

Introduction to smart beta investing

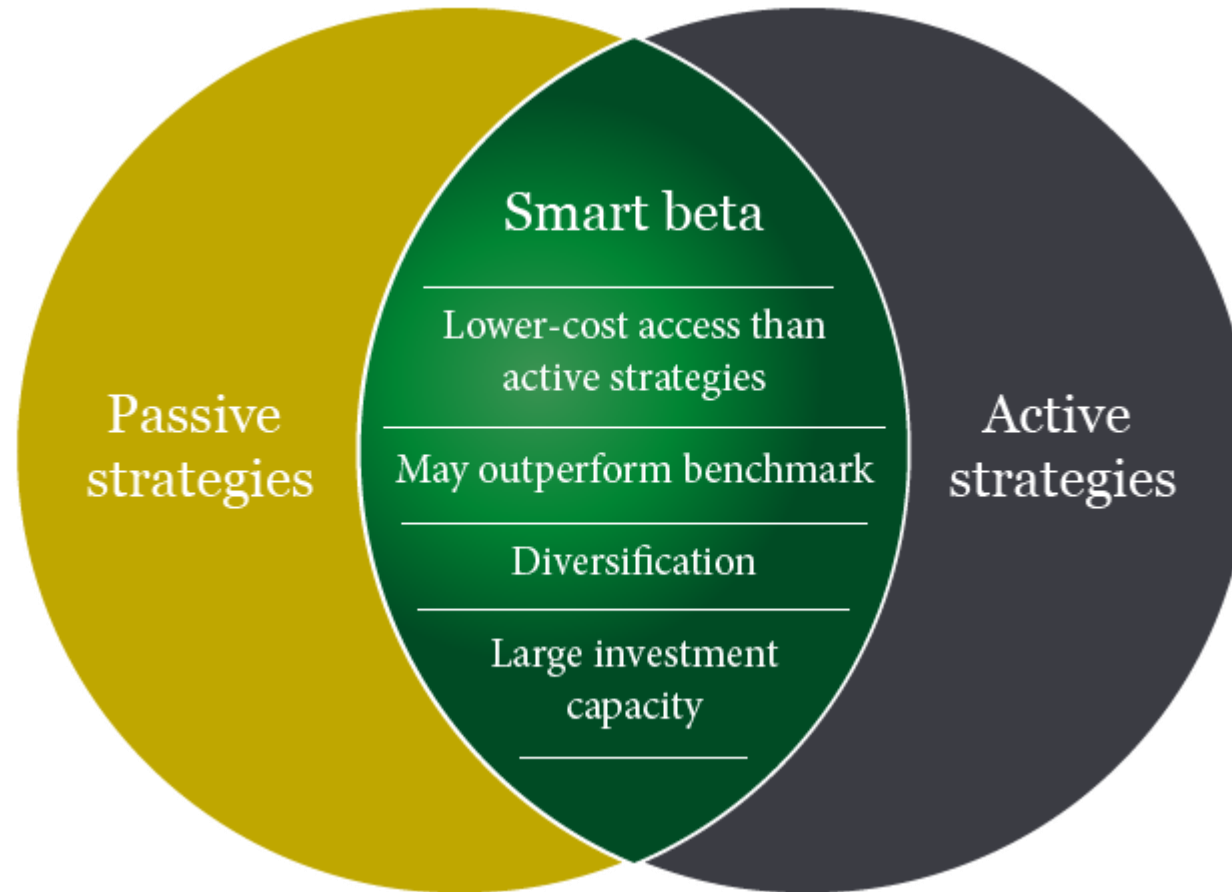
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Active or passive ? | Alpha | Beta | Smart Beta

Combining the benefits of active and passive investing



Pros and cons on smart beta investing

- ❑ Potential for Higher Returns:
- ❑ Lower Costs
- ❑ Enhanced Diversification
- ❑ Transparency
- ❑ Reduced Risk (potentially)

-
- ❑ No Guaranteed Outperformance
 - ❑ Limited Track Record
 - ❑ Fees Can Still Be Higher Than Traditional Index Funds
 - ❑ Choosing the Right Smart Beta Strategy
 - ❑ Performance Dependence on Factors

A Global Guide to Strategic-Beta Exchange-Traded Products © 2023 Morningstar

<https://www.morningstar.com/lp/global-guide-to-strategic-beta>



A Global Guide to Strategic-Beta Exchange-Traded Products

Morningstar Manager Research
20 June 2023

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Executive Summary

In September 2014, Morningstar introduced its naming convention and taxonomy for the fast-growing universe of strategic-beta exchange-traded products, or ETPs. In this year's report, we provide an update on the state of the global strategic-beta ETP landscape, framed using our latest strategic-beta and index attributes, launched in Morningstar's global database in the fourth quarter of 2018.¹

Over most of the past decade, the strategic-beta space grew more rapidly than the broader ETP market. New cash flows, new launches, and the entrance of new players have driven strategic-beta ETPs' growth. However, more recently, these products' market share gains have stalled in most markets we examined—a sign that this segment has reached maturity.

While the strategic-beta ETP segment continued to see healthy net flows in 2022, the overall quantity of strategic-beta funds has decreased in most markets. The number of strategic-beta ETPs declined year over year in the United States, Canada, and Europe, and these ETPs' fees have been squeezed, albeit at a marginal pace. That said, the market share of strategic-beta funds relative to the total ETP market has remained stable in most of the markets that we examined. Environmental, social, and governance products, actively managed exchange-traded funds, and thematic funds have been hogging the spotlight in terms of new launches in recent years. However, it seems that the integration of strategic beta and sustainability is not a prevailing trend across most markets. The subset of sustainable strategic-beta ETPs accounted only for a small percentage of the strategic-beta ETP market.

Key Takeaways

- ▶ As of Dec. 31, 2022, there were 1,384 strategic-beta ETPs worldwide, with collective assets under management of approximately \$1.53 trillion.
- ▶ Assets in these products fell 6.5% in 2022. Top-line figures were hindered by the retreat of the equity markets and foreign-exchange movements, as the Morningstar Global Markets Index fell 17.9%, along with an 8.3% appreciation of the U.S. dollar, as measured by the ICE USD Spot Index.
- ▶ Strategic-beta ETPs amassed \$161.2 billion in net new cash flows, translating to organic growth of 9.6%. Annual net flows were at a record high for two consecutive years.
- ▶ A sharp slowdown in new launches and unrelenting fee competition are signs that the space has reached maturity.
- ▶ The number of strategic-beta ETPs listed worldwide grew just 1.8% in 2022. However, this growth was mostly attributable to the net adds in the Asia-Pacific region. In the U.S., the number of closures (45)

¹ See the Appendix for a full list of attributes and definitions.

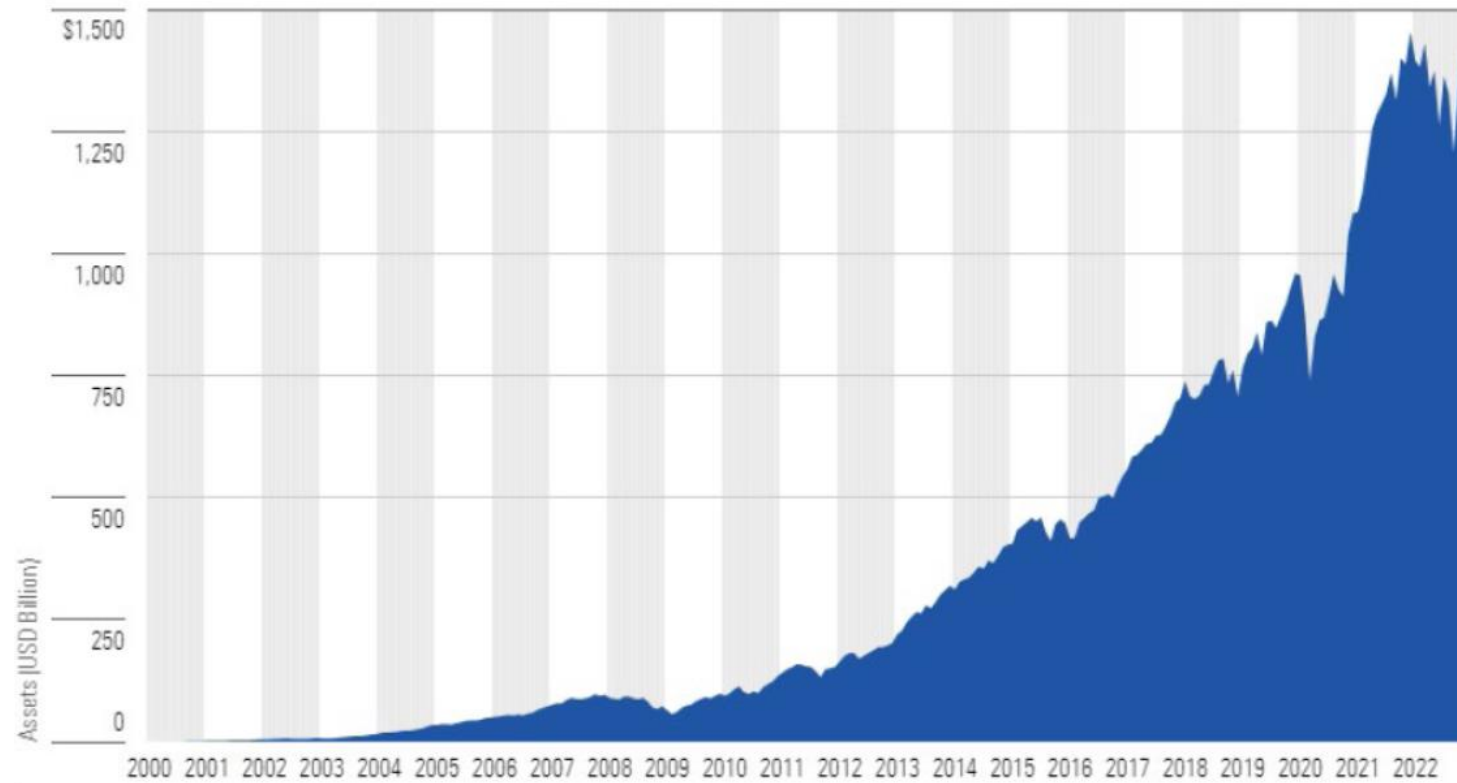
A Global Guide to Strategic-Beta Exchange-Traded Products

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- As of Dec. 31, 2022, there were 1,384 strategic-beta ETPs, with collective assets of approximately \$1.53 trillion worldwide
- For most of the past decade-plus, strategic-beta ETPs made inroads against their peers that are benchmarked to more-traditional indexes.
- More recently, the space has matured in the U.S. and Europe. The category's market share gains have stalled, and closures of products that have not gathered assets have been a common theme. In the Asia-Pacific region, In recent years, sustainable investments have become more prevalent, particularly in Europe.
- Some new products have also introduced the combination of sustainability and strategic beta. However, it is worth mentioning that this blend has not become a prominent trend in terms of asset-gathering at the time of writing this report on the other hand, net flows and product launches both picked up in certain markets in 2022.

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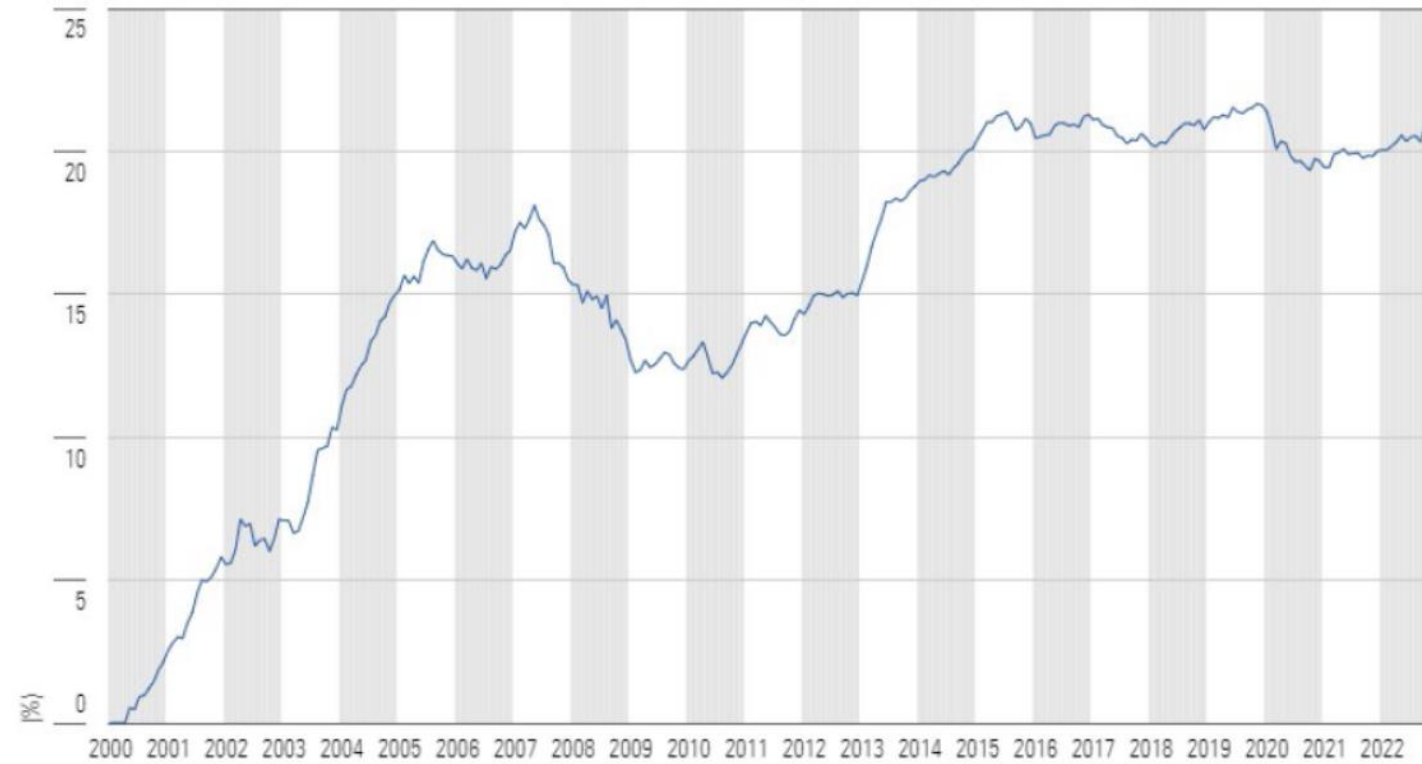
Exhibit 2 U.S. Strategic-Beta ETP Asset Growth



Source: Morningstar Direct, Morningstar Research, Data as of Dec. 31, 2022

% of U.S. ETP Market

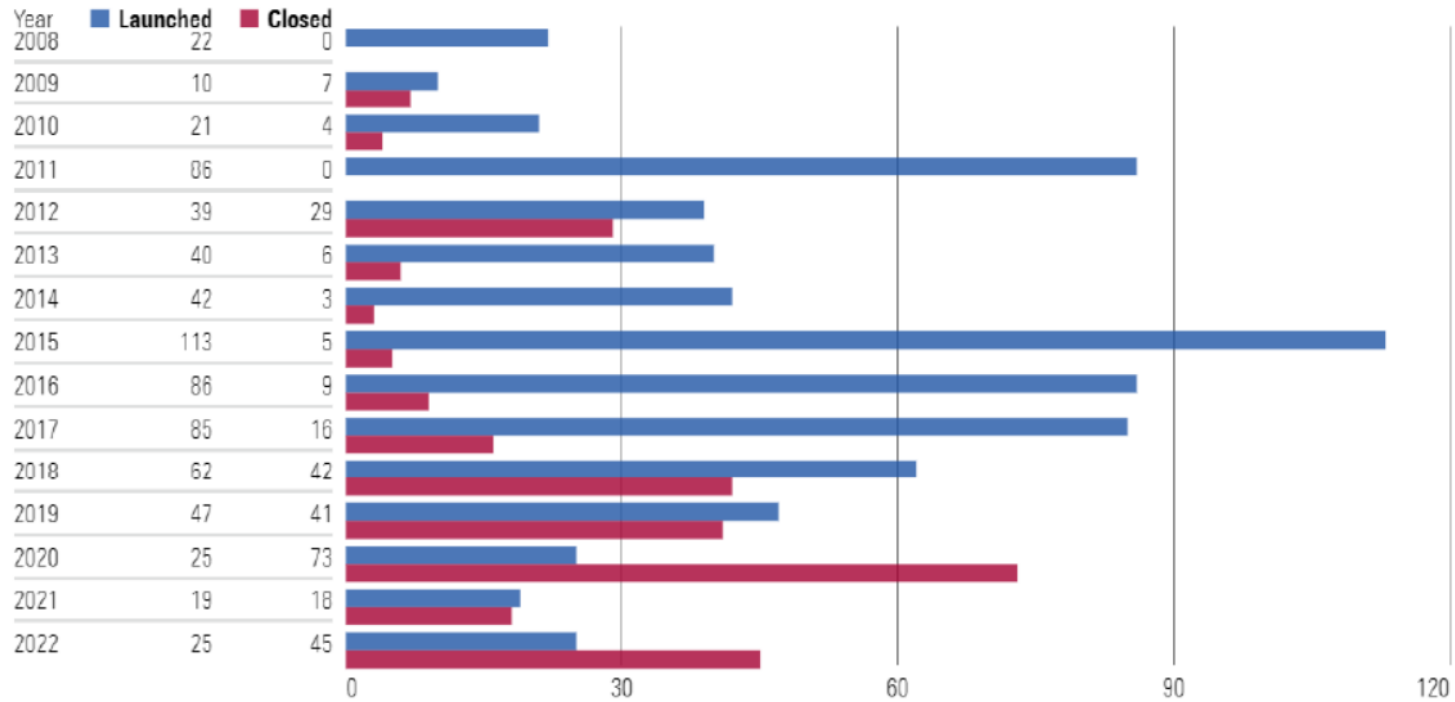
Exhibit 4 Strategic-Beta ETPs' Share of the Overall U.S. ETP Market (%)



Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

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Exhibit 5 U.S. Number of Strategic-Beta ETP Launches and Closures by Year



Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

Strategic Beta Group

Exhibit 6 U.S. Ranking of Strategic-Beta ETPs by Strategic-Beta Group

Strategic Beta Group	No of ETPs	Assets (USD Bil)	% of Assets	2021 Flows (USD Bil)	2021 Organic Growth %
Dividend	146	373.0	27.4	69.8	21.0
Value	46	356.1	26.1	18.6	5.0
Growth	41	302.0	22.2	24.7	6.2
Risk-Oriented	39	70.8	5.2	8.8	12.4
Multi-Factor	152	68.4	5.0	2.4	3.1
Other	42	57.9	4.3	13.6	25.4
Fundamentals	31	50.4	3.7	10.3	22.1
Quality	20	43.6	3.2	0.0	0.0
Momentum	30	21.7	1.6	0.2	0.8
Fixed Income	41	12.0	0.9	-0.2	-1.1
Commodity	27	6.4	0.5	-0.3	-5.2
Total	615	1,362.4		148.0	10.2

Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

European market : Few Launches and Closures in 2022, but ETP Industry Product Development Focus Is Not on Strategic Beta

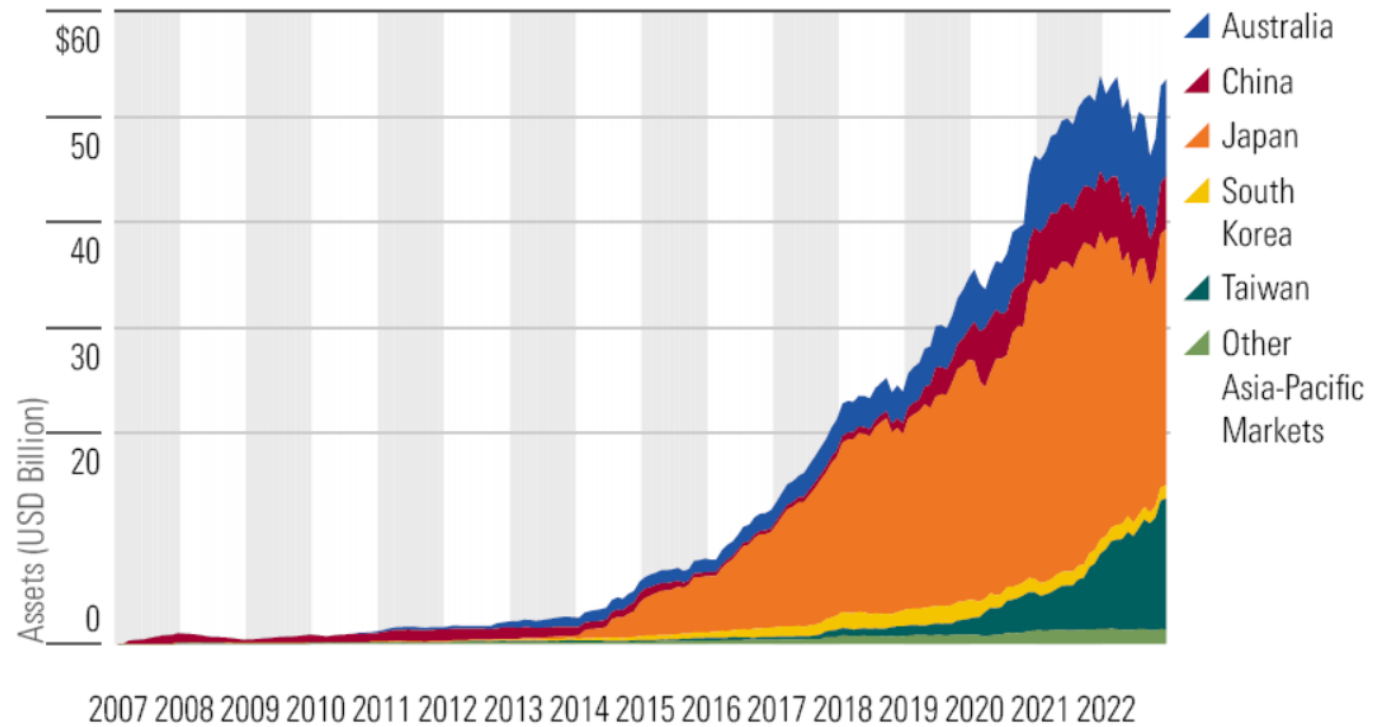
Exhibit 20 Strategic-Beta ETPs' Share of the Overall European ETP Market (%)



Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

Asia-Pacific Market

Exhibit 27 Asia-Pacific Strategic-Beta ETP Asset Growth



Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

Exhibit 31 Ranking of Asia-Pacific Strategic-Beta ETPs by Strategic-Beta Group

Strategic-beta Group	# of ETPs	AUM (USD Mil)	% Attribute AUM												2022 Flows (USD Mil)	Organic Growth %
			Australia	China	Hong Kong	India	Japan	Malaysia	New Zealand	Singapore	South Korea	Taiwan	Thailand	Total Asia-Pac		
Quality	41	25,201.9	6.0	0.5	0.1	0.0	40.3	0.0	0.0	0.0	0.1	0.0	0.0	47.1	555.3	1.8
Dividend	96	21,201.7	5.5	5.6	0.4	0.0	3.9	0.0	0.1	0.5	1.4	22.0	0.0	39.6	7,811.4	47.3
Other	16	2,162.7	2.6	0.2	0.0	0.0	1.1	0.0	0.0	0.0	0.0	0.0	0.0	4.0	23.2	0.9
Multifactor	43	1,962.6	0.5	2.0	0.4	0.0	0.0	0.0	0.0	0.0	0.2	0.5	0.0	3.7	457.4	21.0
Risk-Oriented	20	891.3	0.4	0.1	0.0	0.5	0.1	0.0	0.0	0.0	0.1	0.5	0.0	1.7	371.9	55.8
Fixed Income	8	719.4	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	1.3	141.3	19.4
Growth	6	457.9	0.0	0.6	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.9	290.4	105.2
Fundamentals	6	441.3	0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	12.4	2.6
Value	17	332.2	0.3	0.2	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.6	98.2	34.0
Momentum	12	149.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.3	62.7	42.3
Commodity	2	29.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	-7.0	-21.3
Total	267	53,549.8	17.1	9.4	0.9	0.6	45.4	0.0	0.5	0.5	2.3	23.2	0.0	100.0	9,817.2	18.2

Source: Morningstar Direct, Morningstar Research. Data as of Dec. 31, 2022.

comparison

	Smart Beta Investing	Factor Investing	Thematic Investing
Focus	Capturing factor premiums	Established factors	Long-term trends/themes
Selection	Rules-based weighting	Quantitative models	Active research-driven
Risk	Moderate	Generally lower	Potentially higher
Example	Equal-weighted value index	Value and growth stocks	Electric vehicle companies

Smart Beta Strategy examples (Cont'd)

Smart Beta Strategy	Description	Focus Factor(s)	Potential Benefit	Potential Drawback
Value	Invests in stocks considered undervalued based on traditional metrics like price-to-earnings ratio.	Value	Potentially higher returns	May underperform in growth markets
Momentum	Focuses on stocks with a history of recent price appreciation, aiming to capture ongoing upward trends.	Momentum	Potential for continued growth	Can be more volatile and susceptible to corrections
Low Volatility	Aims to select stocks with historically lower price fluctuations, aiming for smoother returns.	Low Volatility	Reduced portfolio volatility	May underperform the market in strong uptrends

Smart Beta Strategy examples

Smart Beta Strategy	Description	Focus Factor(s)	Potential Benefit	Potential Drawback
Quality	Invests in companies with strong financial metrics like profitability and low debt.	Quality	Potentially better risk-adjusted returns	May be more expensive due to focus on established companies
Size	Weights holdings based on a company's size (market capitalization) in a different way than traditional cap-weighted indexes (e.g., equal weighting, favoring smaller or larger companies).	Size	Potentially capture different risk-return profiles from traditional cap weighting	Performance may depend on the chosen size bias
Multi-Factor	Combines exposure to multiple factors like value, momentum, and quality.	Multiple Factors	Diversification and potentially capturing various market inefficiencies	Complexity in managing and understanding the strategy

Smart beta product's design

1. **Factor(s) Selection**
2. **Ratio and variable selection**
3. **Index Construction**
4. **Rebalancing Rules**
5. **Risk Management**
6. **Cost Management**
7. **Back testing and Simulation**
8. **Implementation Vehicles**
9. **Monitoring and Rebalancing**
10. **Review and Adjust**

Smart Beta Compass

Q1 2024

Seeking Safety in the Soft Landing

04 Investment Outlook

09 Investor Behaviour

13 Factor Performance and Flows



STATE STREET GLOBAL ADVISORS SPDR™

Factors Annual Performance

	2023 (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)	2013 (%)	2012 (%)
Global & World Factors	37.00	-4.74	25.66	33.72	36.08	-2.03	32.09	13.82	5.16	12.37	32.38	17.49
	32.39	-6.52	22.09	28.17	33.68	-2.34	28.01	12.67	4.06	11.37	30.86	16.07
	24.96	-6.84	21.94	22.14	29.71	-2.76	25.96	12.30	3.71	8.45	29.66	15.78
	23.79	-9.54	21.82	17.89	27.67	-5.50	24.63	9.26	3.11	7.28	28.62	15.51
	22.79	-9.79	21.18	15.91	27.67	-6.74	22.69	8.76	2.64	6.55	27.06	15.46
	15.76	-10.65	19.32	15.86	26.19	-7.56	22.66	8.75	1.09	6.48	26.73	14.91
	11.75	-17.79	16.99	2.61	23.17	-7.59	22.40	7.49	-0.31	6.14	26.68	14.04
	11.51	-18.14	15.83	0.52	23.15	-7.61	19.58	7.45	-0.87	4.94	26.62	13.01
	9.13	-18.76	15.75	-0.03	23.06	-8.71	18.14	6.08	-2.63	3.69	21.91	12.21
	7.42	-19.56	15.41	-0.36	22.90	-10.78	17.32	4.54	-3.20	3.19	19.76	11.20
	6.90	-22.21	14.64	-1.16	21.75	-13.86	17.10	4.18	-3.95	2.48	18.61	9.45
	2.39	-29.21	14.26	-11.03	20.31	-14.52	15.99	2.79	-4.82	1.90	18.40	8.03

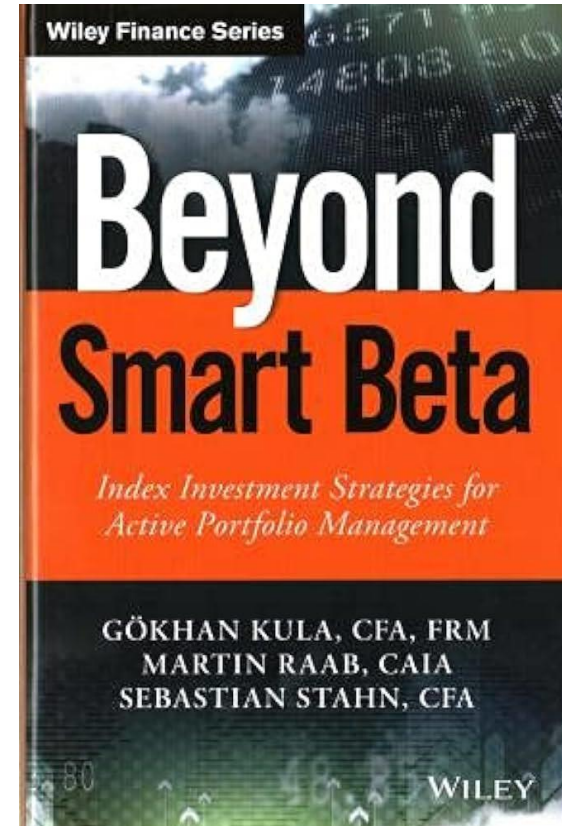
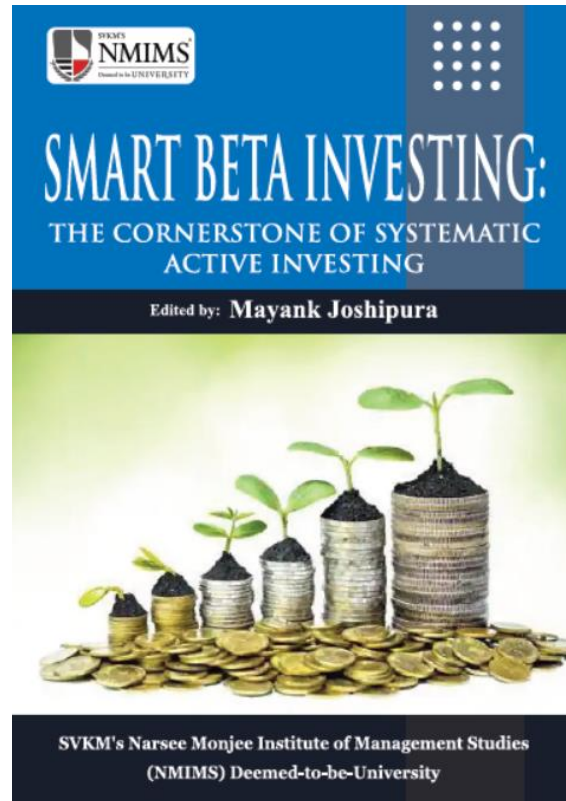
Source: Bloomberg Finance L.P., as of 29 December 2023. Past performance is not a reliable indicator of future performance. The performance figures contained herein are provided on a gross of fees basis and do not reflect the deduction of advisory or other fees which could reduce the return.

- High Dividend
- Value Select
- Momentum
- Min Vol
- MSCI World Index
- Quality
- Low Vol
- Small Cap
- Growth
- Value
- STX Global Index
- Div Aristo

critique

1. Sustainability of Factor Premiums
2. High Costs Can Erode Performance
3. Implementation Challenges
4. Difficulties in Backtesting

further reading



Implication for Iranian capital market

- Index publishing
- Index investing products
- ETFs without AP/market maker role
- innovation
- Asset managers role
- SEO role

