Newsletter

FTSE Russell

INSIGHT

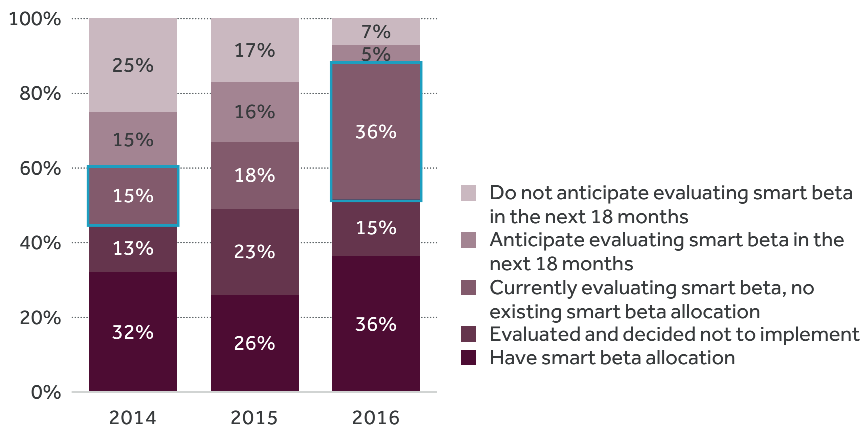
A deeper understanding of the smart beta landscape

According to 2016 research by FTSE Russell, the popularity of smart beta index-based investment strategies continues to strengthen as asset owners are increasingly evaluating and allocating more of their portfolio toward these strategies. For the third year running, our *Smart beta: 2016 global survey findings from asset owners* clearly shows an increase in the usage of smart beta index-based investment strategies by institutional asset owners across Europe, North America and Asia-Pacific (including Australia and New Zealand), and an uptake of combining multiple factor strategies.

The evaluation of smart beta has doubled in two years

The FTSE Russell survey shows the percentage of global asset owners reporting that they are currently evaluating smart beta has doubled since 2014 levels. This growth has come from asset owners who had not previously evaluated smart beta, as well as those who have re-evaluated it but who chose not to implement, and who, we believe, are again evaluating smart beta. As smart beta adoption and evaluation have become more broad-based, the percentage of asset owners reporting that they have not evaluated smart beta has dropped from 40% in 2014 to 12% in 2016. Total adoption levels in the survey have increased, from 32% in 2014 to 36% in 2016.

Which best describes your organisation's usage of smart beta strategies?



Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners

The strongest growth in smart beta adoption has come from the smallest asset owners with under US$1 billion in AUM. Over time, growth is expected to be driven by asset owners who are either assessing smart beta or adding to their existing smart beta allocations.

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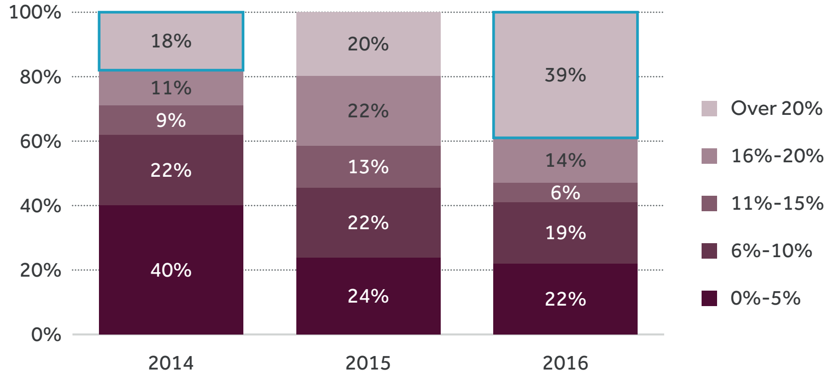
Smart beta is representing a greater share of equity portfolios

Among adopters of smart beta allocations (36% of asset owners), the smart beta share of their equity portfolio has grown over time. Of all asset owners with a smart beta allocation, the share with over 20% of equity assets has grown notably: from 18% in 2014 to 39% in 2016. The share with 0% to 5% invested has similarly decreased, from 40% in 2014 to 22% in 2016.

What percentage of your equity portfolio is invested in smart beta?



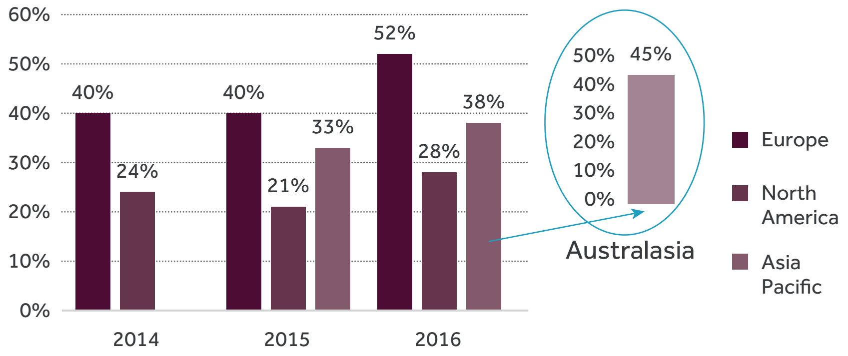
Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners
Segment = Have smart beta allocation

Europeans continue to demonstrate they're smart beta savvy

Europe continues to lead Asia Pacific and North America in smart beta adoption and growth in share of equity portfolio. The smart beta adoption rate in Europe has led that of other regions in each of the past three years. In 2016, 52% of the European asset owners surveyed have adopted smart beta, compared to 28% in North America and 38% in Asia Pacific. The segment with the largest adoption growth has been European asset owners with under $1 billion in AUM; in this segment, adoption has grown from 15% in 2014 to 47% in 2016.

Looking specifically at Australasia compared to the rest of the Asia Pacific region, the adoption percentage is stronger at 45%, showing that Australian and New Zealand asset owners are more involved in this strategy than perhaps the other Asia Pacific countries.

Percentage of smart beta adoption, by region



Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners
The 2014 survey did not survey the Asia Pacific region. Australasia = 22 respondents

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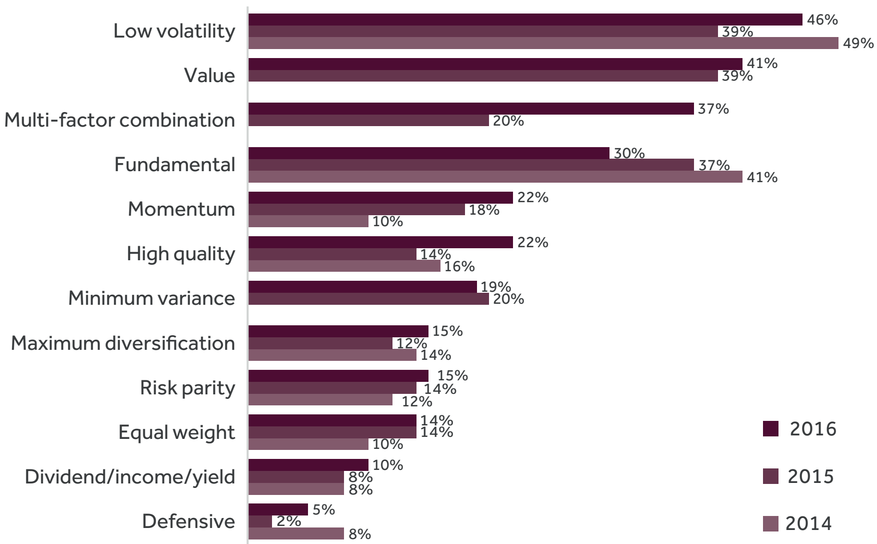
In Australasia, the most popular strategy in 2016 was value, with 60% of respondents saying they currently use that smart beta strategy.

Use of multi-factor combination strategies are increasing

Low volatility and value index-based investment strategies remain popular, but multi-factor combinations nearly doubled year-over-year while the usage of fundamental strategies declined.

What type of smart beta strategies are you currently using?



Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners Multi-pick. Segment = Global. Have smart beta allocation. "Multi-factor," "Value" and "Minimum variance" were not asked in 2014

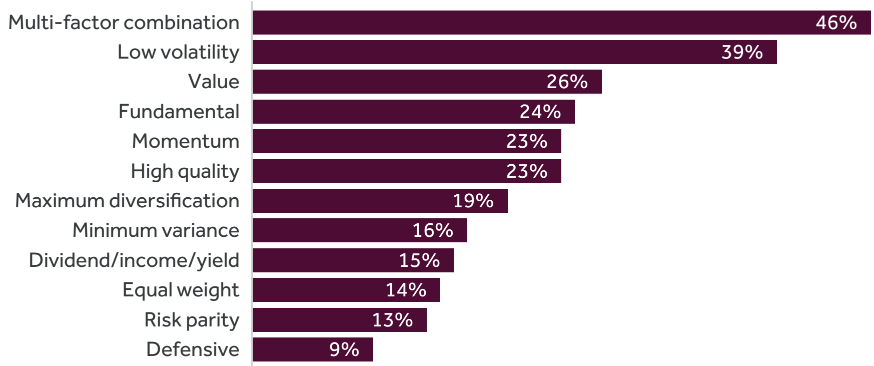
Multi-factor combination and low volatility lead in the strategies currently being evaluated. Nearly half of asset owners who are currently evaluating smart beta are evaluating multi-factor combination strategies, and nearly 40% are evaluating low volatility strategies.

The Australasian market has a much higher percentage currently evaluating value (50%) and low volatility (64%) than the overall global population, which aligns with the high usage of value for Australasian asset owners.

What other smart beta products and tools are desired?

"Increasingly looking at combining multiple factors into a single strategy, rather than blending multiple single-factor strategies." – Australian/ NZ Asset Owner, union or industry-wide pension scheme

What smart beta strategies are you currently evaluating?



Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners Multi-pick. Segment = Global. Have smart beta allocation AND currently evaluating smart beta; Currently evaluating smart beta, no existing smart beta allocation

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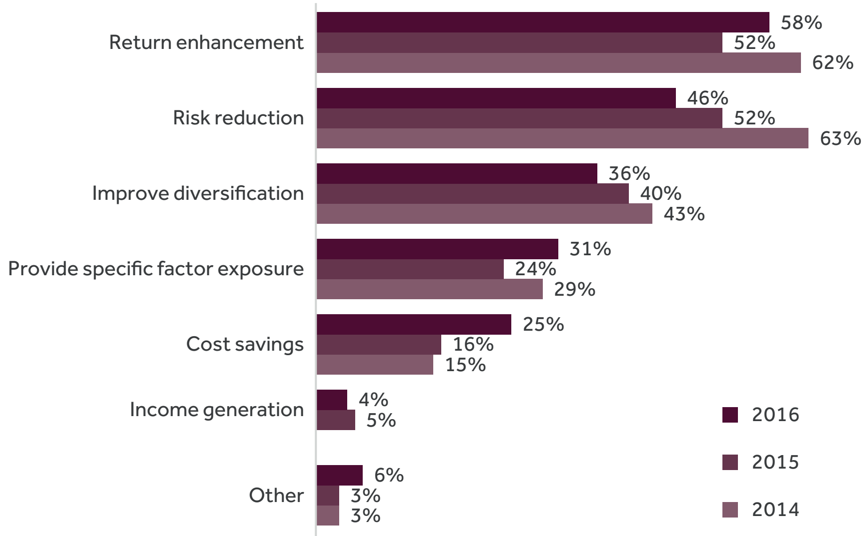
Cost savings is gaining importance as an objective

Most asset owners agree that return enhancement and risk reduction remain the primary objectives in smart beta across all AUM tiers. Also notable in 2016 is the increase in importance of cost savings, compared to 2014 and 2015.

What investment objectives initiated evaluation of smart beta strategies?



Source: FTSE Russell, Smart beta: 2016 global survey findings from asset owners Multi-pick. Segment = Global. Have smart beta allocation; Evaluated and decided not to implement; Currently evaluating smart beta . "Income generation" was not asked in 2014

Closer to home, in Australasia, the key objectives are return enhancement (62%) and improve diversification (48%), with risk reduction less important (19%).

"Smart beta strategies have also been good in helping institutional investors to identify what part of an investment manager's returns is factor-based and what is genuine alpha. I think this a positive step for the industry." – Australian/NZ Asset Owner

In conclusion, the survey's findings demonstrate accelerating interest in and implementation of smart beta among institutional asset owners globally. Each year our survey yields a deeper understanding of smart beta evaluation and adoption in equity portfolios.

While many asset owners and consultants have increased their understanding of smart beta, continuing innovations in other asset classes and the multi-factor arena underscore the need for more information and education.

For a comprehensive analysis of the survey download the report *Smart beta: 2016 global survey findings from asset owners*

To learn more about FTSE Russell's smart beta and factor indexes see ftserussell.com

Appendix

For the purposes of this survey, 'smart beta' is defined as an index-based investment strategy that is not traditionally market cap-weighted (i.e. fundamentally weighted, equal weighted, factor weighted, optimised).

FTSE Russell defines a 'smart beta' index as a market index which is not traditionally market cap-weighted, but rather built on other approaches such as alternative weighting, selecting for single factors or combining multiple investment factors.

Survey methodology

- 253 survey respondents, total AUM of survey respondents estimated to be over US$2 trillion
- Only Asset Owners, representing: Corporation or private business; Government; Non-profit or university; Union or industry-wide pension scheme; other e.g. sovereign wealth funds, insurance companies, health-care organisations and family offices
- US$200 million plan assets or greater
- Survey fielded Jan-Feb 2016

Index examples

Value e.g. FTSE Value Factor Index within the FTSE Global Factor Index Series – Constituents are weighted using a composite of trailing Cash-flow Yield, Earnings Yield and country relative Sales to Price Ratio.

Fundamental e.g. FTSE RAFI™ Index Series – Index constituents are weighted using a composite of fundamental factors, including total cash dividends, free cash flow, total sales and book equity value. Prices and market values are not determinants of the index weights. Consequently the indexes are less prone to excessive concentration arising from market fads, which can result in over-exposure to individual companies, sectors or countries.

Russell Fundamental Index Series – Securities are selected and weighted according to fundamental measures of company size: Adjusted Sales, Operating Cash Flow, and Dividend plus Buybacks.

Multi-factor e.g. FTSE Developed Diversified Factor Index Series, which utilises investment characteristics including attractive relative valuation, positive price momentum, low volatility, and specific market capitalisation, and seeks to equally diversify risk across global regions and industries.

Low Volatility e.g. FTSE Volatility Factor Index within the FTSE Global Factor Index Series, which applies a consistent methodology that defines Volatility as the standard deviation of 5 years of weekly local total returns.

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