Factor/Style Investing

Style Investing: The Long and the Long/Short of It

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Many investors agree that applying systematic tilts away from a passive, capitalization-weighted portfolio is a good idea; fewer agree on how best to capture these style-based returns.

Long-only, or "smart beta," strategies apply tilts (typically within equities) to give exposure to styles such as value, momentum, size or low risk — that is, they overweight stocks that are relatively cheap, have recently outperformed peers, have a small market cap, or are classified as low risk or high quality. These tilts aren't always explicit, as some smart beta strategies emphasize a portfolio goal — maximum diversification, for example, or minimum volatility — rather than a rule for picking securities. However, all these approaches result in deviations from market capitalization weights that in practice imply certain systematic style tilts.

The same principles can be applied in a long/short context — that is, going long cheap assets and short expensive ones; long outperformers and short underperformers, etc. These strategies are variously called "alternative betas" or "alternative risk premia" (and even other names); in this piece, we refer to them as "style premia." Unlike smart beta, we find that style premia can be applied in multiple asset classes, with little or no traditional beta exposure.

We believe that style premia, whether applied in long-only or long/short portfolios, may provide investors much of the excess uncorrelated returns they hope to find from manager alpha, only in a more transparent and systematic framework, and at a fair cost. Because of this, we believe styles deserve meaningful consideration as strategic allocations in institutional portfolios.

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