

# Reaping the benefits from a multi-factor market-neutral equity exposure

With interest rates and bond yields at near-record lows, many investors are driven to the equity markets in search of potential higher returns. However, equities' inherent volatility may be too high for investors seeking a smoother return path. An innovative exposure from Amundi ETF has been recently developed as an answer to this conundrum. The new strategy combines two offsetting equity market positions in a single UCITS fund. The long leg of the strategy index iSTOXX Europe Multi-Factor Market Neutral consists of six factors from the European equity market. The short leg consists of sales of European equity futures.

Combining the two legs results in a market-neutral, hedged equity portfolio, offering superior potential long-term performance with fixed income-like levels of volatility. The index also targets low correlation to other asset classes, thereby offering significant diversification potential in a broader portfolio.

## The time is right for a market-neutral equity approach

European equity markets have recovered hand-somely since the 2008/09 financial crisis. A broad measure of European equity market performance, the STOXX Europe 600 index, has risen by 134% since March 2009<sup>1</sup> and is now close to an all-time high.

The gross dividend yield of 3.8%<sup>2</sup> on European equities is also well above the yield on many regional bond markets: ten-year government bond yields in Germany, France, the UK, Spain and Italy currently range from 0.38%-1.81%<sup>3</sup>.

Unsurprisingly, many investors now choose equities both for the prospect of capital gains and for their income.

But even in the relatively benign market environment we've witnessed so far, investors must bear in mind the inherent volatility of the equity markets. And given the sustained recent increases in share prices, hedging equities' downside risk seems like an increasingly attractive proposition.

An intelligent solution for investors wishing to reduce risk while retaining access to equities'

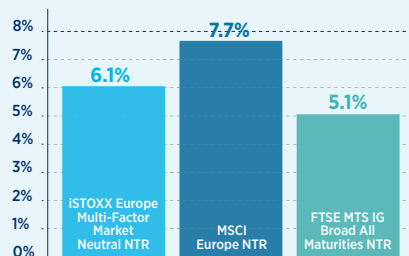
return potential is to construct a market-neutral portfolio. A market-neutral equity fund produces returns through stock selection while an accompanying hedge minimises exposure to overall movements in the equity market.

The Amundi ETF product achieves market neutrality by combining two offsetting positions. It offers long exposure to equity factors that

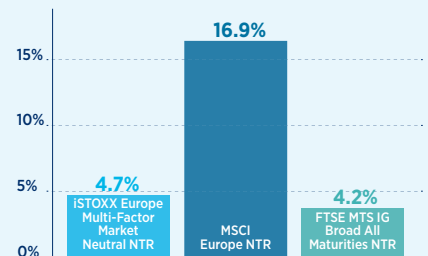
aims at harvesting long-term premia. And it hedges this exposure via short sales of equity futures on a liquid, broad European stock index.

Based on historical data, the net result is a performance outcome that is somewhere between the returns on equities and bonds but with bond-like levels of volatility. ■

Performance of market-neutral strategy is between that of equities and bonds



Volatility of market-neutral strategy is close to that of bonds



Source: Bloomberg, Stoxx, annualised daily volatility and return per annum from 30/12/2010 to 30/09/2017. Investors are reminded that past performance is not a reliable indicator of future results. MSCI Europe and FTSE MTS IG Broad All Maturities are used for illustration purposes only.

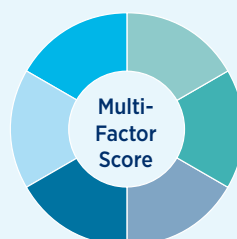
## Harvesting risk premia with a market neutral stance

### Combining six equity factors to capture risk premia

The Amundi ETF product generates its performance by tracking, as closely as possible, the performance of the iSTOXX Europe Multi-Factor Market Neutral strategy index that embeds six equity factors: value, size, quality, carry, momentum and low risk. These factors are drawn from a broad universe of European stocks (the STOXX Europe 600 index).

The iSTOXX Europe Multi-Factor index, which forms part of the ETF's benchmark, is calculated using a transparent procedure. For each

Six factors contribute to the multi-factor score



- Value:** Stocks that trade for less than their intrinsic values based on cash flow and earnings per share
- Carry:** Stocks with high growth potential based on earnings and dividends
- Low Risk:** Stocks with low volatility levels
- Momentum:** Stocks with strong recent performance
- Quality:** Stocks with solid financial background based on debt coverage, earnings and other metrics
- Size:** Stocks with low market capitalization/enterprise value

$$\text{Multi-Factor Score} = \frac{\text{Carry} + \text{Low Risk} + \text{Momentum} + \text{Quality} + \text{Size} + \text{Value}}{6}$$

(1) Source: STOXX Limited, STOXX Europe 600 price index from end-March 2009 to 1 November 2017 - (2) Source: STOXX Limited, STOXX Europe 600 index trailing dividend yield as at 29 September 2017. (3) Source: Bloomberg, end October 2017.

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of the constituent stocks of the STOXX Europe 600 index, a multi-factor score is calculated by averaging the six individual factor scores measured by specific screening criteria. The selection of 50 to 120 stocks is based on an optimisation process, subject to caps on individual stock weightings and maximum

(4) For more details on the index methodology, please consult the index provider website: [www.stoxx.com](http://www.stoxx.com)

## A short futures exposure to achieve market neutral position

In the Amundi ETF exposure, a long tracking position in the iSTOXX Europe Multi-Factor index is hedged by a short position in STOXX Europe 600 futures roll index. This is a transparent benchmark based on a rolled position in highly liquid STOXX Europe 600 futures contracts, listed on the Eurex exchange.

By hedging the long exposure to the multi-factor ETF index in this way, the ETF aims to

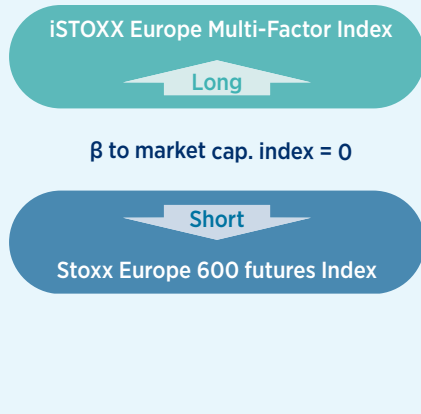
deviations for industry weights from the STOXX Europe 600 index. In the optimisation, turnover and liquidity constraints are applied to help achieve the best trade-off between the tradability of the index and its exposure to the desired factors<sup>4</sup>. ■

achieve an overall beta (sensitivity) to the European equity market of zero.

In other words, the factors can continue generating potential outperformance but the index's performance should be immune over time to upwards and downwards movements in the market.

To ensure that the index maintains a close to perfect hedged position, the short leg is adjusted weekly to the beta of the long leg. ■

Offsetting long and short positions produce zero beta to market cap index



## A source of potential performance and diversification

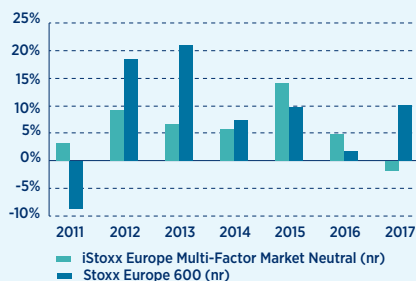
Combining a long, multi-factor performance engine and a short futures hedge in this way produces a significantly different result to a typical long position in the equities market. By removing the beta from the equity market exposure, the ETF provides only exposure to the targeted factors.

Based on a historical analysis of returns from end-2010 to September 2017, the iSTOXX Europe Multi-Factor Market Neutral strategy index gave a much less volatile performance than the STOXX Europe 600 index, with greatly reduced drawdown risk.

For example, the worst quarterly drawdown during this period in the STOXX Europe 600 index was -15.2%, but only -2.1% for the iSTOXX Europe Multi-Factor Market Neutral index<sup>6</sup>.

Investors in the market-neutral strategy can therefore reasonably expect a potential performance outcome over time that is somewhere

Performance comparison between multi-factor market neutral index and STOXX Europe 600 index



Maximum drawdown comparison between multifactor market neutral index and STOXX Europe 600 index

Max drawdown	iStoxx Europe Multi-Factor Market Neutral	Stoxx Europe 600
Weekly	-2.0%	-6.7%
Monthly	-2.2%	-10.9%
Quarterly	-2.1%	-15.2%

Source: Bloomberg, Stoxx, from 30/12/2010 to 30/09/2017. Investors are reminded that past performance is not a reliable indicator of future results. Stoxx Europe 600 index is used for illustration purposes only.

between the returns on equities and bonds but with volatility more akin to that of bonds than that of equities. The historical returns of the strategy underlying the ETF also demonstrate

low correlation to other asset classes. This means the Amundi ETF exposure offers significant diversification potential in a broader portfolio. ■

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