

# ETF Strategy

## Country selection with HOLT® and ETFs

Market Commentary

8 April 2014

### Key Points

- Using the HOLT® Country Ranking Model, we select 10 country ETFs to implement our favored country selection strategy.
- This month our model ETF portfolio has a long position in: South Africa (**EZA**), Italy (**EWI**), Japan (**DXJ**), Taiwan (**EWT**), Canada (**EWC**), Hong Kong (**EWH**), Switzerland (**EWL**), the U.S. (**VTI**), Korea (**EWY**), and Germany (**EWG**).

## Pivot to Asia?

### March Performance in line with MSCI AC World

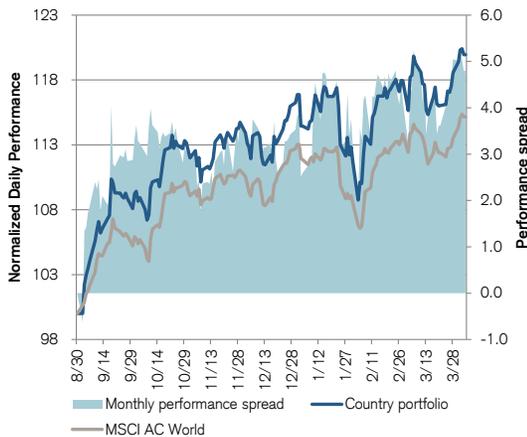
Our country portfolio formulated using the HOLT® Country Ranking Model slightly underperformed the MSCI All Country World Index by 20 bps from 3/7 to 4/2). Since inception in September, the country model has outperformed by 5%.

### Portfolio changes for April

In HOLT's latest full country ranking report:

- Our report for April has three Asian countries meaningfully improving their ranks; Taiwan, Hong Kong and Korea. Improving ranks for Asian countries has been primarily driven by attractive valuation characteristics. When combined with Japan, Asia currently represents 40% of the weight in our model portfolio, nearly 2x the weight of the MSCI All Country World index.
- Improving market sentiment combined with the highest CFROI sentiment rank propelled South Africa to our top overall rank in April. While South Africa has underperformed the AC World index by over 18% (in USD terms) in the year to Feb 2014, in March 2014 performance reversed and South Africa outperformed by almost 6%.
- Japan and Italy remain our longest standing positions, having received full 12% weights in our model portfolio every month for the last year. While Asia is well represented in our portfolio, China fell out of our top 10 rankings for the first time in 9 months.

Exhibit 1: Performance of country portfolio



Source: Credit Suisse Trading Strategy

Exhibit 2: HOLT country ranking model

Sector	Ticker	Current Level	Warranted Level	1 Month Return	Beta	FACTOR RANKING					
						Valuation	Market Sentiment	CFROI® Sentiment	Overall Rank	Previous Overall Rank	
South Africa	MXZA	1,193	1,197	3.0%	0.5	16	5	1	1	↑	12
Italy	MXIT	62	69	4.9%	1.3	10	2	13	2	↑	3
Japan	MXJP	746	803	-0.4%	1.0	3	14	8	3	↓	2
Taiwan	MXTW	315	363	4.3%	0.4	4	15	6	4	↑	10
Canada	MXCA	1,826	1,758	1.1%	0.7	13	16	3	5	↑	9
Hong Kong	MXHK	12,203	12,049	1.1%	0.7	7	25	2	6	↑	13
Switzerland	MXCH	1,106	1,125	0.7%	0.8	6	9	16	7	↑	8
United States	MXUS	1,810	1,841	0.8%	0.9	11	10	7	8	↓	5
Korea	MXKR	580	728	1.0%	0.7	2	21	21	9	↑	19
Germany	MXDE	131	146	0.7%	1.2	8	7	18	10	↓	6

Source: Credit Suisse HOLT

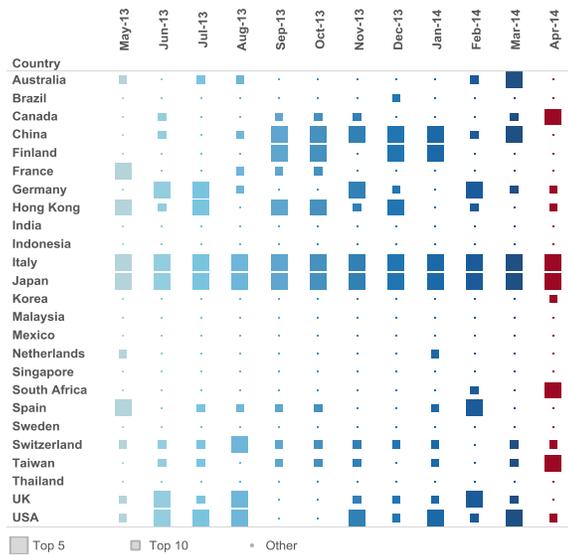
Exhibit 3: Model ETF Portfolio for HOLT Country Model

Country	ETP	Name	Weight
South Africa	EZA	iShares MSCI South Africa ETF	12%
Italy	EWI	iShares MSCI Italy Capped ETF	12%
Japan	DXJ	WisdomTree Japan Hedged Equity Fund	12%
Taiwan	EWT	iShares MSCI Taiwan ETF	12%
Canada	EWC	iShares MSCI Canada ETF	12%
Hong Kong	EWH	iShares MSCI Hong Kong ETF	8%
Switzerland	EWL	iShares MSCI Switzerland Capped ETF	8%
U.S.	VTI	Vanguard Total Stock Market ETF	8%
Korea	EWY	iShares MSCI South Korea Capped ETF	8%
Germany	EWG	iShares MSCI Germany ETF	8%

Source: Credit Suisse Trading Strategy

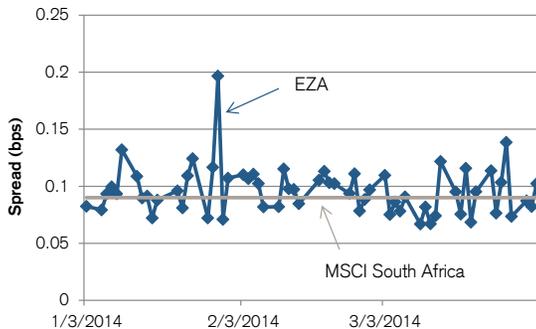
For complete information regarding the ETPs mentioned in this report, please refer to the prospectus for each fund found on the respective ETP provider's website.

Exhibit 4: Country portfolio composition history



Source: Credit Suisse Trading Strategy

Exhibit 5: EZA spread in line with underlying (MSCI South Africa)



Source: Credit Suisse Trading Strategy

## Picking our model ETF Portfolio

In April, new additions to our top 10 include South Africa, Hong Kong, and Korea. Falling out of the top 10 are China, the U.K., and Australia. For the purposes of limiting portfolio turnover, the remaining countries in the portfolio will be represented by the same ETFs as previously.

### Selecting country ETFs

New additions:

**South Africa** – The iShares MSCI South Africa ETF (EZA) is the only choice for pure exposure to South Africa. The ETF trades about \$30mm/day and maintains a bid-ask spread roughly on par with its underlying (see Exhibit 5).

**Hong Kong** – The iShares MSCI Hong Kong ETF (EWH) is the choice for the portfolio with the most liquidity and market-cap weighted methodology. First Trust has an AlphaDex option for those looking to take more of an active bet using their scoring methodology (ticker FHK) and iShares also has a small-cap product (EWS) for those looking for a higher beta.

**Korea** – There are several products that offer exposure to Korea. The iShares MSCI South Korea ETF (EWY) is the largest and most liquid as well as the choice for our portfolio. However, alternatives include:

- Low cost - HKOR is a newer ETF that tracks the KOSPI 200. Its 38 bps expense ratio is substantially less than competitors.
- Currency hedged - DXKW and DBKO help neutralize moves in the Korean won.
- Fundamental themed – FKO uses a fundamental based methodology and skews towards small size and value factors. However, liquidity is an obstacle with wide spreads.
- Leveraged – KORU is an option for those with high conviction, providing 3x daily returns of MSCI Korea.

### Other potential enhancements

There are also other product types that offer investors ways to potentially enhance the portfolio. Tickers for each of these are listed in Exhibit 6:

- **Small cap** – Small caps usually are a higher beta alternative and can be a suitable vehicle for high conviction trades.
- **Currency hedge** – In the current economic environment, currency-hedging is an increasingly important consideration.
- **Fundamental** – Investors who prefer a fundamental overlay or weighting scheme should consider these alternatives.
- **Leveraged** – Leveraged ETPs are generally better suited for shorter-term plays, but can deliver outperformance if investors expect consistent upward trending with minimal volatility.

Exhibit 6: ETPs tracking top 10 countries as ranked in HOLT Country Rotation Model (U.S. products not listed due to number of offerings)

Rank	Country	Weight	Large cap or broad-based	Small/Mid Cap	Hedged currency	Fundamental	Leveraged long
1	South Africa	12%	EZA				
2	Italy	12%	EWI				
3	Japan	12%	EWJ, ITF, JPP, NKY	DXJS, DFJ, JSC, SCJ	DXJ, DXJS, DBJP, HEWJ	FJP, DXJ, DXJS	EZJ, JPNL
4	Taiwan	12%	EWT			FTW	
5	Canada	12%	EWC	CNDA, EWCS		FCAN	
6	Hong Kong	8%	EWH	EWHS		FHK	
7	Switzerland	8%	EWL			FSZ	
8	U.S.	8%	Excluded for brevity				
9	Korea	8%	EWY, HKOR		DXKW, DBKO	FKO	KORU
10	Germany	8%	EWG	EWGS, GERJ	DBGR, DXGE, HEWG	FGM	

Source: Credit Suisse: Trading Strategy

## Methodology

### HOLT Country Ranking Model

Exhibit A: HOLT country ranking model factors

Factor	Explanation	Metrics
Analyst Sentiment (CFROI Momentum)	CFROI Momentum measures the impact that changes in consensus EPS estimates have on HOLT cash flow forecasts	CFROI Momentum Breadth: Ratio of positive to negative revisions to forecasted CFROI levels within a country Change in Momentum Breadth: Is CFROI momentum slowing or accelerating
Market Sentiment (Price Momentum)	How broad has positive price performance been in the country over the short and medium-term	Breadth of Short-term price momentum Breadth of Medium-Term price momentum
Valuation	Measures the attractiveness of the country from a valuation perspective relative to the rest of the market and relative to the country's history	Absolute Valuation: relative to the rest of the global equity market is the country over or under valued Relative Valuation: Relative to the country's history, is it cheap or expensive

Source: Credit Suisse Trading Strategy

The Credit Suisse HOLT Country Ranking Model provides investors with a monthly index ranking of the MSCI AC World countries using a rules-based systematic process. HOLT has developed a multi-factor model based on Valuation, Market sentiment and CFROI® sentiment to rank countries monthly. We found that this model helps to explain a country's performance over time.

The Valuation ranking, which accounts for 1/3 of the country's overall rank, measures of the attractiveness of the country based on its aggregate intrinsic and relative valuation:

- Intrinsic value is based on an index weighted-average of HOLT default DCF valuations for the stocks in the country.
- Relative value measures the country's potential upside/downside assuming the cash yield of the country reverts to its 10-year median level.

The Market and CFROI Sentiment rankings each represent 1/3 of the country's overall rank and are based on the breadth measures of changes in price and forecasted CFROI:

- Market sentiment measures the long-term as well as the short-term price sentiment of the stocks in the country.
- CFROI sentiment measures the monthly trend as well as the cumulative changes in future cash-flow returns across the countries based on I/B/E/S consensus earnings estimates.

The Overall ranking of the countries is a combination of the ranked valuation, market sentiment, and CFROI sentiment.

### Weighting and rebalancing

Ranking updates and portfolio rebalancing will occur on a monthly basis within the first 10 business days of the month.

Top 10: At each monthly rebalance, the top 5 ranked countries according to the country ranking model will each be weighted at 12%. The next 5 highest ranked countries will be weighted at 8%.

### ETP selection

Country ETPs will be primarily selected based on the following considerations:

- U.S. listed
- Benchmark and composition of ETP
- Liquidity (both on-screen and underlying liquidity will be taken into consideration)
- Trading bid and offer spreads
- Fees/costs incurred holding the ETP (expense ratio, turnover, etc)
- For the purposes of minimizing turnover, we generally will keep existing product choices barring significant developments that warrant a change.

#### More than one right choice

When there are multiple choices for a country in the portfolio, we consider a number of variables, including liquidity, tradability and suitability of exposures (note that HOLT country rankings are determined using MSCI indices).

However, all of these factors can be of different importance to different investors – not to mention there are multiple ways to measure these factors.

We fully acknowledge certain products may be better suited for specific investors depending on benchmark, exposure, fee preferences, and other factors.

## CREDIT SUISSE QUANTITATIVE & STRATEGY TEAMS

To discuss these and other ideas, please contact:

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