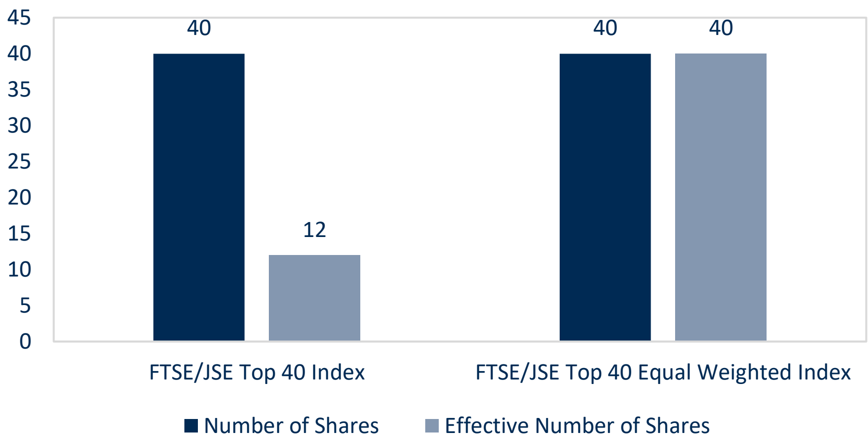
**The Consistent Smart**

***A motivation for replacing an equal weighting methodology with a Multi-Factor strategy***

Equal weighting is a widely accepted portfolio construction technique. The primary goal of equal weighting is to reduce exposure in your portfolio to any individual company thereby minimizing company specific risk and maximizing share diversification. An equally weighted portfolio has a role to play when addressing concentration risk and, if one considers how concentrated our local market is, one could argue that there is an even greater case for equal weighted portfolios in South Africa.

*Figure 1: The impact of equal weighting on diversification. The Top 40 Equal Weighted vs. The Top 40* [(i)]



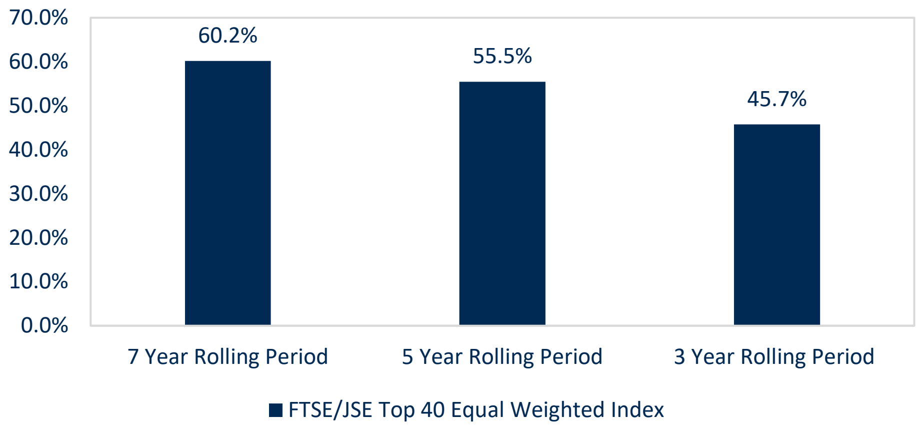

i. *Source: CoreShares Asset management. Effective number of shares is a statistical measure of how many shares are responsible for driving the return and risk outcome of a portfolio. Equal weighted portfolios allow equal contribution from all shares, this results in a well-diversified portfolio.*

The premise of the launch of the CoreShares Top 40 Equal Weighted ETF was to offer investors a more diversified equity exposure and to provide them with a greater exposure to smaller companies (which have been proven to outperform their larger counterparts over the long term). The characteristic of a portfolio where small companies outperform large companies is part of a larger body of evidence known as factor-based investing. Factor-based investing identifies common characteristics (factors) of shares that when combined within portfolios lead to long term outperformance relative to market cap portfolios such as the Top 40. Globally there has been a significant amount of research investigating these portfolio characteristics and to date there are five consensual factors that when held over long periods of time provide clients with improved performance. These consensual factors that have been rigorously challenged, empirically tested and cited in leading independent academic journals are:

1. Value *(portfolios of cheap shares outperform portfolios of expensive shares)*
2. Momentum *(portfolios of recent share winners continue to win in the near term)*
3. Size (*portfolios of small companies outperform portfolios of large companies) e.g. Equal weight*
4. Quality *(portfolios high quality shares outperform poor quality shares)*
5. Low Volatility *(portfolios of low risk shares outperform high risk shares)*

While the evidence supports the success of long-term allocation to these individual factors, what typically arises when investing in any of them individually is that their returns tend to exhibit cyclicality relative to market cap weighted portfolios. In addition, each factor tends to perform differently during different market environments. For example, on a cumulative basis, Size (as represented by equal weighting) outperforms a market cap weighted index over an extended period (see Figure 5 for cumulative performance). However, during the same period it only outperforms 55.48% of the time on a five-year rolling basis. This dynamic is similar across the other proven factors.

*Figure 2: Equal weight cyclicality of returns: The Top 40 Equal Weighted historic probability of outperforming the Top 40 over various time periods (ii)*




ii. *Source: CoreShares Asset Mangement. Over the Period from 01 July 2002 (common inception of both the Top 40 and the Top 40 EW) until 31 January 2019 an investment in a Top 40 equal weighted portfolio would have had outperfomed. However, invetsors with shorter invetsment timeframes have a significantly lower probabilty of outperforming.*

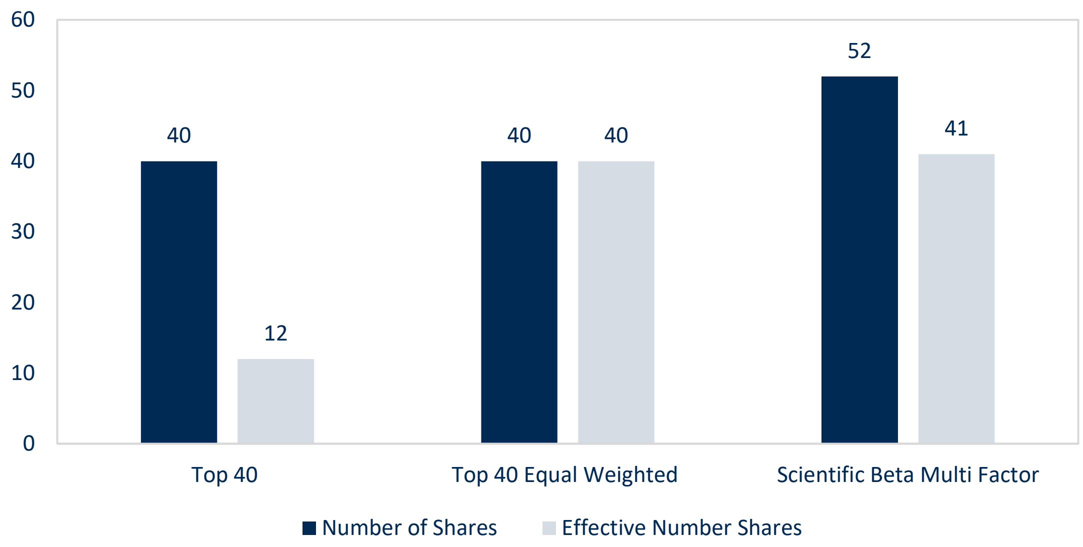
Given the relative cyclicality of factor returns (including size) it becomes very difficult for investors to stay invested during periods of underperformance and often leads to investors changing strategies and unfortunately this typically happens at the wrong time. Given this problem, CoreShares embarked on a thorough assessment of how to address the kind of cyclicality as is exhibited in Equal Weighting. The search for a rigorous approach to portfolio construction and factor risk management culminated in the use of Multi-Factor portfolios–these are portfolios which combine the before mentioned proven factors together in one all-encompassing and diversified index. Such an approach aims to achieve the best combination of proven factors without risking over-exposure to any individual factor or company and thereby reducing cyclicality and improving diversification.

As a result of this assessment, CoreShares appointed EDHEC Risk Institute (ERI) Scientific Beta as its key provider of a Multi-Factor based framework for the South African equity market. ERI Scientific Beta was importantly differentiated to other providers of Multi-Factor indexes as its Multi-Factor framework placed an equal emphasis on seeking out exposure to factors as it did to diversification - a key consideration for our local market as was the goal of the Top 40 Equal weighted portfolio.

The important outcomes of the Scientific Beta Multi-Factor Index relative to the Top 40 Equal Weighted Index were twofold:

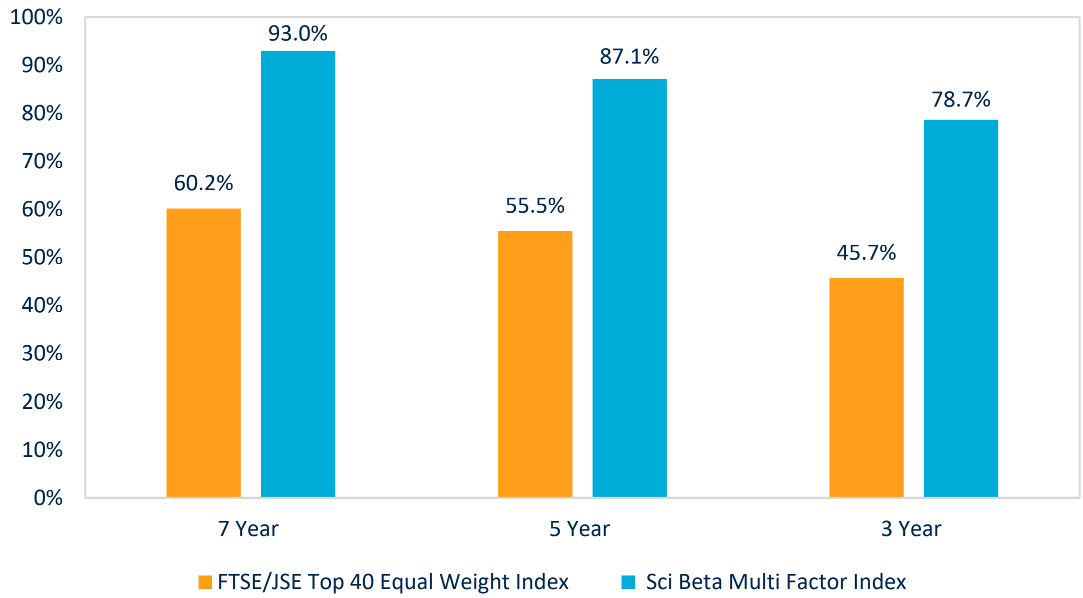
1. **Diversification:** An equal or better diversification and risk management process. This is achieved through “smart weighting”.
2. **Consistent Returns:** A more consistent relative return and path to outperformance creating a more “investor friendly” portfolio. This is achieved through consistent exposure to all consensual factors.

*Figure 3: Diversification, comparison of Top 40 Equal Weighted to Sci Beta Multi Factor.* (iii)



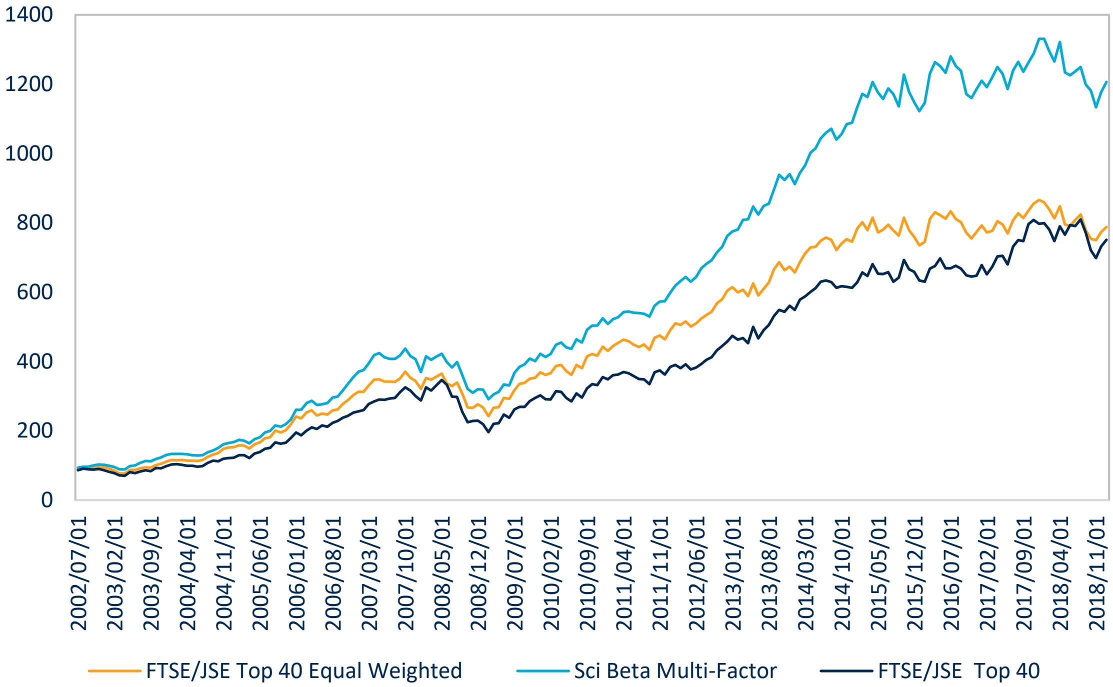

iii. *Both Equal weighting and Multi Factor achieve high levels of diversification.*

*Figure 4: Return consistency, comparison of Top 40 Equal Weighted to Sci Beta Multi Factor.* (iv)




iv. *Over the Period from 2002 (common inception of all three Indices) until 31 January 2019 an investment in either the Equal Weighted or the Multi-Factor portfolio would have outperfomed compared to the FTSE/JSE Top 40 . However the Multi Factor Index was able to achive a far more consitent return profile over the period giving investors who were invetsed for a shorter period a greater chnace of relative outperfomance.*

*Figure 5: Cumulative Return: comparison of Top 40 Equal Weighted to Sci Beta Multi Factor. (v)*




v. *Cumulative Total Return from July 2002 until 31 January 2019.*

We believe the Multi Factor is a suitable replacement of the Top 40 Equal Weighted which addresses the major shortcomings without losing the benefit. The solution is suitable for investors looking to achieve a well-diversified portfolio, while smoothing the cyclicality of returns that is typically associated with individual factors. This strategy is all deliverer to investors within a low cost, rules based, Exchange Trade Fund available on the JSE.

**Action required by investors:**

- Please refer to SENS announcement dated 18th February 2019. Click Here.
- Please ensure your votes have been submitted to your brokers by the 1st April 2019.
- For any further information please don't hesitate to contact CoreShares at info@coreshares.co.za