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Smart beta 2019

Smart beta causes revolution

Smart beta offers new investment angle

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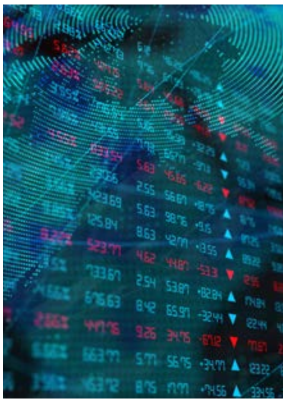

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Smart beta causes ETF revolution in the asset management industry

By Beverly Chandler

Latest figures from exchange traded fund (ETF) data provider ETFGI reveal that ETFs globally gathered net inflows of USD68.95 billion in June, bringing year-to-date net inflows to USD209.54 billion, and creating a new record of USD5.64 trillion in assets.

ETFs continue on their victory parade across the world's investments, as investors are increasingly attracted by their transparency, liquidity and their low fees.

The smart beta strategy, within the ETF eco-system, also continues to enjoy success, with Amundi detailing within this smart beta report what it calls the The Smart Beta ETF (r)evolution.

The firm writes that smart beta has created a revolution in the asset management industry over the past 10 years. By implementing factors in the underlying ETF portfolio, smart beta allows investors to implement investments with certain characteristics, such as value and momentum, designed to outperform the market.

As Amundi says, for many years, investors had no choice but to choose an active manager who selected those stocks with a particular characteristic.

Smart beta ETFs allow the investor to choose an ETF which will systematically select stocks with characteristics like low volatility and growth, or even combine factors, at lower cost, the firm says.

Data and index provider Morningstar has also examined the growth of strategic or smart beta ETFs. The firm found that at the end of 2018, there were 1,493 strategic-beta exchange-traded products, with collective assets under management of approximately USD797 billion worldwide.

Morningstar describes smart beta ETFs as a blend of active and passive funds, offering a happy mix of the outperformance of the former and the lower fees of the latter.

It is within smart beta ETFs that the investor can find sophisticated opportunities to access alpha and ideally outperformance of a market, and all through the ETF wrapper.

Growth in the sector has been driven by new cash inflows, new launches and the entrance of new players who often come from firms that offer active investment management, Morningstar says.

The amount of market share represented by smart beta has slowed though, with a decrease in new smart beta product launches and increasing pressure on fees.

That Morningstar study found that in 2018, the number of new product launches declined from the record level set in 2017. There were 132 new strategic-beta ETPs brought to market in 2018, down from 257 in 2017.

Morningstar feels that the decline speaks to the fact that the menu has been saturated. "This process of growth and maturation ultimately will lead to a culling of the herd, which has already begun in some countries, albeit to a limited extent.

"An increasingly crowded and competitive landscape will also continue to put pressure on fees. We have already seen instances of aggressive fee reductions for strategic-beta ETPs. We anticipate that cost competition in this space will become more prominent in the coming years," the firm writes.

Meanwhile, another study found that smart beta poses something of a conundrum

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Marc Zeitoun, Columbia Threadneedle

for financial advisers within the US. The study reported that most US financial advisers are familiar with the concept of smart beta, or strategic beta as the report calls it, but few feel confident in implementing it in client portfolios.

Columbia Threadneedle Investments' US survey reported that 98 per cent of advisers were familiar with the concept of smart beta, but just 36 per cent were confident in using it.

Interviewed for ETF Express, Marc Zeitoun, Head of Strategic Beta and Private Client Advisory at Columbia Threadneedle, reports that he was surprised by this survey's findings. Another finding was that less than half of the people could name their portfolio manager on their strategic beta ETFs. The survey reported that only 18 per cent of advisers could name most or all of the portfolio managers of ETFs they use, while 27 per cent of advisers can do the same for the actively managed funds they use in client portfolios.

Commenting on the difference between ETF users in the US and Europe, Zeitoun said: "I know from our European colleagues that smart beta is readily adopted at the institutional level and when you think about what is the institutional process – it's all about due diligence. We need to push that along the spectrum into wealth management," he says. "Advisers think price and tracking error are the only two salient points."

Other findings from the survey were that while few advisers (15 per cent) were

talking to clients about strategic beta today, more than half (52 per cent) of advisers familiar with strategic beta planned to use it when constructing client portfolios in the coming year.

Advisors rank enhancing portfolio diversification, incorporating factor-based investments and leveraging active manager insights in a passive product as their top three reasons for planning to use strategic beta in their clients' portfolios; just 4 per cent said lower fees were the driver for implementation.

Portfolio diversification is also part of what smart beta offers the ETF investor, whether institutional or retail.

Looking at the latest set of ETFGI data on the sales of ETFs globally, seven of the top ETPs by net new assets in 2019 were invested in gold or precious metals.

Thematic investing, particularly in a commodity that is enjoying its biggest rally in a number of years, is another way that investors and their advisers can tailor make their portfolios using ETFs.

A new study from Invesco, published in June, revealed that 72 per cent of professional investors believed the gold price would rise in 2019, and the firm reported that the amount of assets invested in Invesco Physical Gold ETC had reached a record high on the product's 10-year anniversary.

The attraction of physically backed gold ETCs is evidenced by market flows, Invesco says, quoting data that revealed that Gold ETCs listed in Europe had gathered USD3.5 billion of assets at the end of June, taking total assets invested in these products to almost USD50 billion.

Using smart beta to bring in market timing and market themes is another extension of the uses of the strategy. Top themes this year are clearly dominated by gold, but ESG is also undeniably a key theme for investors, and equally well represented in the ETF lexicon, along with Robo, Artificial Intelligence and Marijuana.

However it is utilised, smart beta clearly remains a driving force in the ETF ecosystem. ■

Finding a new investment angle with Smart Beta ETFs

Interview with Nicolas Fragneau

In a recent paper entitled 'The Smart Beta ETF (r) evolution', Amundi suggests that origins of smart beta ETFs lies in the aftermath of the global financial crisis. At the time investors were concerned about the inherent volatility of the equity markets, a problem that was amplified by the introduction of ultra-low monetary policies that sent liabilities ballooning.

"Investors faced a tough conundrum," the paper says. "Their funding gaps had risen, which required a more aggressive investment strategy but, at the same time, over-allocating to risky assets like equities was ill advised. High volatility and steep market corrections could create losses they could ill afford."

The perfect solution for many investors, and a perfect entry point for smart beta was the evolution of low volatility equities, Amundi says. Here investors could still access equity markets, but with less risk than conventional strategies, and with the low costs that come with investing in ETFs.

This strategy works well during periods of economic contraction, which can often translate into market corrections and increases in volatility. But, Amundi notes, it will usually underperform in a bull market which could be accompanied by increases in interest rates.

Low volatility strategies got investors familiar with the concept of using smart beta. As they became more comfortable with this investment concept and, as economic growth recovered and equity markets started to perform well, they realised there was a broader universe available.

According to Nicolas Fragneau, head of Amundi's ETF product specialist team,

Nicolas Fragneau, head of Amundi's ETF product specialist team

users of Smart Beta ETFs are still largely professionals who appreciate the low cost, transparent and liquid nature of ETFs.

"Quite honestly largely educated investors use these products," Fragneau says. "It takes a bit of knowledge to understand exactly how they will perform against the market as they are more complex than your regular index."

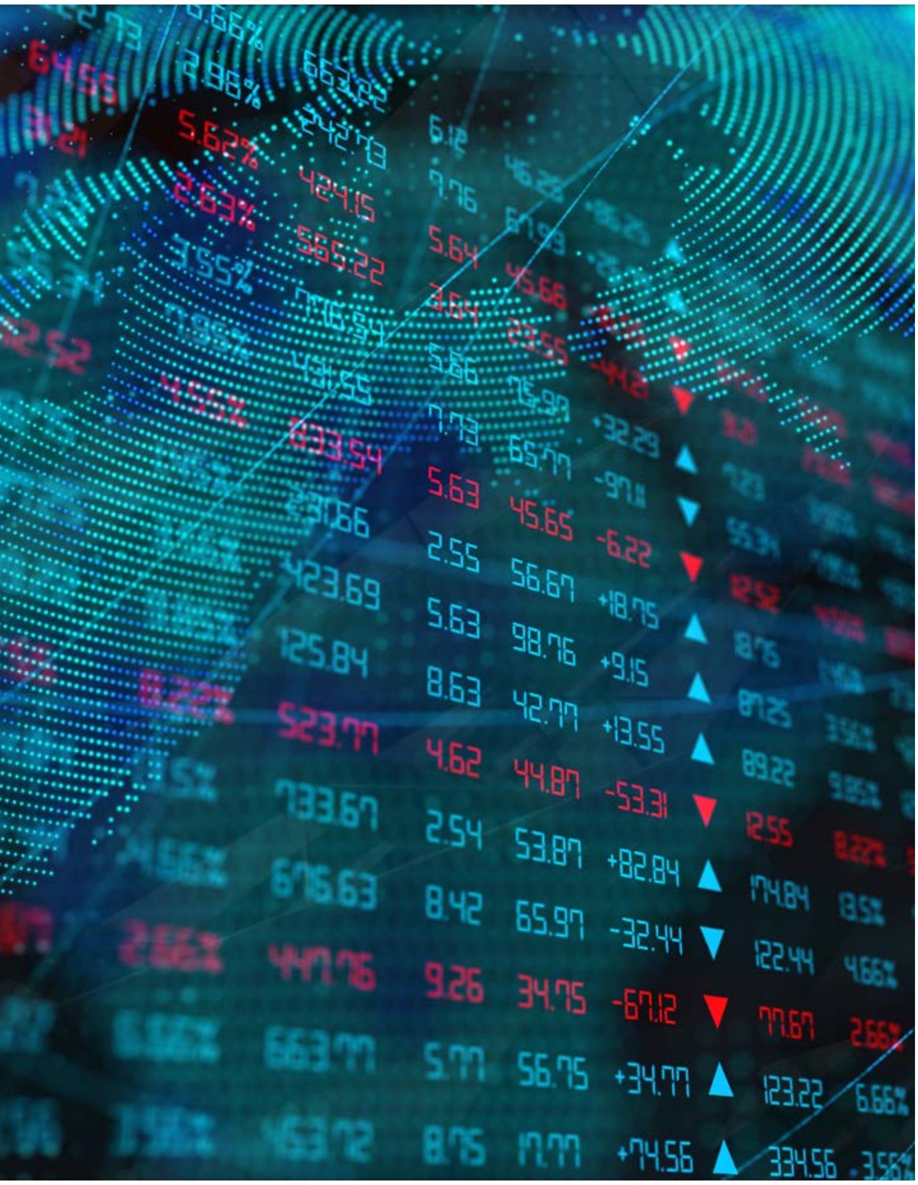
The use of Smart Beta ETFs varies greatly from one investor to another. This is why Amundi has chosen to offer two very distinct ranges within their smart beta offering so that they can meet the needs of all their clients. The first are the single factor ETFs. Here Amundi offers ETFs for each of the major factors in a portfolio, including factors such as value, low volatility or quality.

"Those ETFs are for investors who want to make their own factor allocations, maybe play one factor against another depending on the environment," he says. "They allow you to create a portfolio depending on your view, giving you full control over the factor allocation process."

Nicolas explains that the second smart beta range at Amundi is the multi factor range. "Here the idea is that factor timing can be complicated, and building your own model using several factors, and weighing them in a manner that can outperform the market over the long term can be difficult."

For those investors who would prefer a combination of factors within one product, the multi factor range offers a solution.

"One route is to build up your own allocation and have all the tools for implementing your changes in your view, and the other is to buy and hold a single product



that aims to outperform in the long run, simply by spreading your exposure across factors" Fragneau says.

Amundi offers eight single factor ETFs, which cover mainly Europe but also the US, while multi factor products are available for Europe, the US and world.

"The idea of multi factor products is that they offer an alternative to core positions. Therefore, if you own some European or US ETF exposures, you can switch into a multi factor in an effort to out-perform the market. This is why our multifactor range mirrors the vanilla index exposures," Fragneau says.

The latest ETF launch from Amundi was the single factor ETF on US minimum volatility, the only US factor ETF, whereas in the European range, they have all the factors covered. A new launch might be within the US range, depending on how that product does, Fragneau says.

"I think smart beta is an important part of the ETF offering," he says. "It's an essential part of any allocation as there is a place for factors and in the last decade factor investing has become as important as your country allocation or your sector allocation within your portfolios."

Fragneau comments that if you buy a country or geographical region ETF, you also need to look at the sectors in the markets. "Some are more dividend or tech orientated," he says. "Factors have truly become the equivalent of sectors or countries when you build your allocation.

"What's important here is that they give you another angle to the market, another way to allocate and try and outperform the market. Smart beta ETFs are added value in the tool box of any investor."

The development of smart beta now allows investors to tailor their portfolios through ETFs, Amundi says. They can split stock characteristics into two broad groups: those which have defensive characteristics and those which have cyclical attributes.

Like low volatility, the 'dividend' and 'quality' factor shares tend to perform well when the economy is contracting. They are defensive attributes. Dividend factors select those stocks which can deliver a sustainable high income, a characteristic that has been popular as investors have sought alternative sources of yield in a low interest rate environment.

The 'quality' factor emphasises those companies with lower debt and higher profit margins than the market average. Most importantly, these firms are capable of comfortably generating regular cash flows. These corporates provide a measure of protection during a period of rising interest rates because they have few liabilities on their balance sheet.

When economies start to recover and financial markets rise, these defensive factors will tend to underperform the broader market and those with cyclical characteristics will perform better. ■

For more infotmation on Amundi's range of Smart Beta ETFs visit www.amundietf.com.