What pension schemes really think about 'smart beta'

Jamie Forbes reveals the results of Russell's survey, which looks at European and American investors' perceptions and adoption of smart beta

Change is difficult. Whenever change occurs, doubt surfaces – accompanied by the wave of resistance that undermines progress. Such is the case with alternatively weighted or factor-based indices and their related investment strategies, known generally as 'smart beta.'

Although the concept of style or factor investing is not new, we are seeing fresh interest in this category with the introduction of new tools and vehicles allowing investors to access exposures previously only available through active management. Predictably, detractors are expressing their doubts, with accusations involving marketing, naming, performance, risk and cost structure, yet investors are pouring assets into these strategies[1].

So, what do institutional investors really think about 'smart beta' indices? In January 2014 Russell's index business conducted a survey[2] of almost 200 institutional asset owners with at least $200 million in assets under management (AUM) in North America and Europe. More than half (52%) of the respondents were European asset owners.

The goal was to better understand perceptions and adoption of smart beta within these important investor populations and regions. The survey targeted equity investment decision-makers across a broad spectrum of AUM and at different stages in their evaluation of smart beta. The results of the survey, entitled *Smart Beta: A Deeper Look at Asset Owner Perceptions* confirm that asset owners in North America and Europe are actively using smart beta indices in strategic and tactical ways to pursue a wide range of investment outcomes.

In Europe, the survey findings are quite interesting. Europe is clearly leading North America in smart beta interest and adoption, with 40% of European respondents currently reporting having a smart beta allocation, compared to 24% in North America. And European investors seem less critical about the term 'smart beta' than their North American counterparts, with more than a third (35%) citing 'smart beta' as the preferred name, versus just 15% in North America.

Even more interesting than the rate of adoption is how smart beta indices are being used. 72% of European asset owners surveyed view 'investment strategy' as an appropriate application for smart beta indices, while more than half (53%) view smart beta indices as tools to help control unwanted or introduce wanted exposures into an investment portfolio. In the UK, 90% of those surveyed have evaluated or are currently evaluating fundamentally-weighted index strategies, while more than half (55%) have considered or are considering low-volatility index strategies.

This is of course good news for investors. The proliferation of smart beta indices has put more tools in the hands of European pension schemes. And they aren't just benchmarks anymore.

Yet this is just the beginning. Effectively integrating smart beta strategies within a broader portfolio requires an asset owner to maintain standards of assessment and ongoing review similar to those associated with any active strategy.

In our discussions with clients, we are finding that increased interest and adoption of smart beta indices has driven a commensurate increase in the need for insight and advice on how to best implement them. For those investors who embrace change, the integration of smart beta index tools into the investment process can be of great benefit. Yet like any innovation in our history, acceptance and adoption takes time.

[1] Flows Show Investors Favouring Smart Beta, EM ETFs. ETFTrends.com
[2] Russell Indexes conducted its global institutional market survey, entitled Smart Beta: A Deeper Look at Asset Owner Perceptions, in January 2014. The survey's aim is to gain better insight into the adoption and perception of smart beta by asset owners globally to help provide additional insights for investors considering the use of smart beta strategies in their portfolios. The survey was conducted between January 22nd and February 20th 2014. Survey participants included 181 asset owners with at least $200m in AUM in the United States, Canada, Europe, and the Middle East.

Written by Jamie Forbes, director, Indexes EMEA, Russell Investments

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