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Expert's View

What Tesla's entry into the S&P 500 means for investors

Tesla's inclusion in the S&P 500 speaks to how far the car industry has shifted in recent years. The electric vehicle maker is likely to be 2020's best-performing US blue-chip, and its staggering performance since the beginning of the year has been a key support of the performance of many indices. In this Expert's View we analyse the drivers of Tesla's performance ahead of its S&P 500 inclusion, along with a comprehensive index performance analysis of MSCI USA vs. S&P 500.

Facts and overview

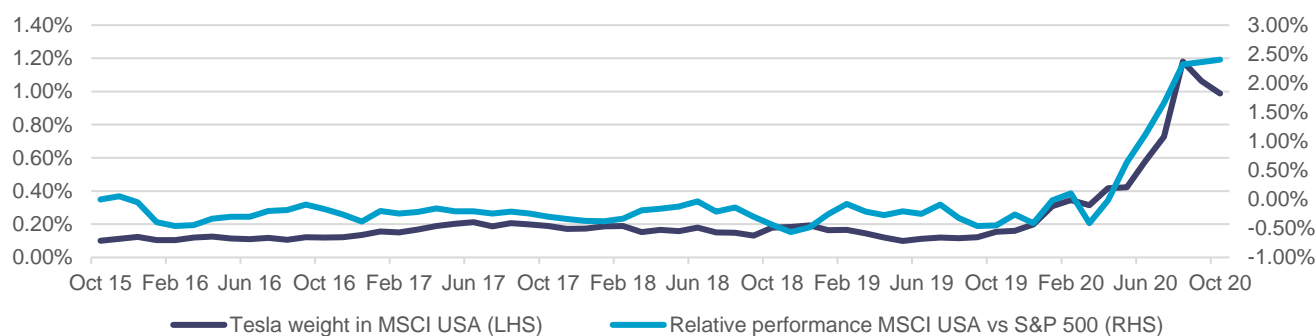
- ▶ **Tesla's inclusion in the S&P 500 like no other:** We estimate that Tesla's index weight in the S&P 500 may end up closer to 1.3%, turning it into the S&P 500's seventh or eighth largest company.
- ▶ **\$94bn potential market impact:** We estimate that flows from index funds into Tesla could add up to \$68bn when the stock is included. Moreover, if we assume that half of the active funds without an exposure to Tesla would decide to invest, this could represent an additional \$26bn. Such market flow would **add another 20% to Tesla's current market capitalisation.**

Our key takeaways

- ▶ **MSCI USA vs S&P 500 active risk performance analysis:** The key drivers are the Size (MSCI USA holds greater exposure to small cap) and Momentum style factors.
- ▶ **Quantifying Tesla's influence:** The fact that Tesla was only included in MSCI USA has been a source of outperformance for the index. Tesla has been by far the largest contributor to MSCI USA's performance this year.
- ▶ We expect S&P 500's underperformance vs. MSCI USA to narrow once the Tesla inclusion effects fade.

Tesla has driven MSCI USA outperformance this year

MSCI USA vs S&P 500 relative performance and Tesla's weight



Source: S&P, MSCI, Bloomberg LP, Lyxor International Asset Management as at 30/10/2020
Past performance is not a reliable indicator of future performance

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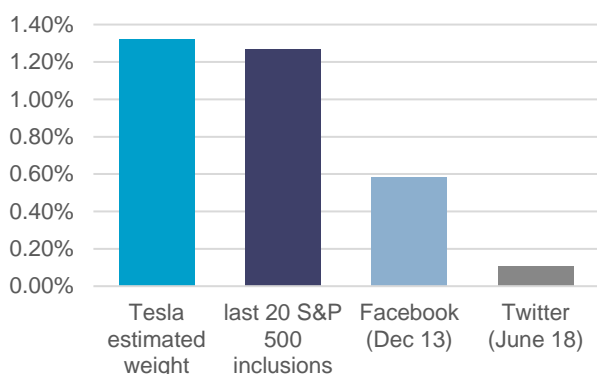
Tesla to enter the S&P 500 club with a bang

The announcement that leading electric vehicle maker Tesla will enter the S&P 500 on 21 December has held markets' attention. Firms included in the S&P 500 index usually exhibit a large increase in earnings, appreciation in market value, and positive price momentum in the period ahead of the index inclusion.

Expectations about Tesla's inclusion have certainly supported some of the more than six-fold stock rally since the beginning of the year. Many market participants will have to adjust their portfolios, including forced purchases for index-tracking investors and mutual funds. The more valuable the electric vehicle maker becomes the more shares index funds will have to buy.

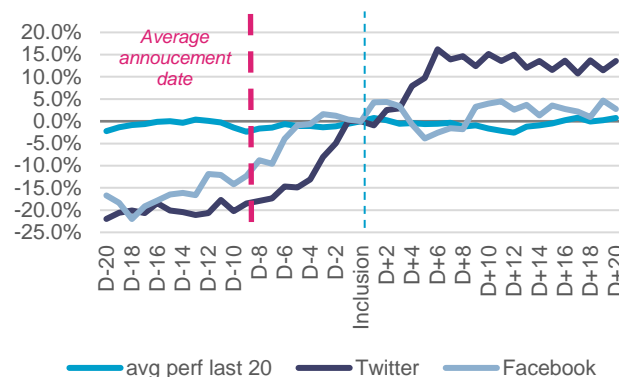
Tesla will be in the S&P500's top 10

Tesla's estimated weight vs previous S&P 500 inclusions



Index inclusion can be good for performance

Performance of notable S&P 500 candidates around inclusion day (in %, base date = inclusion day)



Tesla estimated weight based on Tesla's free float/ S&P total market capitalisation. Cumulative weight of S&P 500's last 20 inclusions. All data based on stock weight on day of inclusion. Source: S&P, Bloomberg LP, Lyxor International Asset Management as of 24/11/2020 Past performance is not a reliable indicator of future performance

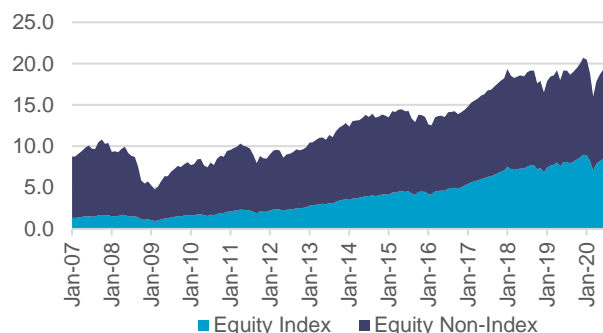
When Tesla's index announcement was made on 16 November, S&P estimated an index weighting around 1%. However, since then, Tesla's market capitalisation has soared by 38% and the company is now worth more than \$543bn, just shy of Berkshire Hathaway's \$547bn market capitalisation (data as at 25/11/2020). Based on Tesla's current free float, we estimate that its index weight in the S&P 500 may well end up closer to 1.3%, turning it immediately into the S&P 500's seventh or eighth largest company.

\$94bn potential market impact

Index fund requirements to include stocks after inclusion can create additional price effects, particularly when a company is added to a popular market index. Many investors question the potential market impact of the announcement considering the steady growth in the passive investment industry over recent years, and the stock's staggering rally since the announcement of the inclusion.

Equity index funds' AuMs growth has been steady

Total AuMs of equity funds (in USD trn)



Universe covered: Worldwide Open End funds & ETF ex FoF ex Feeder, Include Obsolete Funds. Sources: Morningstar, Lyxor International Asset Management, Data as at 24/11/2020. Past performance is not a reliable indicator of future returns.

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Focusing on S&P 500's holdings, S&P DJI estimated in late 2019¹ that over \$11.2trn of assets were indexed or benchmarked to the S&P 500 alone, of which at least 40% were held by index funds or ETFs (\$4.6trn). This compares to less than 30% of total S&P 500 assets back in 2015. Between 2015 and 2019, index funds holdings of S&P 500 have more than doubled. Current holdings of funds tracking the S&P 500 can conservatively be estimated (excluding 2020's inflows) at around \$5.2trn, when considering the index 14.23% YTD total return.

Based on this data we estimate that **flows from index funds into Tesla could add up to \$68bn** when the stock is included (1.3% of \$5.2trn = \$68bn). Additionally, around \$6.6trn of funds are considered 'benchmark' to the S&P 500. Out of a total of 1584 funds², we find that 965 have currently no exposure to Tesla (61%). If we assume that half of the funds without an exposure to Tesla would decide to invest, this could **represent an additional \$26 Bn** (61%/ 2 * \$6.6trn * 1.3%).

Therefore, we estimate the total impact on **Tesla's market capitalisation around \$94bn**, roughly a fifth of its current market capitalisation.

Index analysis: S&P 500 vs. MSCI USA

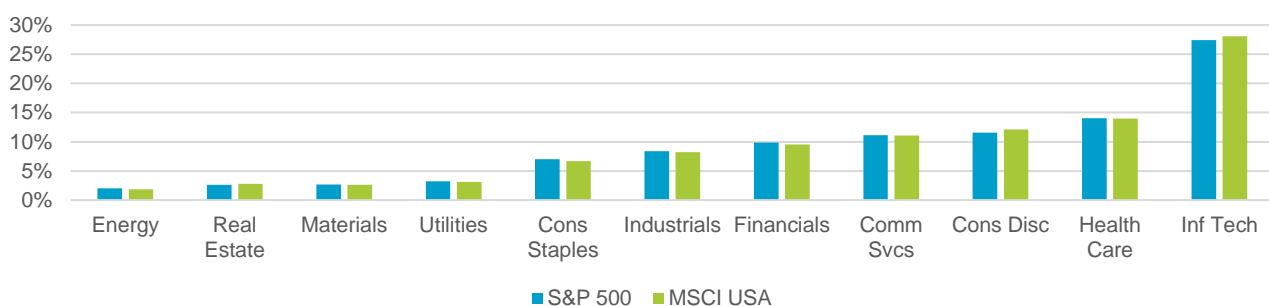
Tesla has been a part of the MSCI USA index since 2010. In this section we compare MSCI USA's performance with the S&P 500 to quantify the stock's influence on the overall index's performance.

*Index overview***Top 10 constituents in % market value**

Top 10 S&P 500		Top 10 MSCI USA	
Apple Inc	6.45	Apple Inc	6.48
Microsoft Corp	5.65	Microsoft Corp	5.01
Amazon.com Inc	4.77	Amazon.com Inc	4.42
Alphabet Inc	3.55	Alphabet Inc	3.35
Facebook Inc	2.33	Facebook Inc	2.17
Berkshire Hathaway Inc	1.48	Johnson & Johnson	1.24
Johnson & Johnson	1.33	Procter & Gamble Co/The	1.17
Procter & Gamble Co/The	1.26	NVIDIA Corp	1.06
NVIDIA Corp	1.14	Visa Inc	1.05
Visa Inc	1.13	JPMorgan Chase & Co	1.03

Comparable sector breakdown

GICS sectors Level 1 breakdown, in % market value



Source: S&P, MSCI, Bloomberg LP, Lyxor International Asset Management as at 30/10/2020
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¹ S&P, "Annual Survey of Assets", 31/12/2019

² Source Bloomberg, Lyxor Asset Management, data as at 26/11/2020. Analysis based on Bloomberg data on Equity funds with AUM > 100 M, with US as geographic focus.

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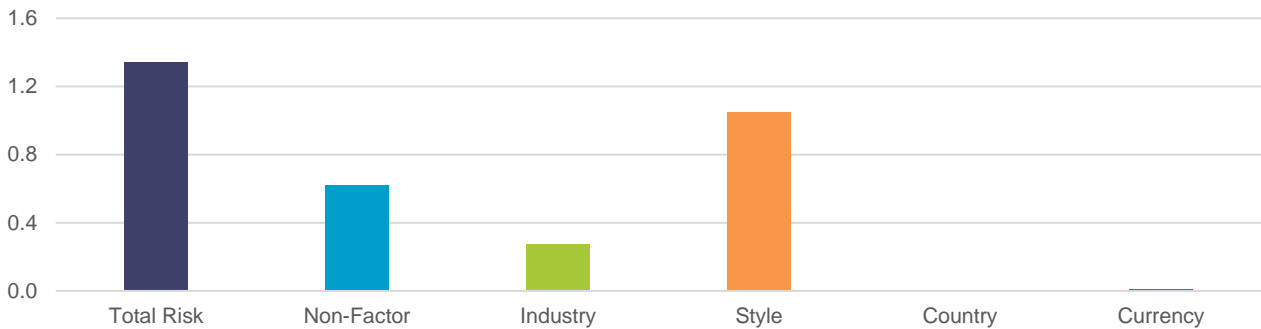
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Active risk analysis

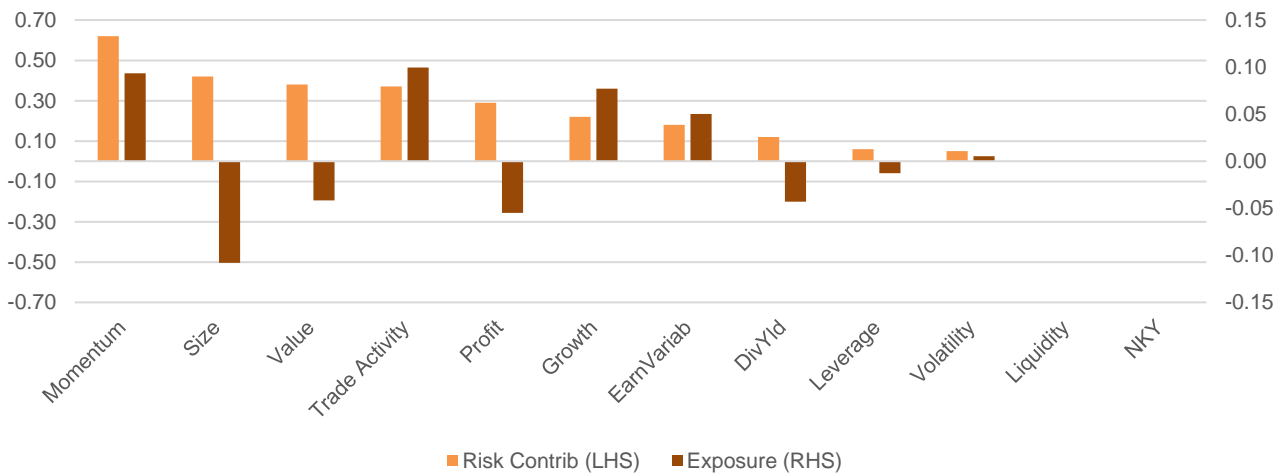
Active risk decomposition³

MSCI USA vs S&P 500 in %



Momentum and size have been key drivers in MSCI USA's performance

Active style risk decomposition, in %

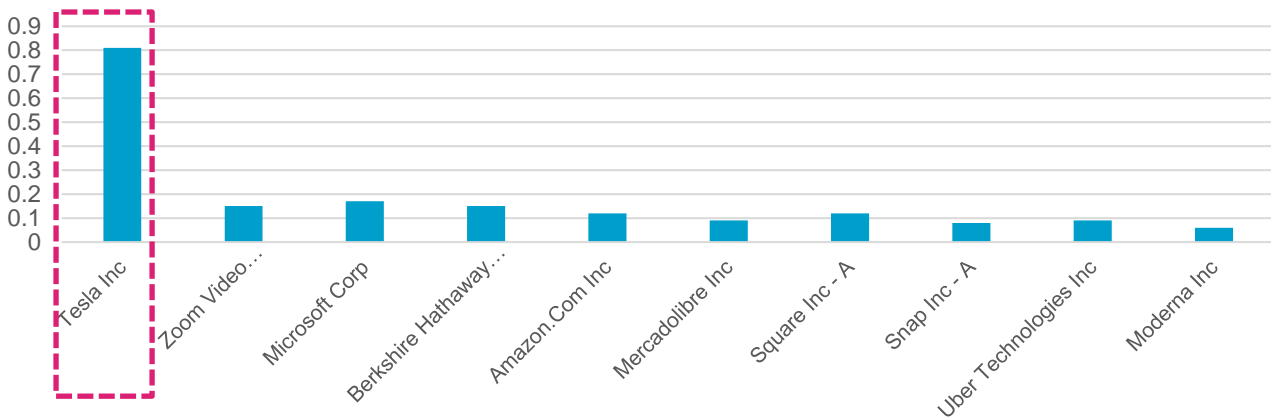


Source: S&P, Bloomberg LP, Lyxor International Asset Management as of 30/10/2020
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³ Ex-ante Tracking error, more details available in the Glossary p.7 ("Active Risk decomposition analysis")

Tesla is the main contributor to the Non-Factor bucket of the active risk by far

Active risk decomposition by single stock, in %



Source: S&P, Bloomberg LP, Lyxor International Asset Management as of 30/10/2020
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*Performance attribution analysis***MSCI USA Performance attribution by components***GICS Sector Level 1 performance attribution, in %*

	Allocation	Selection	Total
Total	0.20	2.01	2.20
Cons Disc	0.08	1.04	1.13
Inf Tech	0.04	0.45	0.48
Health Care	0.01	0.24	0.25
Comm Svcs	0.00	0.24	0.24
Energy	0.10	0.00	0.11
Industrials	-0.01	0.12	0.11
Cons Staples	0.01	-0.01	0.00
Materials	-0.01	0.00	-0.01
Utilities	0.01	-0.02	-0.01
Financials	0.00	-0.03	-0.03
Real Estate	-0.03	-0.04	-0.07

Top 10 positive contributors to outperformance in %

	Avg wgt in Index	Avg wgt diff.	Total return	Active return
Tesla Inc	0.62	0.62	0.00	1.02
Square Inc	0.13	0.13	0.00	0.16
MercadoLibre Inc	0.14	0.14	0.00	0.12
DexCom Inc	0.11	0.03	-23.11	0.09
Snap Inc	0.06	0.06	0.00	0.08
Twilio Inc	0.08	0.08	0.00	0.08
Zoom Video Communications Inc	0.09	0.09	0.00	0.07
Berkshire Hathaway Inc	0.99	-0.53	0.23	0.07
Trade Desk Inc/The	0.04	0.04	0.00	0.07
DocuSign Inc	0.08	0.08	0.00	0.06

Source: S&P, Bloomberg LP, Lyxor International Asset Management as at 30/10/2020

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1. Total takes into account Allocation and Selection effect but also the Currency effect

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Glossary

Active Risk decomposition analysis

Analysis of the index ex-ante risk (i.e. predicted tracking error). Tracking errors are annualised volatilities of active returns, expressed in percentages. The analysis can give two sets of information:

- It can decompose this tracking error into isolated tracking errors (Risk contributions) attributed to different risk model factors and Non-factor (i.e. stock picking). The factors used are driven by the risk model of choice. Generally speaking, for equities these include the market, country, industry and style factors. For fixed income, these include curve and spread factors. For global portfolios, it also includes currency factors.
- It can also give you the active exposure of the index to a specific factor.

This analysis can be drilled down into sub factors (see Style sub factors definition below).

Total return performance attribution

Allocation effect: active return that can be attributed to asset allocation bets (e.g. under or overweighting a specific sector). It is the difference between the portfolio and benchmark sector weights times the difference between the benchmark and the benchmark total return.

Currency effect: active return that can be attributed to currency allocation bets (e.g. under or overweighting a currency).

Selection effect: active return that can be attributed to security selection within a specific sector (e.g. choosing different securities within a grouping from those in the benchmark). It is the difference between the portfolio and benchmark sectorial returns times the benchmark sector weights.

Interaction effect: active return that can be attributed to simultaneously making both an allocation and security selection bet. In this analysis, this term is added to allocation effect for simplicity purposes.

Residual: the unexplained segment of the relative excess return between the index and the benchmark (e.g. not explained by the attribution performance).

Total attribution: total active return. It is equal to the sum of the allocation, selection, intersection and currency effects.

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Bloomberg Style sub factors definitions

Style factor	Definition	Calculation
Momentum	Separates stocks that have outperformed over the past year and those that have underperformed.	Cumulative return over one year (averaged), skipping the most recent two weeks to mitigate the price reversal effect.
Value	Composite metric that differentiates "rich" and "cheap" stocks. Bloomberg combines fundamental and analyst consensus data to calculate this factor.	Combination of the following descriptors: <ul style="list-style-type: none"> • Book to Price (13%) • Earnings to Price (19%) • Cash Flow to Price (18%) • Sales / EV (10%) • EBITDA / EV (21%) • Forecast Earnings to Price (19%)
Dividend Yield (DivYld)	Another dimension of value, but distinct enough to be a standalone factor.	Most recently announced net dividend (annualised) divided by the current market price.
Size	Composite metric distinguishing between large and small stocks.	Combination of the following descriptors: <ul style="list-style-type: none"> • log(Market Capitalisation) (31%) • log(Sales) (34%) • log(Total Assets) (35%)
Trading Activity	Turnover based measure. Bloomberg focuses on turnover which is trading volume normalised by shares outstanding. This indirectly controls for the Size effect.	The exponential weighted average (EWMA) of the ratio of shares traded to shares outstanding (where the average is over 2 years - 504 trading days).
Earnings Variability (EarnVariab)	Gauges how consistent earnings, cash flows, and sales have been in recent years.	Combination of the following descriptors: <ul style="list-style-type: none"> • Earnings Volatility to Total Assets (34%) • Cash Flow Volatility to Total Assets (35%) • Sales Volatility to Total Assets (31%)
Profitability (Profit)	Studies firms' profit margins to differentiate between money makers and money losers.	Combination of the following descriptors: <ul style="list-style-type: none"> • Return on Equity (26%) • Return on Assets (28%) • Return on Capital Employed (28%) • EBITDA Margin (18%)
Volatility	Differentiates more volatile stocks and less volatile ones by quantifying "volatile" from several different angles.	Combination of the following descriptors: <ul style="list-style-type: none"> • Rolling Volatility = Return volatility over latest 252 trading days (29%) • Rolling CAPM Beta = Regression coefficient from the rolling window regression of stock returns on local index returns (18%) • Historical Sigma = Residual volatility from the rolling window regression of stock returns on local index returns (28%) • Cumulative Range = The ratio of maximum and minimum stock price over the previous year (25%)
Growth	Aims to capture the difference between high and low growers by using historical fundamental and forward-looking analyst data.	Combination of the following descriptors: <ul style="list-style-type: none"> • Total Asset Growth (23%) • Sales Growth (25%) • Earnings Growth (18%) • Forecast of Earnings Growth (14%) • Forecast of Sales Growth (20%)
Leverage	Composite metric to gauge a firm's level of leverage.	Combination of the following descriptors: <ul style="list-style-type: none"> • Book Leverage (34%) • Market Leverage (33%) • Debt to Total Assets (33%)

Source: Bloomberg, Lyxor International Asset Management. For illustrative purpose only

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It is important for potential investors to evaluate the risks described below and in the fund prospectus on our website www.lyxoretf.com

Capital at risk

ETFs are tracking instruments: Their risk profile is similar to a direct investment in the Underlying index. Investors' capital is fully at risk and investors may not get back the amount originally invested.

Replication risk

The fund objectives might not be reached due to unexpected events on the underlying markets which will impact the index calculation and the efficient fund replication.

Counterparty risk

With synthetic ETFs, investors are exposed to risks resulting from the use of an OTC swap with Societe Generale. In-line with UCITS guidelines, the exposure to Société Générale cannot exceed 10% of the total fund assets. Physically replicated ETFs may have counterparty risk if they use a securities lending programme

Underlying risk

The Underlying index of a Lyxor ETF may be complex and volatile. For example, when investing in commodities, the Underlying index is calculated with reference to commodity futures contracts exposing the investor to a liquidity risk linked to costs such as cost of carry and transportation. ETFs exposed to Emerging Markets carry a greater risk of potential loss than investment in Developed Markets as they are exposed to a wide range of unpredictable Emerging Market risks.

Currency risk

ETFs may be exposed to currency risk if the ETF is denominated in a currency different to that of the Underlying index they are tracking. This means that exchange rate fluctuations could have a negative or positive effect on returns.

Liquidity risk

Liquidity is provided by registered market-makers on the respective stock exchange where the ETF is listed, including Societe Generale. On exchange, liquidity may be limited as a result of a suspension in the underlying market represented by the Underlying index tracked by the ETF; a failure in the systems of one of the relevant stock exchanges, or other market-maker systems; or an abnormal trading situation or event.

Concentration risk

Thematic and Smart Beta ETFs select stocks or bonds for their portfolio from the original benchmark index. Where selection rules are extensive it can lead to a more concentrated portfolio where risk is spread over fewer stocks than the original benchmark.

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