Amplify
EXCHANGE TRADED FUNDS

PARTNER INSIGHTS

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RETAIL IN THE MIDST OF DIGITAL DISRUPTION

Online is on the rise, while bricks-and-mortar are fading.

Brick-and-mortar retail stores—monoliths like Macy's, JCPenney, Sears, and Kmart as well as specialty shops like Abercrombie and Fitch and The Limited —are closing stores in 2017.

It's a sign of our digital times. Competitive pricing, increased selection, and convenience are drawing a record number of consumers to online retail. According to the National Retail Federation, 2016 holiday retail sales during November and December increased 4% over 2015 to $658 billion. That number includes $123 billion in 'non-store' sales, which were up 12% over the year before, illustrating that online is the driver of growth in retail.

While the growth story of online retail goes back more than 15 years, the growth of online retailers versus traditional retailers is diverging.

In this exclusive Q&A, Founder and CEO of Amplify ETFs Christian Magoon talks about retail ETF trends, and specifically why investors might consider an online retail ETF to complement their portfolio of traditional retail stocks.

Q. In the consumer discretionary sector, how have retail ETFs fared?

A. **Christian Magoon:** There are 19 ETFs as of February 28, 2017 that invest in the consumer discretionary sector. Retail ETFs are among the 19, and the two largest traditional retail ETFs have not been faring well because of their exposure to traditional brick-and-mortar retail companies.

As of December 2016, Amazon's market value alone is bigger than that of Walmart, Macy's, Best Buy, Target, Kohl's, Nordstrom, JCPenney, and Sears combined (according to data from Yahoo Finance and Google Finance). And Amazon is only one of many online retailers that are on the rise.

The problem with traditional retail ETFs is that they have very little exposure to online retail.

Q. Why is online retail outgrowing brick-and-mortar retail?

A. **Magoon:** Technology is reinventing the retail business and providing a massive advantage to companies that have the majority of their sales coming from online channels. Traditional retailers not only have massive real estate costs (rent/mortgage and taxes) but they also have increased labor costs.

To differentiate, they have to invest in excellent service, which is people-intensive—and costly.

The people-factor is comparatively lower at an online retailer. Online retail leverages technology (conveyor belts, computers, robotics). Consequently, the average worker's productivity is largely increased.

Q. What trends do you see shaping the online retail sector?

A. **Magoon:** There are several, and the first is that there should be an increase in marketplace sites, like Amazon and Alibaba, where people can purchase a lot of different types of products. For example, Walmart recently acquired Jet.com to boost their online marketplace experience.

Another is that there will be more highly specialized online retailers with unique brands and following, such as Pet Meds, 1-800 Flowers, or Lands' End. I also see specialty online retailers being scooped up by traditional retailers to boost their online presence. For example, Moose Jaw, an online retailer specializing in outdoor gear and apparel, was recently acquired by Walmart to boost their online presence for that type of merchandise.

Finally, I believe that omnichannels will continue to pop up. Stores with a strong online presence, like Amazon, will open physical locations for a more traditional store experience or for pickup of items purchased online.

Q. How is an omnichannel different than a traditional brick-and-mortar?

A. **Magoon:** Omnichannels create a frictionless online buying experience for consumers.

Amazon, for instance, is opening brick-and-mortar bookstores and concept grocery stores. Omnichannel stores allow customers to shop online but pick up their orders at their convenience. Some stores might have lockers where deliveries can be deposited and consumers can pick up merchandise with a simple scan of their phone. Physical stores also keep shipping costs down for consumers.

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Q. So as online retailers make the move to brick-and-mortar, will brick-and-mortars invest in online?

A. Magoon: Traditional brands like JCPenney will likely combine with online brands (like Walmart did with Jet.com). Part of the investment opportunity for online retailers is they will be acquisition targets for large retailers who need to reinvent themselves. You can't organically attract ecommerce talent to traditional companies like Sears or JCPenney. Their DNA isn't techy. To survive, brick-and-mortars have to be disruptive and buy some of these teams to get the tech talent in-house, in our opinion.

Q. Why would an investor buy an online retail ETF rather than simply buying stock in online retail companies?

A. Magoon: In a growing and merging industry like online retail, where things are always in flux, it is a challenge to identify the best stock to own. An online retail ETF takes away risk of figuring out the best 1, 2 or 3 stocks to own, and instead allows you to own a diversified basket—a market segment. That basket exposes you to the market leader (like Amazon), while also exposing you to the "the next Amazon," which may be in the U.S. or overseas.

It is a lot easier to be in the right market segment, than in the right stock.

Also, an ETF is convenient. A rules-based index does all the work for an investor in selecting its holdings. I like to think of it as an auto-pilot way to gain exposure in a market. Initial public offerings, mergers and acquisitions happen all the time that could change the portfolio.

As an individual investor, you don't have to monitor your exposure, because it is done via the index.

Q. What is distinct about the Amplify Online Retail ETF (Nasdaq: IBUY)?

A. Magoon: IBUY invests in companies with at least 70% of their sales derived online. It offers pure-play global exposure to online retail companies. IBUY follows a modified equal weight index (EQM Online Retail Index). This reduces company specific risk, because there isn't much concentration in any of the top ten holdings in the ETF (AmplifyETFs.com/IBUY).

Online shopping has permanently transformed the retail landscape, and we believe IBUY is one of the best ways to invest in this macro theme for the long run. ▲
