

Scientific Beta will not be including China A-shares in its indices

**Increasing the number of Chinese stocks in an investment universe
dedicated to smart beta is not appropriate at this time**

ERI Scientific Beta, as a leading smart beta index provider, aims to build and publish equity indices that reflect the current state of the global economy while exhibiting a high level of liquidity, investability and replicability.

To fulfil these objectives, the definition and the construction of the ERI Scientific Beta Universe is essential, as it serves as the basis for all Scientific Beta indices and solutions. The investment community has agreed that the Chinese equity market has undergone substantial changes in terms of accessibility to institutional investors, but Scientific Beta has taken the decision not to add China A-Shares to its universe at present.

Nevertheless, Scientific Beta has recognised the growing importance of China in the global economy and has taken the following actions in this area:

- Creation of a dedicated and independent Chinese geographic basic block made up of 100 liquid constituents to ensure proper representation of the Chinese equity market within the Scientific Beta Emerging Universe. Multi-regional indices offered by ERI Scientific Beta are built by aggregating the strategies constructed at the geographic basic block level based on the total free-float-adjusted market capitalisation of each geographic basic block in the reference capitalisation-weighted index of the global universe. This approach ensures proper exposure to each geographic basic block and avoids taking geographical risks, which correspond to deviations from the weights of economic regions expressed by their market capitalisations.
- Addition of Chinese ADR (American Depositary Receipts) to the list of eligible securities for inclusion in the Scientific Beta Universe. Chinese ADRs offer a level of reassurance for investors, since they are not directly subject to Chinese market regulations while offering exposure to the Chinese economy.

Scientific Beta noted the efforts made by the Chinese authorities to open Chinese equities to institutional investors and align its accessibility with international standards. Nevertheless, some accessibility issues that Scientific Beta considers to be penalising for its clients remain:

- Derivatives products linked to China A-shares need to be pre-approved (in particular index-linked investment products) and can be restricted by the exchange.
- Large number of suspensions affecting China A-shares when compared to other emerging equity markets.
- Stock Connect daily limit: Even if in April 2018, the daily quota of both Northbound stock-connect programs (Shanghai and Shenzhen) between Hong Kong and mainland China quadrupled to RMB 52 billion, the risk of breaching it during index rebalancing still exists.
- Limited securities lending and borrowing market.

Ultimately, the China block, thanks to the inclusion of the American Depositary Receipts provides exposure to China while ensuring a good level of liquidity. The investment capacity and liquidity of the China block is comparable to that of the whole emerging universe and of the global index.

Noël Amenc, CEO of Scientific Beta, said, “An investment universe that is dedicated to smart beta needs not only to be representative, but also investable and liquid. The exposure to China in an index can be controlled by creating a China block, not necessarily through an inordinate increase in the number of Chinese stocks, to the detriment of their liquidity.”



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About ERI Scientific Beta

ERI Scientific Beta aims to be the first provider of a smart beta indices platform to help investors understand and invest in advanced beta equity strategies.

Established by EDHEC-Risk Institute, one of the very top academic institutions in the field of fundamental and applied research for the investment industry, ERI Scientific Beta shares the same concern for scientific rigour and veracity, which it applies to all the services that it offers investors and asset managers.

The ERI Scientific Beta offering covers three major services:

- **Scientific Beta Indices**

Scientific Beta Indices are smart beta indices that aim to be the reference for the investment and analysis of alternative beta strategies. Scientific Beta Indices reflect the state-of-the-art in the construction of different alternative beta strategies and allow for a flexible choice among a wide range of options at each stage of their construction process. This choice enables users of the platform to construct their own benchmark, thus controlling the risks of investing in this new type of beta (Smart Beta 2.0).

Within the framework of Smart Beta 2.0 offerings, ERI Scientific Beta provides access to smart factor indices, which give exposure to risk factors that are well rewarded over the long term while at the same time diversifying away unrewarded specific risks. By combining these smart factor indices, one can design very high performance passive investment solutions.

- **Scientific Beta Analytics**

Scientific Beta Analytics are detailed analytics and exhaustive information on its smart beta indices to allow investors to evaluate the advanced beta strategies in terms of risk and performance. The analytics capabilities include risk and performance assessments, factor and sector attribution, and relative risk assessment. Scientific Beta Analytics also allow the liquidity, turnover and diversification quality of the indices offered to be analysed. In the same way, analytics provide an evaluation of the probability of out-of-sample outperformance of the various strategies present on the platform.

- **Scientific Beta Fully-Customised Benchmarks and Smart Beta Solutions** is a service proposed by ERI Scientific Beta, and its partners, in the context of an advisory relationship for the construction and implementation of benchmarks specially designed to meet the specific objectives and constraints of investors and asset managers. This service notably offers the possibility of determining specific combinations of factors, considering optimal combinations of smart beta strategies, defining a stock universe specific to the investor, and taking account of specific risk constraints during the benchmark construction process.

With a concern to provide worldwide client servicing, ERI Scientific Beta is present in Boston, London, Nice, Singapore and Tokyo. As of June 30, 2018, the Scientific Beta indices corresponded to USD 34bn in assets under replication. ERI Scientific Beta has a dedicated team of 45 people who cover not only client support from Nice, Singapore and Boston, but also the development, production and promotion of its index offering. ERI Scientific Beta signed the United Nations-supported Principles for Responsible Investment (PRI) on September 27, 2016.