S&P Dow Jones Indices

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TalkingPoints

Finding Resilience amid Uncertainty: A Low Volatility High Dividend Approach for the A-Share Market

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The S&P China A-Share LargeCap Low Volatility High Dividend 50 Index is designed to offer liquid and tradable exposure to dividends and low volatility, two well-known risk factors that have delivered risk premium in the China A-share market in the past.

The two factors are combined through sequential dividend and low volatility screens. Companies exhibiting high dividend yield may fall in a "dividend trap," since high dividend yield can be caused by decreasing stock prices rather than increasing dividend payments. Overlaying a low volatility screen on a high dividend portfolio may help to eliminate the dividend trap, resulting in improved absolute and risk-adjusted returns.[1]

Over the 10-year back-tested period, the index has shown robust return, lower risk, reduced drawdown, and cheaper valuation than its benchmark. The index may be appealing to those who wish to maintain equity exposure but limit risk or those who are interested in increasing equity exposure without increasing risk.

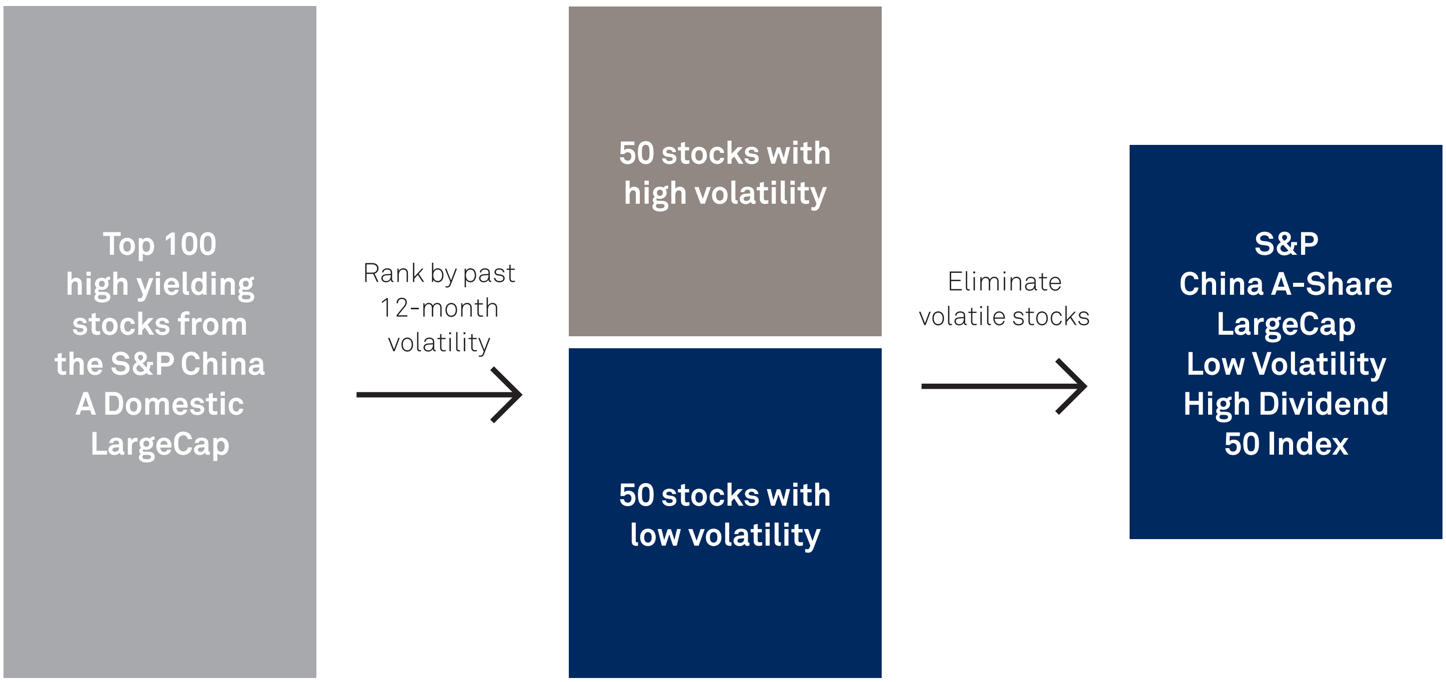
Uncertainty has been a common theme throughout 2019 and rolling into 2020, with escalated risk of Covid-19. The S&P China A-Share LargeCap Low Volatility High Dividend 50 Index may help to provide an alternative for investors to ride through this challenging period.

[1] Qu, Xiaoya et al. Blending Low Volatility with Dividend Yield in the China A-Share Market.

1. How does the index work?

The S&P China A-Share LargeCap Low Volatility High Dividend 50 Index is designed to have significant large-cap and dividend exposure while limiting volatility. Index construction starts from the S&P China A Domestic LargeCap,[2] which consists of the largest and most liquid stocks in the China A market. As of year-end 2019, S&P China A Domestic LargeCap had 291 constituents. First, the top 100 stocks with the highest yields are selected. After that, volatility screening is applied to eliminate the 50 most volatile stocks. To maximize dividend exposure, the remaining 50 names are weighted by dividend yield. The index rebalances semiannually in January and July.

Exhibit 1: Construction of the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index



Source: S&P Dow Jones Indices LLC. Chart is provided for illustrative purposes.

2. What are the characteristics of this index?

Superior Historical Performance

From January 2009 to December 2019, the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index was superior to the CSI 300 in terms of absolute return and volatility. Over the period studied, it had an impressive return of 13.7%, outperforming the CSI 300 by 5.2% per year (see Exhibit 2). Meanwhile, the volatility was lower than the CSI 300 in the 3-year, 5-year, 10-year, and full sample periods, resulting in better risk-adjusted returns.

[2] The S&P China A Domestic LargeCap comprises the stocks representing the top 70% float-adjusted market cap of China A-shares.

Exhibit 2: Historical Performance

Metric	S&P China A-Share LargeCap Low Volatility High Dividend 50 Index	CSI 300
Annual Return (%)		
3-Year	8.78	8.89
5-Year	8.41	4.67
10-Year	8.13	3.21
Since Jan. 31, 2009	13.69	8.5
Annual Volatility (%)		
3-Year	11.45	16.11
5-Year	19.04	22.61
10-Year	21.58	23.72
Since Jan. 31, 2009	23.48	25.76

Source: S&P Dow Jones Indices LLC, FactSet. Data from Jan. 31, 2009, to Dec. 31, 2019. Index performance based on total return in CNY. 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.

Downside Protection in Volatile Markets

As various financial reforms are ongoing, the Chinese equities market is especially volatile compared with many developed markets. The 2015 Market Crash is a vivid memory for many A-share investors. Thanks to low volatility screening and a large-cap focus, the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index could provide some extent of downside protection during market downturns. It reduced drawdowns by 12.3% and 15.3% in the 2015 Market Crash and 2018 Bear Market, respectively (see Exhibit 3).

Exhibit 3: Performance during Down Markets

Index	2015 Market Crash (May 2015–July 2016)	2018 Bear Market (January 2018–December 2018)
S&P China A-Share LargeCap Low Volatility High Dividend 50 Index Return (%)	-27.50	-12.73
CSI 300 (%)	-39.78	-28.04
Excess Return of the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index (%)	12.27	15.30

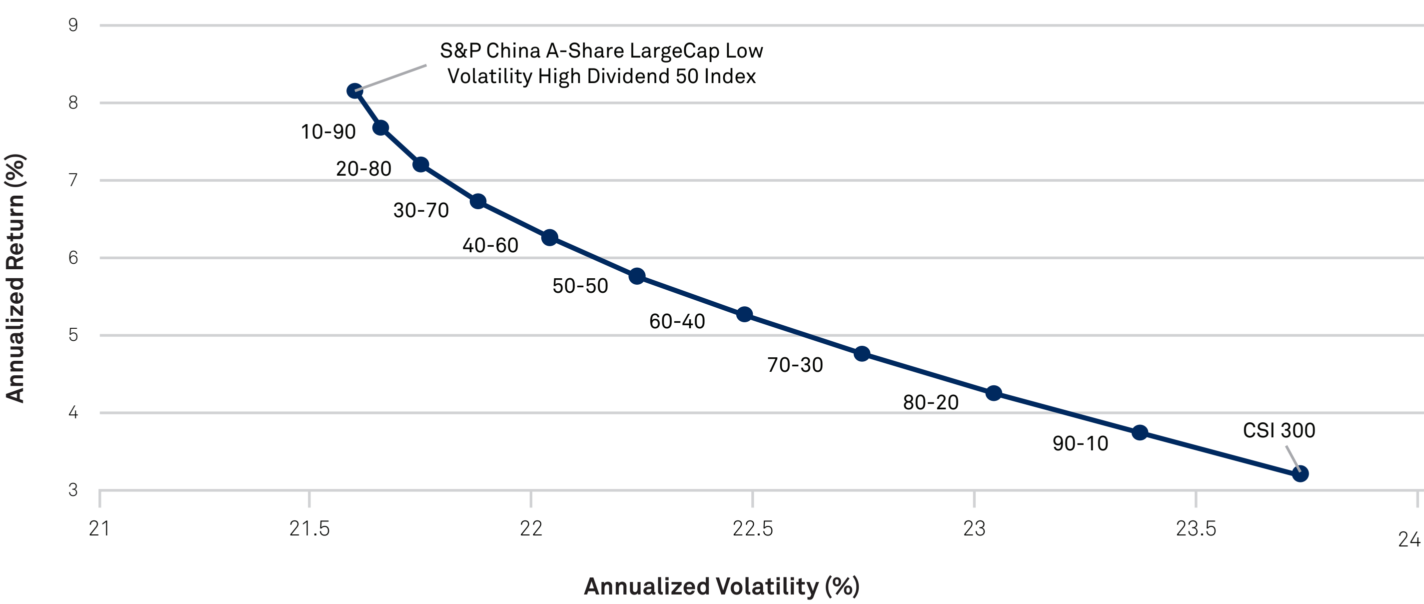
Source: S&P Dow Jones Indices LLC, FactSet. Data as of Dec. 31, 2019. Index performance based on total return in CNY. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Complementing Core Holding

Many investors start equity investment with a broad market holding, sometimes as long-term investment that forms the basis of one's portfolio. Like a healthy meal cannot comprise only staple foods, a portfolio needs "nutrition" from "side dishes" as well. The S&P China A-Share LargeCap Low Volatility High Dividend 50 Index is significantly different from the broad-based equity benchmarks in A-share market. Measured by active share,[3] 82% of stock holdings were different from the CSI 300 as of January 2020. Thus, the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index could potentially complement a core holding in a portfolio and supply the right "nutrition".

Illustrated in Exhibit 4, when the allocation moved from CSI 300 to the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index by 10%, 20%, 30%, etc., the risk/return point moved toward the top left of the CSI 300 portfolio, which means higher return and lower risk. For example, at a 50-50 allocation, the total return increased by 250 bps to 5.7% per year and volatility decreased to 22.2%.

Exhibit 4: Historical Risk/Return Profile When Blending CSI 300 with the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index



Source: S&P Dow Jones Indices LLC, FactSet. Data from Dec. 31, 2010, to Dec. 31, 2019. Index performance based on total return in CNY. 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.

[3] Active share = $1/2 \sum_{i=1}^{n} | \text{weight}_{\text{portfolio},i} - \text{weight}_{\text{benchmark},i} |$ where the benchmark is the CSI 300.

Favorable Valuation

Due to dividend yield screening, the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index tends to be less expensive than its benchmark, the S&P China A Domestic LargeCap. During the past seven years, the price/earnings and price to book ratios of the S&P China A-Share LargeCap Low Volatility High Dividend 50 Index were consistently lower than those of the S&P China A Domestic LargeCap (see Exhibits 5 and 6).

Exhibit 5: Price/Earnings (Trailing)

Source: S&P Dow Jones Indices LLC, FactSet. Data from Jan. 31, 2012, to Dec. 31, 2019. Index performance based on total return in CNY. 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 6: Price-to-Book Ratio (LTM)

Source: S&P Dow Jones Indices LLC, FactSet. Data from Jan. 31, 2012, to Dec. 31, 2019. Index performance based on total return in CNY. 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.

Performance Disclosure

The S&P China A-Share LargeCap Low Volatility High Dividend 50 Index was launched April 1, 2019. 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.

The Index returns shown do not represent the results of actual trading of investable assets/securities. S&P Dow Jones Indices LLC maintains the Index and calculates the Index levels and performance shown or discussed, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the Index or investment funds that are intended to track the performance of the Index. The imposition of these fees and charges would cause actual and back-tested performance of the securities/fund to be lower than the Index performance shown. As a simple example, if an index returned 10% on a US $100,000 investment for a 12-month period (or US $10,000) and an actual asset-based fee of 1.5% was imposed at the end of the period on the investment plus accrued interest (or US $1,650), the net return would be 8.35% (or US $8,350) for the year. Over a three year period, an annual 1.5% fee taken at year end with an assumed 10% return per year would result in a cumulative gross return of 33.10%, a total fee of US $5,375, and a cumulative net return of 27.2% (or US $27,200).

General Disclaimer