Introducing MSCI Factor Indexes

msci.com
MSCI: A leader in Factor Indexing

MSCI Factor Indexes seek to reflect the performance characteristics of a range of investment styles and strategies using transparent and rules-based methodologies. Each MSCI Factor Index is derived from the equity universe of a traditional market cap weighted MSCI index.

Evolution in the understanding of portfolio returns

1960s and 1970s
During this period, investors did not distinguish between the sources of portfolio returns. Active investing was predominant way of managing long-term portfolios.

1980s and 1990s
In the 1980s, finance research underpinned the adoption of passive investing as an alternative basis for implementation. Investors started to capture market beta efficiently through passive mandates.

2000s and 2010s
Post 2000, investors increasingly recognized factors as the key drivers of long-term performance. Factor investing implemented through rules-based transparent indexes offered an alternative for implementation.

Factors are the building blocks of many portfolios – the elements capable of turning data points into actionable insights.

Elements of performance™
Factors by MSCI
Why factors matter?
- A factor is any characteristic that helps explain the long-term risk and return performance of an asset
- Factors are well documented in academic research and have been used extensively in portfolio risk models and in quantitative investment strategies. Active fund managers use these characteristics in their security selection and portfolio construction process.
- Factor indexes provide a transparent and efficient method to seek exposure to factors

Factor investing and the asset allocation process
Factor investing seeks to capture higher risk adjusted returns via systematic exposure to stock characteristics. Factor investing is not new; it has long been used in risk models and quantitative investment strategies. Factors also can help explain part of the long term portfolio performance of fundamental active investors*

Performance & implementation
Over time, individual factors have delivered outperformance relative to the market (see chart below).

MSCI World Factor Indexes

Using an obsession with data, an innovative spirit, and a drive to always go further for our clients, MSCI worked to perfect a breakthrough method for Factor Investing.

* For example, see "Buffett's Alpha", NBER Paper, Andrea Frazzini, David Kabiller and Lasse Pedersen, December 2013
MSCI Factor Indexes

Introducing A Common Language for Factor Investing:
MSCI FaCS

Based on MSCI’s Barra Global Equity Factor Model

<table>
<thead>
<tr>
<th>VALUE</th>
<th>SIZE</th>
<th>MOMENTUM</th>
<th>QUALITY</th>
<th>YIELD</th>
<th>VOLATILITY</th>
<th>GROWTH</th>
<th>LIQUIDITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book-to-price</td>
<td>Size</td>
<td>Momentum</td>
<td>Leverage</td>
<td>Dividend yield</td>
<td>Beta</td>
<td>Growth</td>
<td>Liquidity</td>
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<tr>
<td>Earnings yield</td>
<td>Mid cap</td>
<td>Earnings variability</td>
<td>Earnings quality</td>
<td>Residual volatility</td>
<td></td>
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<td>Long-term reversal</td>
<td></td>
<td>Investment quality</td>
<td>Profitability</td>
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Factor Investing is transforming the way investors construct and manage portfolios. The increasing popularity of Factor Investing can create the need for standards.

MSCI FaCS creates a common language and definitions around Factors to be used by broader audiences. MSCI FaCS is built from MSCI’s Barra Global Equity Factor Model and includes 8 Factor Groups and 16 Factors.

MSCI’s Barra Global Equity Factor Model (GEMLT) extends beyond MSCI FaCS to include 8 Factor Groups and 16 Factors with an additional 41 Factor Descriptors.

The factor box is powered by MSCI FaCS and provides a visualization designed to easily compare factor exposures between funds and benchmarks.
## MSCI Factor Indexes

<table>
<thead>
<tr>
<th>Factor groups</th>
<th>MSCI Factor Indexes</th>
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<tbody>
<tr>
<td>VOLATILITY</td>
<td><strong>Lower risk stocks</strong>&lt;br&gt;MSCI Minimum Volatility Indexes aim to reflect the performance characteristics of a minimum volatility strategy by optimizing towards the lowest absolute risk within a given set of constraints to minimize unintended risks and exposures.</td>
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<tr>
<td>YIELD</td>
<td><strong>Cash flow paid out</strong>&lt;br&gt;MSCI High Dividend Yield Indexes aim to represent the performance of companies that have historically demonstrated stable and increasing dividends, while mitigating risks against value traps.</td>
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<tr>
<td>QUALITY</td>
<td><strong>Sound balance sheet stocks</strong>&lt;br&gt;MSCI Quality Indexes aim to reflect the performance of high quality stocks by weighting based on debt-to-equity, return-on-equity and earnings variability. They are designed to reflect the performance of a quality growth investment strategy.</td>
</tr>
<tr>
<td>MOMENTUM</td>
<td><strong>Rising stocks</strong>&lt;br&gt;MSCI Momentum Indexes are designed to target securities based on risk-adjusted performance, with the goal of mitigating momentum crashes and reducing unnecessary turnover.</td>
</tr>
<tr>
<td>VALUE</td>
<td><strong>Relatively inexpensive stocks</strong>&lt;br&gt;MSCI Enhanced Value Indexes are based on research that has found that combining value ratio descriptors has captured the value factor better than using any individual ratio descriptor alone.</td>
</tr>
<tr>
<td>SIZE</td>
<td><strong>Smaller companies</strong>&lt;br&gt;MSCI Equal Weighted Indexes and Risk Weighted Indexes give investors several ways to access the size factor premium.</td>
</tr>
<tr>
<td>GROWTH</td>
<td><strong>Measure of sales and earnings</strong>&lt;br&gt;The MSCI growth target indexes aim to reflect the performance of a growth strategy by optimizing toward higher growth characteristics controlling for unintended risks and exposures.</td>
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### MSCI Multiple-Factor Indexes

In addition to Single Factor Indexes MSCI offers Multiple-Factor Indexes, which aim to give institutional investors a foundation for implementing multi-factor strategies transparently and efficiently. There are two key ways to gain multi-factor exposure:

- **MSCI Diversified Multiple-Factor Indexes**: Aim to maximize exposure to four factors – Value, Momentum, Quality and Low Size – while maintaining a risk profile similar to that of the underlying parent index.
- **MSCI Factor Mix Indexes**: Designed to represent the performance of equity in multiple factors, while benefiting from diversification and flexibility. The MSCI Factor Mix A-Series, MSCI Factor Mix A-Series Capped and MSCI Quality Mix (E-Series) are part of MSCI Factor Mix Indexes.

### Factors are the building blocks of a successful portfolio.
The elements capable of turning data points into actionable insights.

### Why MSCI?

MSCI, beginning with Barra, invented a common language to explain risk and return through a lens of countries, sectors and factors. Our more than 40 years of experience with factors uniquely position MSCI to help investors use factors to explain return, manage risk and construct portfolios.

**Research based**

MSCI Factor Indexes are based on well-established Academic Research. Academic findings have supported the identification and development of the MSCI Factor Indexes.

**40+ Years of factor experience**

MSCI, beginning with Barra, invented a common language to explain risk and return through the lens of factors. Barra factor models are used to create and validate MSCI Factor Indexes.

**Empirical evidence**

MSCI, beginning with Barra, invented a common language to explain risk and return through the lens of factors. Barra factor models are used to create and validate MSCI Factor Indexes.
MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 45 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

To learn more, please visit www.msci.com.

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