AJBell Investcentre

Fundamentals with Tom Selby

October 2016

Hello, I'm Tom Selby, AJ Bell's Senior Analyst, and welcome to Fund-amentals, where I'm going to look at the third-most popular Exchange-Traded Fund on the AJ Bell Investcentre platform right now, namely Powershares NASDAQ-100.

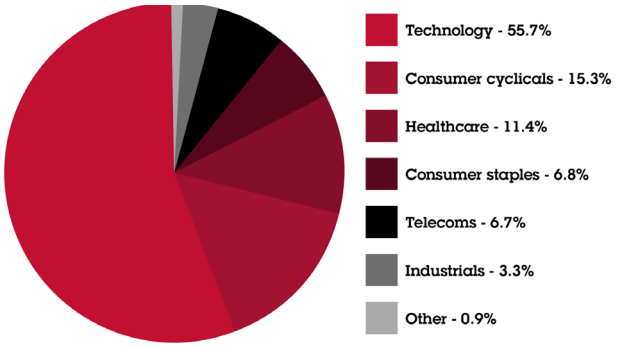
[CAPTION - Powershares EQQQ NASDAQ-100 UCITS ETF (GBP) EPIC code – EQQQ SEDOL – B0GL4T3 ISIN – IE0032077012]

This tracker product is an ETF – or Exchange-Traded Fund. It is designed to track and deliver the performance of the underlying index. In this case the tracker follows America's NASDAQ 100. As its name suggests this market-cap weighted fund follows 100 of the largest firms quoted on the US NASDAQ exchange, but it specifically excludes financial stocks – something we'll come back to later.

Powershares NASDAQ-100 uses physical – or direct – replication to generate performance. This means that it owns the underlying stocks.

The five biggest stocks in the underlying index are Apple, Microsoft, Amazon, Facebook and Alphabet and in the top 10 you have 8 tech stocks, 1 media-cum telecoms firm (Comcast) and 1 healthcare stock (Amgen).

Given NASDAQ's bias toward tech and biotech this is hardly a surprise and those two areas represent two-thirds of the tracker's £1.1 billion in assets under administration. Utilities, energy, real estate and financial stocks come to less than 1% of the assets between them:



Source: Invesco Powershares factsheet, Morningstar

The product, which began trading in 2002, comes with an ongoing charge figure of 0.15%, which is competitive by anyone's standard. For those who care about such things, the tracker comes with a five-star rating from Morningstar.

So those are the mechanics of the instrument. The next question to address is why would advisers and clients potentially be buying now, besides the low cost?

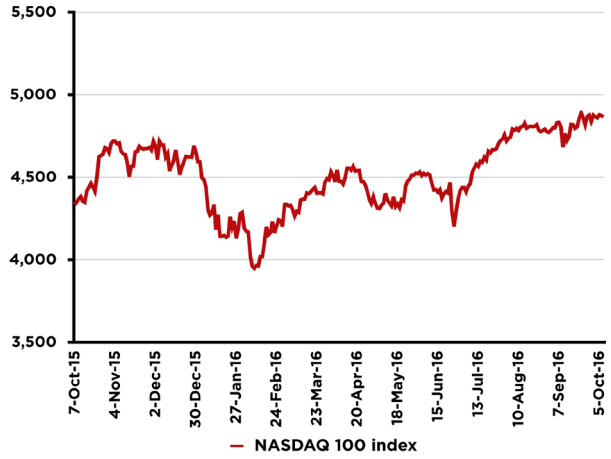
Well, I think there are two main reasons:

- First, overseas exposure is desirable as the pound continues to go through the floor, especially against the dollar. Even excluding the early October flash crash, sterling is trading near 30-year lows against the greenback and this automatically increases the value of dollar assets in pound terms – assuming those assets themselves do not see any price changes, of course. Advisers and clients who fear a further slide in sterling may just be looking to park cash outside of the UK.

Source: Invesco Powershares factsheet, Morningstar

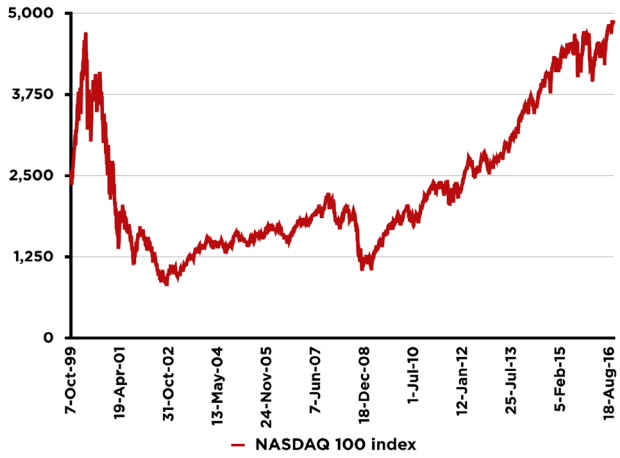
- Second, we still seem to be stuck in a growth challenged world and this tracker looks to deliver the performance of some pretty high octane stocks. Although it does offer a yield of around 0.8%, paid in four quarterly dividends, the emphasis here is on growth and capital appreciation – and firms who can generate consistent increases in earnings and cashflow in this difficult environment are likely to be highly prized.

According to the Invesco Powershares factsheet the average return on equity generated by the underlying holdings is north of 20%, which is good going and as we can see from the chart of the NASDAQ 100, it's been going well over the last 12 months.



Source: Thomson Reuters Datastream

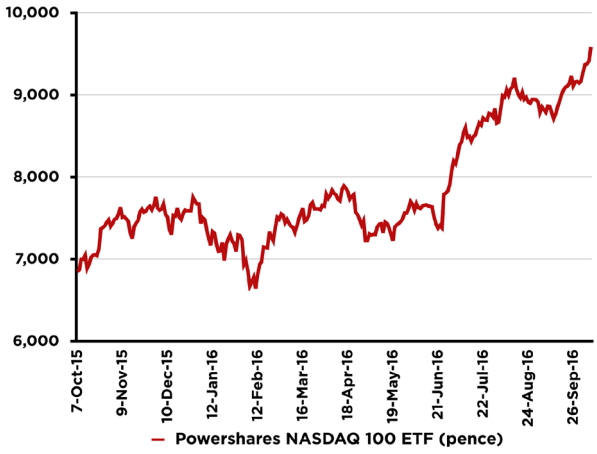
In fact, if we go further back, we can see that the benchmark index has rocketed back to levels last seen at the very peak of the tech, media and telecoms bubble in 2000.



Source: Thomson Reuters Datastream

Growth is the key here, but there are clear risks. The yield is skinny and tech and biotech stocks are notoriously volatile, not least as the market is often happy to pay lofty valuations to access their growth potential – this works well when that growth comes but it can be dangerous when it doesn't.

According to Invesco Powershares the average price/earnings multiple of the index constituents is 21 times, a big premium to the 16 or so times for the broader US markets. That leaves little margin of safety if anything goes wrong and the ETF's own 12-month performance, shown in the final chart, does show that the going can get pretty choppy



Source: Thomson Reuters Datastream

This one is therefore best suited to risk-tolerant, capital gain seekers who are happy to go with momentum stocks. Any advisers seeking income or value may have to look elsewhere.

Thank you for watching and I look forward to seeing you next time.

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