

# Factor investing: a different approach to seeking market performance

Factor investing has overhauled the way investment professionals explain market performance, manage risk and capture returns. Building a diversified factor investing portfolio provides investors with a powerful tool to take full advantage of market cycles aiming to generate stronger risk-adjusted returns over the long-term.

“If we can build a multi-factor portfolio which is well diversified and well balanced, across different factors, we will be better equipped to navigate the equity market,” outlined Bruno Taillardat, Global Head of Smart Beta & Factor Investing at Amundi.

In a webinar hosted by Amundi titled **“Smart Beta & Factor Investing: Where do we stand?”** Taillardat explained that investment portfolios based on factors such as value, low volatility, momentum, size and quality can help investors capture different risk premia in the market. These factors provide explicit exposure to underlying risk factors and help investment professionals obtain market beta more efficiently while allowing them to plan for consistent alpha generation.

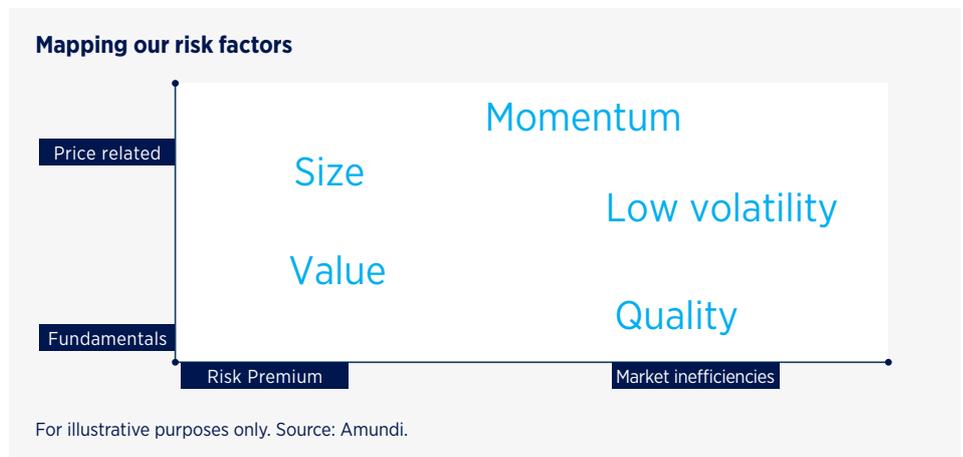
The different characteristics of each factor and the fact they are driven by different selection criteria means they can work together to produce an optimal exposure for investors. For example, the momentum factor is driven by information on price movements while fundamental criteria are more related to quality concerns. Furthermore, factors like

value tend to be higher risk than low volatility for example, which is more defensive and rewards investors during turbulent times.

“Factor investing is a very efficient way of managing risk and we believe that risk management leads to better performance over the long term,” Taillardat stated.

The varying nature of the factors identified brings complementarity for investors

with a diversified portfolio, meaning that factors can bring different performance contributions at different times in the market cycle. “Primarily, factor investing is a tool for generating higher returns and to achieve long-term performance. This is delivered through the power of risk factor-based diversification as it allows the portfolio to be well balanced on a practical dimension. Portfolio construction is crucial in factor investing” Taillardat explained. ■



## Factor performance during the pandemic

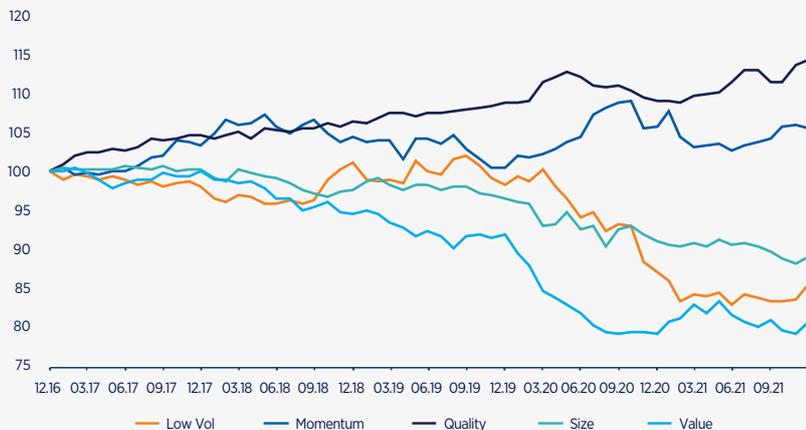
Although the Covid-19 crisis did see quantitative investment strategies struggle overall, Taillardat emphasizes there is investment rationale behind each factor's performance - the surprises in this regard were sparse.

The value factor, for example, underperformed throughout most of 2020, until showing a recovery towards the end of the year as a result of the Pfizer vaccine being announced. This performance was expected since it's a risky factor which has high correlation with credit risk.

The size factor also behaved as typically expected in a crisis due to the strong focus on highly liquid stocks.

Taillardat noted that the underperformance of the low volatility factor was somewhat unexpected.

**Factors' historical cumulative excess returns**



Past performance is not a guarantee or indication of future results.  
Source: Amundi AM, Factset, as of 30/12/2021  
Chart rebased to 100.

“Low volatility outperformed in the first part of the year when the market was turbulent but then didn’t deliver protection as it should in a bear market. Furthermore, during the market relief that followed, low volatility lagged due to the lack of exposure to concentrated names like big tech stocks.”

Arguably, the lacklustre performance of low volatility strategies was driven by the unprecedented circumstances arising from the Covid-19 outbreak and the subsequent policy response to the crisis. The momentum and quality factors performed quite well throughout 2020. ■

**Cyclicality, performance and risk**

Hamza Bahaji, Head of Engineering and Solutions at Amundi highlighted how the global picture has changed dramatically in 2021. He explained the way factors behave and the features of these market patterns.

“Cyclicality is a noticeable feature in the factor dynamic. For instance, the performance of the value factor can be clearly distinguished by smooth, repetitive peaks and troughs,” Bahaji notes.

Although cyclicality is identified within all factors, each one follows a different cycle. This leads to factor performance being de-correlated, which highlights their complementary nature – a second crucial

element of the factor dynamic. It is their ability to provide returns at different points in the market cycle that results in the diversification benefits indicated earlier.

Ultimately, factor investing has shown significantly positive risk-adjusted returns. This means there are long-term premia associated with these factors, which is the third important feature of factor investing and makes it an efficient tool to hedge against the market turbulence seen since the mid-point of 2021.

The critical aspect of successful factor investing lies in the way portfolios are constructed. “In a volatile and uncertain

market context, the best way to harness global equity performance is to invest in a well-diversified portfolio across different factors”, states Taillardat. He noted that one of the potential benefits of a multi-factor portfolio is to deliver consistent performance over time, within a governance structure which is straightforward and easy to understand.

Amundi has mapped the way different factors should behave within different market scenarios. For example, within a bear market, defensive factors like low volatility and quality are expected to perform. This allows for more robust portfolio construction and the potential for predictable returns. ■

**ESG as a new factor**

Taillardat then addressed the question of whether it is possible to consider ESG as a new equity factor. Looking at an empirical analysis of ESG as an additional risk factor in the Eurozone and in the US over the last six years shows that ESG integration has proven to be a driver of alpha. The research looked at the performance attribution of ESG

over the period, comparing an ESG portfolio with a non-ESG portfolio. Today, there is greater evidence that ESG is a source of additional performance.

Returning to how factors are defined (cyclicality, complementarity, and long-term risk premia), Taillardat explained that for ESG

to be considered a factor, “it has to deliver positive risk-adjusted returns, but it also has to be different or at least complementary to other factors already being used by investors.”

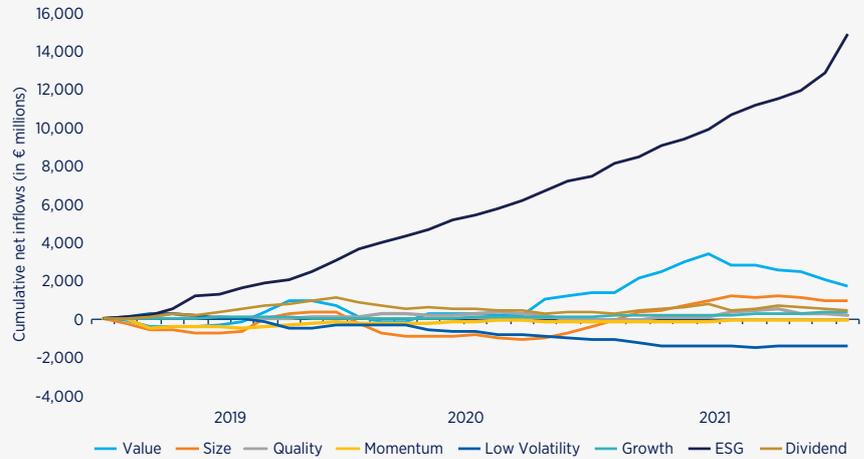
When considering the performance of stocks according to their ESG scores, the period prior to 2014 showed little differentiation

in the analysis. This changed in 2014 when the names in the top quintile of ESG scores-ranked stocks began to outperform. It was this distinction which drove Amundi to consider ESG as a new investment factor.

The complementary nature of ESG as a factor further emerged as a result of the positive inflows into passive ESG ETPs.

However, for ESG to stand its ground as a factor, it also must provide added value within a multi-factor portfolio, as mentioned earlier. The analysis indicated higher systematic effects and significant diversification in the ESG portfolio. When considering the performance attribution, ESG accounted for a significant portion of market return, even when presented alongside other factors. ■

**Cumulative style ETFs net flows in Europe**



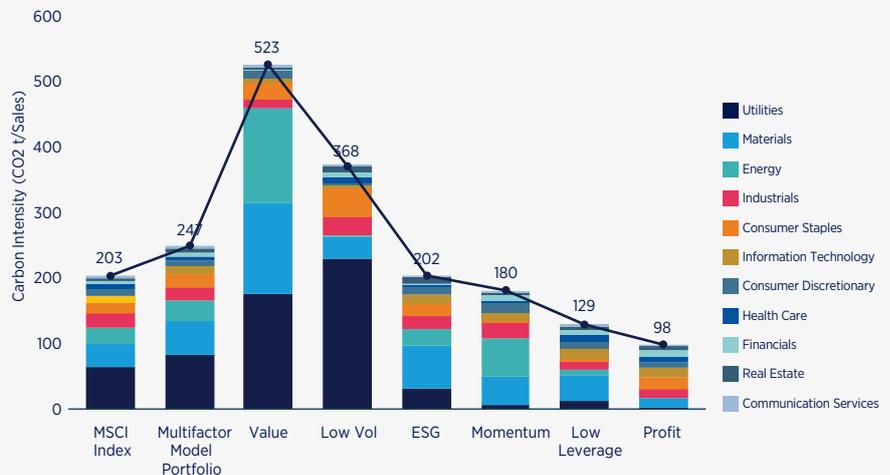
Past performance is not a guarantee or indication of future results.  
Sources: Factset, Amundi analysis as of 31/12/2021.

## Is there a role for factor investing in tackling climate change?

Bahaji discussed the ability for factor portfolios to also account for climate change and take into consideration the carbon footprint of the investments. “Combining carbon intense factors (value and low volatility) with others - like momentum, quality and even ESG - in a multi-factor portfolio, with a fairly balanced factor exposure, investors end up with a portfolio which has a higher carbon footprint than the benchmark. This comes as a result of higher exposures to some carbon-intensive stocks and sectors such as utilities.

However, this risk can be managed without affecting the central investment objective of an active multi-factor strategy. The portfolio can continue to provide balanced and diversified exposure to underlying factors. “The reduction of the carbon emissions intensity within the final portfolio can be gradually obtained without affecting its overall factor exposure. This would be done through a non-uniform reduction of the contributions of each of those carbon contribution-based stock ‘buckets,’” Bahaji concludes, noting that it is possible to significantly reduce the carbon emissions intensity from the portfolio while maintaining a similar factor exposure compared to the initial multifactor portfolio. ■

**Sector contributions to factors' carbon footprints**



Past performance is not a guarantee or indication of future results.  
Source: Trucost, MSCI, Amundi, as of 30/11/2021.

### Taillardat concluded with a summary of Amundi's clear convictions on factor investing:

- Factor investing and multi-factor portfolios can be an efficient way to manage risks
- Requires strong convictions around risk management and diversification
- Risks must be considered multifaceted
- A disciplined portfolio construction process is required to manage risks efficiently for reward

### About Amundi ETF, Indexing & Smart Beta

The Amundi ETF, Indexing and Smart Beta business line provides investors - whether institutional or distributors - with robust, innovative, and cost-efficient solutions, leveraging Amundi Group's scale and large resources. The platform also offers investors fully customized solutions (ESG, Low Carbon, specific exclusions, risk constraints, etc.).

With over 30 years of benchmark construction and replication expertise, Amundi is a trusted name in ETF & Index management among the world's largest institutions. The team is also recognized for its ability to develop Smart Beta & Factor Investing solutions, with a track record of more than 10 years.

### Important information

Investment in a Fund carries a substantial degree of risk such as Risk of capital loss - Underlying risk - Volatility Risk. Before any investment, please read the detailed descriptions of the main risks in the KIID and prospectus.

This material is solely for the attention of professional, and eligible counterparties, as defined in Directive MIF 2014/65/UE of the European Parliament acting solely and exclusively on their own account, or Institutionals, and acting exclusively on their own account. In Switzerland, it is solely for the attention of qualified investors within the meaning of Article 10 paragraph 3 a), b), c) and d) of the Federal Act on Collective Investment Scheme of June 23, 2006.

Amundi Suisse SA is distributing in Switzerland and from Switzerland the collective investment schemes managed by Amundi AM and/or Amundi Luxembourg. In this respect, Amundi Suisse SA informs investors that it collects, from Amundi AM and/or Amundi Luxembourg, a compensation under article 34 al. 2bis in the Ordinance on collective investment schemes (Ordonnance sur les placements collectifs de capitaux, OPCC). This compensation can constitute a part of the management fees stated in the prospectus. Additional information regarding the existence, nature and calculation method for the compensation received by Amundi Suisse SA within the frame of its distribution activity in Switzerland or from Switzerland may be provided upon written request to Amundi Suisse SA 6-8 rue de Candolle 1205 Genève Suisse.

Promotional and non-contractual information which should not be regarded as an investment advice or an investment recommendation, a solicitation of an investment, an offer or a purchase.

Before any subscriptions, the potential investor must read the offering documents of the Funds approved by the Autorité des Marchés Financiers for French Funds or by the Commission de Surveillance du Secteur Financier of Luxembourg for the sub-funds of the Luxembourg Sicav Amundi Index Solutions, including the KIID, available on [www.amundi.com](http://www.amundi.com) or [www.amundiETF.com](http://www.amundiETF.com) or upon request from the headquarters of the Sicav or free of charge from CACEIS Bank, 1-3 place Valhubert 75013 Paris - France, French Paying Agent of the Sicav.

Investment in a Fund carries a substantial degree of risk (i.e. risks are detailed in the DICI and prospectus). Transaction cost and commissions may occur when trading ETFs. The policy regarding portfolio transparency and information on the funds' assets are available on [amundiETF.com](http://amundiETF.com). Indicative net asset value is published by stock exchanges. The Funds' units purchased on the secondary market cannot usually be sold directly back to the Funds. Investors must buy and sell units on a secondary market with the assistance of an intermediary (e.g. a stockbroker) and may incur fees for doing so. In addition, investors may pay more than the current net asset value when buying units and may receive less than the current net asset value when selling them.

United Kingdom

**For Professional Clients only.** This article is being issued in the United Kingdom ("UK") by Amundi (UK) Limited, 77 Coleman Street, London EC2R 5BJ, UK, which is authorised and regulated by the Financial Conduct Authority (the "FCA") and entered on the FCA's Financial Services Register under number 114503. This may be checked at <https://register.fca.org.uk/> and further information of its authorisation is available on request.

**Past performance is not a guarantee or indication of future results.** This article is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Amundi (UK) Limited or any entity within the Amundi group (together, "Amundi") to any registration requirements in these jurisdictions. This article and all the information, data, opinion, performance, and other figures contained herein are proprietary and cannot be published or reproduced, fully or partly, without Amundi's prior written authorisation. Amundi does not accept any liability, responsibility or duty of care, whatsoever, with respect to this article. Amundi does not give any guarantee (whether express or implied), warranty, undertaking or representation as to the accuracy, validity, relevance, exhaustiveness, timeliness, completeness and/or reliability of the information contained herein. The opinions expressed reflect the current judgement of the personnel of Amundi and may be subject to change without notice. Amundi shall be under no obligation to update the information. **This article is only directed at persons who are Professional Clients (as defined in the FCA's Handbook of Rules and Guidance), must not be distributed to the public and must not be relied or acted upon by any other persons for any purposes whatsoever.**

Switzerland

Amundi ETF Funds available for distribution to all investors:

This AMUNDI ETF Fund has been authorized for distribution to non-qualified investors in or from Switzerland by the Swiss Financial Market Supervisory Authority ("FINMA"). Subscriptions in the ETF Fund will only be accepted on the Fund's Key Investor Information Document ("KIID") and the prospectus, or the fund's regulation as well as the annual and semi-annual financial reports that may be obtained free of charge from the Swiss Representative. Swiss Representative: CACEIS (Switzerland) SA - Route de Signy 35 - CH1260 Nyon. Paying Agent in Switzerland: CACEIS Bank, Paris, Nyon branch / Switzerland - Route de Signy 35 - CH- 1260 Nyon. Amundi ETF Funds aimed at qualified investors only: This Amundi ETF Fund (collective investment schemes) authorized by the AMF, has not been approved by FINMA. This Amundi ETF Fund is available in Switzerland for distribution exclusively to Qualified Investors, as defined in the Collective Investment Schemes Act of 23 June 2006, as amended ("CISA") and its implementing ordinance, in conjunction with the Financial Services Act. The KIID, prospectus, fund's regulation and annual and/or semi-annual financial reports relating to this Amundi ETF Fund are available free of charge from the Swiss Representative or from authorized distributors to Qualified Investors. Swiss Representative: CACEIS (Switzerland) SA - route de Signy 35 - CH 1260 Nyon. Paying Agent in Switzerland: CACEIS Bank, Paris, Nyon Branch / Switzerland, Route de Signy 35, 1260 Nyon, Switzerland.

This information is not for distribution and does not constitute an offer to sell or the solicitation of any offer to buy any securities or services in the United States or in any of its territories or possessions subject to its jurisdiction to or for the benefit of any U.S. Person (as defined in the prospectus of the Funds). The Funds have not been registered in the United States under the Investment Company Act of 1940 and units/shares of the Funds are not registered in the United States under the Securities Act of 1933.

Amundi Index Solutions", a Luxembourg SICAV, RCS B206810, located 5, allée Scheffer, L-2520 Luxembourg. The sub-funds were approved for public distribution in Luxembourg by the Commission de Surveillance du Secteur Financier of Luxembourg.

Please note that the management company may de-notify arrangements made for marketing as regards units/shares of the Fund in a Member State of the EU in respect of which it has made a notification.

A summary of information about investors rights and collective redress mechanisms can be found in English on the regulatory page at <https://about.amundi.com>.

### Index disclaimer

Amundi ETF funds are neither sponsored, approved nor sold by the index providers. The index providers do not make any declaration as to the suitability of any investment. A full description of the indices is available from the providers.