

# Equity Factor Investing 101

What is equity factor investing, and how is it useful?

## What are factors?

A factor is an attribute of a security that is identified as a potential driver of return.

Factors form the basis of performance. Just as an interviewer might consider “work experience” or “technical abilities” factors in a job interview, an investor might consider “value” and “momentum” as factors in a security or a portfolio.

## What is equity factor investing?

Equity factor investing is a systematic approach to evaluating companies.

Companies are assessed on how attractive they are based on one or more factors, and then ranked against other firms. Higher ranked companies may indicate a greater opportunity for alpha.<sup>1</sup>

## Is all equity factor investing the same?

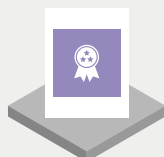
No. In fact, GSAM’s Quantitative Investment Strategies team (QIS) is focused on two main forms of equity factor investing: Smart Beta<sup>2</sup> strategies, and alpha generation.



Good Value



Strong Momentum



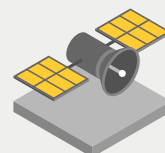
High Quality



Low Volatility



Credit Card Transactions



Satellite Imaging



Internet Traffic



Research Reports

**Smart beta** investing seeks to derive return from risk premia<sup>3</sup> in the market; smart beta factors tend to be well known and easier to implement.<sup>4</sup> For example, the “momentum” factor is well known and is based on the belief that stocks that have recently increased in price may continue to increase in price due to the bandwagon effect.

**Equity alpha strategies** typically seek to generate an informational advantage by utilizing various datasets to help identify securities that are priced too low or too high, and then buy or sell based on that information. For instance, quantitative investors seeking equity alpha could incorporate credit card data to potentially better predict sales growth before the market can price it in.



## How are equity factors identified?

Equity factors begin with a thesis describing how a company attribute may affect forward returns.

A thesis starts off with an idea, such as “Stocks that have recently increased in price will continue to increase in price due to the bandwagon effect.”

Researchers will then aggregate relevant datasets—both traditional (e.g., stock prices, valuation metrics) and alternative (e.g., analyst reports, credit card data)—and analyze the raw data to form an investment view. The performance of the factor is evaluated for potential usefulness and significance.



## Putting it all together

Factor investing requires more than data and research.

It takes a team of investment professionals to devise theses, make decisions and implement factor investing strategies. From the advanced statistical analysis to the optimization of portfolios, to the understanding of clients’ needs, factor investing requires expertise. Explore Quantinomics to learn more about how GSAM uses factor investing to help pursue our clients’ investment objectives.

**Quantinomics** is a behind-the-scenes look at insights and factors that shape GSAM quant team’s investment strategies.

The **Quantitative Investment Strategies** team aims to create innovative and insightful solutions for our clients across a range of equity alpha, alternative risk premia and smart beta strategies. We utilize large amounts of traditional and alternative data sources supported by an

expansive technology program to perform our proprietary research. This series provides a behind-the-scenes look into how we identify and research the economic intuitions and factors that drive our investment strategies.

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## Disclosures

<sup>1</sup> **Alpha** is the portion of the total return on the portfolio not attributable to the portfolio's exposure to its benchmark or index.

<sup>2</sup> **Smart Beta** refers to quantitative index-based strategies

<sup>3</sup> **Risk Premia** refers to the excess return demanded by investors to compensate them for a specific risk of holding an asset.

<sup>4</sup> **Smart Beta** factors tend to be well known in academic literature and are well-documented. The factors tend to be easier to implement since they can be created with readily available data and simple, rules-based frameworks.

All investing involves risks, including possible loss of principal.

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Date of first use: 01.31.18.  
Compliance code: 118000-OTU-731938