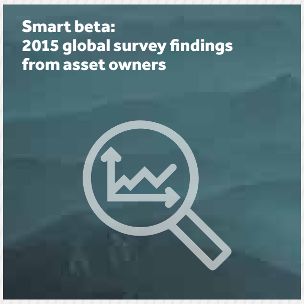
FTSE INSIGHT //

NEWSLETTER
AUGUST 2015

WHAT YOU SHOULD KNOW ABOUT THE ADOPTION OF SMART BETA

There is no denying that as an investment tool, the 'smart beta' approach has arrived and will continue to transform and impact the investment landscape for years to come. Over a quarter of asset owners globally have smart beta strategies in their portfolios, with many increasingly combining multiple smart beta strategies according to 2015 research by FTSE Russell. To understand how the perception and adoption of smart beta has continued to evolve globally, for the second year running, FTSE Russell conducted a survey of institutional asset owners across Europe, North America and Asia-Pacific including Australia and New Zealand. The results are in...



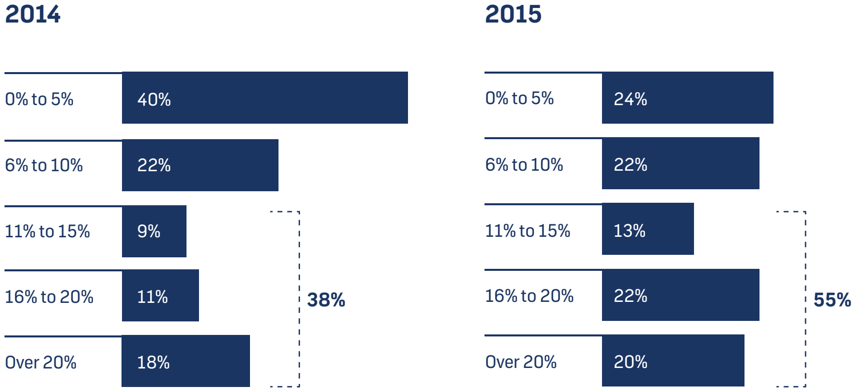
SMART BETA DEFINITION

For the purposes of this survey, smart beta is defined as an index-based investment strategy that is not traditionally market capitalisation weighted e.g. fundamental weighted, equal weighted, factor weighted.

SMART BETA USAGE IS GROWING

The results of the 2015 survey indicate an increased interest in and adoption of smart beta strategies among institutional asset owners globally. There were some interesting differences in the results of the 2015 survey versus the 2014 version. In 2014, 40% of the survey respondents with an allocation to smart beta had allocated 5% or less of their organisation's equity portfolio. In 2015, only 24% have allocated 5% or less; 55% have allocated more than 10% to smart beta strategies.

What % of your organisation's equity portfolio is invested in smart beta strategies?



CONTINUED OVER PAGE

Among survey respondents who **do not plan on evaluating smart beta in the next 18 months,** the number-one reason is 'Consultant has not recommended this option' with 45%.

What are the primary reasons you have not yet evaluated smart beta strategies?

	Anticipate evaluating in the next 18 months	Do not anticipate evaluating in the next 18 months
Lack of investment resources to make the evaluation	44%	18%
Consultant has not recommended this option	22%	45%
Do not believe they have investment merit	7%	21%
AUM is too small for this type of strategy	15%	12%
Do not believe in passive allocations	0%	15%
Other	26%	9%

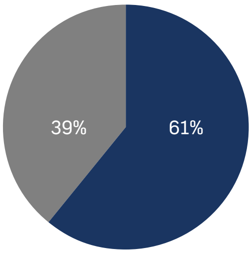
Multi-pick; Segment = Do not anticipate evaluating smart beta in the next 18 months, Anticipate evaluating smart beta in the next 18 months

However, there continues to be a positive outlook for adoption and increased investment in both respondents already with smart beta allocations and those currently evaluating smart beta.

What is your outlook for future usage of smart beta in your portfolio in the next 18 months?

Respondents with smart beta allocations

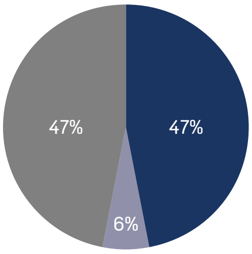
61% Increase % allocation
39% Maintain current allocation
0% Reduce % allocation



Segment = Have smart beta allocation

Respondents currently evaluating smart beta

47% Expect to make an allocation
47% Don't know
6% Do not expect to make an allocation

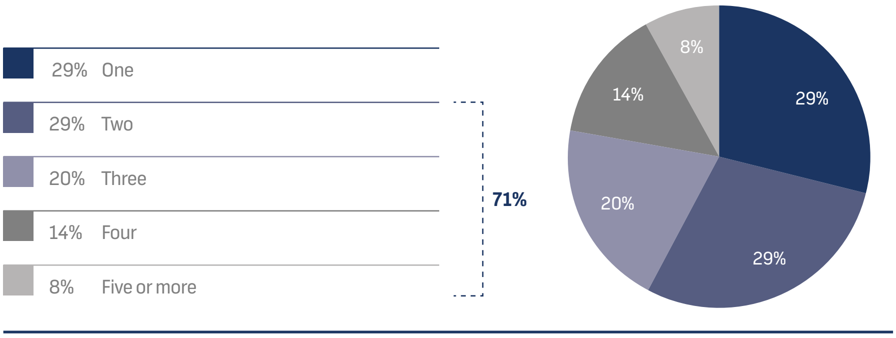


Segment = Currently evaluating smart beta

INCREASINGLY COMBINING MULTIPLE FACTOR AND STRATEGY INDEXES

Another interesting difference is in the number of asset owners using multiple smart beta strategies, so the strategies are not being used in isolation. In 2014, 59% of the asset owners responding to the survey were using more than one strategy; in 2015, 71% are using more than one strategy, and 22% of those respondents are using four or more strategies. These differences highlight not only a growing allocation to smart beta strategies, but also a movement toward combining multiple factor and strategy indexes.

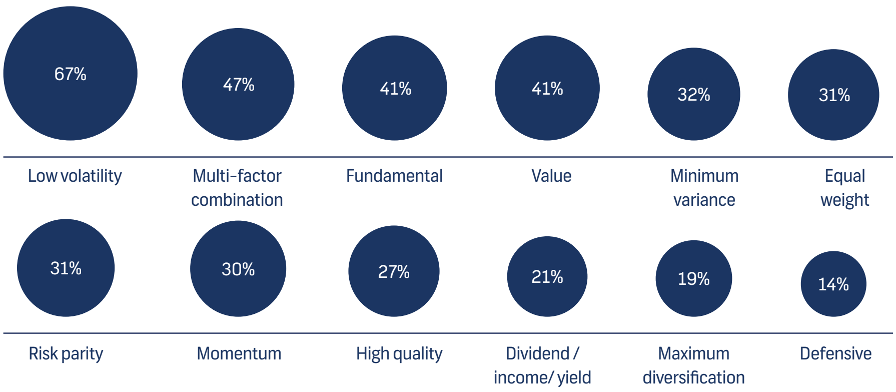
Number of strategies being used currently



Segment = Have smart beta allocation

On average, asset owners are evaluating four different smart beta strategies. Low Volatility (67%), Multi-factor Combination (47%), Fundamental (41%) and Value (41%) are the most commonly evaluated smart beta strategies. Similarly, those with a smart beta allocation are also focused on the same four strategies: Low Volatility (41%), Value (41%), Fundamental (39%) and Multi-factor combination (20%).

What smart beta strategies have you evaluated or are you currently evaluating?



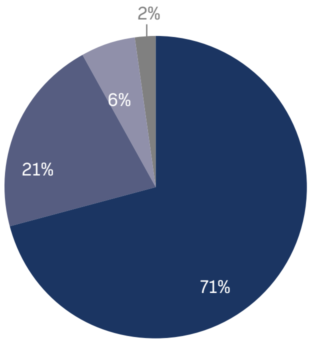
Multi-pick; Segment = Have smart beta allocation, Evaluated and decided not to implement, Currently evaluating smart beta

GETTING SMARTER: THE PRACTICAL USES OF SMART BETA

The majority of asset owners anticipate holding smart beta strategies for five years, or longer, to achieve their investment objectives, showing a focus for long-term.

How long do you expect to hold your smart beta strategies to achieve your investment objectives?

71%	5 years or greater
21%	3 to 5 years
6%	1 to 3 years
2%	Other
0%	One year or less



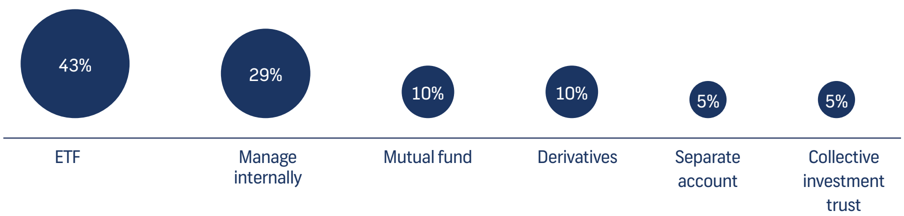
Segment = Have smart beta allocation, Currently evaluating smart beta

For strategic allocations of smart beta, Exchange Traded Funds (ETFs) are in demand among survey respondents with under $1billion in AUM, and managing assets internally is of interest to those with $10billion or more in AUM.

For strategic uses of smart beta strategies what vehicle type would you prefer?	Under $1B	$1- $10B	$10B+	Total
Separate account	19%	35%	42%	36%
Manage Internally	6%	6%	44%	26%
Collective investment trust	25%	35%	0%	14%
ETF	31%	0%	8%	11%
Mutual fund	13%	18%	6%	10%
Derivatives	6%	6%	0%	3%

Segment = Have smart beta allocation, Currently evaluating smart beta AND has or intends to have a strategic allocation

For tactical use of the smart beta strategies, ETFs are the most preferred vehicle.



Segment = Have smart beta allocation, Currently evaluating smart beta AND has or intends to have a tactical allocation

Alex Vynokur, Managing Director BetaShares

AUSSIE APPROACH TO SMART BETA ETFS

FTSE Russell Insight spoke to Alex Vynokur, Managing Director at BetaShares to understand how the smart beta trend has been adopted by ETFs and what is expected in the future.

How does Australia's adoption of smart beta ETFs compare to other countries?

Over the past couple of years, the ETF industry in Australia has matured and investors are starting to look beyond the traditional vanilla index fund when thinking about ways they can use ETFs in their portfolio. They are increasingly starting to see smart beta as an option because it combines the low cost and transparency of their traditional index ETF, with the ability to access intelligent methodology that avoids 'overheated' stocks and has the potential to generate better long-term returns. That said, compared to more developed overseas markets which have a huge variety of smart beta funds available across many different market exposures, Australian adoption is still very much in its infancy.

What is expected of the adoption of smart beta ETFs by investors in the next few years in Australia?

The selection of funds on the Australian Securities Exchange that currently offer elements of smart beta strategy, such as fundamental index ETFs, are starting to generate significant interest. These have been mainly concentrated in the broad-based Australian equities product category, although we have also seen the launch of the first US equities ETF using fundamental indexing this year. As investors take a more active interest in the smart beta concept, and particularly the simple low-cost benefits of accessing the strategy through an ETF, we expect the product range on offer to expand both in terms of the methodologies used and the different market exposures available.

How do you see the use of smart beta ETFs evolving in the future?
We see smart beta ETFs as a natural evolution of the indexing process. Just as other forms of technology, like phones or computers, have evolved to become more user friendly, the index industry has also been evolving over the last few years as research has questioned the efficiency of market-capitalisation weighted indexing. Given this, we expect smart beta to become more of a mainstream strategy within ETF products that offer broad-based equities market exposure.

In conclusion, smart beta indexes have given asset owners and their consultants more choice and greater flexibility in the construction of portfolios with an outcome-oriented focus—but increases in choice and flexibility require further education, information and advice evaluating smart beta strategies to make informed decisions.

For a comprehensive analysis of the survey download the report
Smart Beta: 2015 Global Survey Findings from Asset Owners

To learn more about FTSE Russell's alternatively-weighted indexes see
FTSE AW monthly report and Russell Smart Beta Indexes

APPENDIX

Survey methodology

- 214 survey respondents, total AUM of survey respondents estimated to be over $2 trillion
- Only Asset Owners, representing: Corporation or private business; Government; Non-profit or university; Union or industry-wide pension scheme; other
- US$200 million plan assets or greater
- Survey fielded Jan-Feb 2015

Index examples

Value	FTSE Value Factor: Index constituents are weighted using a composite of trailing Cash-flow Yield, Earnings Yield and country relative Sales to Price Ratio.
Fundamental	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.
	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	FTSE Developed Diversified Factor Index Series: 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.
	Russell High Efficiency™ Factor Indexes: Employs a consistent, factor-based weighting methodology to deliver institutional quality targeted exposure to Low Volatility, Momentum, Quality, and Value.
Low Volatility	FTSE RAFI™ Low Volatility Index Series: Applies the FTSE RAFI™ index methodology to a universe of low volatility securities in Global, Developed, Emerging markets and single countries.

FOR FURTHER INFORMATION VISIT
WWW.FTSE.COM