The Nasdaq-100 Index

A flexible index for changing times

The global markets soared at the end of 2017, delivering 71 new highs, and closing the year up 21% on average[1]. Of course, that rise had many investors reviewing their strategies—a sentiment that was even more necessary as market volatility returned with a vengeance in the first few months of 2018. It's hard to find an analyst today who isn't predicting continued volatility. Whether that means a correction in one sector, a broad market correction, or a bona fide market downturn, wise investors are in the process of navigating for change. The question on everyone's minds is "How?"

In the face of market uncertainty, one approach that may prove particularly helpful is to strive to "bulletproof" your portfolio by increasing diversification. But building a strategy that can accomplish this can be a challenge.

A changing strategy for changing times

If you ask almost anyone to name the biggest driver of change today, there's typically one common answer: technology. The pace of innovation has been increasing exponentially for decades. As a result, it is transforming nearly every industry and redefining how we live, work, and play. Companies like Apple, Facebook, Amazon, and Google have not only been revolutionising our everyday lives, but they've been driving the growth of the technology sector for years. And while the names of those in the forefront may change over time, one thing that is highly unlikely to change is the growing dependency on technology by businesses and consumers alike.

Manufacturers can no longer be competitive without investing in highly automated factories. Retailers who even hope to compete with Amazon are leveraging new technologies to reinvent every process—from marketing to distribution. Innovations are enabling healthcare providers to deliver better, faster, more effective services and improve patient outcomes. Consumers have an insatiable desire for new tools to make their lives move faster, more efficiently, and just plain easier. In December 2017, Forrester Research reported that sustained economic growth, combined with cloud and business technology, is expected to accelerate US tech growth in 2018 to almost 6%.[2] The momentum is real, and the potential for growth is significant.

For investors, this reality dictates the need for a different strategy—one that is designed to take full advantage of the rise of technology to not only capture potential returns from the sector, but also to increase diversification across their portfolios to help mitigate market risk.

Reaching beyond the S&P/ASX 200 Index

In Australia, the S&P/ASX 200 Index is often the go-to index for gaining broad sharemarket exposure. But while the index does offer much of the exposure investors in the region generally seek, the index is undeniably lacking in its technology exposure, which means that investors may risk missing out, from an investment point of view, on much

1 As of 12/29/17. Closing values of a selection of global equity markets

2 "2018 US Tech Budget Outlook: Growth Will Accelerate to Almost 6%," Forrester Group, December 13, 2017

of the global innovation changing our world. With technology currently the unchallenged driver when it comes to global growth, there is an investment case to focus on gaining exposure to the technology companies behind that expansion. To do so requires reaching beyond the S&P/ASX 200 Index and adding a tech-rich component to the mix to enhance and diversify these holdings.

Introducing the Nasdaq-100 Index

From a performance perspective, the Nasdaq-100 Index is designed to capture the impressive growth of the technology sector. Known for its heavy weight in technology, tech-focused companies comprise 56.14% of the index as of 29 June 2018. That's quite a contrast to the S&P/ASX 200 Index that is vastly underweight technology at just less than 1%.[3] Consumer services also plays an important contributing factor in the Nasdaq-100, comprising 24.90% of the index (including key names such as Starbucks, Netflix, Amazon, Sirius, Costco, and Viacom) as does Healthcare, which comes in third in weighting at 9.01%.[4]

NDX: Weights (as of 6/29/18) and Contributed Return (6/30/17- 6/29/18) **in USD

INDUSTRY	WEIGHT	CONTRIBUTED RETURN
Technology	56.41%	17.61%
Consumer Services	24.90%	7.03%
Health Care	9.01%	0.17%
Consumer Goods	4.44%	-0.10%
Industrials	4.46%	1.32%
Telecommunications	0.78%	-0.03%
Basic Materials	0.00%	0.00%
Oil & Gas	0.00%	0.00%
Financials	0.00%	0.00%
Utilities	0.00%	0.00%

Source: Nasda/Bloomberg. Contributed returns are shown in US dollars, which might differ from returns in Australian dollars. Past performance is not indicative of future returns.

To understand the impact the Nasdaq-100 can have on a diversified portfolio, it's important to look at the differences in weighting between this index and the S&P 500 Index, as well as the corresponding S&P/ASX 200 Index. As the numbers below illustrate, both indices have much lower exposure to the sectors that have been delivering the most positive returns, relative to the Nasdaq-100:

S&P 500 / S&P ASX 200: Weight (as of 6/29/18) and Contributed Return (6/30/17- 6/29/18) **in USD

S&P 500	WEIGHT	CONTRIBUTED RETURN	S&P ASX 200	WEIGHT	CONTRIBUTED RETURN
Technology	21.36%	5.64%	Financials	40.25%	0.20%
Financials	18.56%	2.29%	Basic Materials	15.65%	4.24%
Health Care	12.95%	2.51%	Consumer Services	11.16%	1.71%
Consumer Services	13.44%	1.11%	Industrials	10.02%	0.23%
Industrials	11.71%	1.27%	Health Care	8.79%	1.93%
Consumer Goods	8.09%	-0.13%	Oil & Gas	4.90%	1.13%
Oil & Gas	6.30%	1.25%	Telecommunications	2.19%	-1.21%
Utilities	2.92%	0.12%	Utilities	2.36%	0.16%
Basic Materials	2.11%	0.27%	Consumer Goods	1.87%	0.25%
Telecommunications	1.98%	0.04%	Technology	0.98%	0.23%

Source: Nasdaq/Bloomberg: Contributed returns are shown in US dollars, which might differ from returns in Australian dollars. Past performance is not indicative of future returns.

3 Source: Bloomberg: S&P Dow Jones Indices, 29 June 2018

4 As of 29 June 2018.

Nasdaq-100 Index and the Nasdaq 100 ETF

Creating a balanced blend

While the historical performance of the Nasdaq-100 Index is certainly impressive, we need only look back to the early 2000s to remember what can happen when a sector becomes overvalued and over invested. The dot-com bubble was created largely by companies that were rich in concept, but poor in execution. Investors and venture capitalists poured money into 'sure things' that were not able to deliver on their promise. Though that was a very different scenario than today, the need for diversification can't be understated. That's just as true when adding technology to the mix as it is when adding a deliberate mix of other industry sectors to a portfolio to create a robust, balanced blend that aims to capture alpha in different market cycles.

As the above illustrates, investors are able to use the Nasdaq-100 Index to create a more balanced portfolio blend that offers the exposure diversification investors seek today and the higher allocations towards technology and consumer services sectors. In Australia, BetaShares has created the BetaShares NASDAQ-100 ETF (ASX code: NDQ). Designed to track the performance of the Nasdaq-100 Index, NDQ gives Australian investors access to many of the world's most innovative technology companies.

The below table shows how using a 70/30 allocation between the Nasdaq-100 Index and the S&P/ASX 200 Index can target potential growth in a wide variety of sectors—putting technology growth to work within the portfolio, while also maintaining some level of exposure to financials.

Illustrative portfolio blend: 70% Nasdaq-100 Index, 30% S&P/ASX 200 Index:
Portfolio sector weightings as at 29 June 2018 **in USD

INDUSTRY	.70 NDX EXPOSURE	INDUSTRY	.30 ASX EXPSOURE
Technology	39.49%	Financials	12.08%
Consumer Services	17.43%	Basic Materials	4.70%
Health Care	6.31%	Consumer Services	3.35%
Consumer Goods	3.11%	Industrials	3.01%
Industrials	3.12%	Health Care	2.64%
Telecommunications	0.55%	Telecommunications	1.47%
Basic Materials	0.00%	Oil & Gas	0.66%
Oil & Gas	0.00%	Utilities	0.71%
Financials	0.00%	Consumer Goods	0.56%
Utilities	0.00%	Technology	0.29%

Source: Nasdaq. Not a recommendation to adopt any particular investment strategy. You cannot invest directly in an index.

Another key advantage of the 70/30 blend is that it takes advantage of the historical low correlation between the Nasdaq-100 Index and the S&P/ASX 200 Index. Assuming this persists, this low correlation could help provide additional risk management by reducing the potential for drawdowns while allowing investors to capture sector rotation across a much broader menu—regardless of the current market cycle. Looking at the numbers from 31 December 2008, the height of the financial crisis, through 29 June 2018, when the bull market hit new highs, this lack of correlation is clear.

Correlation between equities indices: 31 Dec 2008- 29 June 2018 **in USD

	NDX (TR)	ASX S&P 200 (TR)	SPX (TR)	MSCI (TR)
NDX (TR)	1.00			
ASX S&P 200 (TR)	0.35	1.00		
SPX (TR)	0.93	0.38	1.00	
MSCI (TR)	0.84	0.60	0.91	1.00

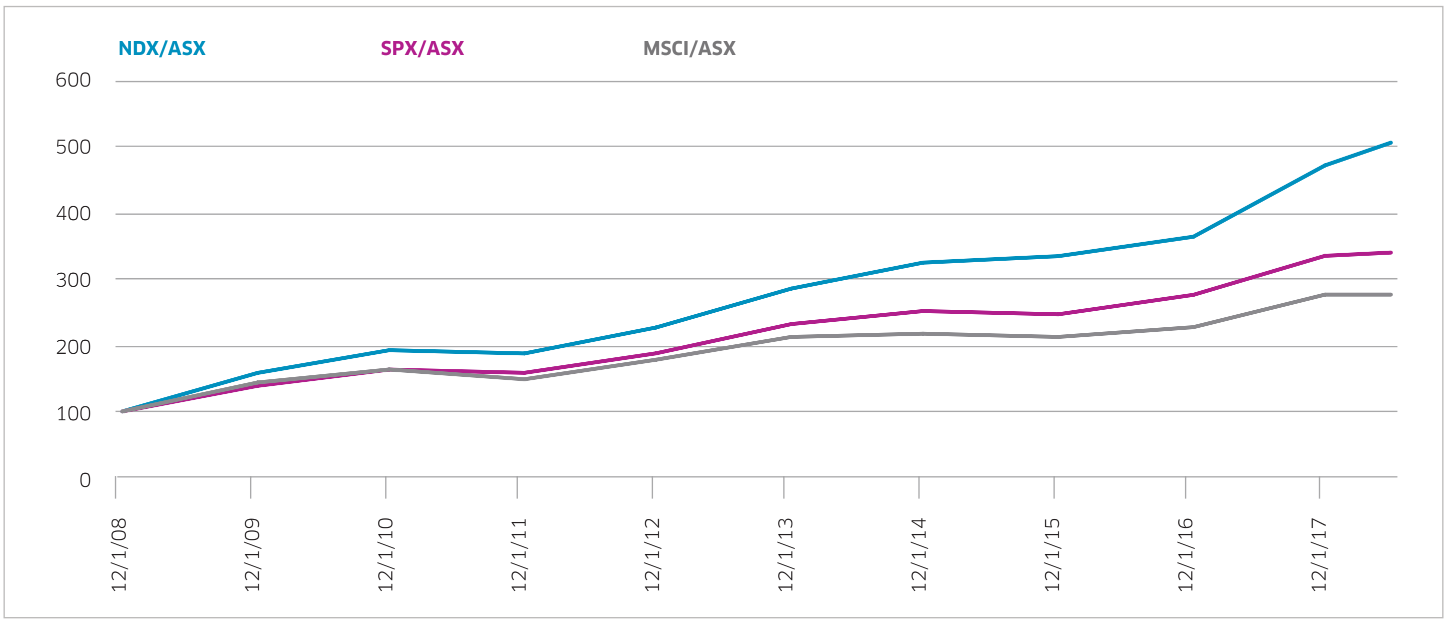
Source: Nasdaq/Bloomberg. Not a recommendation to adopt any particular investment strategy. You cannot invest directly in an index. Past correlations are not necessarily indicative of future correlations.

While low correlation is particularly important in a volatile market environment, even more critical is the ability to select a blend that is capable of performing over the long term. Yes, the Nasdaq-100 Index offers exposure to coveted technology stocks, but what is the potential for outperforming other comparable mixes?

When comparing a 70/30 blend of Nasdaq-100 Index and S&P/ASX 200 Index to similar blends of other indices, the historical outperformance is significant. In the below study, we analysed the time period between 31 December 2009 – 29 June 2018. The portfolio was rebalanced annually keeping consistent with our 70/30 blend. Where a 70/30 blend of Nasdaq 100 and the S&P/ASX 200 delivered annualised returns of 21%, the same blend of SPX/ASX 200 and S&P 500 Index delivered 16% annual returns, and a blend of MSCI World & S&P/ASX 200 delivered even less impressive performance with returns of 14% per year. This difference is largely attributable to the sheer outperformance of the Nasdaq-100 Index which, again, has been fueled largely by growth in the technology sector. With historical cumulative returns of the Nasdaq 100 nearly three times higher than that of the S&P/ASX 200 and nearly double the S&P 500 Index returns, it is clear why the Nasdaq 100 can be an important component of a balanced core portfolio focused on growth.

Historical performance of portfolio blends: 31 December 2008 - 29 June 2018 **in USD

	NDX (70%)/ASX (30%)	SPX (70%)/ASX (30%)	MSCI (70%)/ASX (30%)
Cumulative Returns	406%	242%	194%
Annualized Returns	21%	16%	14%
Annualized Volatility	17%	13%	18%

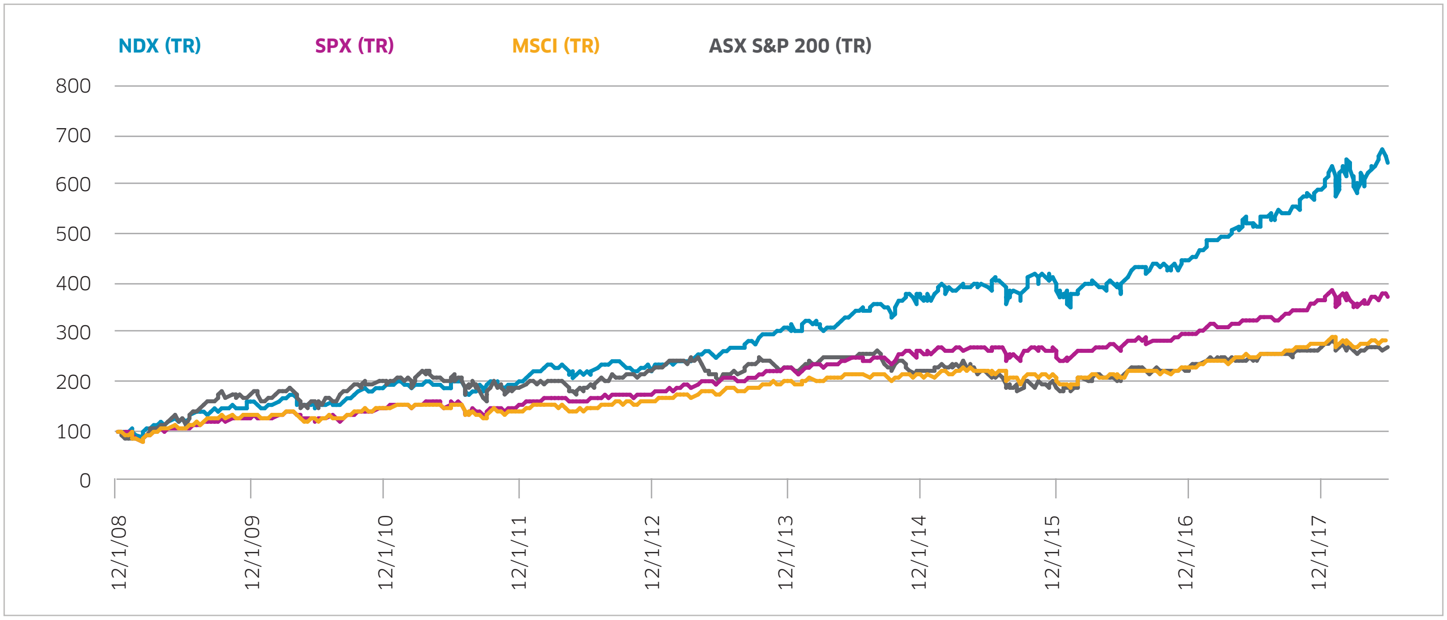


Source: Nasdaq/Bloomberg: Not a recommendation to adopt any particular investment strategy. Past performance is not an indicator of future performance. You cannot invest directly in an index. Returns are shown in US dollars, which might differ from returns in Australian dollars.

Today's technology growth is clearly being fueled by much more than investor exuberance. Since 2008, the tech-heavy Nasdaq-100 has been gaining steadily based on real technology and real and growing global demand from business and consumers. While a market downturn may certainly have the potential to dampen this growth, there is little doubt that technology stocks are an important component of a balanced, blended portfolio.

Performance of global equity indices: 31 December 2008 – 29 June 2018 **In USD

	NDX (TR)	ASX S&P 200 (TR)	SPX (TR)	MSCI (TR)
Cumulative Returns	545.49%	166.59%	268.27%	176.81%



Source: Nasdaq/Bloomberg. Past performance is not an indicator of future performance. You cannot invest directly in an index. Returns are shown in US dollars, which might differ from returns in Australian dollars.

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