How to get superior returns and lower fees

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Smart Beta products have been enjoying large inflows worldwide for some time now, thanks to their unique positioning between traditional and index funds. While their objective is to deliver benchmark-beating returns, like traditional funds, Smart Beta funds do so at much lower fees. This is possible as they follow a rules-based approach to investing, and therefore do not require expensive in-depth fundamental research.

The name Smart Beta became popular when referring to strategies that systematically exploit the behaviour of investment styles such as 'momentum', 'value' and 'quality'.

Momentum, value and quality

The roots of momentum or 'trend' investing are found in the well-known truisms "the trend is your friend". Investors as a group get anchored to historic perceptions and they tend to react slowly to new information, and share prices initially underreact. As time goes by and things become clearer, they react more and more in line with new information. This causes a trend. And due to herd behaviour, leading market participants start, and followers extend these trends that investors can exploit.

Share prices sometimes overreact and move into value territory after bad news or when themes or sectors temporarily fall out of favour. Opportunities to "buy low and sell high" arise when a share's price is out of sync with the value that one gets as measured by factors such as dividend yields, price-to-book ratios, cashflow yields and price-to-sales ratios. However, when sanity eventually prevails, patient investors get rewarded when prices move towards fair value.

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If quality is ingrained in a company's DNA, it should show up in key profitability and stability indicators. Profitability measures indicate how efficient a company is in producing earnings. But earnings also need to be credible, stable and repeatable. This would require sound financial reporting, a strong balance sheet, and relatively steady share price behaviour. If a company scores well on these measures, it should be able to consistently generate superior earnings growth that would, in return, result in attractive stock market returns.

Diversification over different styles creates risk reduction

Individual investment styles are cyclical by nature, and while an individual style is expected to outperform its benchmark over a cycle, it is normal that it would sometimes lag its benchmark within a cycle. However, as different styles usually peak and trough at different times, investors can benefit from being diversified over multiple styles or risk premia. This would provide more risk reduction than an approach of diversifying over a group of traditional funds that all broadly follow similar processes. That said, many investors embrace the cyclicality of Smart Beta products as they know there is more upside when they enter close to a cyclical bottom than when they enter close to a cyclical top.

Momentum's smart beta offering

With us, investing is personal, and for investors who want to invest in smart beta funds, our Momentum Core Equity Fund offers exposure to multiple styles within one product. Clients who prefer to make their own style choices can consider the single-style Momentum Trending, Momentum Value and Momentum Quality Equity funds. Apart from the Momentum Quality Equity Fund (launched in August 2021), all our funds were launched in April 2017 and offer solid track records since inception. For more information, visit our website at momentum.co.za.