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# The Investment Case for Online Retail

## Executive Summary

There are many reasons that online retail appears attractive from an investment standpoint. Online retail offers investors a growing global opportunity.<sup>1</sup> While growth has slowed for traditional brick-and-mortar retailers, online commerce continues to exhibit strong growth characteristics, gain market share, and expand globally. From our vantage point, competitive pricing, shopping convenience, greater product selection, and rapid delivery have made online commerce a disruptive technology that is here to stay. One of the key drivers contributing to this growth is expanding internet and mobile penetration, enabling more consumers to shop online anywhere and anytime. Future technological advancements in electronic payment, delivery, and virtual and augmented reality should continue to enhance the online shopping experience and further drive the expansion and growth of this investment theme.

## A Brief History of Online Retail

Online commerce has permanently transformed the retail sector and the way we shop for everything from books to office supplies to shoes and furniture. But how did it all begin?

The origins of online commerce pre-date the Internet age. Indeed, the first predecessor of online commerce was the mail order catalog. In the 1970's, protocols such as Electronic Data Interchange (EDI) and Electronic Funds Transfer (EFT) were created providing the infrastructure needed to support electronic transactions.

The British inventor Michael Aldrich<sup>2</sup> is credited with being the official "inventor of ecommerce" back in 1979. Aldrich connected a television and a telephone line and invented "teleshopping" or shopping at a distance. Meanwhile in the U.S., infomercials (paid television advertisements) were gaining in popularity, paving the way for the first cable home shopping channels. Finally, the Internet came along and changed the way we shop forever.

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<sup>1</sup> <https://www.emarketer.com/Article/Worldwide-Retail-Ecommerce-Sales-Will-Reach-1915-Trillion-This-Year/1014369>

<sup>2</sup> [http://www.aldricharchive.com/inventors\\_story.html](http://www.aldricharchive.com/inventors_story.html)

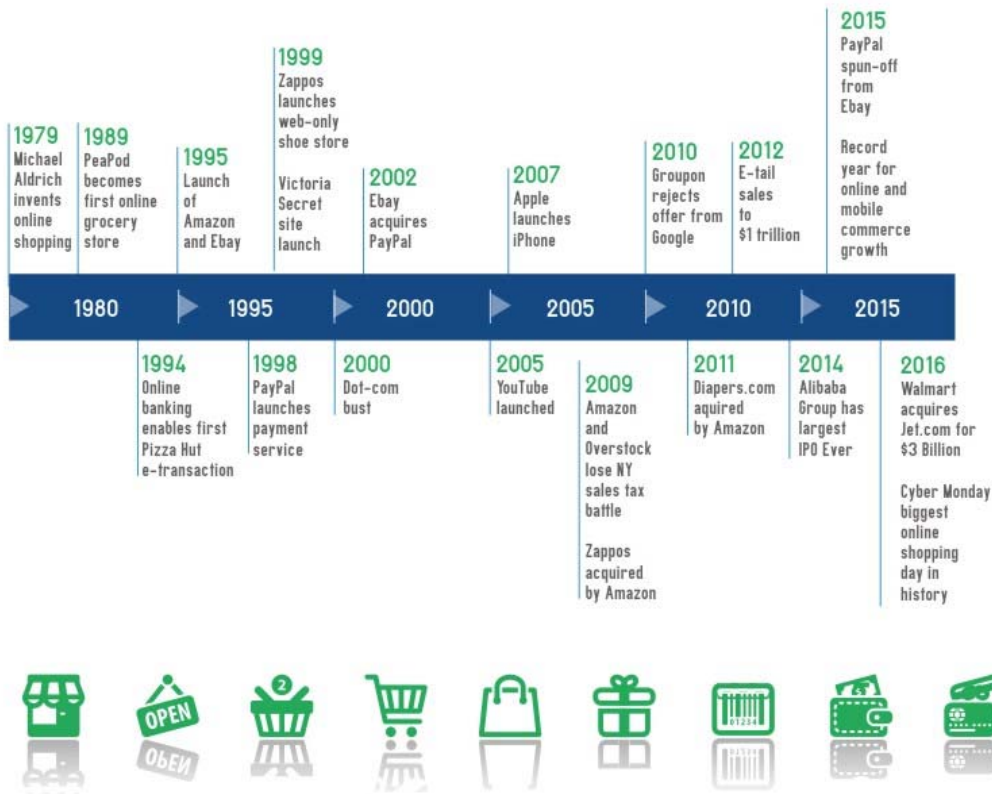
Here's a brief timeline highlighting some of the historical milestones that paved the way for modern day e-retail commerce:



# History of Online Retail

## Major Milestones

The evolution of events and ascent of ecommerce



Source: Internet Retailer, Wikipedia

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## Value Proposition

Certainly, one of the driving forces behind the growth of ecommerce is the valuable benefit it provides for the business, the end consumer, and society as a whole.

Business	Consumer	Society
Lower costs associated with not having a physical presence	Enhanced product selection	Less traffic and crowds
Automated inventory management	No geographic sourcing boundaries	Price competition and democratization of selection
Customer analytics	Competitive pricing, virtual auctions	Expanded access to rural areas
Unlimited geographic presence	Convenience of shopping from home, office, or mobile device 24/7/365	Shopping and delivery access for housebound consumers
Open for business 24/7/365	Time savings for consumer, one-stop shopping	Facilitated delivery of public services such as education and healthcare
Reduced advertising and marketing costs	Customer reviews and social input	Global in scope
Scalability, fewer employees	Delivery options	Eco-friendly

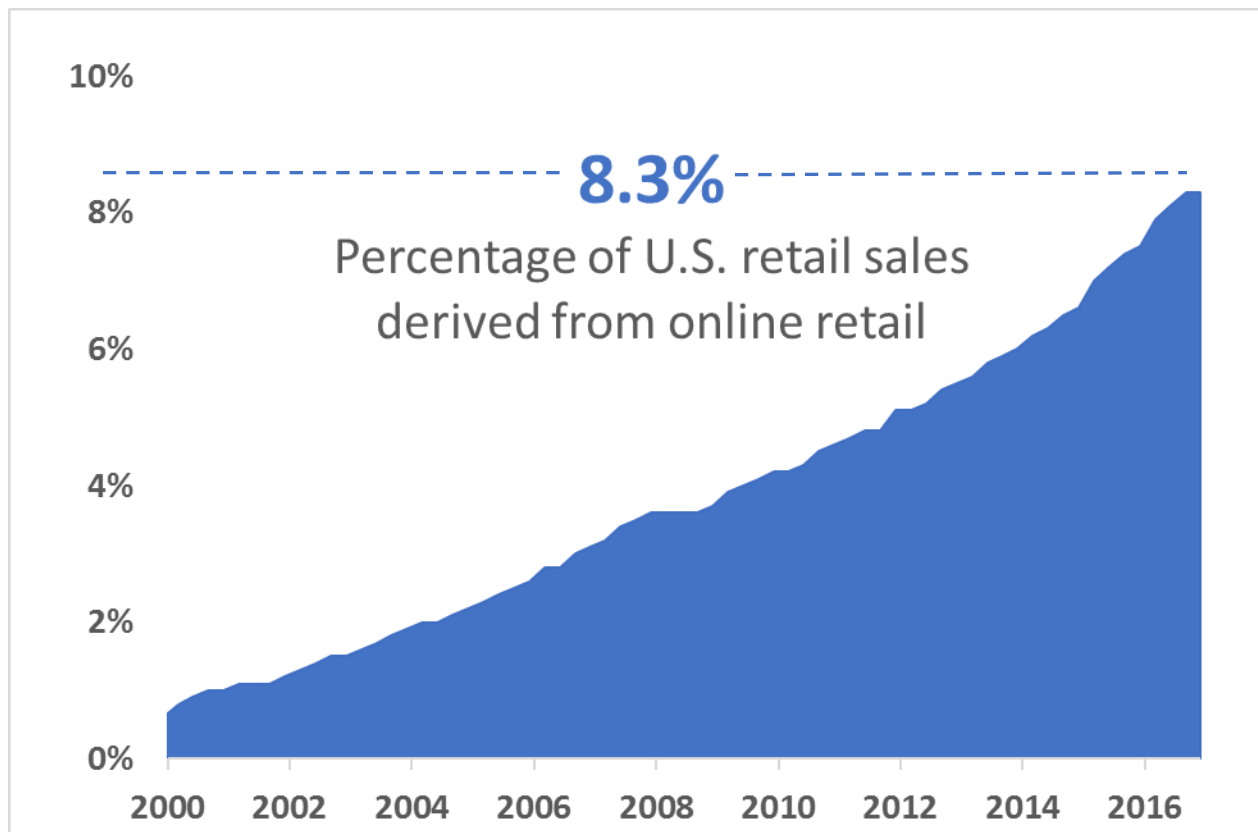
Source: EQM Indexes Research



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## Growing Global Opportunity

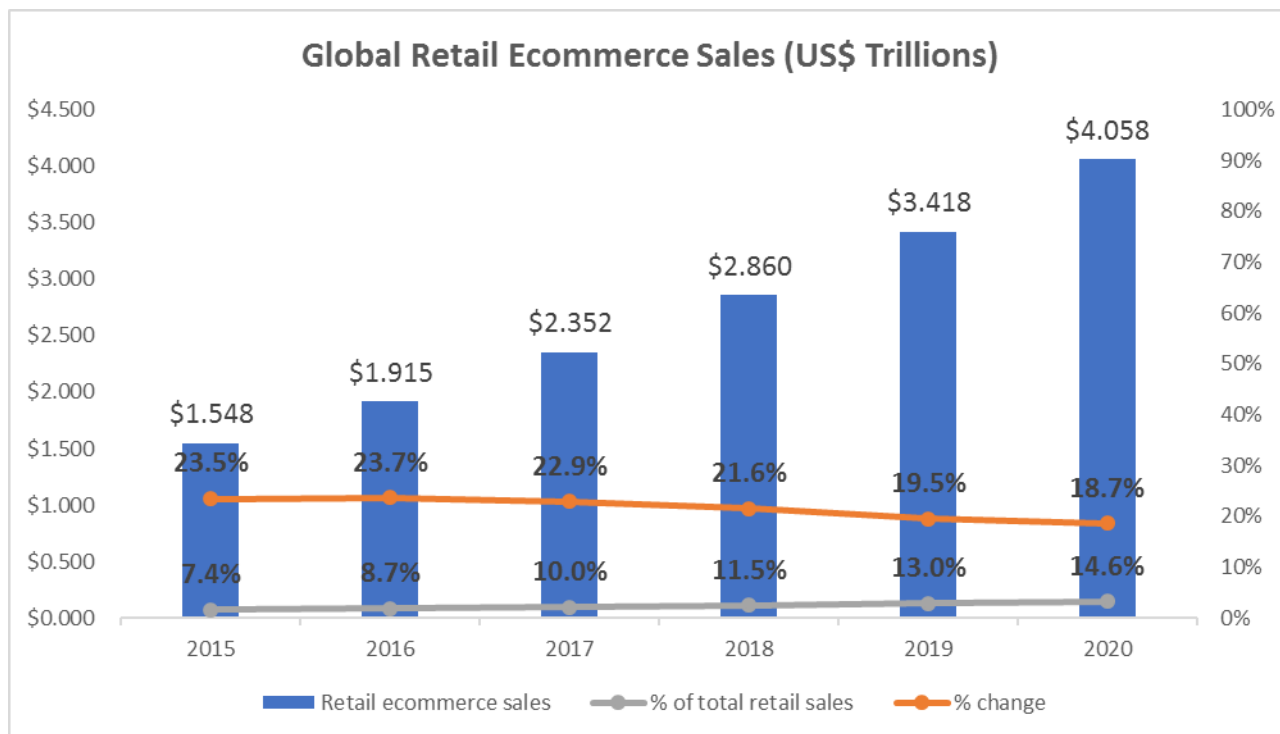
Given the superior benefits online and virtual commerce provide, it is no wonder it is also growing at a superior pace than traditional retail. In the U.S. ecommerce sales now represent 8.3% of total retail sales.



Source: U.S. Department of Commerce Quarterly Retail Ecommerce Sales 4th Quarter 2016, Reported 2/17/17

Globally ecommerce is growing at an even more rapid pace, with forecasted year-over-year percentage growth of 22.9% in 2017 according to market research firm eMarketer.<sup>3</sup> They project ecommerce sales will eclipse \$4 trillion by 2020.

<sup>3</sup> <https://www.emarketer.com/Chart/Retail-Ecommerce-Sales-Worldwide-2015-2020-trillions-change-of-total-retail-sales/194275>



Source: eMarketer, as of 8/1/16

While in the U.S. online retail sales comprise only 8.3% of total retail sales<sup>4</sup>, other large ecommerce markets such as the United Kingdom and China have a much higher proportion of online-to-total retail sales. Besides, the U.S., here are some of the other top global markets for ecommerce:<sup>5</sup>

**China** – China is the world’s biggest ecommerce market led by companies such as Alibaba Group, namely Taobao, Alibaba.com, Tmall, and others. With a 35% annual growth rate, China’s ecommerce market is also one of the fastest growing. Its \$340 billion in sales represents 15.9% of total retail sales.

**United Kingdom** – Despite its small size, the United Kingdom is a big player in the area of ecommerce, securing third position with \$99 billion in annual sales. Amazon UK, Argos, and Play.com are some of the U.K.’s biggest ecommerce sites and the country also has one of the highest ecommerce sales percentages at 14.5% of total retail sales.

<sup>4</sup> [https://www.census.gov/retail/mrts/www/data/pdf/ec\\_current.pdf](https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf)

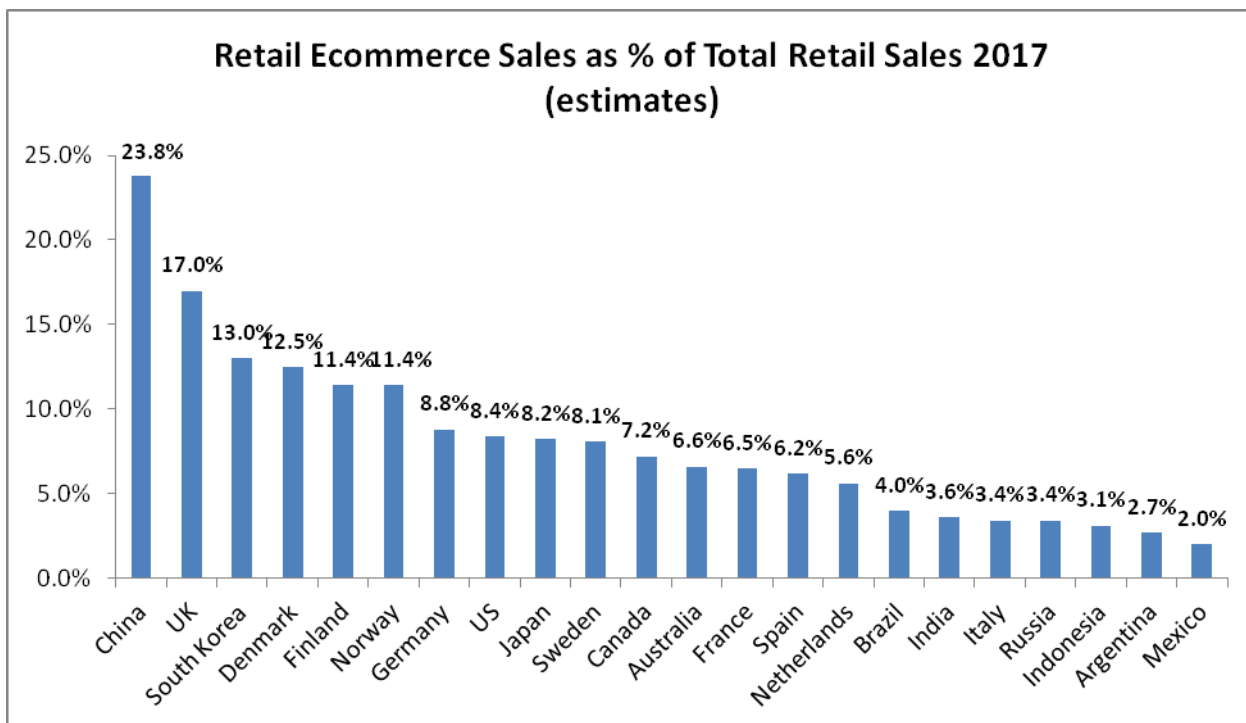
<sup>5</sup> <https://www.business.com/articles/10-of-the-largest-ecommerce-markets-in-the-world-b/>



**Japan** – Japan, the fourth largest ecommerce player in the world, is the leading mcommerce player. Rakuten is Japan’s leading ecommerce platform. Annual online sales are \$79 billion, which is 5.4% of total retail sales.


**Germany** – Germany is Europe’s second largest ecommerce market behind the U.K. And like the U.K., Amazon has a good foothold on the market in Germany. eBay has a large presence there as well. Annual online sales are \$73 billion or 8.4% of total retail sales.

The chart below forecasts the percent of online sales for 2017 in select countries around the globe. With perhaps the exception of China, global online retail penetration rates are still quite low as a percentage of total sales, suggesting this global retail phenomenon still has enormous potential for future global growth.



Source: eMarketer eTailWest 2016 Worldwide Ecommerce Report, as of 12/31/15

Ecommerce has emerged as a global shopping phenomenon, from Cyber Monday to Singles Day, here are some of the year's busiest online shopping days.



## Top Ten Global Spending Days

Online Retailers are Getting a Greater Share

Global e-commerce sales approached **\$2.0 trillion** in 2016. Thanks to its convenience, price, selection, and rapid delivery options, online shopping has transformed the way we shop. Here's a list of some of the biggest cyber shopping days around the globe.

GLOBAL SHOPPING CALENDAR

**JANUARY 1**  
**NEW YEAR'S DAY**

As the holiday shopping season comes to a close, many more shoppers are spending those gift cards online.

**FEBRUARY 8**  
**CHINESE NEW YEAR**

The Chinese New Year or Spring Festival is a 15-day holiday celebrated by a number of countries in Asia. Cleaning before the New Year is a tradition, followed by the need to shop for new purchases to ring in the new year.

**FEBRUARY 14**  
**VALENTINE'S DAY**

Western cultures celebrate with the purchase of flowers, chocolates, and jewelry. In 2016, a growing amount of "love dollars" were spent using mobile devices, with more than 20% of purchasers using smartphones, and 17% tablets.

**MARCH-MAY**  
**MOTHER'S DAY**

Originating in the U.S., Mother's Day is now celebrated around the world. In Brazil, it is the second most profitable day for retailers, driving more than 1 billion R\$ in online sales.

**MID-OCTOBER/NOVEMBER**  
**DIWALI**

India's 5-day Diwali festival celebrating the victory of light over darkness, has become a big online shopping period. The Festive Sale of 2016 saw a battle between Flipkart and Amazon for market share dominance.

**11.11**  
**SINGLES DAY**

Singles Day, China's 24-hour online shopping, once again smashed records in 2016, raking in \$17.8 billion USD of gross merchandise volume (GMV) for a 32% YOY increase.

**LATE NOVEMBER**  
**THANKSGIVING**

Thanksgiving Day marks the traditional start of the U.S. holiday shopping season. A growing number of shoppers are opting to stay home, eat turkey, watch football, and shop online. In 2016, U.S. online sales totaled \$1.3 billion.

**DAY AFTER THANKSGIVING**  
**BLACK FRIDAY**

Black Friday, the traditional U.S. holiday shopping day which falls the day after Thanksgiving, has now spread to many countries around the globe. The U.S. still led the way with a record \$2.0 billion in sales in 2016.

**MONDAY AFTER THANKSGIVING**  
**CYBER MONDAY**

Created originally to get more people to shop online, Cyber Monday has become the biggest U.S. online holiday shopping day of the year. In 2016, cyber sales were \$3.45 billion, the heaviest U.S. online spending day in history. For the first time, mobile sales surpassed the \$1 billion mark.

**DECEMBER 26**  
**BOXING DAY**

Boxing Day is traditionally a day synonymous with discounts and savings for UK consumers. Although online spend has increasingly become spread out throughout the entire holiday shopping season, Brits still spent an estimated £900 million online in 2016.

ONLINE COMMERCE

Since 2000, **75% of retail sales have occurred through online channels**, growing at an annual rate of 15%.

Sources: Adobe Digital Insights, eMarketer, National Retail Federation, Comscore, VoucherCodes.co.uk and the Centre for Retail Research, InternetRetailing.net, travelstraguide.com, PwC.

Not investment advice or a recommendation to buy or sell securities. Investors may not invest directly in an index.

Innovative. Transparent. Exposure.

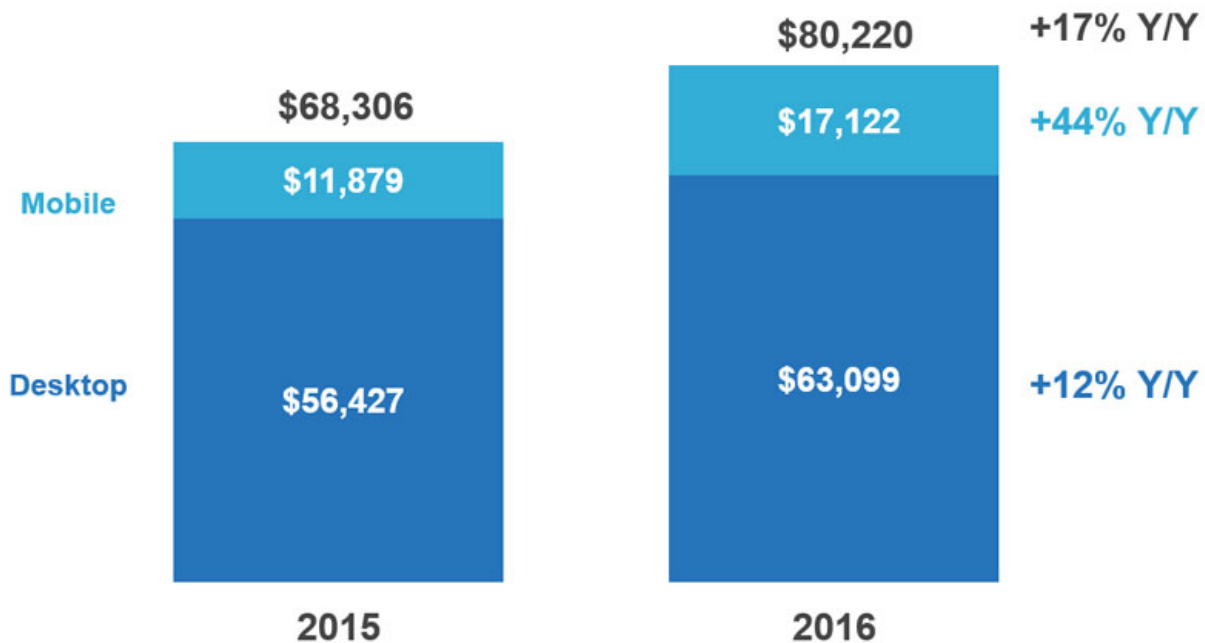


## Expanding Internet and Mobile Penetration

The 2016 holiday season will go down as the strongest mobile commerce holiday season on record. According to ComScore<sup>6</sup>, mobile commerce growth of 44% over a season ago helped drive online spending of \$80.2 billion during the November – December 2016 holiday season.

### Total Online Retail Spending for Full Holiday Season: 2016 vs. 2015

Source: comScore e-Commerce & m-Commerce Measurement, U.S.



Bigger screens, improved mobile shopping apps and secure payment options have helped encourage mobile commerce growth. Mobile is exploding as a shopping channel, not just from a traffic standpoint, but in terms of sales and dollar growth.

In 2017, U.S. consumer mobile engagement is expected to drive mobile commerce revenue to more than 30% of total ecommerce sales according to research firm eMarketer.<sup>7</sup>

Half the globe now has access to the Internet<sup>8</sup> and the opportunity set is rapidly expanding thanks to smart mobile devices that allow consumers to shop anywhere and anytime online. Thanks to the smartphone, internet access is expanding broadly around the world and is on an upward trajectory.

<sup>6</sup> <http://www.comscore.com/Insights/Blog/Mobile-Pushes-2016-Online-Holiday-Spending-Above-80-Billion>

<sup>7</sup> <https://www.emarketer.com/Article/Mcommerces-Rapid-Growth-Primarily-Coming-Smartphones/1013909>

<sup>8</sup> <http://www.internetworldstats.com/stats.htm>





## Technological Innovation

While mobile penetration is a big driver of current online retail growth, future technological innovations such as seamless methods of electronic payment, rapid delivery by drone, and virtual and augmented reality will take the online shopping experience to the next level and further drive market expansion and growth.

Many consider Uber the proverbial “gold standard”<sup>9</sup> for invisible payment that digital players want to replicate. In the future, payment will be something that just happens seamlessly in the background without much thought or input from the consumer.

Should the Amazon’s Prime Air delivery by drone<sup>10</sup> effort receive regulatory approval, purchases will be delivered to customers in 30 minutes or less. This would revolutionize the concept of rapid delivery and transform the online shopping experience.

Finally, virtual and augmented reality is another promising growth driver as online shopping aims to marry the “real-life” shopping experience with the convenience of ecommerce on smartphones, tablets, and computers. Virtual and augmented reality headsets targeting the consumer market<sup>11</sup> such as Facebook’s Oculus Rift and Microsoft’s HaloLens, will likely become tools used to virtually enhance the online shopping experience with virtual showrooms and realistic 3D views of merchandise.

## Investment Case

The rapid growth and expansion of retail ecommerce has led many to proclaim “the mall is dead.” Online shopping offers a wider selection of merchandise, better prices, and greater convenience.

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*“The mall isn’t dead, it has  
just moved online.”*

*– EQM Indexes*

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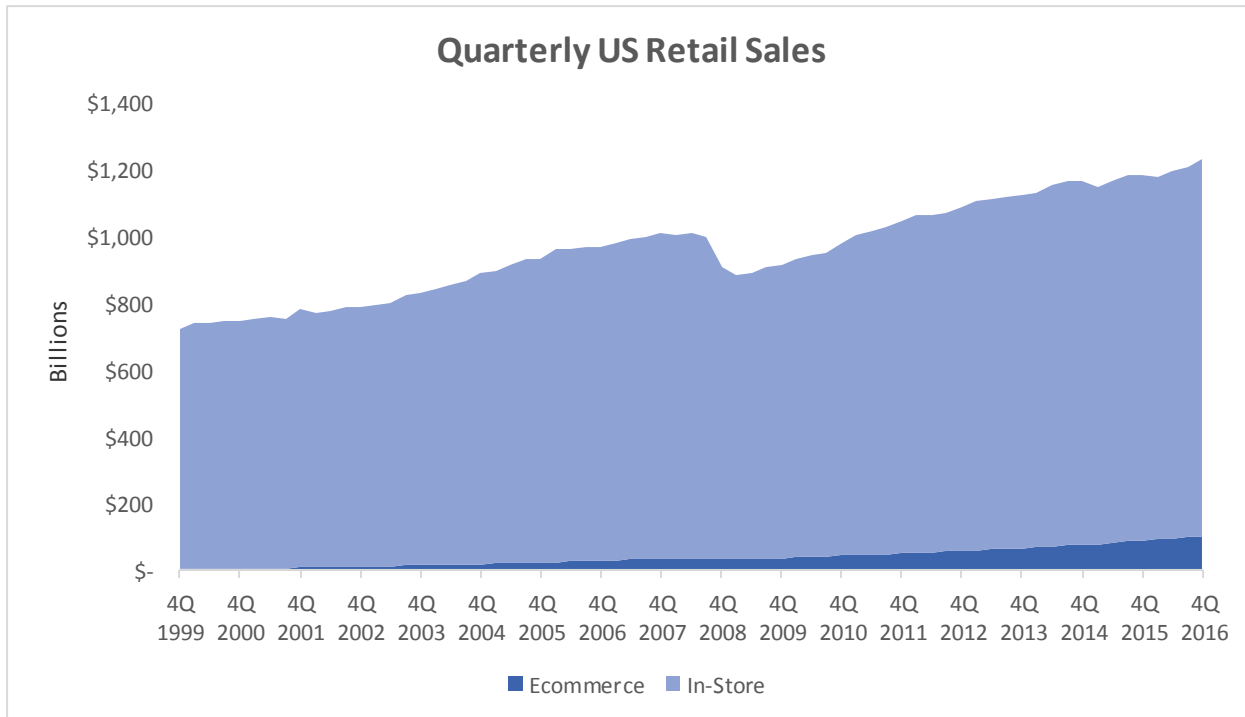
<sup>9</sup> <http://www.pymnts.com/in-depth/2015/mobile-payments-without-the-merchant-fuss/>

<sup>10</sup> <http://www.amazon.com/b?node=8037720011>

<sup>11</sup> <http://uk.reuters.com/article/britain-retail-trillennium-idUKL5N11726Y20150911>

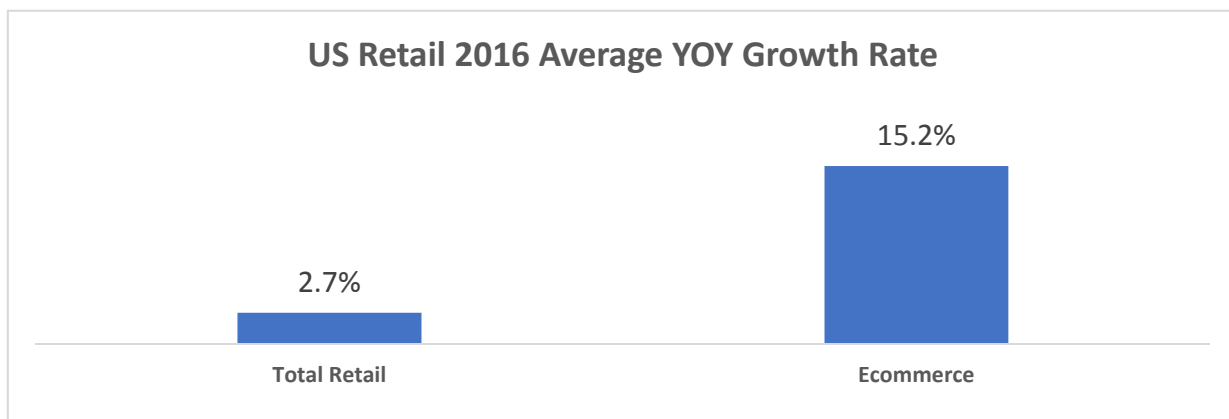


**Online retail may make up a small percentage of sales compared to in-store retail...**



Source: US Census Bureau as of 2/17/17, BI Intelligence

**...but nearly all growth in retail sales comes from online sales.**



Source: US Census Bureau as of 2/17/17

Explicit exposure to ecommerce retail may provide investors with access to superior growth characteristics than traditional brick-and-mortar retail holding. A universe of global online retail stocks, as represented by the EQM Online Retail Index, exhibits better long-term earnings estimates and sales growth characteristics relative to traditional retail indices and the market as a whole.

Growth Characteristic	EQM Online Retail Index	S&P Select Retail Index	S&P 500 Index
F12M Earnings Growth	<b>99.1%</b>	-20.1%	23.7%
F12M Long Term Growth	<b>17.2%</b>	7.4%	7.3%
F12M Sales Growth	<b>12.4%</b>	4.3%	7.9%

Source: Bloomberg Estimates as of 12/31/16

And, given the continued expansion of internet and mobile penetration and the introduction of new technological innovations that will further enhance the online shopping experience, online shopping should continue to grow globally at a superior rate.

Over the past year, the bifurcation in retail between the brick-and-mortar traditional retailers, “**the bricks**” and online retailers, “**the clicks**,” has been quite pronounced. U.S. retail bankruptcies skyrocketed in 2016, with the number of large-liability retail Chapter 11 filings (>\$250 million in liabilities) nearly doubling.<sup>12</sup> By the end of the first quarter of 2017, there were seven more bankruptcy files and more than 3,500 store closings with rumors of more filings and closures to come.

<sup>12</sup> <http://www.prnewswire.com/news-releases/us-retail-bankruptcies-skyrocket-in-2016-grim-outlook-for-the-industry-300401495.html>

1Q 2017 Retail Store Closures	#	Bankruptcy	Details
Payless Shoes	1,000	Y	
Radio Shack	552	Y	
The Limited	250		Closed all stores Jan 9 2017
Family Christian	240		
Wet Seal	171	Y	Closed all stores Jan 26
Crocs	160		
J.C.Penney	138		Starting April 2017
Chico	120		
BCBG Max Azria	120	Y	Early Spring
Kmart	108		Spring
American Apparel	104	Y	Closed all stores
Office Depot	100		
hhgregg	88	Y	
CVS	70		
Macy's	63		Early Spring
Guess	60		
Gander Mountain	60	Y	
Abercrombie & Fitch	60		As leases expire in 2017
American Eagle	50		150 over 3 years
Sears	42		Spring
Eastern Mountain	35		
<b>TOTAL</b>	<b>3,591</b>		

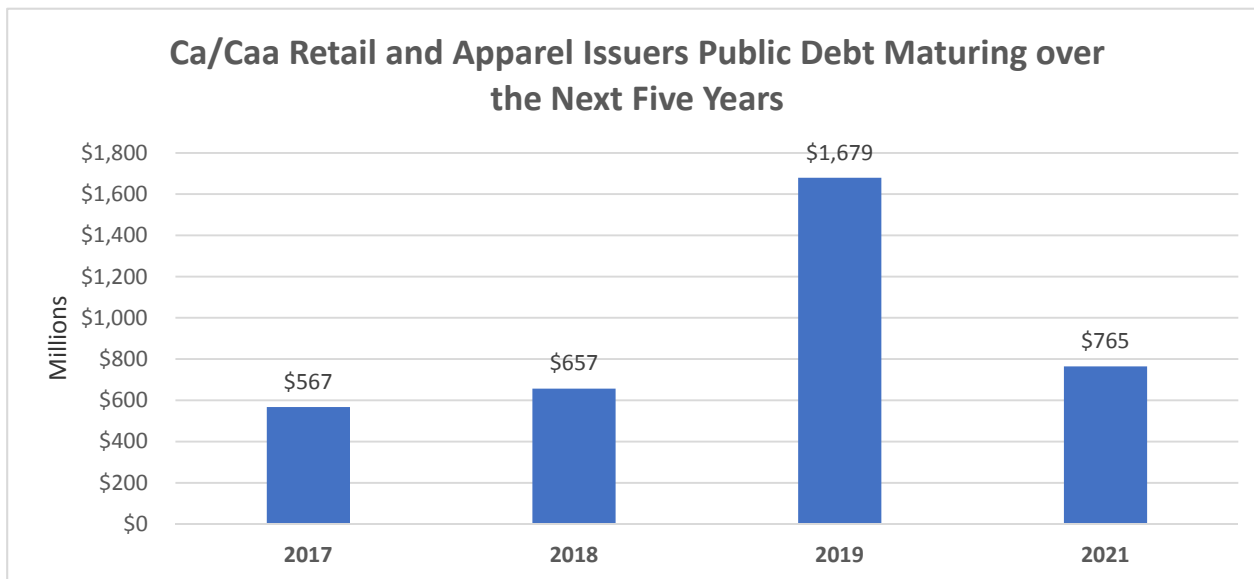
Source: *Forbes*<sup>13</sup>

According to credit rating agency Moody's, the number of distressed U.S. retailers is at the highest level since the Great Depression. Over the past six years, exacerbated by slowing sales and financial engineering, the number of retailers in the lowest credit tier has tripled, making up just over 13% of Moody's rated retail portfolio.<sup>14</sup> To make matters worse, \$3.7 billion of that public debt issuance is maturing over the next 5 years, suggesting that there is more trouble for brick-and-mortar and mall-based retailers ahead.

<sup>13</sup> <https://www.forbes.com/sites/walterloeb/2017/03/20/these-21-retailers-are-closing-3591-stores-who-is-next/#377e50574854>

<sup>14</sup> [https://www.moody.com/research/Moodys-Number-of-distressed-US-retailers-triples-since-the-Great--PR\\_362722](https://www.moody.com/research/Moodys-Number-of-distressed-US-retailers-triples-since-the-Great--PR_362722)





*Excludes private maturities, 2019 includes \$1 billion HoldCo PIK Notes for J Crew, 2020 only includes private data and is not shown. Source: Moody's Investors Service*

### Investment Vehicles

Despite the material transformation going on in retail and the seeming growth potential of online retail stocks, there were no investment vehicles available that provide explicit exposure to this investment theme. As depicted in the table below, existing retail and internet ETF's hold very few online retail stocks.

Only the Amplify Online Retail ETF (IBUY) which tracks the EQM Online Retail Index, has 100% dedicated online retail exposure. To be included in the Index, companies must derive at least 70% of their revenues from online and/or virtual transactions. The Index also includes a maximum exposure of 25% to international, providing exposure to several online retailers outside the U.S. as well.

Top holdings as of 3/31/17 include: Nutrisystem (NTRI), Land's End (LE), Netflix (NFLX), Wayfair (W), and eBay (EBAY).

ETF	Ticker	# of Online Retail Stocks	% Weight	AMZN % Weight	Non-US?
Amplify Online Retail ETF	IBUY	40	100.0%	3.5%	Y, 17
Consumer Discretionary Select Sector SDPR Fund	XLY	5	20.9%	14.0%	N
SPDR S&P Retail ETF	XRT	12	12.3%	1.1%	N
PowerShares Dynamic Retail Portfolio	PMR	0	N/A	N/A	N
Market Vectors Retail ETF	RTH	2	21.2%	16.8%	Y, 1
First Trust Dow Jones Internet Index Fund	FDN	7	25.7%	8.7%	N

as of 3/31/17

Furthermore, those ETF's that do have some exposure to online retail fall short in several respects. They are either U.S focused products and/or their online retail exposure is concentrated mostly in shares of Amazon as opposed to offering diversified exposure to a number of different online retail companies.

## Conclusion

In summary, in our view there are many reasons to own a basket of global stocks directly focused on online retail sales:

- ✓ Get explicit investment exposure to the fastest growing global segments of online commerce: online retail, online marketplace, and online travel
- ✓ Participate in the accelerating growth potential being fueled by mobile growth and user-interface innovation
- ✓ Gain access to online retail growth opportunities outside the U.S.

## ABOUT EQM INDEXES LLC

*EQM Indexes LLC is a woman-owned firm dedicated to creating and supporting innovative indexes that track growth industries and emerging investment themes. Co-founded by Jane Edmondson, a former Institutional Portfolio Manager with more than 25 years in the investment industry, our index design expertise spans a wide range of asset classes and financial instruments.*

*We partner with issuers and work jointly with other index firms to provide benchmarks for Exchange Traded Products (ETPs) such as Exchange Traded Funds (ETFs), Exchange Traded Notes (ETNs), and other similar products. EQM Indexes LLC also assists firms on a fee basis to design and implement their index ideas.*

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The EQM Indexes Online Retail Index™ (“IBUYXT” or the “Index”) seeks to track the combined performance of a basket of global stocks that derive significant revenue from online and virtual retail commerce including the online retail, online marketplace, and online travel market segments. The index is equal-weighted with a maximum of 25% of exposure to non-US stocks. American Depositary Receipts (“ADR’s”) will be utilized for non-US holdings where available provided they meet liquidity requirements. The Index was developed by and is the exclusive property and a trademark of EQM Indexes. EQM Indexes makes no express or implied warranties or representations with respect to the Index.

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### Definitions

**Ecommerce** - commercial transactions conducted electronically on the Internet.

**Virtual Commerce** - a type of application, service, or product feature that helps enterprises implement strategies and design Web sites for ecommerce (the buying and selling of goods and services using the Internet).

**Virtual Reality Headset** - is a device that you wear over your eyes like a pair of goggles. It blocks out all external light and shows you an image on high-definition screens in front of your eyes.

**Augmented Reality Headset** - is a device that you wear over your eyes like a pair of glasses. It is not totally immersive, but instead augments reality with images and/or data.