

# Innovation-Driven, Mid Cap Growth Steps into the Spotlight

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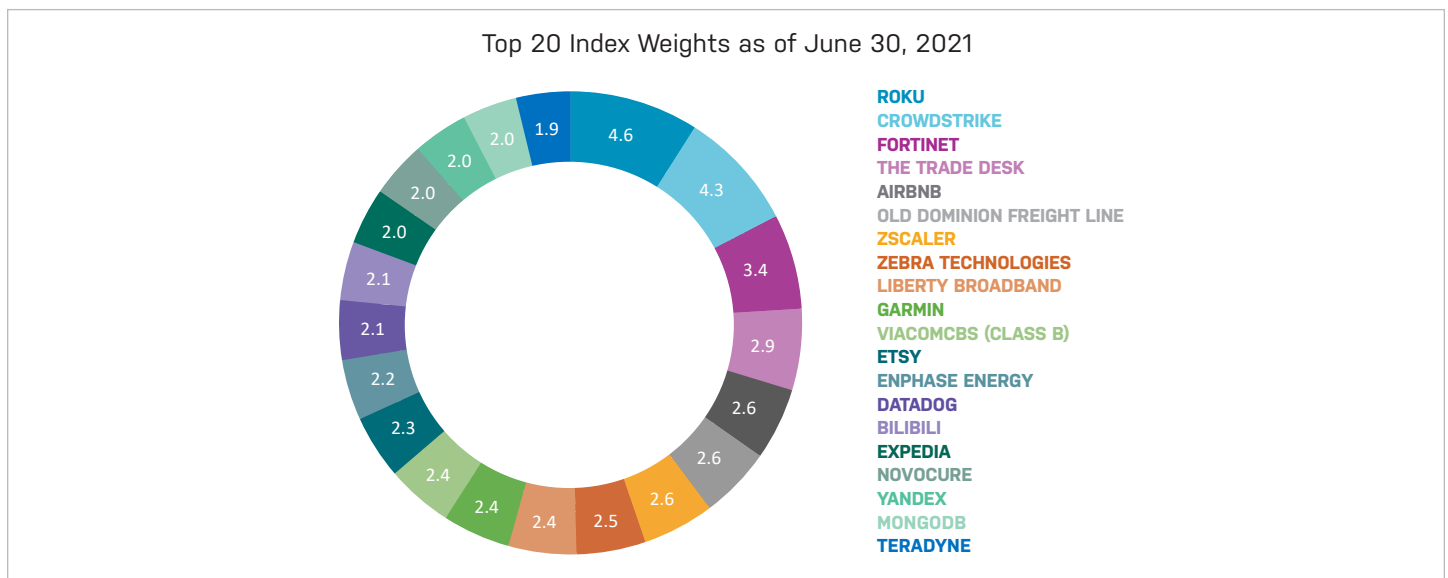
The Nasdaq Q-50 Index (NXTQ) tracks the performance of the 50 securities that are next eligible for inclusion into the Nasdaq-100 Index. Launched on October 10, 2007, the index deploys the proven methodology behind the time-tested Nasdaq-100 Index, with its emphasis on innovation and growth.

Investors can access the Nasdaq Q-50 Index through ETFs such as the VictoryShares Nasdaq Next 50 ETF (Nasdaq: QQQN)

## Methodology

The index begins with the universe of all companies, both domestic and foreign, that are listed on the Nasdaq Stock Market. The index then removes all companies classified as Financials from eligibility according to the Industry Classification Benchmark (ICB). Finally, the top 50 market cap names not currently in the Nasdaq-100 are included in the index. The methodology keeps the Nasdaq Q-50 Index aligned with the innovation and growth focus of the Nasdaq-100 Index, but with acute focus on the next generation of market leadership. The most significant difference in methodology lies in the quarterly reconstitution schedule, which enables the Q-50 to add fast-growing names four times a year versus once annually for the Nasdaq-100. Let's review how the Q-50 has performed in the recent past and what its components look like today, before analyzing its relevance within the broader universe of thematic technology.

## Current Composition

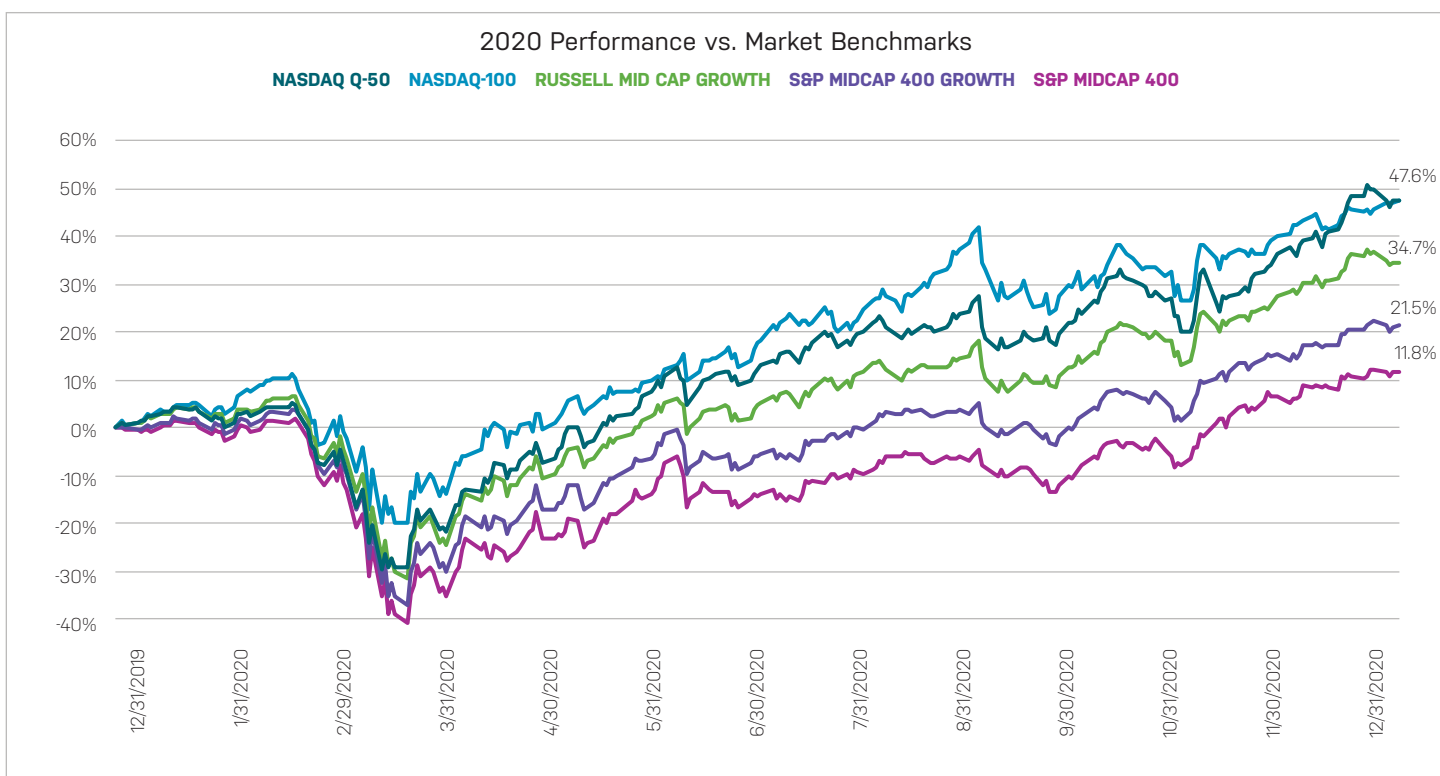


Of the 52 constituents in NXTQ (50 unique companies, 2 of which utilize dual share classes), the top 20 represented 51% of the index weight as of June 30, 2021. The top 10 names accounted for 30%, while the top 5 comprised approximately 18%. The largest of these was ROKU, with a cumulative return of 325% since joining the index in September 2019. As a technology-enabled Telecommunications company with a focus on Streaming as its main business area, ROKU represents the next generation of Thematic Tech champions: fast-growing, R&D-intensive midcap companies that specialize in one or two key areas – unlike the much larger, more diversified companies typically found in the Nasdaq-100 Index.

In terms of market capitalization for the current group of Q-50 companies, the average was \$25.7Bn, while the weighted average was \$28.4Bn (as of June 30, 2021). The median was \$21.4Bn, and the range from largest to smallest was \$40.1Bn (excluding the outlier due to inclusion of AstraZeneca's ADR).

## Recent Performance

2020 was a banner year of performance for NXTQ, exactly matching the Nasdaq-100 price return of 47.6% and more than tripling the return of the S&P Midcap 400 Index. The Q-50 also easily outpaced both the S&P Midcap 400 Growth and the Russell Mid Cap Growth Indexes. Full-year performance in 2019 was similarly strong, up 32.7% on a price-return basis vs. 38.0% for the Nasdaq-100, 34.3% for the Russell Mid Cap Growth, 24.5% for the S&P Midcap 400 Growth, and 24.1% for the S&P Midcap 400 Index. So far in 2021, the Q-50 Index is up 8.3% (as of June 30).

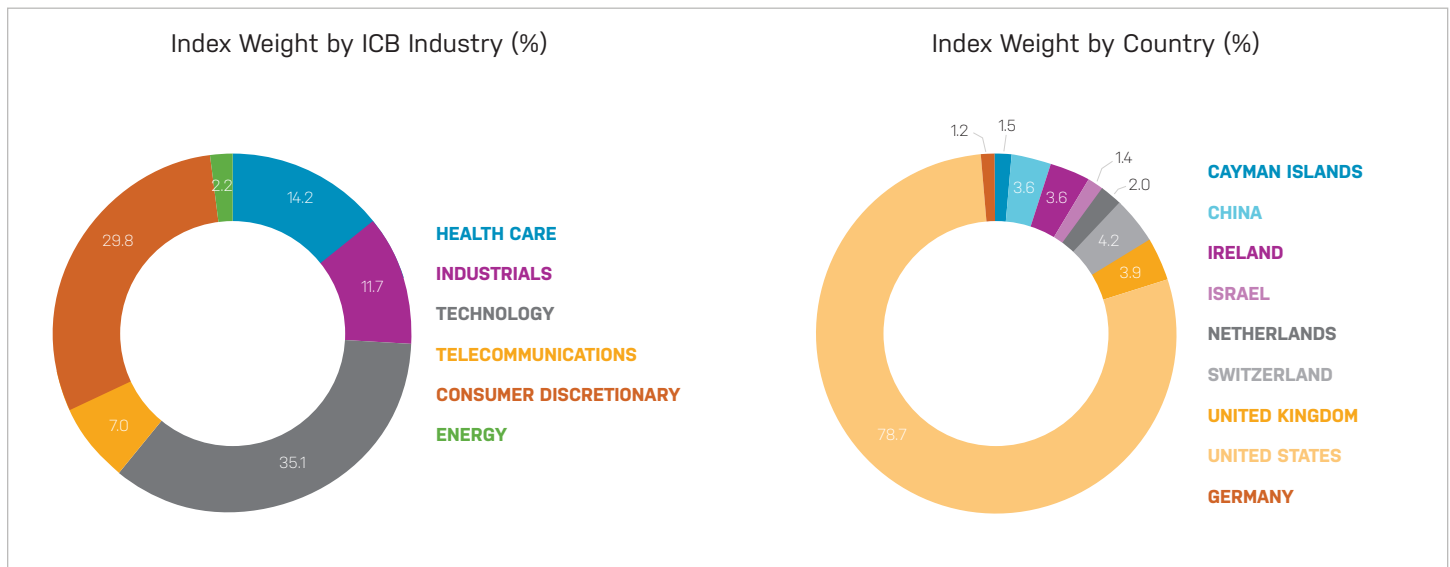


## Sector and Country Exposures

Compared to the Nasdaq-100, which tends to average between 50-60% of its index weight allocated to Technology, the Q-50 is less concentrated from a sector perspective with an allocation of only 35.1% as of June 30, 2021. A substantial chunk of the difference shows up in a higher allocation to Health Care, which is not only highly relevant from a thematic perspective thanks to Covid-19, but is also in the midst of its own technologically-assisted transformation. (No fewer than three constituents – AstraZeneca, Novavax, and CureVac – have developed or are in the late stages of developing highly effective Covid-19 vaccines for mass-market use.) Consumer Discretionary, Industrials, and Telecommunications allocations also skew higher in the Q-50 than in the Nasdaq-100. The "old economy" sectors of the 20th century including Energy, Materials, Utilities and Financials reflect the same trend as in the Nasdaq-100, though, with a de minimis allocation in aggregate.

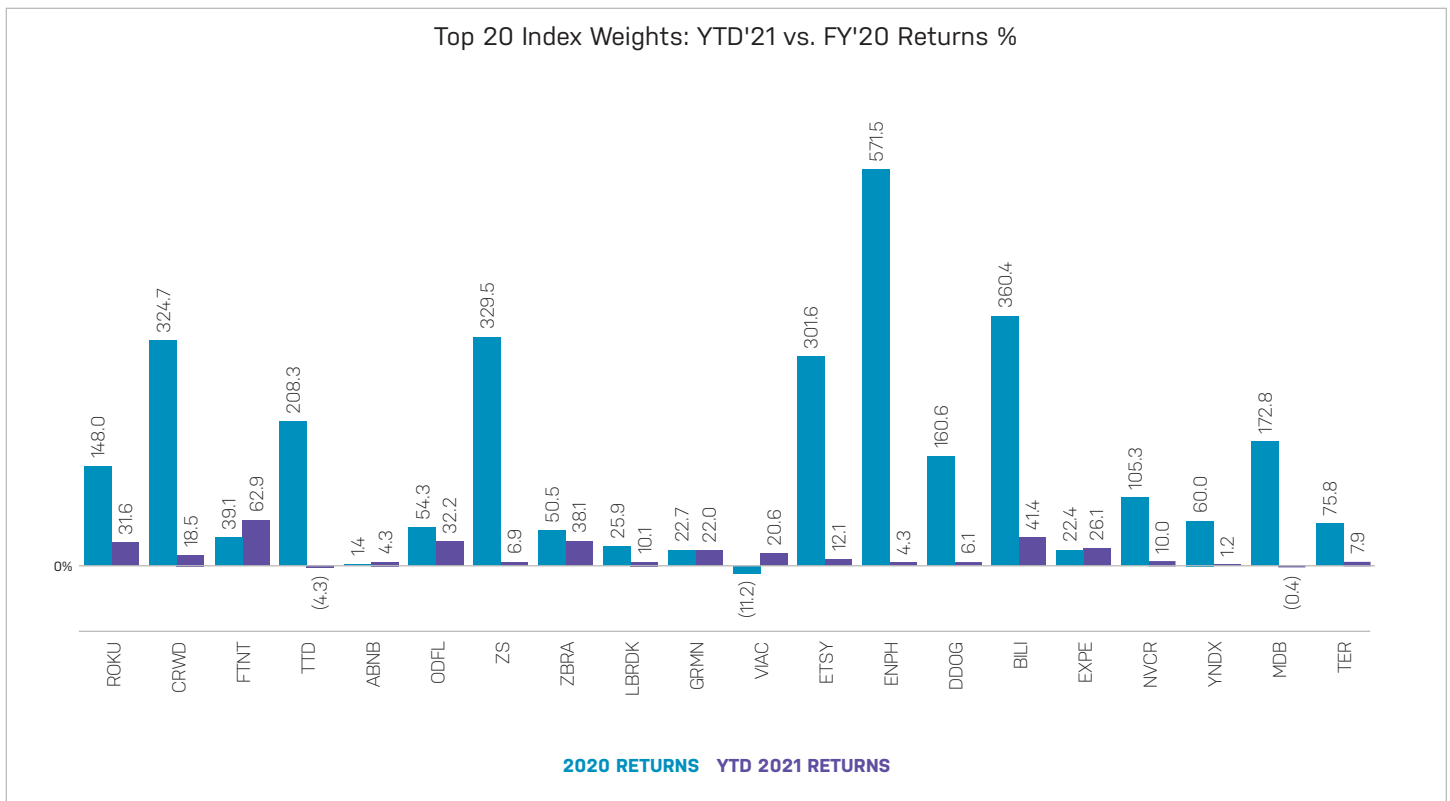
In terms of geographic exposure, the Q-50 offers an interesting diversification benefit with more than 20% of index weight recently allocated to companies based outside the US. The Nasdaq-100 tends to average no more than 5%, while similar US

midcap benchmarks are usually at or near 100% domestic. With the reopening trade beginning in late 2020, there has been widespread discussion not only of US equity market leadership passing from large-cap growth to small and midcaps, but globally speaking, perhaps beyond the US to other developed and emerging markets as well. Accordingly, the Q-50 represents a compelling opportunity to capture some of this broader macro trend, if so desired.



### Individual Drivers of Performance

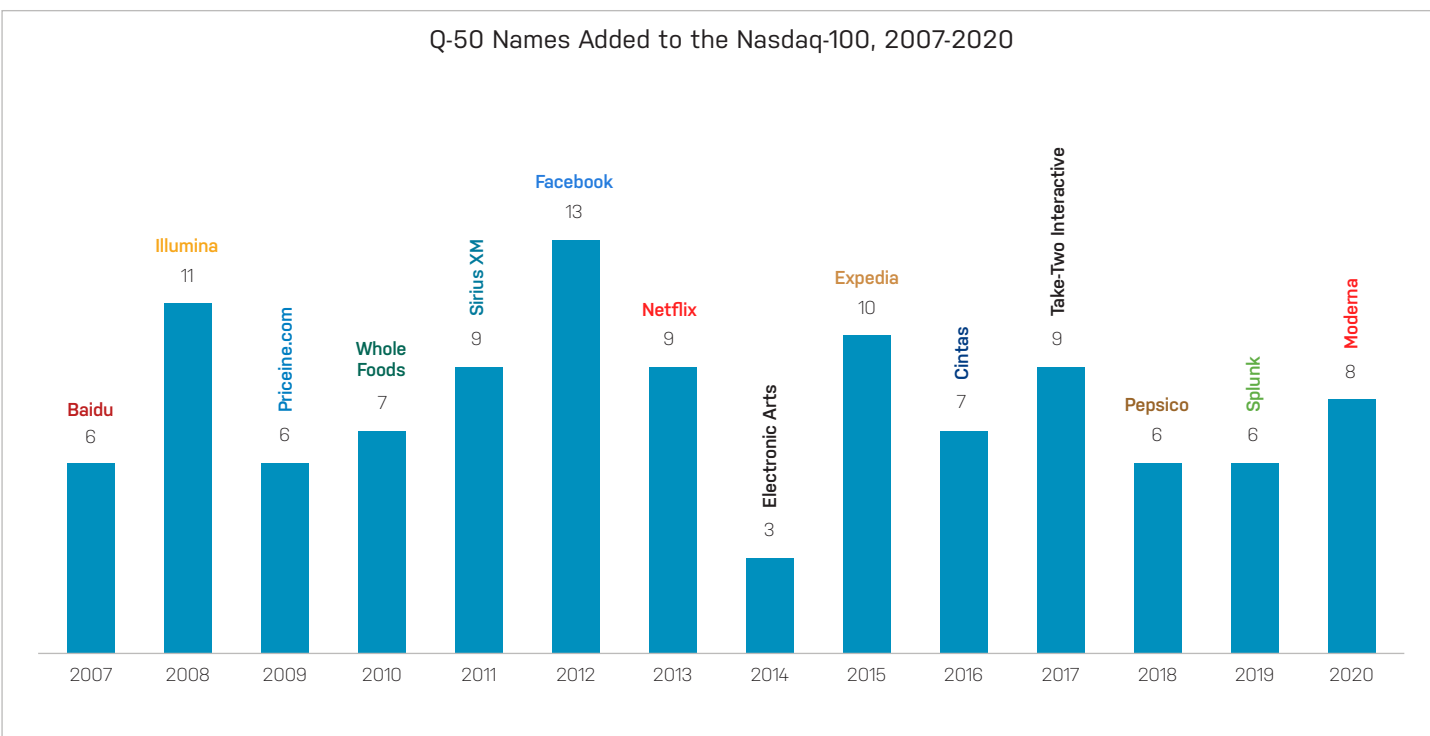
The top 20 names by index weight averaged a return of 151% in 2020, with only one company recording negative full-year returns. YTD returns as of June 30, 2021 have averaged nearly 18% for this group, of which two companies have thus far registered negative price movements.



## Q-50 Companies as Future Nasdaq-100 Graduates

Since the index launched in 2007, 110 members of the Q-50 went on to graduate into the Nasdaq-100 – a rate of nearly 8 graduates per year, on average<sup>1</sup>. The illustrious list of companies includes some of today's megacap Tech names such as Facebook (2012) and Netflix (2013), as well as major Health Care innovators like Illumina (2008) and Moderna (2020). In the 12 months prior to graduating, these 110 names increased 76.2% on average, with a median return of 64.7%. In contrast, the same companies increased by only 18.3% during the 12 months post-graduation and by 57.8% in the next 36 months; the median increase was 15.9% and 39.0%, respectively<sup>2</sup>. Thus the evidence supports the theory that Q-50 constituents should experience a more rapid pace of growth while still inhabiting the midcap size spectrum, prior to attaining large cap status in the Nasdaq-100. Taken together with the knowledge that, upon graduating into the Nasdaq-100, they debut at exceedingly small weights in the index due to the dominance of the largest market cap companies like Apple, Amazon, Microsoft, Google, Facebook, and Tesla, the compounding opportunity available to investors who choose not to wait for a Q-50 company to graduate may be highly compelling indeed. As of June 30, 2021, the smallest constituent in the Nasdaq-100 had a weight of only 0.12%, compared to 1.12% in the Q-50 (dual listing examples excluded); the largest had a weight of 11.0% versus 4.6%, respectively. Effectively, even though the Q-50 Index is less concentrated from an individual company perspective with max constituent weights rarely exceeding 5%, the tight range of market caps ensures that each constituent will contribute more meaningfully to overall performance than the smallest members of the Nasdaq-100.

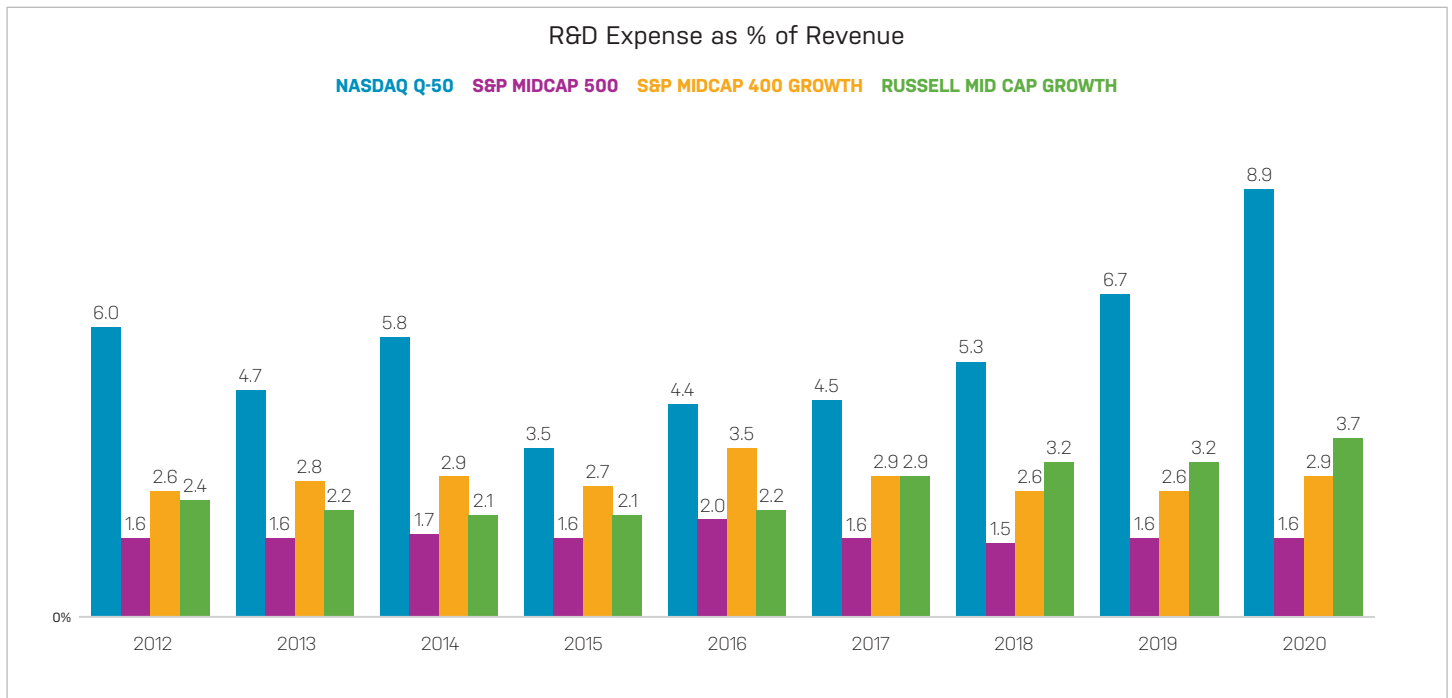
Compared to the Nasdaq-100, the Q-50 is less concentrated from a sector perspective with an allocation of only 35.3% to Technology.



<sup>1</sup> Constituent counts by year include some double-counting, for example Illumina was originally moved into the Nasdaq-100 in 2008, subsequently kicked back out to Q-50, then moved back in 2013. Of the 110 constituent "graduations," there were 102 unique companies. In addition to Illumina, Ctrip.com International; Green Mountain Coffee Roasters; Hansen Natural; Hologic; J.B. Hunt Transport Services; Netflix; and NXP Semiconductors moved from the Q-50 into the Nasdaq-100 twice during the 2007-2020 period.

<sup>2</sup> In the case of next-12-month statistics, names added in 2020 were excluded from averages and medians; in the case of next-36-month statistics, names added in 2018-2020 were excluded.

## An Outperformer in Terms of Innovation and R&D



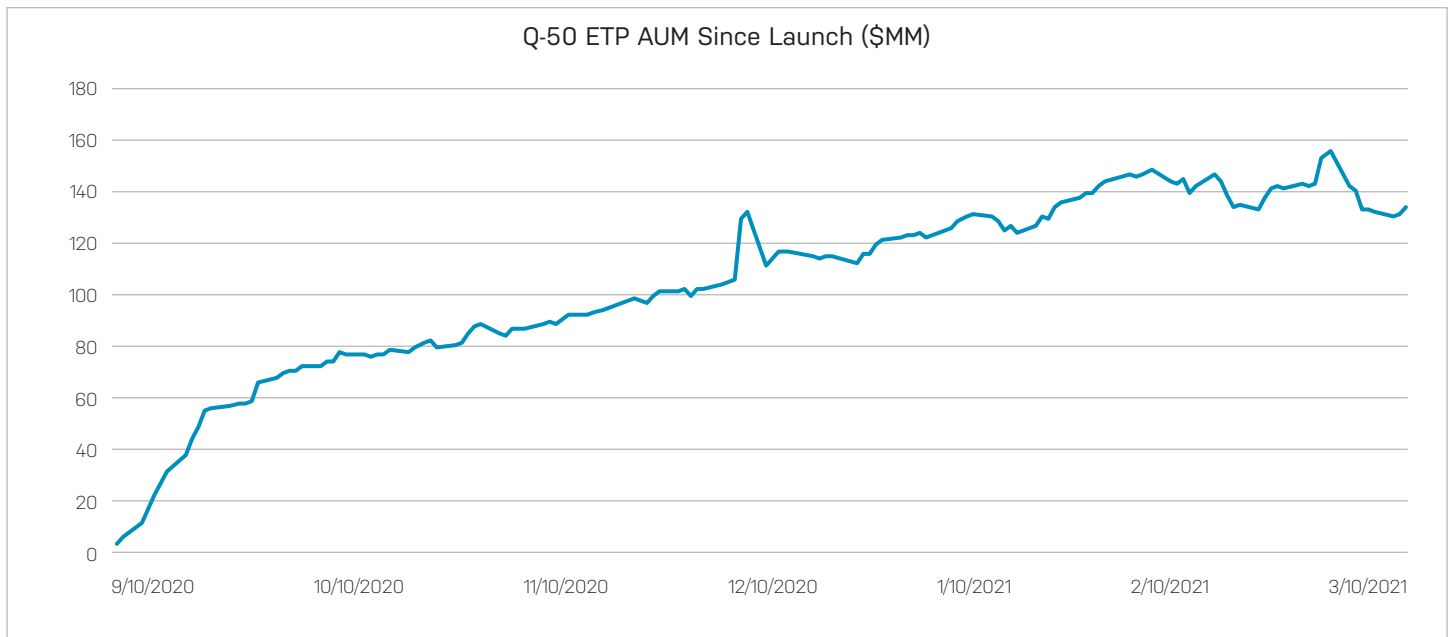
Perhaps the clearest demonstration of why the Q-50 represents a natural complement to the Nasdaq-100 is in its constituents' similar emphasis on innovation to drive growth. Compared to similar midcap benchmarks from Russell and S&P, the Nasdaq Q-50 Index spends on average more than twice as much on research and development (R&D) as a percentage of overall company revenues. The trend has been consistent over the past decade, with a pronounced acceleration in the most recent two calendar years. Looking at the current snapshot of constituents as of June 30, 2021, the ratio appears even higher at nearly 11%, with \$25.3Bn of R&D expense recorded during the trailing four quarters versus \$233Bn of overall revenue.

An alternate approach towards quantifying innovation exists in the analysis of patent filings. Leveraging work done with an alternative data product partner, Yewno, to identify 35 key areas (i.e., themes) of disruptive technology innovation, we discovered patent activity by Q-50 companies in 22 of these areas (based on analysis as of March 31, 2021). The most active areas included Digital Currency, Cloud Computing, Spacecraft & Satellites, Cybersecurity, and Human Augmentation – all of which saw in excess of 1% of global patent filings made by Q-50 companies.<sup>3</sup> In total, 17 companies filed patents in one or more areas of disruptive tech, representing 34% of the index constituents. In contrast, the Russell Mid Cap Growth Index saw patent "breadth" of 28%, with the S&P Midcap 400 Growth at only 19%. On average, Q-50 patent filers were active in 4.5 different areas of disruptive tech. This also exceeded the average patent "depth" of 3.3 within the Russell Mid Cap Growth, and only 3.0 in the S&P Midcap 400 Growth.

<sup>3</sup> Most recently available data based on 12 month period ending November 30, 2020.

## Q-50 ETP Assets

Finally, let's take a quick look at how assets under management (AUM) have grown for the US-listed tracking product since its launch in September 2020. It took approximately three months for the product to reach \$100MM in AUM. As of June 30, 2021, AUM totaled \$148.5MM, up almost \$34MM YTD.



## Summary

The Nasdaq Q-50 Index naturally complements the better-known Nasdaq-100 Index in multiple ways. With its higher frequency reconstitution schedule, the index welcomes new additions more rapidly, creating an earlier window for tracking investors to gain exposure to fast-growing, innovative names near the upper end of the midcap spectrum. And while the Q-50 maintains numerous commonalities with the Nasdaq-100 – an elevated rate of investment in R&D, most importantly – the smaller average market cap of its constituents results in a lower concentration towards its largest members, and more meaningful exposure to most of them. Furthermore, the higher average weighting across each member of the Q-50 presents a compelling compounding opportunity to potential investors who may instinctually prefer to wait for a company to graduate into the ranks of the Nasdaq-100. Indeed, the historical evidence supports the opposite decision.

From a sector perspective, there is less concentration in Technology versus the Nasdaq-100, with offsetting higher allocations to Healthcare and other "new economy" sectors. Meanwhile, from a geographic perspective, the Q-50 Index offers diversification with much greater allocations to non-US-based companies.

Recent performance trends have cemented the index's status as an extension of the Nasdaq-100, with an identical full-year price performance in 2020 and similar performance in years prior. Since the Q-50 launched in 2007, it has generated cumulative price returns of 482% and total returns of 530% – not quite at the level of the Nasdaq-100, but not far behind, relatively speaking. Similar midcap growth benchmarks from competitors such as S&P and Russell have simply failed to keep pace.

Index Name / Ticker	Price Return 10/10/07-6/30/21	Total Return 10/10/07-6/30/21
Nasdaq Q-50 (NXTQ)	482%	530%
Nasdaq-100 (NDX)	569%	668%
Russell Mid Cap Growth (RDG)	282%	338%
S&P Midcap 400 Growth (MIDG)	246%	298%
S&P Midcap 400 (MID)	194%	263%
S&P 500 (SPX)	175%	266%

**Products tracking the Nasdaq Q-50 Index include the VictoryShares Nasdaq Next 50 ETF (Nasdaq: QQQN).**

Sources: FactSet, Bloomberg, Nasdaq Global Indexes, Yewno.

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