IPE Awards Seminar: Market concentration to boost smart beta – TOBAM

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Smart-beta strategies are set to give investors higher relative returns in the next few years because market-cap weighted benchmarks have now become so concentrated, according to one of the sector's key players.

Yves Choueifaty, president and chief executive of asset management firm TOBAM, told IPE: "I am sure in the coming years we are going to increase the return by a lot more than that [3%] because the markets are extremely concentrated."

The term smart beta is used to label investment techniques that use rules-based strategies rather than market-cap weighted benchmarks.

After a seminar at the IPE Awards in Noordwijk, Choueifaty said that, in the past, TOBAM, with its "anti-benchmark" strategy, had been able increase the return over the market by 3% a year.

"The cap-weighted benchmark has never been as concentrated as it is today," he said.

In emerging markets, for example, there is a huge concentration towards financials and a second concentration towards materials and energy, he said.

He questioned whether the current market therefore represented emerging markets, with financials on the one side and energy and materials on the other.

With the MSCI up 31% in the year to date, Choueifaty said markets were doing well.

But his firm's smart-beta strategy will systematically increase eventual returns, he claimed, unless a highly improbable scenario occurred under which markets became fully concentrated.

"It is very important to understand that, when you buy the benchmark, you are in fact saying concentration is going to increase," he said.

"Otherwise, why would you put so much money in such a low number of risk drivers like financials and energy and materials only?"

Choueifaty and other panelists at the seminar on smart-beta strategies – all from asset management firms that have pioneered such methods – said they were unafraid of the business consequences of having published their formulae.

"When a client understands and agrees with your methodology, he will always go with the original and not a copy," Choueifaty said.

François Millet, head of index and quantitative fund development at Lyxor, said allowing the public access to the formula did not equate to giving away the firm's secret sauce.

"Of course, we give away all of the formula, but we also have a lot of applied research – for example, how you calibrate the parameters of your portfolio, […] how you address liquidity," he said.

"There is a lot of added value no matter what we give away regarding the calculation of strategies."

Jeff Wilson, head of institutional relations at smart-beta firm Research Affiliates, said that, 10 years ago, when the firm did its research, it specifically published in order to have the material vetted by the academic community.

"Our model is out there – the understanding of why the method works has given investors a lot of confidence to go with one of the pioneers rather than try to go with a new entrant into the market," he said.