

webinar

# How Can Smart Beta Lead To Better Outcomes?



*Presenter*



**Michael Aked, CFA**

*Partner, Director of Research  
for Australia*

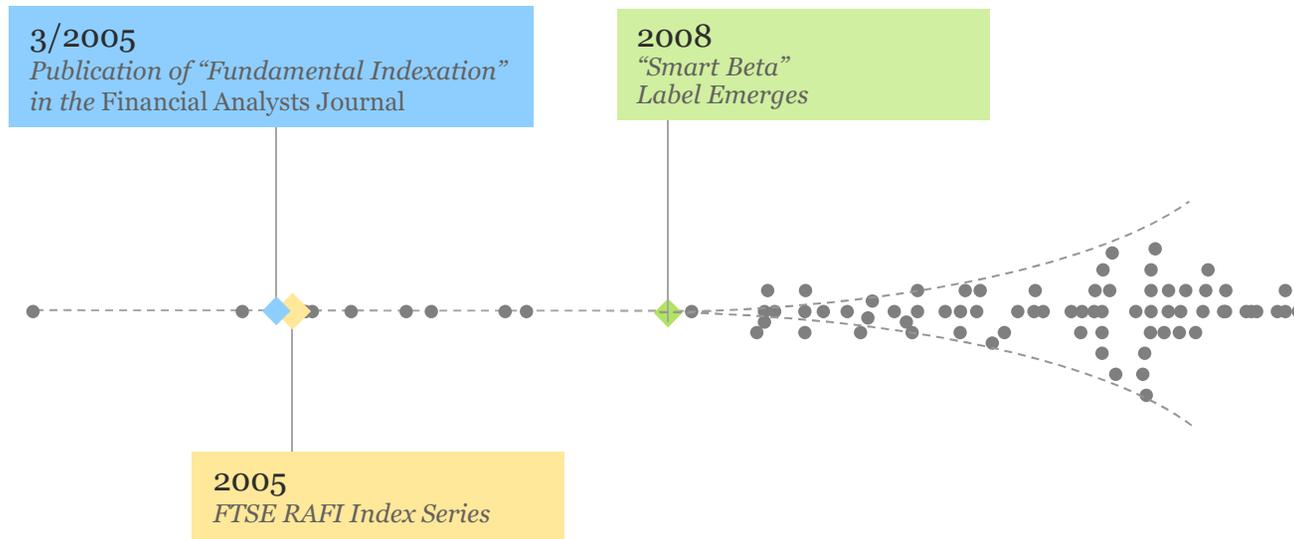
*Host*



**Prashant Pandey, CFA**

*Vice President,  
Client Strategies*

# The Proliferation of Smart Beta Index Strategies

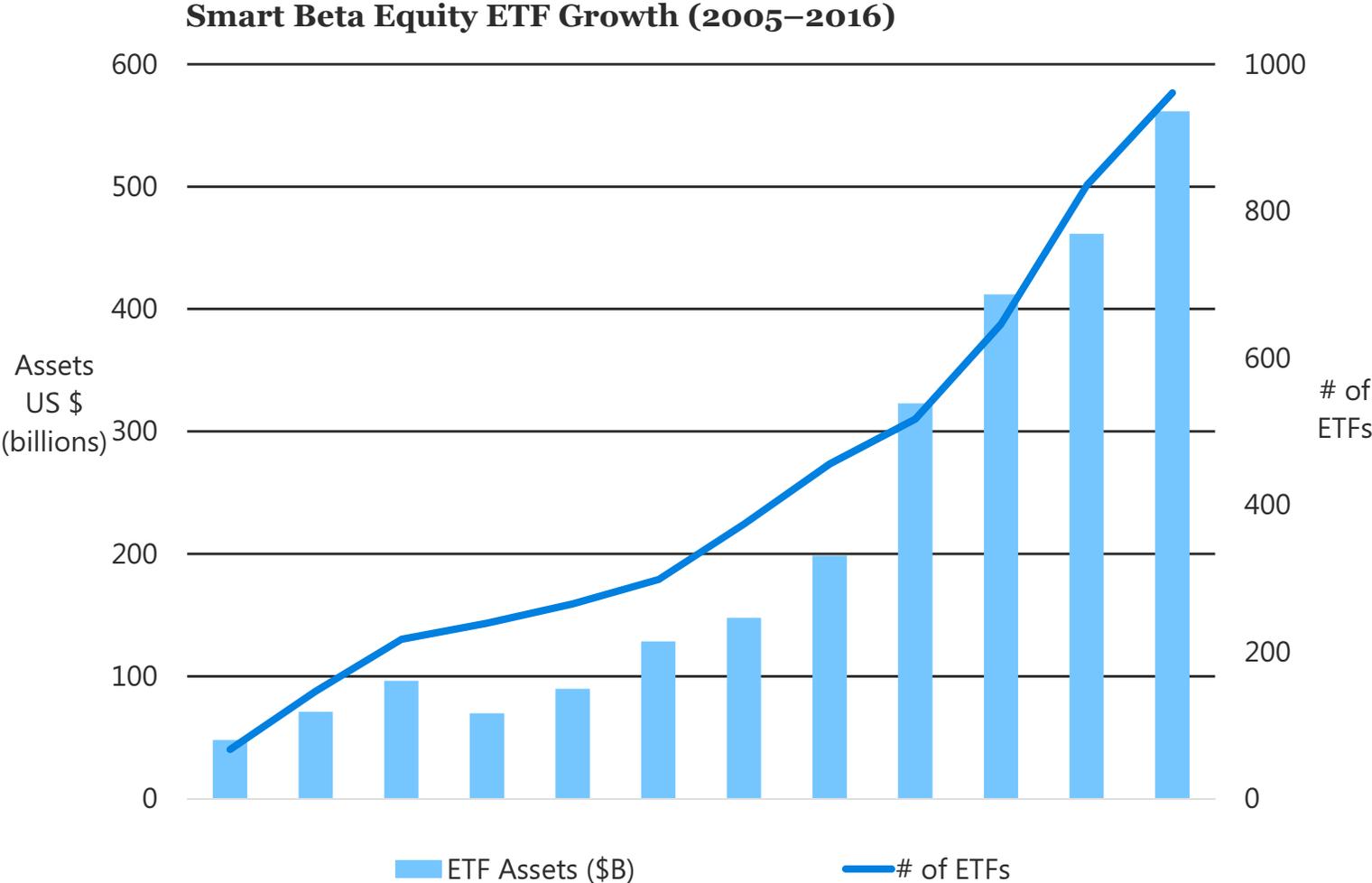


- » Each dot represents a "family" of smart beta index strategies, which could have dozens of underlying indices (geography, size, etc.)
- » For example, there are over 100 indices associated with the RAFI™ Fundamental Index™<sup>1</sup>



<sup>1</sup> Includes FTSE RAFI, Russell RAFI, and RAFI Indices, LLC strategies. Note: Chart represents smart beta index strategies launched since 2003.

# Has Led to ETF Product Proliferation



Source: Research Affiliates, LLC, based on data from Morningstar.



Result.

Too.

Many.

Options.

# A Natural Extension of Our Research

<p>The RAFI™ Fundamental Index™ Approach</p>	<p><b>“Fundamental Indexation”<sup>1</sup></b> Arnott, Hsu, Moore <i>Financial Analysts Journal</i> March 2005</p>	<p><b>“An Overwrought Orthodoxy”</b> Arnott <i>Institutional Investor</i> December 2006</p>	<p><b>“Institutionalizing Courage”</b> Arnott May 2012</p>
<p>Smart Beta Strategies and Factor Exposures</p>	<p><b>“A Survey of Alternative Equity Index Strategies”<sup>2</sup></b> Chow, Hsu, Kalesnik, Little <i>Financial Analysts Journal</i> September 2011</p>	<p><b>“The Surprising Alpha from Malkiel’s Monkey...”<sup>3</sup></b> Arnott, Hsu, Kalesnik, Tindall <i>Journal of Portfolio Mgmt.</i> August 2013</p>	<p><b>“Mixing versus Integrating”</b> Chow, Li, and Shim <i>Journal of Index Investing</i> April 2018</p>
<p>Robustness of Factors</p>	<p><b>“Finding Smart Beta in the Factor Zoo”</b> Hsu, Kalesnik July 2014</p>	<p><b>“Will Your Factor Deliver?...”<sup>4</sup></b> Beck, Hsu, Kalesnik, Kostka <i>Financial Analysts Journal</i> September 2016</p>	<p><b>“What is Quality?”</b> Hsu, Kalesnik, Kose <i>Financial Analysts Journal</i> Forthcoming</p>
<p>The Effects of Valuations on Smart Beta</p>	<p><b>“How Can ‘Smart Beta’ Go Horribly Wrong?”</b> Arnott, Beck, Kalesnik, West February 2016</p>	<p><b>“To Win with ‘Smart Beta’ Ask If the Price Is Right”</b> Arnott, Beck, Kalesnik June 2016</p>	<p><b>“Timing ‘Smart Beta’ Strategies? Of Course! Buy Low, Sell High!”</b> Arnott, Beck, Kalesnik September 2016</p>
<p>The Impact of Implementation</p>	<p><b>“The Market Impact of Index Rebalancing”</b> Aked, Moroz January 2016</p>	<p><b>“The Dirty Little Secret of Passive Investing”</b> Aked January 2016</p>	<p><b>“Cost and Capacity: Comparing Smart Beta Strategies”</b> Chow, Li, Pickard, Garg July 2017</p>

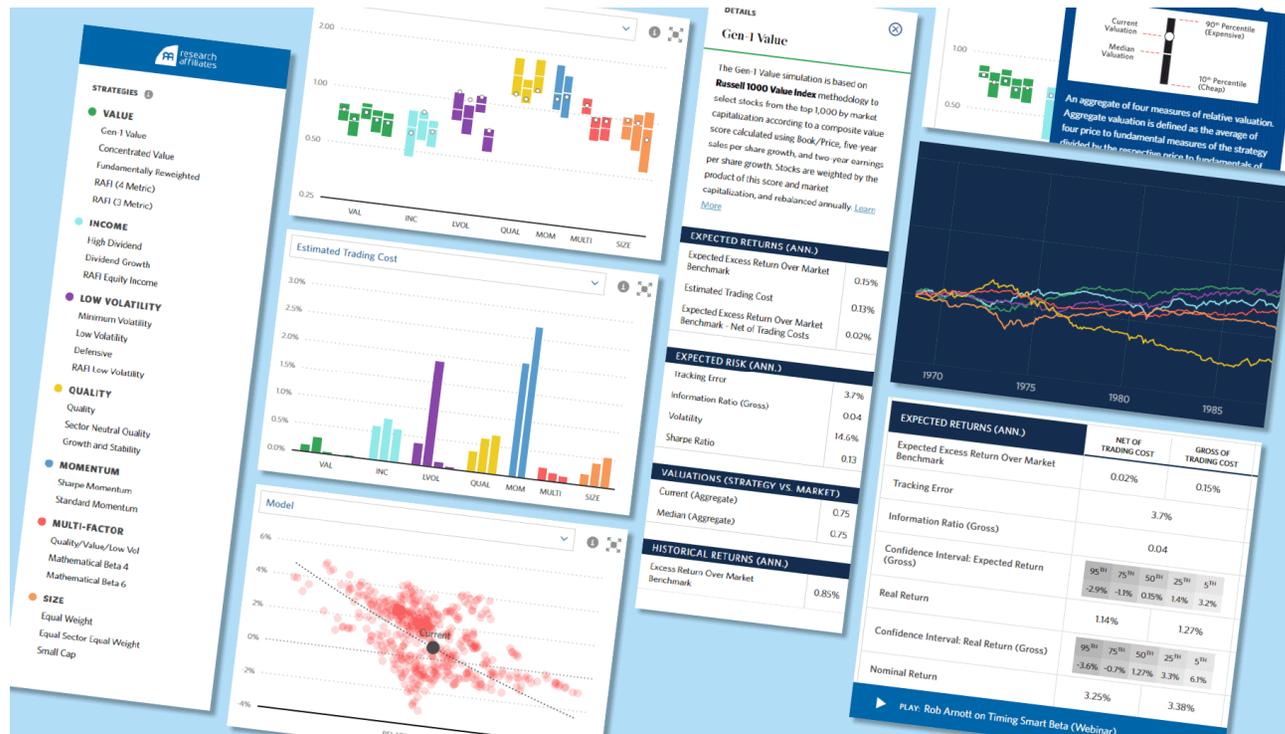
1. 2005 William F. Sharpe Indexing Achievement Award for Best Index-Related Research Paper.
2. 2012 *Financial Analysts Journal* Graham & Dodd Scroll and Finalist of the Whitebox Selected Research Best Financial Research Paper of 2011.
3. 2014 Bernstein/Fabozzi/Jacobs Levy Award for Outstanding Article.
4. 2016 *Financial Analysts Journal* Graham and Dodd Scroll Award of Excellence.



## WWW.RESEARCHAFFILIATES.COM/SBI

Launched on February 2017

- Emphasizes future return expectations anchored on relative valuations and transaction costs across factors and smart beta strategies
- Sheds light on implementation characteristics and risk measures such as trading costs, capacity, turnover, tracking error, volatility, etc.



**Demonstration begins. Please  
reference [webinar replay here.](#)**



# The Biggest Failure in Investment Management

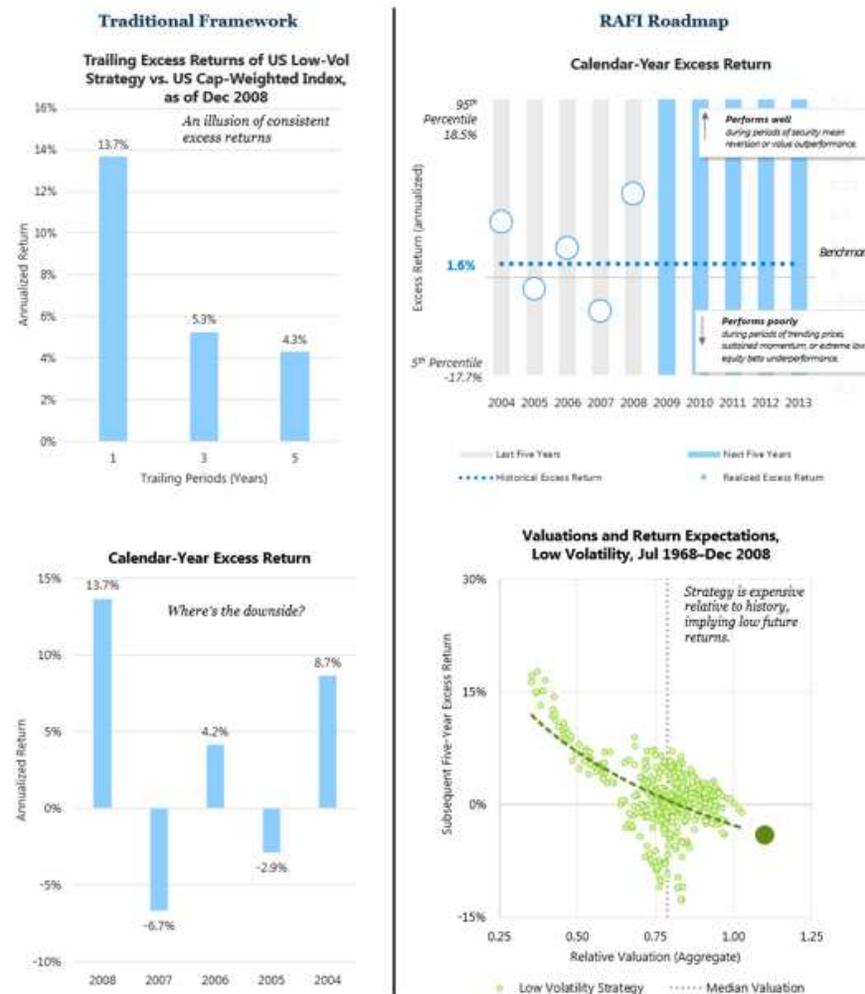
## » Step 1. Believing in the style

- We should begin, as our colleague Cam Harvey states, by establishing the economic plausibility of the strategy

## » Step 2. Understanding the journey

- As Charlie Munger said, “The big money is not in the buying and selling ... but in the waiting.”

RAFI Roadmaps pair a range of expected returns, past and future, with current relative valuation to help frame a more positive client experience.

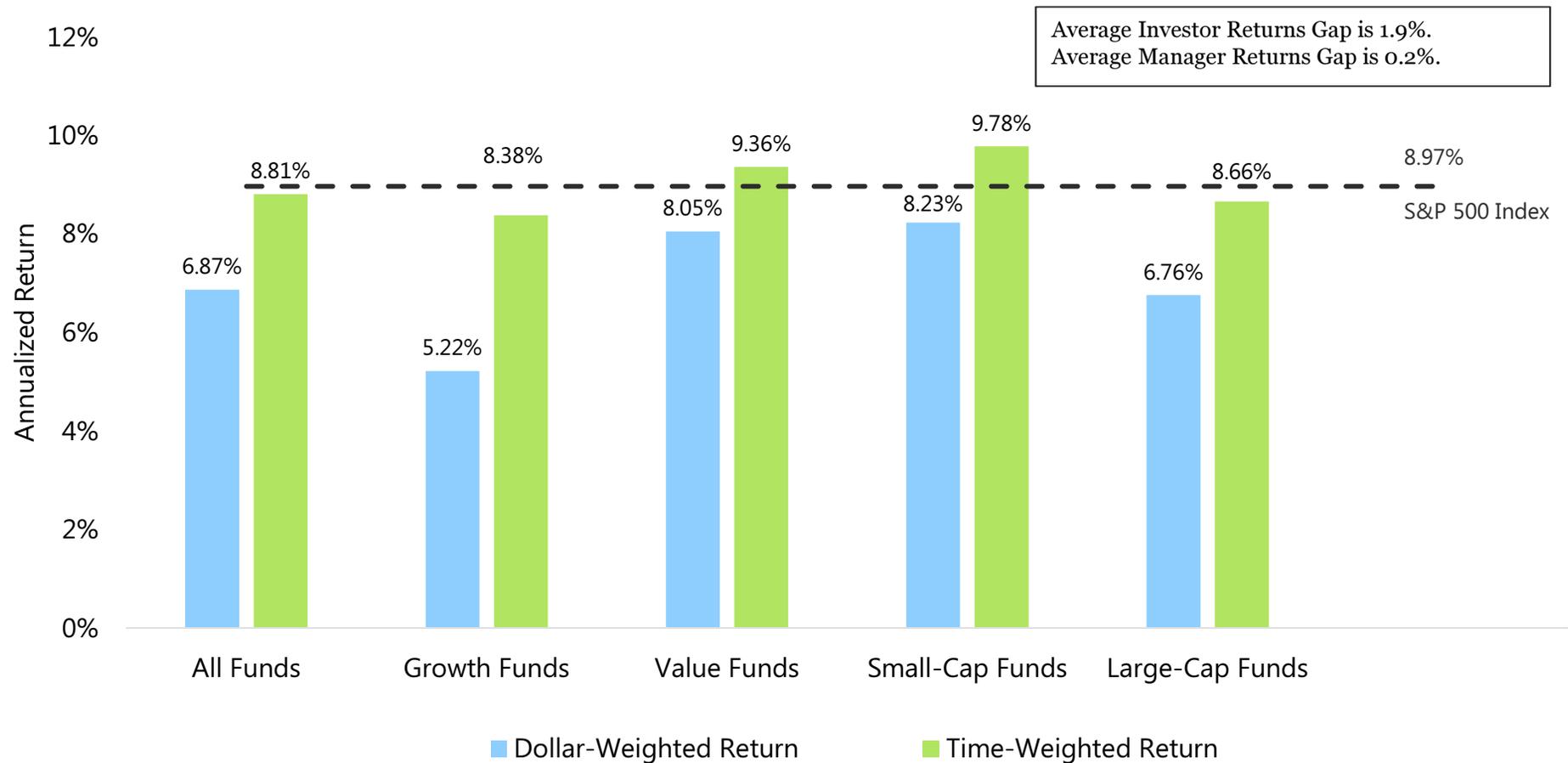


Note: RAFI Roadmaps are available on RAFI.com. Please see disclosures at the end for additional information on simulated data.

Source: Research Affiliates, LLC, using data from CRSP/Compustat, Morningstar Direct, and the Kenneth French Data Library.

# ...Or We Are Destined to Repeat History!

Performance Chasing Leads to Return Gaps Everywhere, Jan 1991–Jun 2013



Source: Jason Hsu, Brett Myers, and Ryan Whitby. "Timing Poorly: A Guide to Generating Poor Returns while Investing in Successful Strategies," *Journal of Portfolio Management* (Winter 2016).

# Recap

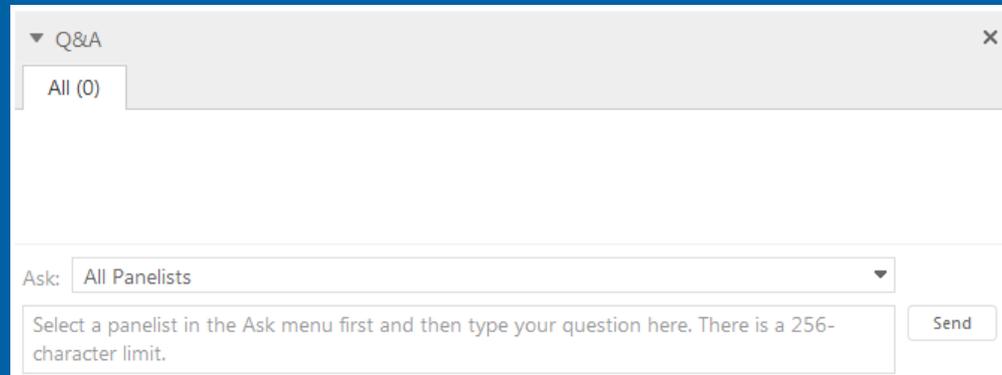
- » You can identify great smart beta strategies if you...
  - DO choose robust smart beta strategies
  - DO focus on well-crafted product
  - DO NOT chase performance
- » ...these strategies deliver well-understood sources of excess returns through simple, transparent, low cost indices that lead to...
  - Better net-of-cost return and Sharpe ratios
  - Superior long-term client outcomes



# Q&A

# Submitting Questions

Please submit questions using the **Q&A** panel located at the lower right of your screen >>



The screenshot shows a web interface for submitting questions. At the top, there is a header with a dropdown arrow and the text "Q&A" and a close button "x". Below the header is a tab labeled "All (0)". The main area contains an "Ask:" label followed by a dropdown menu currently set to "All Panelists". Below the dropdown is a text input field with a placeholder message: "Select a panelist in the Ask menu first and then type your question here. There is a 256-character limit." To the right of the input field is a "Send" button.

# Q&A

*Host*



**Prashant Pandey, CFA**

*Vice President,  
Client Strategies*

*Presenter*



**Michael Aked, CFA**

*Partner, Director of Research for  
Australia*

# Q&A

*Presenter*



**Michael Aked, CFA**

*Partner, Director of Research for  
Australia*

# Q&A

*Host*



**Prashant Pandey, CFA**

*Vice President,  
Client Strategies*

# Thank You



*[www.ResearchAffiliates.com](http://www.ResearchAffiliates.com)*



*[@ra\\_insights](https://twitter.com/ra_insights)*



*[research-affiliates](https://www.linkedin.com/company/research-affiliates)*



# Important Information

By accepting this document, you agree to keep its contents confidential. You also agree not to disclose the contents of this document to third parties (including potential co-investors) without the prior written permission of Research Affiliates, LLC (including its related entities).

The material contained in this document is for information purposes only. This material is not intended as an offer or solicitation for the purchase or sale of any security or financial instrument, nor is it advice or a recommendation to enter into any transaction. Any offer to sell or a solicitation of an offer to buy or sell shall be made solely by the legally permitted entity registered or licensed with the applicable regulator(s) and only to qualified investors through a regulatory registration statement or subject to an applicable exemption and disclosure document such as a private placement memorandum for pooled investment vehicles, or investment management agreement for separately managed accounts. The information contained herein may be opinions, which are subject to change, at any time, and should not be construed as financial or investment advice on any subject matter.

Certain performance information presented represents simulated performance. Hypothetical investor accounts depicted are not representative of actual client accounts. Certain performance information presented represents performance based on combined simulated index data (pre-index launch) and live index data (post-index launch). Indexes are unmanaged and cannot be invested in directly. Past simulated performance is no guarantee of future performance and does not represent actual performance of an investment product based on the index. No allowance has been made for trading costs, management fees, or other costs associated with asset management, as the information provided relates only to the index itself. Actual investment results may differ. As such, the simulated data may have under- or over-compensated for the impact, if any, of certain market factors. Simulated returns may not reflect the impact that material economic and market factors might have had on the advisor's decision making if the advisor were actually managing clients' money. Simulated data is subject to the fact that it is designed with the benefit of hindsight. Simulated returns carry the risk that the performance depicted is not due to successful predictive modeling. Simulated returns cannot predict how an investment strategy will perform in the future. Simulated returns should not be considered indicative of the skill of the advisor. Investors may experience loss. Any information and data pertaining to an index contained in this document relate only to the index itself and not to any asset management product based on the index. With the exception of the data on Research Affiliates Fundamental Index, all other information and data are generally based on information and data from third party sources.

Research Affiliates, LLC, its affiliates, agents, and each of their respective officers, directors, employees, agents, representatives and licensors (collectively "RA") does not make any warranties, express or implied, to anyone regarding the information provided herein, including, without limitation, any warranties with respect to the timeliness, sequence, accuracy, completeness, currentness, merchantability, quality or fitness for a particular purpose or any warranties as to the results to be obtained by any third-party in connection with the use of the information. Nothing contained in this material is intended to constitute legal, tax, securities or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this material should not be acted upon without obtaining specific legal, tax and investment advice from a licensed professional. Investors should be aware of the risks associated with data sources and quantitative processes used to create the content contained herein or the investment management process. Errors may exist in data acquired from third party vendors, the construction or coding of indices or model portfolios, and the construction of the spreadsheets, results or information provided. RA takes reasonable steps to

eliminate or mitigate errors, and to identify data and process errors so as to minimize the potential impact of such errors, however RA cannot guarantee that such errors will not occur. Use of this material is conditioned upon, and evidence of, the user's full release of Research Affiliates from any liability or responsibility for any third party for any loss or damage, direct, indirect or consequential, arising from or related to (i) any inaccuracy or incompleteness in, errors or omissions in the provided information or (ii) any decision made or action taken by any third party in reliance upon this information. RA shall not be liable to anyone for loss of business revenues, lost profits or any indirect, consequential, special or similar damages whatsoever, whether in contract, tort or otherwise, even if advised of the possibility of such damages.

Indices referenced herein (individually, the "Index") are the property of Research Affiliates, LLC, which has contracted with S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC) to calculate and maintain the Index. The Index and any products based on the Index are not sponsored, endorsed, sold or promoted by S&P Dow Jones Indices or its affiliates or its third party licensors (collectively, "S&P Dow Jones Indices"). "Calculated by S&P Dow Jones Indices" and the related stylized mark(s) are service marks of S&P Dow Jones Indices and have been licensed for use by Research Affiliates, LLC. S&P® is a registered trademark of Standard & Poor's Financial Services LLC ("SPFS"), and Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). S&P Dow Jones Indices does not make any representation or warranty, express or implied, to the owners of any products or any member of the public regarding the advisability of investing in securities generally or in any products particularly or the ability of the Index to track general market performance. S&P Dow Jones Indices' only relationship to Research Affiliates with respect to the Index is the licensing of the underlying S&P indices, certain trademarks, service marks and trade names of S&P Dow Jones Indices, and the provision of the calculation services related to the Index. S&P Dow Jones Indices is not responsible for and has not participated in the determination of the prices and amount of the products or the timing of the issuance or sale of the products or in the determination or calculation of the equation by which the products may be converted into cash or other redemption mechanics. S&P Dow Jones Indices has no obligation or liability in connection with the administration, marketing or trading of the products. S&P Dow Jones Indices LLC is not an investment advisor. Inclusion of a security within the Index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, nor is it investment advice. S&P Dow Jones Indices does not guarantee the adequacy, accuracy, timeliness and/or the completeness of the Index or any data related thereto or any communication with respect thereto, including oral, written, or electronic communications. S&P Dow Jones Indices shall not be subject to any damages or liability for any errors, omissions, or delays therein. S&P Dow Jones Indices makes no express or implied warranties, and expressly disclaims all warranties or merchantability or fitness for a particular purpose of use or as to results to be obtained by Research Affiliates LLC, owners of any of the products, or any other person or entity from the use of the Index or with respect to any data related thereto. Without limiting any of the foregoing, in no event whatsoever shall S&P Dow Jones Indices be liable for an indirect, special, incidental, punitive, or consequential damages, including but not limited to, loss of profits, trading losses, lost time, or goodwill, even if they have been advised of the possibility of such damages, whether in contract, tort, strict liability, or otherwise.



# Important Information

Frank Russell Company is the source and owner of the Russell index data contained or reflected in this material and copyrights related thereto. Frank Russell Company and Research Affiliates, LLC have entered into a strategic alliance with respect to the Russell RAFI Indexes. The Russell RAFI Indexes are calculated by Russell in conjunction with Research Affiliates LLC. All intellectual property rights in the Russell RAFI Indexes (the "Index") vest in Russell and RA. Neither Russell nor RA or their licensors accept any liability for any errors or omissions in the Index and / or Index ratings or underlying data. No further distribution of Russell Data is permitted without Russell's express written consent. Russell® is a trademark of Frank Russell Company. Research Affiliates, LLC is the owner of the trademarks, service marks, patents and copyrights related to the Fundamental Index and the Fundamental Index methodology. The presentation may contain confidential information and unauthorized use, disclosure, copying, dissemination, or redistribution is strictly prohibited. This is a presentation of Research Affiliates, LLC. Frank Russell Company is not responsible for the formatting or configuration of this material or for any inaccuracy in Research Affiliates' presentation thereof.

The FTSE Research Affiliates Fundamental Indexes are calculated by FTSE International Limited ("FTSE") in conjunction with Research Affiliates LLC ("RA"). All rights and interests in the FTSE Research Affiliates Fundamental Indexes vest in FTSE. All rights in and to the RA fundamental weighting methodology used in the calculation of the FTSE Research Affiliates Fundamental Indexes vest in RA. All rights in the FTSE indices and / or FTSE ratings (together the "FTSE Data") vest in FTSE and/or its licensors. Except to the extent disallowed by applicable law, neither FTSE nor RA nor their licensors shall be liable (including in negligence) for any loss arising out of use of the FTSE Research Affiliates Fundamental Indexes, the FTSE Data or underlying data by any person. "FTSE™" is a trademark of the London Stock Exchange Plc and is used by FTSE under license. FTSE is not an investment adviser and makes no representation regarding the advisability of investing in any security. Inclusion of a security in an index is not a recommendation to buy, sell or hold such security. No further distribution of FTSE Data is permitted without FTSE's express written consent.

Copyright MSCI. All Rights Reserved. Without prior written permission of MSCI, this information and any other MSCI intellectual property may only be used for your internal use, may not be reproduced or disseminated in any form and may not be used to create any financial instruments or products or any indices. This information is provided on an "as is" basis, and the user of this information assumes the entire risk of any use made of this information. Neither MSCI nor any third party involved in or related to the computing or compiling of the data makes any express or implied warranties, representations or guarantees concerning the MSCI index-related data, and in no event will MSCI or any third party have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) relating to any use of this information. All MSCI returns information provided under license through MSCI. Any expected returns forecasted herein may be calculated by Research Affiliates LLC using data provided by MSCI Inc. No funds or securities relating to those expected returns forecasted herein are sponsored, endorsed or promoted by MSCI Inc., and MSCI bears no liability with respect to any such funds or securities.

The RAFI™ Bonds US Investment Grade Index and RAFI™ Bonds US High Yield Index is calculated by ALM Research Solutions, LLC. in conjunction with Research Affiliates, LLC. All rights and interests in the RAFI™ Bonds US Investment Grade Index and the RAFI™ Bonds US High Yield Index vest in Research Affiliates, LLC. All rights in and to the Research Affiliates, LLC Fundamental Index™ concept used in the calculation of the RAFI™ Bonds US Investment Grade Index and the RAFI™ Bonds US High Yield Index vest in Research Affiliates, LLC. The RAFI™ Bonds US Investment

Grade Index and the RAFI™ Bonds US High Yield Index are not sponsored, endorsed, sold or promoted by ALM Research Solutions, LLC., and ALM Research Solutions, LLC. makes no representation regarding the advisability of investing in such product(s). Neither ALM Research Solutions, LLC. nor Research Affiliates, LLC make any warranties, express or implied, to any of their customers nor anyone else regarding the accuracy or completeness of any data related to the RAFI™ Bonds US Investment Grade Index or the RAFI™ Bonds US High Yield Index. All information is provided for information purposes only. Neither ALM Research Solutions, LLC. nor Research Affiliates, LLC accept any liability for any errors or any loss arising from the use of information in this publication.

The trademarks Fundamental Index™, RAFI™, Research Affiliates Equity™, RAE™, and the Research Affiliates™ trademark and corporate name and all related logos are the exclusive intellectual property of Research Affiliates, LLC and in some cases are registered trademarks in the U.S. and other countries.

Various features of the Fundamental Index™ methodology, including an accounting data-based non-capitalization data processing system and method for creating and weighting an index of securities, are protected by various patents, and patent-pending intellectual property of Research Affiliates, LLC. (See all applicable US Patents, Patent Publications, Patent Pending intellectual property and protected trademarks located at [https://www.researchaffiliates.com/en\\_us/about-us/legal.html](https://www.researchaffiliates.com/en_us/about-us/legal.html), which are fully incorporated herein.) Any use of these trademarks, logos, patented or patent pending methodologies without the prior written permission of Research Affiliates, LLC, is expressly prohibited. Research Affiliates, LLC, reserves the right to take any and all necessary action to preserve all of its rights, title, and interest in and to these marks, patents or pending patents.

Neither Research Affiliates, LLC nor its related entities provide investment advice outside of Australia, the United States, Canada and Ireland or offer or sell any securities, commodities or derivative instruments or products. Any such business may only be conducted through registered or licensed entities and individuals permitted to do so within the respective jurisdiction and only in conjunction with the legally required disclosure documents and subject to the all legally required regulatory filings.

Research Affiliates, LLC is an investment adviser registered under the Investment Advisers Act of 1940 (the "Advisers Act") with the U.S. Securities and Exchange Commission (SEC). Our registration as an Investment Adviser does not imply a certain level of skill or training. Additionally, Research Affiliates, LLC may engage in sales and marketing activities with your firm. This includes making available information, education, and guidance materials, herein and otherwise, regarding certain investment advisory services and/or indices that are constructed, published, and licenses. It is not our intent to provide investment advice and accordingly, we will not receive any fees or other compensation directly from you for the provision of investment advice (as opposed to other services) in connection with any Transaction, unless contracted for or permissioned to do so. Without an express written objection from you, we will deem that these acknowledgments and representations apply.

Notice to wholesale clients in Australia:  
Research Affiliates, LLC is exempt from the requirement to hold an Australian financial services license by operation of ASIC Class Order 03/1100: US SEC regulated financial service providers.

© 2019 Research Affiliates, LLC. All rights reserved. Duplication or dissemination prohibited without prior written permission.

