



Strategic Beta and Factor-Based Investing

Strategic beta, and the sub-universe of factor-based strategies, has wedged itself squarely between passive and active investing philosophies. It combines active management acumen to capture compensated sources of return with the objectivity of rules-based, repeatable implementation processes to reign in fees, **resulting in active management packaged at a passive price point.**

What is Strategic Beta?

Strategic beta strategies systematically create a portfolio of securities that differ materially from passive, core market capitalization-weighted indices. Through alternative weighting rules, strategic beta products seek to perform better and/or with less risk than market capitalization-weighted benchmarks.

Factor-based investing is an important subset of the strategic beta universe that refers to systematically managed strategies that weight holdings based on academically vetted, rewarded risk factors. **In addition to the market factor, the most widely recognized rewarded factors include Value, Quality, Momentum, Size and Low Volatility.**

		Passive Investing	Active Investing	
		← LOW DUE DILIGENCE BURDEN		HIGH DUE DILIGENCE BURDEN →
		Traditional Passive	Strategic Beta Factor-Based Investing <small>Holdings weighted on rewarded risk factors size, value, momentum, quality, low volatility</small>	Traditional Active
KEY HIGHLIGHTS	Systematic	Systematic	Systematic	Idiosyncratic
	Objective	Objective	Objective	Subjective
	Market cap weighted	Market cap weighted	Non-market cap weighted	Non-market cap weighted
	Most transparent	Most transparent	Varying levels of transparency	Least transparent
	Low cost	Low cost	Low to moderate costs, more in-line with passive	Moderate to high cost
	High number of holdings	High number of holdings	High number of holdings but fewer than Traditional Passive	Generally low number of holdings
	Highest capacity	Highest capacity	Moderate capacity	Lowest capacity

Separating Strategic Beta and Factor-based Investing

Although factor-based strategies can be considered strategic beta, not all strategic beta strategies are factor-based. Both are systematically derived from a core market capitalization universe, but are constructed with different goals in mind.

Core Market Capitalization Universe

Weighting components in amounts *proportional to their market value*.

Strategic Beta

Systematically weighting constituent holdings to be *meaningfully tilted away* from market capitalization weights using predefined metrics.

Factor-based Investing

More precisely defined *subset of the strategic beta universe* that systematically weights holdings based on academically vetted, *rewarded risk factors* to provide consistent, intentional, and significant exposure to these factors.

	Strategic Beta Investing		Factor-based Investing
Intent	Reselect and/or reweight the market cap universe	➔	Deliberate exposure to academically derived style factors
Philosophical Basis	Based on a set of literature that challenges market cap weight as the optimal weighting approach	➔	Based on a set of literature that seeks to identify explanatory variables and rewarded risk premia
Style exposure	May incidentally lead to style factor exposure	➔	Intentional style factor exposure
Examples	Fundamental Indexing, Equal Weighting, Dividend Weighted	➔	Value-, Momentum-, Quality-, Small Size-, Low Volatility-Weighted

Our Approach to Strategic Beta

Increasing availability of strategic beta products means investors are no longer tied to paying traditional active management fees for what may amount to systematic beta exposures. As a result, investors can more efficiently allocate fee budgets to focus on paying lower fees for factor exposures and only paying higher fees for unique manager skill.

As the availability and complexity of these products has grown, so too has the due diligence burden involved in their evaluation. We offer multiple tools and resources to help navigate this universe:



Select List: These are the highest conviction strategic beta strategies identified by our research team, and will include products meant to gain exposure to rewarded risk factors.



Approved Lists: The Envestnet platform highlights the following types of approved strategic beta products:

Approved – Quantitative: These products have met various quantitative screens for cost, liquidity and performance (which includes an assessment of factor exposure).

Approved – Qualitative: In addition to the rigorous due diligence standards in place for all active strategies reviewed by our research team, strategic beta strategies are evaluated with a particular sensitivity to the strength and consistency of exposure to targeted factors and diversification of non-targeted factor exposures.



Strategic Beta Flag: Products that meet our definition of strategic beta are flagged and searchable on the Envestnet platform.



Thought Leadership: Thought leadership and guidance regarding strategic beta and its uses, including a foundational overview of the [strategic beta landscape](#).



Disclosure:

For more details on PMC's research practices and/or portfolio attributes, please contact pmc@envesnet.com or call 1-888-612-9300. Advisors should always conduct their own research and due diligence on investment products and the product managers prior to offering or making a recommendation to a client

The information, analysis, and opinions expressed herein are for general and educational purposes only. Nothing contained in this document is intended to constitute legal, tax, accounting, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. All investments carry a certain risk, and there is no assurance that an investment will provide positive performance over any period of time. An investor may experience loss of principal. Investment decisions should always be made based on the investors' specific financial needs and objectives, goals, time horizon, and risk tolerance. The asset classes and/or investment strategies described may not be suitable for all investors and investors should consult with an investment advisor to determine the appropriate investment strategy. Past performance is not indicative of future results.

FOR HOME OFFICE AND ADVISOR USE ONLY

©2021 Envestnet, Inc. All rights reserved.

PMC-SB-1P-0621