Factor investing foundations

Looking beneath the asset class labels

October 2026

Key takeaways

— Factors are measurable characteristics that help explain differences in securities' risk and return.

— A credible factor needs an economic rationale, robust evidence, validation across markets and regimes, and a practical route to implementation.

— Factor investing is a systematic complement to market-cap indexing and fundamental active management.

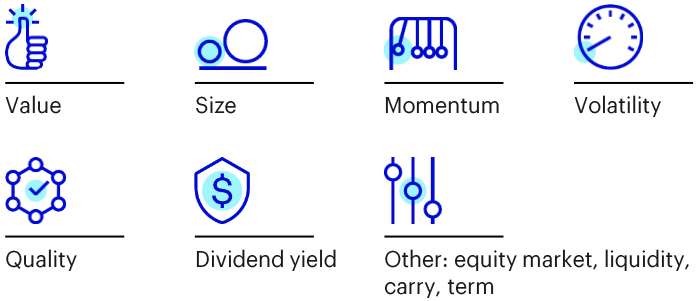
What is a factor?

A characteristic observed across many securities and used systematically in portfolio construction. Asset class labels show what a portfolio owns; factors help explain why portfolios with similar weights can behave differently.

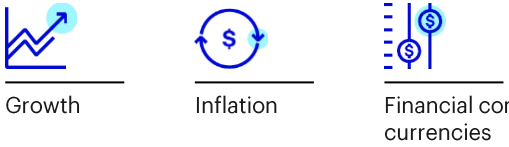
Factor investing is one form of systematic investing: a disciplined, rules-based process using measurable data rather than primarily discretionary judgement.

Examples of style and macro factors

Style factors: can be expressed in investment strategies



Macro factors: broad forces that affect asset prices



Why can factor premiums be expected?

Risk premiums	Compensation for an undesirable return pattern versus the broad market. e.g., smaller companies may be less liquid or more economically sensitive.
Behavioural psychology	Investor biases such as anchoring, action bias and loss aversion allow mispricing to persist. e.g., momentum and herding; value and excessive pessimism.
Market structure	Regulation, benchmarks, leverage constraints and institutional preferences create recurring demand. e.g., the low volatility effect.

No single explanation needs to account for every factor in every market. What matters is that the rationale is plausible, evidence is broad and implementation does not erase the benefit.

A third pillar, not a passive shortcut

Market-cap index	Factor investing	Fundamental active
Market value sets the weights	Consistent rules applied to many securities sharing chosen traits	Research and judgement on a concentrated set

The distinction is the source of the decision, not active versus passive.

Is it a credible factor? We look for:

Rationale
economic, not coincidence

Evidence
persistent over long periods

Breadth
across markets, sectors, regimes

Robustness
to definitions and parameters

Distinct
from other factors

Investable
after costs and constraints

From research to portfolio reality

— **Definitions vary.** Value: price-to-book, earnings or cash flow. Quality: profitability, earnings stability, leverage.

— **Construction matters.** Rebalancing, turnover controls and sector constraints can change results.

— **Returns are uneven.** Factors can lag for years; no premium is guaranteed.

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