

Press Release

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Scientific Beta confirms the non-eligibility of China A-shares for its indices

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

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.

The definition and construction of an investable universe are key steps in the construction of every equity portfolio and in equity indexing. Investing in smart beta indices requires investors to have access to solutions where liquidity risk is thoroughly considered, because ultimately the weights of the stocks will not be equivalent to their cap-weighting but will depend on other weighting criteria.

This key driver is the main reason why Scientific Beta will not be adding China A-shares at this point, even if the Chinese authorities have made some progress on important aspects:

- In December 2018, Chinese stock exchanges tightened their suspensions rules and conditions in an effort to reduce the number of suspensions.
- In January 2019, the QFII quota doubled to USD 300bn to meet investment demand from overseas investors and prepare for the partial inclusion of China A-shares in some equity benchmarks.

Scientific Beta has noted these efforts made by the Chinese authorities to further promote the functioning of its stock market and enhance the overall market liquidity. Nevertheless, some accessibility issues, which Scientific Beta considers to be potential liquidity risks, or at least penalising for its clients, remain:

- Chinese authorities could lock up foreign investor money in the case of extreme moves. Even with the recent liberalisation of QFII programmes, SAFE retains its power to exercise macro-prudential supervision over the repatriation of capital and may impose temporary restrictions.
- Limited domestic availability of derivative instruments, in particular index futures, access to which is restricted to approved foreign institutional investors and remains limited in scope. This reduces investor ability to implement hedging strategies and risk management strategies.
- Foreign-ownership restrictions on China A-shares, set at 30%, could become critical with future inflows. Indeed, buy orders via stock trading links with Hong Kong will be halted if foreign holdings reach 28%, creating liquidity issues. Buying will resume only when the figure falls to 26%.

Ultimately, the precautions taken by cap-weighted index providers, which are often adjustments to the capitalisation of the stocks in the indices, are of little use in protecting the liquidity of non-cap-weighted indices. As far as smart beta indices are concerned, this is why the rules applied to cap-weighted indices and their underlying universes are not appropriate and pose serious risks for investors. Scientific Beta is convinced that the current exposure offered to China through a dedicated Chinese geographic basic block made up of one hundred liquid constituents, which are H-Shares, P chips, Red chips and depositary receipts, all listed on foreign exchanges without trading restrictions, preserves investors from these unnecessary investment risks.



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About Scientific Beta

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 top academic institutions in the field of fundamental and applied research for the investment industry, 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 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, 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 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, Scientific Beta is present in Boston, London, Nice, Singapore and Tokyo. As of December 31, 2018, the Scientific Beta indices corresponded to USD 43bn in assets under replication. Scientific Beta has a dedicated team of 52 people who cover not only client support from Nice, Singapore and Boston, but also the development, production and promotion of its index offering. Scientific Beta signed the United Nations-supported Principles for Responsible Investment (PRI) on September 27, 2016. On November 27, 2018, Scientific Beta was presented with the Risk Award for Indexing Firm of the Year 2019 by the prestigious professional publication Risk Magazine.

