



Tobam and FTSE launch risk-weighted index series eligible for use in ETFs and structured products

ASSET MANAGER Tobam and index provider FTSE have launched the FTSE Tobam Maximum Diversification Index Series, a collection of alternatively weighted indexes based on diversification.

Yves Choueifaty, president and founder of Tobam in Paris, says market cap-weighted portfolios appear to consistently underperform other systematic portfolios for long periods of time. "Financial markets have never been so uncertain – there is a clear urgency to diversify," says Choueifaty. "The lower diversification in the concentrated market cap-weighted portfolios can account for the poor risk-adjusted performance relative to other portfolio construction. Credible alternatives have been empirically shown to provide better absolute returns, as well as risk-adjusted returns."

Sourced from the FTSE All-World Index, constituents are risk- rather than market cap-weighted. "Investors are right to believe in diversification as the best source of both performance and risk control. They are right to seek a 'risk-aware' approach to investing and efficient tools such as exchange-traded funds (ETFs) to implement a diversified portfolio," says Elizabeth Breden, vice-president and product specialist at Tobam. "Diversification is not 'owning the market' in the traditional sense,



Yves Choueifaty, Tobam

because the cap-weighted indexes many investors continue to use do not provide diversified access to the risk premium." In fact, their structural inclination is to concentrate higher weights and they run the risk of over-exposure to volatile sectors, she says.

"Why buy all the stocks in the market when an intelligent, risk-aware selection can provide a more precise, and thus more effective, exposure to all of the individual drivers of the risk premium?" asks Breden. "Maintaining neutral exposure to the risk factors underlying 'market' returns requires active management and skilled, systematic implementation."

While the asset manager has tended to focus on creating mandates for institutional clients in the creation of structured funds, a spokesman for the company said the FTSE Tobam Maximum Diversification Index Series

will open doors for the creation of ETFs and structured products.

The series is set to attract institutional investors who may not want an individual mandate, but may feel more comfortable in investing in an index. "We feel that the real issue is that cap-weighted indexes fail to capture the entire available risk premium, because they always maximise their risk allocations to the most expensive risk factors," adds Breden.

Maximising diversification, on the other hand, provides full exposure to the equity risk premium, and – because of this diversification across risk factors, above and beyond individual stocks – lower portfolio volatility, she says. The index series will initially consist of five regional indexes and will subsequently be followed by three single-country indexes.

According to Breden: "An efficient index or portfolio will provide exposure to all of the risks underlying individual stock returns – without doubling up on certain factors." Market returns are not driven by individual stocks, but rather, individual stock returns are driven by many different risk factors underlying these stocks, for example the oil price, retail sales, interest rates or other sector-specific factors, she adds.

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