{ FUND MANAGEMENT }

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Smart beta testing is the latest buzz term in the fund management sector, but does it net results?

When Aberdeen Asset Management recently announced an £11bn merger with Scotland's largest insurer, Standard Life, it was more out of necessity than starry-eyed vision of boundless opportunities for the future.

With decent investment returns ever harder to come by in today's low interest rate, low growth world, active fund management is in ragged retreat; rather, it is passive investment that makes the weather. To thrive in this wafer-thin margin, business requires both ultra-low costs and cutting-edge IT. The two companies calculate that together they can make a better go of these requirements.

Credit Suisse estimates that, in the US alone, more than $1 trillion has flowed out of active fund management and into passive funds since the financial crisis in 2008. Many hedge funds have been particularly badly hit; 'normal' pricing signals have been all but wiped out by massive central bank money printing, and many of them now struggle to outperform.

But it is not just because investors are increasingly sceptical about the ability of actively managed funds to add value. It's also because passive fund management has become more sophisticated, taking on some of the attributes of active investment, but at a lower cost.

The buzz term is 'smart beta', or so-called factor investing. A recent survey of major investors cited in the latest *Credit Suisse Investment Returns Yearbook* found that three-quarters of asset owners are already using or actively evaluating smart beta, and of those with an existing exposure, nearly two-thirds are evaluating additional allocations. The proportion of asset owners using at least five smart beta strategies rose from 2% in 2014 to 20% last year. It's the latest thing, but does it work?

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Smart beta refers to the supposedly superior returns that can be extracted

First, let's disentangle the terminology. The return delivered by the market overall is known as 'beta'. Smart beta refers to the supposedly superior returns that can be extracted using particular, usually algorithmically driven, passive strategies. Traditional passive investment merely tracks the market; smart beta tracks indices that have been constructed to have built-in biases. These biases typically include momentum, value and income investing. Or the 'exchange-traded funds' may have a bias to investing in larger companies and, sometimes, smaller companies. Some will apply a mixture of different factors. In all, researchers have identified at least 316 separately applied factors.

This type of investing has of course been around for decades, but smart beta aims to go the extra mile and systematically apply modern computing power to the various investment strategies.

So, does smart beta succeed in delivering superior returns? Research by Credit Suisse in conjunction with the London Business School comes to a not altogether surprising conclusion: sometimes it does, and sometimes it doesn't. As ever with stock market investment, much depends on timing. Momentum works well in certain kinds of markets, value investing better in others, and so on.

The researchers tracked five of the most commonly used forms of factor investing – low volume, income, momentum, size and value – and found that in all cases performance is variable, doing very well one year, and badly the next. If you bought a basket of all the different factors, you would probably end up with something pretty close to the market anyway.

With traditional active fund management on the wane, money managers are desperate to find strategies that might justify higher charges. It's hard to reach any definitive conclusions; some smart beta providers are better than others. But in the round, it seems unlikely that these relatively new forms of investment are going to prove any better at beating the market than the older ones.

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