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TRANSCRIPT

Factors and their role in investment process

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Jenna

Now more than ever, it's important for investors to understand the drivers of risk and return in their portfolios. With that in mind, investors are often turning to factors to help them in their investment decision making process and to better understand how their portfolios are positioned. Joining us today with a closer look at factor investing, we have Rina Oberoi, Global head of Equity Solutions at MSCI.

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Jenna

Luke Smart, head of U.S. iShares Sustainable and Factors product segments. And Harrison Sidhu, head of manager selection at Fiduciary Trust Company. Well, everyone, it's great to have you with us. And right now kicking us off here. Why don't we start with perhaps just the basic question of what exactly are factors and what role do they play in the investment process.

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Raina Oberoi

Thanks, Gina. So factor could be thought of as a characteristic that is common to a group of securities, and that is also really important explaining their risk and return. Now the term factor is often used liberally and may refer to one of the many thousand different stock at risks such as country and industry groupings. So the level set, when we refer to factors, we really are referring to style factors such as quality, minimum volatility, value to name a few.

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Raina Oberoi

Now, factors do play a critical role as they can help investors meet their investment objectives, which could be reducing risk, increasing returns and or enhancing diversification. Factor investing is also aligned with how many investors would actually think about evaluating a company. Many investors seek profitable companies that can sustain profits over a period of time and also be disciplined about the use of leverage.

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Raina Oberoi

These companies are also known as high quality companies. Investors also prefer to buy companies that are good value for money, just like all of us. And these are known as value forms, and investors would rather not overpay for these companies unless it is warranted. Last but not least, many investors also like to be in control of their portfolio volatility and this could be achieved using minimum volatility strategies.

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Jenna

Very interesting. And sticking with you here. What is research shown with regard to the relevance of factors in portfolios?

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Raina Oberoi

Absolutely. So the use of factors in the investment process, which we call factor investing. Really, if you think about it, consists of three distinct pillars. So you have the factor models which empower investors to understand and manage the sources of portfolio risk. You have factor strategies which allow investors to seek factor returns and then thirdly, you have factor allocation, which is really a framework in which factors drive asset allocation decisions.

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Raina Oberoi

Now factors such as quality, value, momentum, to name a few are grounded in academic research as to why the historically have provided a premium. But what is really critical is that those factors remain extremely relevant even today. In fact, MSCI launched a survey with global investors earlier this year to get their views on equity factors. And what we found is that many investors actually placed on factor allocations foremost in their ability to generate alpha ahead of stock selection sector or country based allocations.

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Raina Oberoi

We in fact, even ran another study where we analyzed about 1300 Global Active Fund to understand their drivers of performance in 2022. And what we found once again, is that style factors on average explain the largest share of return of the top and bottom performing funds. Even more than stock selection did. Once again, underscoring the relevance of factors in the investment process.

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Jenna

Luke, turning to you, how could investors today access the power of factors in their portfolios?

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Luke Smart

Well, we're in the remarkable position of having benefited from incredible advancements in technology and data over the last 50 years or so, and these advancements have allowed us to access factor strategies that are very systematic and rules based fashion, which allows us to approach and identify companies that meet certain factor characteristics. Right now, just identify such strategies are widely available in the marketplace, and we're very proud to provide such broad choice amongst factor strategies here at BlackRock.

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Jenna

And Luke, what are some of the key considerations for investors when implementing factors in their portfolios?

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Luke Smart

I think there are a number of things that we want to think about here. The first is, is that we can use factors strategically to really dial in a portfolio for foreign investor, meaning that we where we can allow, we can use factors to advisors, can use factors to dial in the correct experience for a client's objectives and their risk tolerance.

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Luke Smart

Advisors can also use factors to address specific moments in the market, meaning there are times when perhaps an advisor is looking to reduce the overall level of risk in a portfolio and they can lean into that. Or perhaps there are there are moments where it's more appropriate to lean a little bit more into higher quality exposures, as Rina has also discussed.

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Luke Smart

I think above all is an understanding of what factors are and that and the expectations that come along with them. The higher expected returns associated with factors are something that we hold in expectation. But we must understand that there are periods where they can not only out but but underperform. And that's yet another reason why investors may want to diversify across several factors strategies in order to enhance the overall robustness of their portfolio.

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Jenna

Now, Harrison, turning to you, I understand you use factor based strategies in your portfolios. Can you share a bit about your investment process and how you're leveraging vector strategies today?

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Harison Sidhu

Yeah, sure. So a fiduciary trust is an investment management firm that primarily works with high net worth individuals and foundations and endowments. We're looking to drive excellent returns for our clients with very managed, well managed levels of volatile data that are well within a client's risk tolerance. And factors really help with that process. And I'd say there's kind of three main ways that they do that.

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Harison Sidhu

The first being it allows us to manage risk and construct their portfolios in a far better way. We can look really in a granular way and understand what our exposures are to these various risk factors and see are we out of line relative either in an absolute sense or relative to our benchmark? And do we need to utilize some of these factor strategies or portfolios to either dial up risk levels or hedge off risks that are within our portfolios?

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Harison Sidhu

I'd say that the second way that we utilize factor strategies and kind of factor technology is within manager selections. So we think matter manager selection is really one of the primary ways that we can kind of deliver outperformance and drive excess returns. And one thing that we want to make sure is that we're identifying top tier managers that are delivering performance that's unique from what just a simple factor exposure can deliver.

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Harison Sidhu

So a lot of this technology helps us understand are we just getting a single factor or a group of factors back and paying active manager prices for that, or are we getting really differentiated returns? And then the last thing I'd say sort of echoing what Rayna and Luke have mentioned before, is that factors allow us to get very intentional and granular with the portfolios that we build on behalf of our clients.

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Harison Sidhu

Some prefer kind of yield oriented portfolios or more defensive equity strategies or just simple kind of returns seeking multifactor type of portfolios. And the in the products and technology that we've seen proliferated in recent years really helps us build those strategies and serve our clients better.

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Jenna

And finally, Harrison, what are some key criteria to your diligence process when considering investing in factors?

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Harison Sidhu

Yes. So we're we're an active manager. We have a view of the world in terms of not only which factors are set to deliver excess performance over time, but how we would go about constructing portfolios. So any type of factor, strategy or product that we select sort of needs to comport with that view of the world overall. Second is cost.

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Harison Sidhu

What's really interesting about factor strategies is that we think that they're much lower cost than traditional kind of active strategies overall, which is exciting to us. But then there's also those implicit costs around tracking the benchmark that we've allocated to that strategy overall. So once we've sort of identified the strategy, that looks like something that we would be interested in investing in and as low cost, we think group strategies together that diversified each other nicely to come up with an overall allocation of factors within a portfolio.

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Jenna

While this has been variance eightfold, thank you, Raina, Luke and Harrison for a great conversation today.

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Raina Oberoi

Thank you for having me.

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Harison Sidhu

Thank you, John.

00:09:42:03 - 00:09:43:01

Luke Smart

Pleasure to be here, Jenna.

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