.4% of the total weight in the S&P/ASX 200 Index, vs only 21.3% of the total weight in EX20's Index. This is even more marked when you look at the weighting of the largest 20 companies in the two indices, representing 58.1% in the S&P/ASX 200 v. 35.5% in EX20's Index.

[2] The last time this particular question was asked by the ASX in their annual survey was 2008, but given the consistency in the results from 2002-2008 we have no reason to think that this would have changed markedly in the last 8 years.

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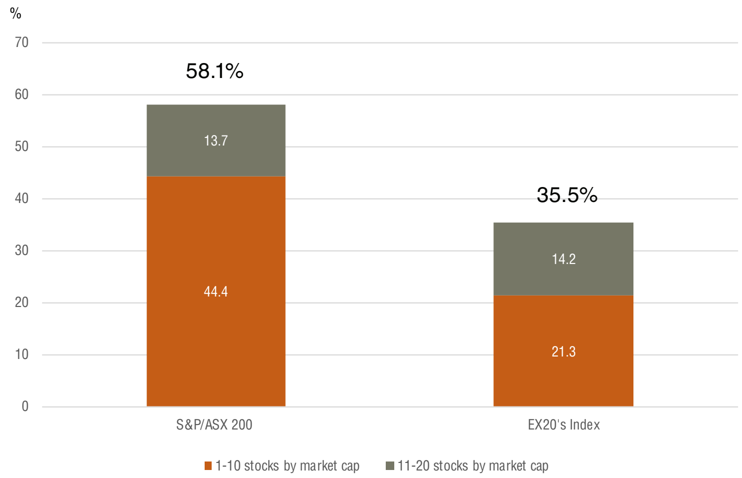
INDEX WEIGHT OF TOP-10 AND TOP-20 LARGEST CONSTITUENTS – 31 MAY 2018



Source: Bloomberg. EX20 aims to track the Nasdaq Australia Completion Cap Index. You cannot invest directly in an index.

EX20's Index offers less sector specific risk

Not only are many Australian investors heavily exposed to large-cap stocks, however, they also face significant sector concentration - due to the fact many of Australia's largest companies are bunched in only two of the eleven industry sectors covered by the market.

Indeed, since its inception in April 2000, the S&P/ASX 200 Index has historically tended to have a relatively high exposure to two major sectors: financials and materials (largely mining stocks). As at end-May 2018, for example, financials (even excluding listed property stocks) accounted for 33% of the market capitalisation of the S&P/ASX 200 Index. The S&P/ASX 200 had a further 18.2% weighting to the materials sector at 31 May 2018, meaning half the index was accounted for by just two sectors.

By contrast, the largest sector weighting for the Index that EX20 aims to track was only 18.9% (the materials sector) as at 31 May 2018, and the top two sectors accounted for only around 33%. By having a better spread of exposures across a range of sectors, the Index that EX20 aims to track offers investors better sector diversification.

SECTOR WEIGHTING FOR EX20'S INDEX V. S&P/ASX 200 INDEX – 31 MAY 2018

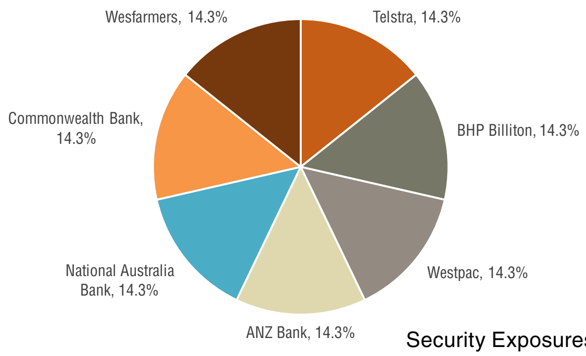
	Sector Weightings (%)		
Sector	S&P/ASX200 Index	EX20's Index	Difference
› Financials	33.2	11.3	-22.0
› Materials	18.2	18.9	0.6
› Health Care	8.6	7.0	-1.7
› Consumer Staples	8.1	4.9	-3.2
› Real Estate	7.6	12.7	5.1
› Industrials	7.2	14.0	6.7
› Energy	5.5	8.8	3.3
› Consumer Discretionary	4.8	11.5	6.7
› Information Technology	2.4	4.6	2.1
› Telecommunication Services	2.3	1.9	-0.4
› Utilities	2.0	4.7	2.7

Source: Bloomberg. EX20 aims to track the Nasdaq Australia Completeion Cap Index. You cannot invest directly in an index.

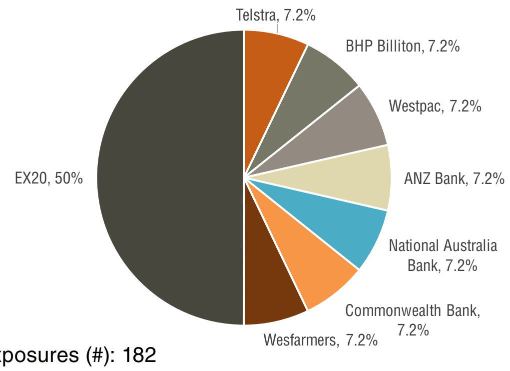
Using EX20 in investment portfolios

The potential reduction in sector-specific risk available through exposure to EX20's Index can perhaps be best demonstrated by way of a specific example. The chart below compares two portfolios: the first, comprises seven of some of the best known and most popularly held stocks by investors, whereas the second allocates a 50% weighting to this set of seven stocks, and the other 50% to the Index that EX20 aims to track.

HYPOTHETICAL INVESTOR PORTFOLIO WEIGHTS: BEFORE AND WITH 50% ALLOCATION TO EX20



Security Exposures (#): 7



Security Exposures (#): 182

Illustrative portfolio based on the largest 7 domestic holdings in Class Super's SMSF Benchmarking Report, June 2016. 7 stocks chosen to align with ASX Share Ownership Survey discussed above. EX20 aims to track the Nasdaq Australia Completion Cap Index. You cannot invest directly in an index. EX20 index weights as at 30 September 2016. Between rebalance dates, the index constituents may differ from 180 due to corporate actions.

As seen in the table below, by allocating 50% of this investor's portfolio to the Index that EX20 aims to track, exposure to the financials sector is dramatically reduced (from 57% to 34%), and exposure to the consumer staples and telecommunication sector is also reduced. The resulting portfolio has a more diverse spread of exposure across all eleven industry sectors. Of course, there is also a substantial reduction in individual security risk, with the portfolio going from underlying constituent exposure of 7 to 182 when adding the EX20 index exposure.

HYPOTHETICAL INVESTOR SECTOR WEIGHTS: BEFORE AND WITH 50% ALLOCATION TO EX20

Name	Investor Portfolio	EX20's Index	Difference
› Financials	57.2	34.2	-23.0
› Consumer Staples	14.3	16.6	2.3
› Materials	14.3	10.6	-3.7
› Telecommunication Services	14.3	9.6	-4.7
› Real Estate	0.0	6.3	6.3
› Health Care	0.0	7.0	7.0
› Industrials	0.0	4.4	4.4
› Consumer Discretionary	0.0	5.7	5.7
› Energy	0.0	2.3	2.3
› Utilities	0.0	0.9	0.9
› Information Technology	0.0	2.3	2.3

Source: Bloomberg. EX20 aims to track the Nasdaq Australia Completion Cap Index. You cannot invest directly in an index. EX20 index sector weights as at 31 May 2018

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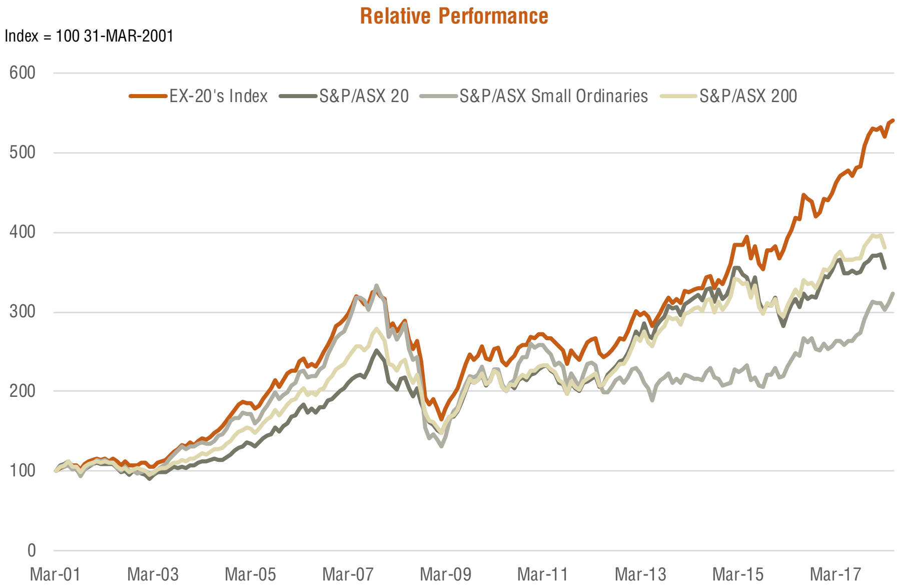
EX20 companies have historically offered attractive risk adjusted returns

One potential advantage of investing in EX20 companies is they may tend to enjoy something of "sweet spot" in terms of the typical growth trajectory of listed companies. As EX20 companies are still larger than the average listed company by market capitalisation, they're more likely to have overcome the early growth hurdles typically faced by small companies. Yet by remaining outside of the top-20 companies by market capitalisation, EX20 companies may tend to be not "too large" that most of their growth potential is already past.

Indeed, as seen in the chart below, the Index that EX20 aims to track has generally outperformed the large cap dominated S&P/ASX 20 Index over the past decade and a half. Over the past year, EX20's Index has increased by 14.3% vs. 6.9% for the S&P/ASX 20 Index.

EX20'S INDEX VS. S&P/ASX 20 INDEX AND S&P/ASX SMALL ORDINARIES INDEX TOTAL RETURN: MARCH 2001 – MAY 2018



RELATIVE EQUITY PERFORMANCE TO 31 MAY 2018

	S&P/ASX 20	Ex-20 Index	S&P/ASX Small Ordinaries	S&P/ASX 200 Index
1-yr	6.9%	14.3%	25.4%	9.6%
3-yr	2.7%	11.1%	11.6%	5.9%
5-yr	6.6%	13.0%	9.7%	8.8%
Inception*	8.3%	10.8%	7.4%	8.8%

Source: Bloomberg. Performance shown here is the Index which EX20 aims to track (Nasdaq Australia Completion Cap Index). You cannot invest directly in an index. Performance excludes the impact of ETF fees and expenses. Performance for periods greater than 1 year is annualised. Past performance is not an indication of future performance of the Index or the ETF. Index inception was March 2001.

As the above shows, the Index that EX20 aims to track has also performed well against the S&P/ASX Small Ordinaries Index since the global financial crisis. Indeed, small caps fell harder during the financial crisis and have rebounded by less in post-crisis share market recovery.

Note, moreover, the outperformance of the Index that EX20 aims to track has come at the expense of only modestly higher return volatility compared to the large cap S&P/ASX 20 Index, whereas the volatility of this Index has been considerably less than that of small cap S&P/ASX Small Ordinaries Index.

Since inception in March 2001, the annualised standard deviation of monthly total returns for the Index tracked by the EX-20 has been 12.9%, similar to that of the S&P/ASX 20 Index, and notably lower than the 16.8% for the S&P/ASX Small Ordinaries Index.

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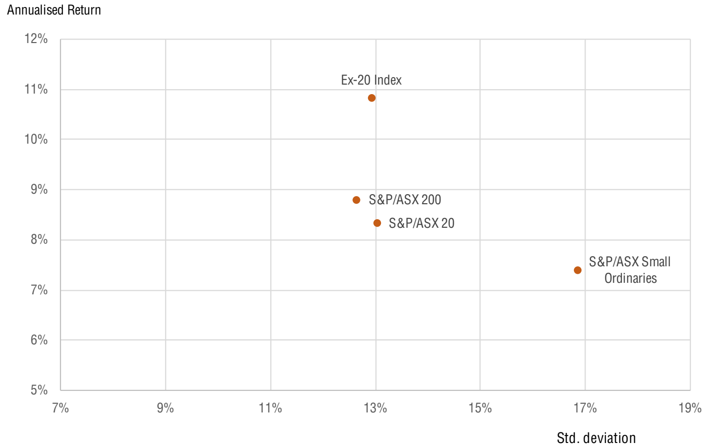
EX20'S INDEX VS. S&P/ASX 20 INDEX, S&P/ASX 200 INDEX AND S&P/ASX SMALL ORDINARIES INDEX TOTALRETURN: MARCH 2001 - MAY 2018



Source: Bloomberg. Performance shown here is the Index which EX20 aims to track (Nasdaq Australia Completion Cap Index). You cannot invest directly in an index. Performance excludes the impact of ETF fees and expenses. Past performance is not an indication of future performance of the Index or the ETF. Index inception was April 2001.

This suggests that the Index that EX20 aims to track has been able to provide better risk-adjusted returns than both the Australian market's established large and small cap indices over the past decade or so.

Conclusion

Many Australian investors tend to be very top heavy in terms of their large-cap stock exposures as well as their exposure to the financials and materials sectors in particular. Such an investment concentration not only results in high stock and sector specific risk, but also means investors are at risk of missing some of the return opportunities available among more moderately sized companies and from a more diverse range of sectors.

With this in mind, the BetaShares Australian Ex-20 Portfolio Diversifier ETF (ASX Code: **EX20**) has been developed to provide a simple, transparent and cost-effective way to instantly diversify investment portfolios to Australian mid to smaller-cap companies listed on the Australian stock exchange.

Trading Information

BetaShares ETFs can be bought or sold during the trading day on the ASX, and trade like shares.

EXCHANGE	ASX
ASX CODE	EX20
INAV ASX CODE	YEX2
CURRENCY	AUD
TRADING	10:00-16:00 (AEST)
BLOOMBERG CODE	EX20 AU
IRESS CODE	EX20.AXW

Index Information

INDEX	Nasdaq Australia Completion Cap Index
BLOOMBERG CODE	NQAUCCT INDEX

Fund Information

ISSUER	BetaShares Capital Ltd
ADMINISTRATOR	RBC Investor Services
CUSTODIAN	RBC Investor Services
REGISTRAR	Link Market Services
AUDITOR	KPMG
DISTRIBUTIONS	Semi-Annual
MANAGEMENT FEE	0.20% p.a
EXPENSES	estimated at 0.05% p.a
FUND INCEPTION	5 October 2016

Available at betashares.com.au

- Net asset value
- Product disclosure statement
- Portfolio holdings
- Distribution details

There are risks associated with an investment in the Fund including small-mid cap securities risk, market risk and liquidity risk. For more information on risks and other features of the Fund please see the Product Disclosure Statement.