Summary Report EMEA

Invesco Global Factor Investing Study 2020

For Professional Clients, Qualified Investors and Qualified Clients/ Sophisticated Investors only.

Welcome

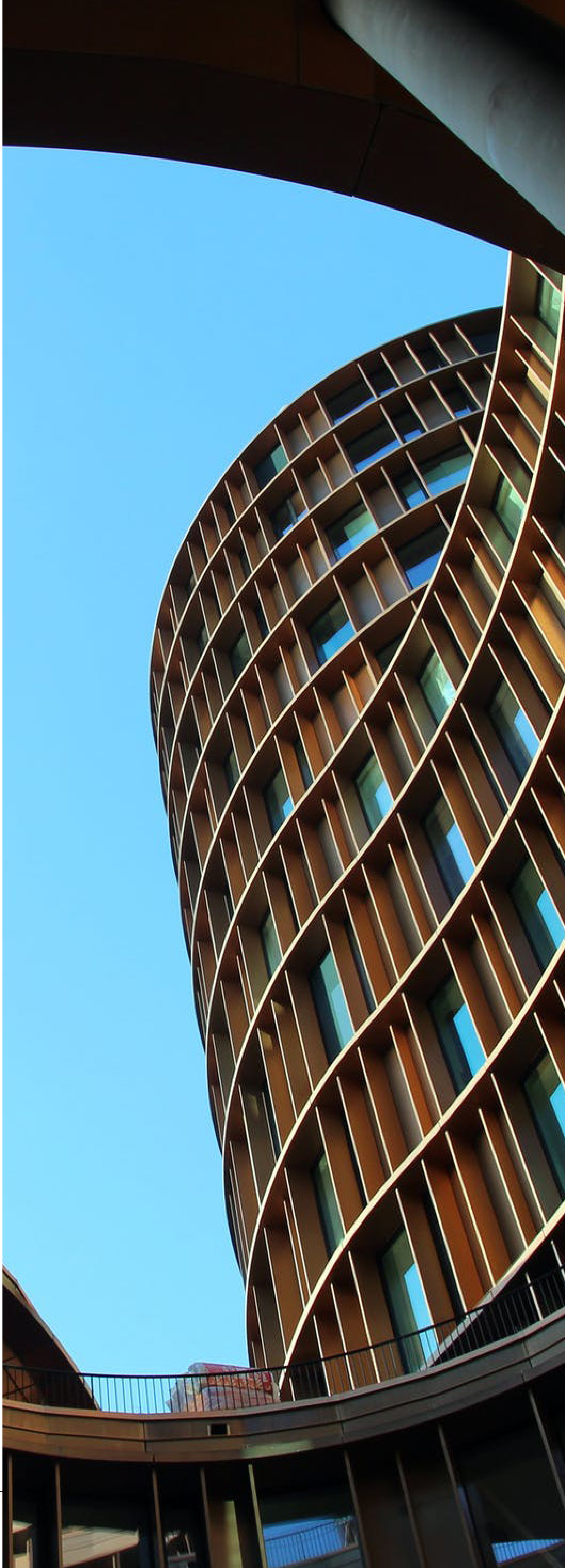
Welcome to our fifth annual Global Factor Investing Study, based on an interview programme with 238 factor investors. This study incorporates the views of 138 institutional investors and 100 wholesale investors that are together responsible for managing over US$25.4 trillion in assets (as of 31 March 2020).

Factor investing is a type of investment strategy whereby securities are chosen based on their characteristics and attributes (commonly termed 'factors') that have tended to offer favourable risk and return patterns over time. While the concepts behind this approach have existed since the mid twentieth century, levels of adoption and sophistication have increased rapidly in recent years with investors recognising the potential benefits of incorporating factor strategies within their portfolio.

This study, the largest and most in-depth examination of global factor investing currently being undertaken, offers an opportunity to understand investor experiences, paths and barriers to adoption as well as methods of implementation. Interviews for this study were conducted in April and May of 2020, against the backdrop of COVID-19 and following the initial shockwaves this pandemic sent through investment markets. We note instances throughout the report where investors' reactions to the COVID-19 pandemic may have impacted responses.

We explore these topics through five key themes:

1. Factor investors are resilient in the face of uncertainty
2. Fixed income factor investing continues to gain traction, through potential for enhanced returns and stronger risk management
3. Investors look to the intersection of ESG and factor investing
4. ETFs can offer a familiar and flexible tool for implementing factor strategies
5. Levelling up: demand for additional services and improvements in implementation



Theme 1

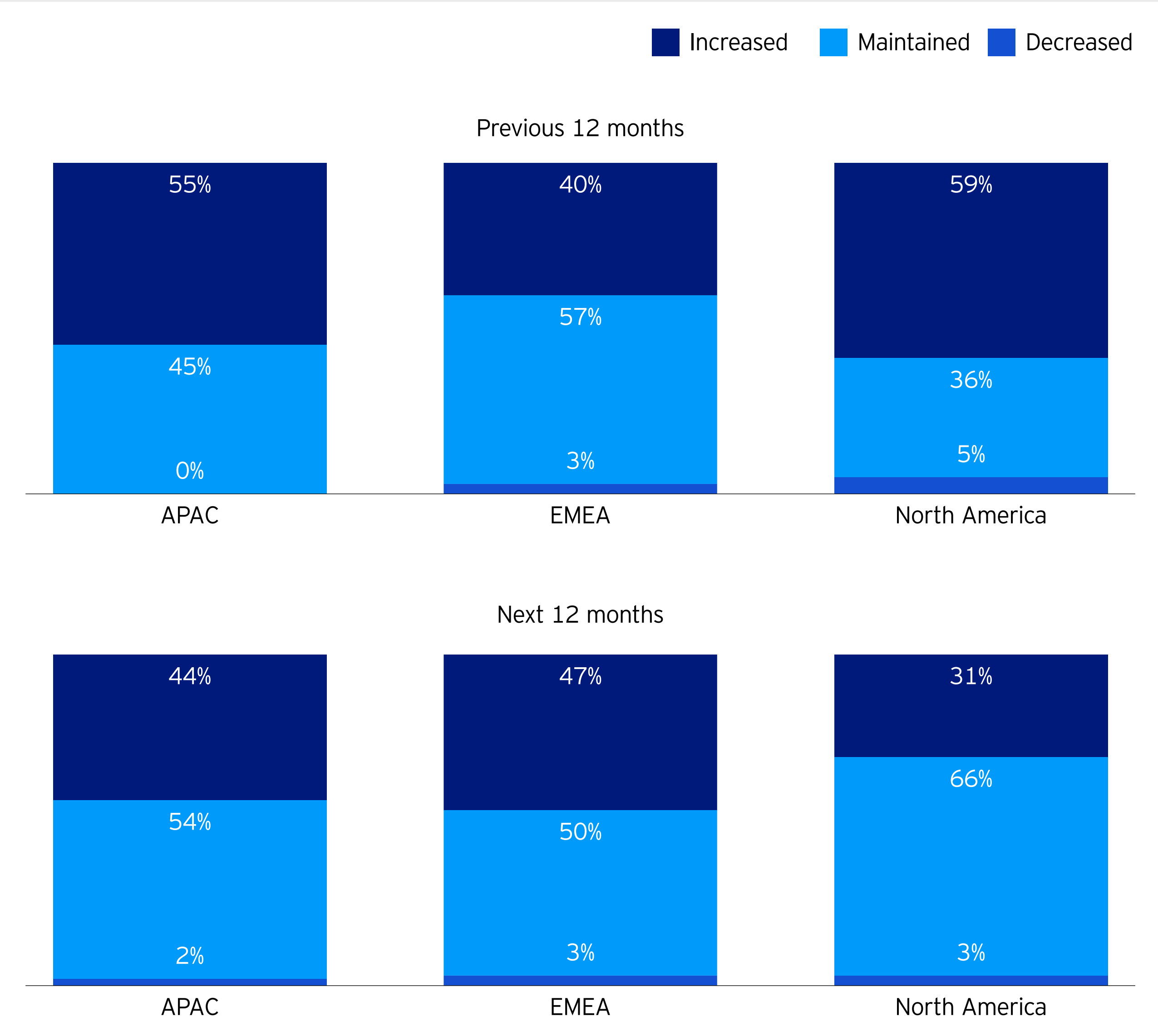
Factor investors are resilient in the face of uncertainty

Theme one focuses on recent experiences and allocation intentions. We found around half of investors increased their factor allocations in the 12 months leading up to the study with a similar proportion planning an increase in allocations over the next 12 months.

Investors in EMEA were more likely to be making additional allocations to factor strategies than their counterparts globally. Some 47% were expecting to increase allocations, while half were expecting to maintain their existing allocations (**Figure 1.1**).

This incremental rise in allocations was being driven in part by the broader adoption of factors including its incorporation in additional asset classes (especially fixed income), and by the gradual building up of exposures over some time.

Figure 1.1
Factor allocation changes (% citations)

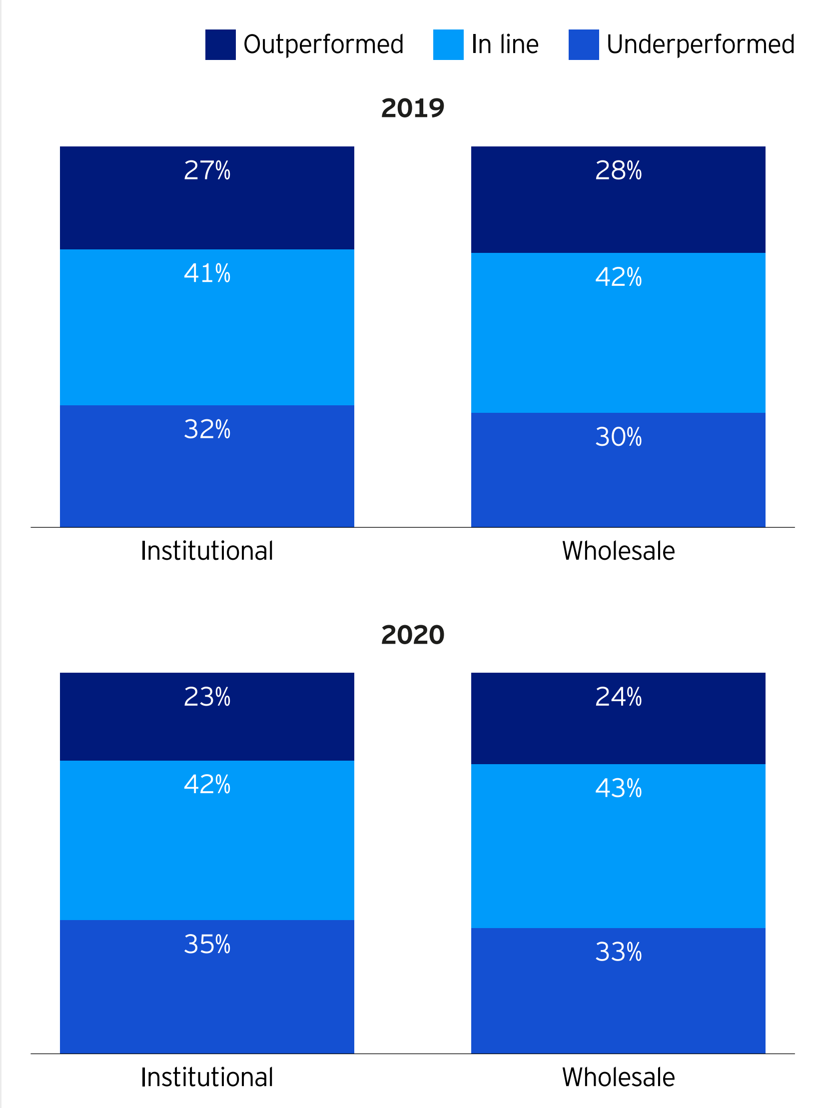


Over the last 12 months, have you increased, decreased or maintained your factor allocations? Over the next 12 months, how do plan to change your factor allocations?

Sample size: 233

Investor perceptions of performance relative to expectations were only marginally more negative than recorded in last year's study (**Figure 1.2**). Around two-thirds of investors reported that their factor allocations had met or exceeded expectations. While investors expressed some caution towards the outlook for their portfolios generally, sentiment towards their factor strategies remained largely positive.

Figure 1.2
Factor performance relative to expectations in 12 months to March 2020 (% citations, common cohort)

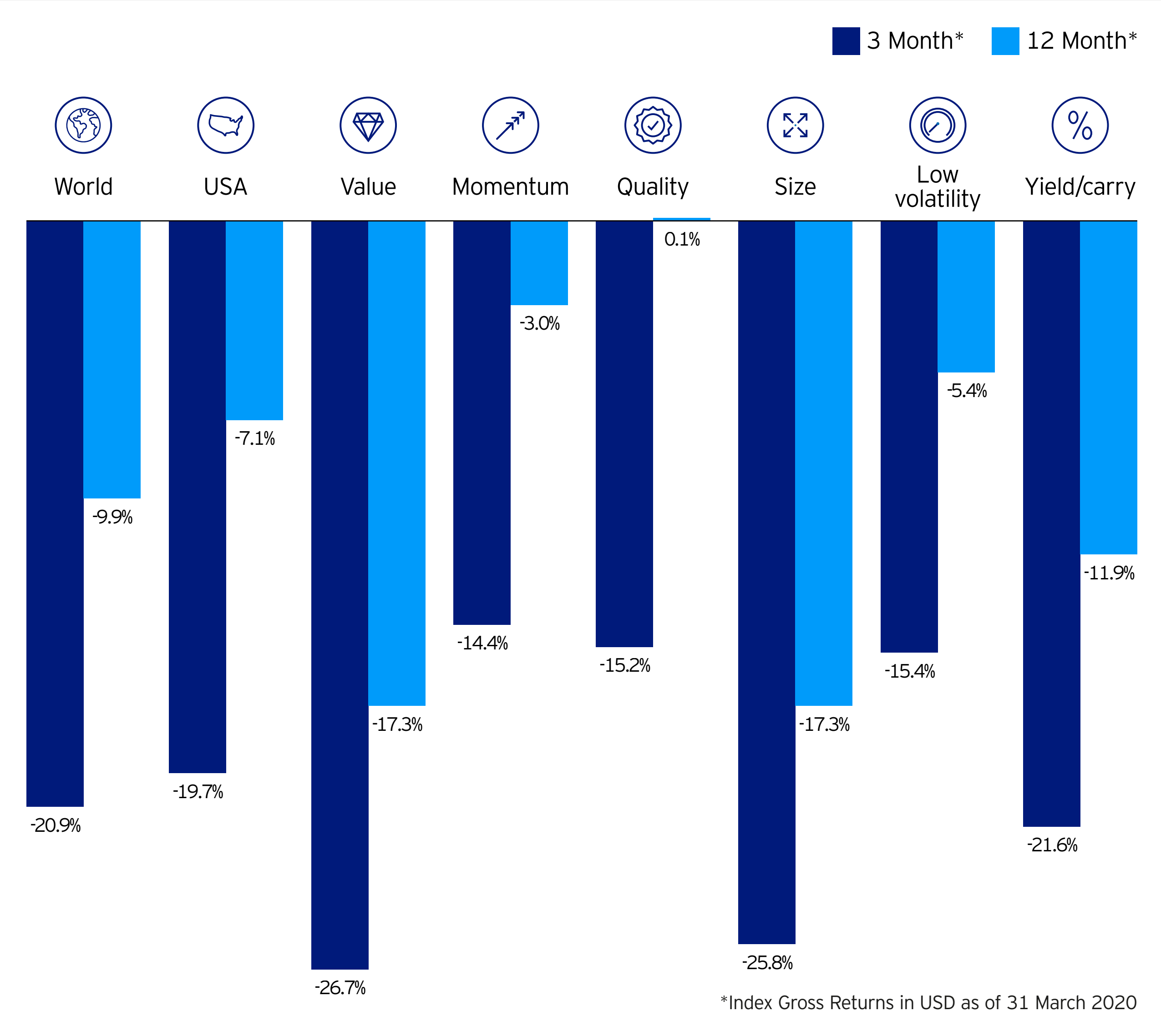


Looking holistically across your portfolio, how have your factor strategies performed in terms of return relative to your expectations over the past 12 months?

Sample size:
2019 = 217
2020 = 228

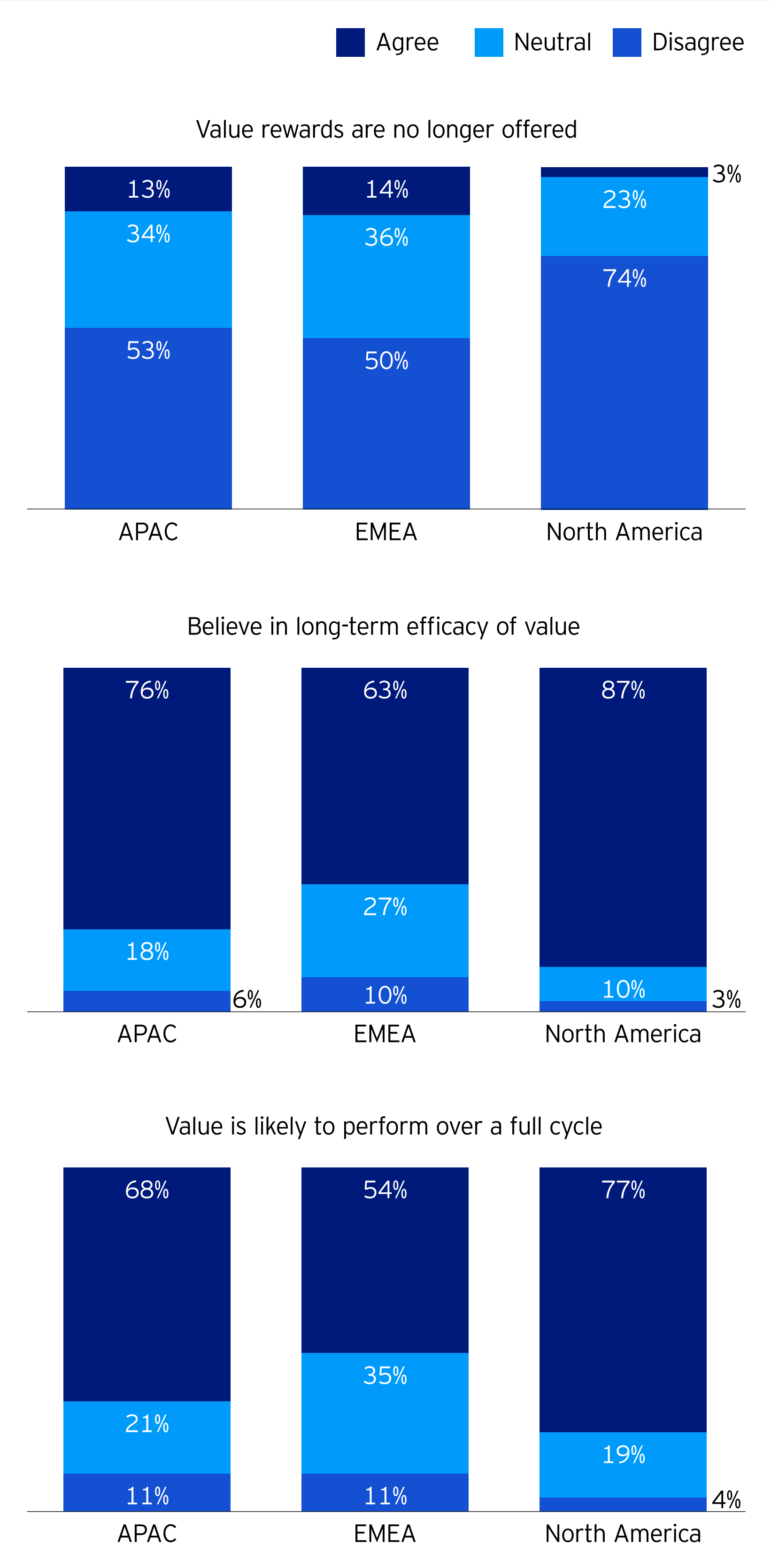
This is despite a period of divergent factor performance which saw some factors outperform but saw others, including value, perform poorly. In global equity markets, the momentum, quality, and low volatility factors generally outperformed the market over the survey period (**Figure 1.3**). In contrast, the value factor, and to a lesser extent the size factor, performed poorly. Indebtedness and liquidity concerns weighed particularly on the size and value factors, especially early in the interview period when many firms rushed to raise capital.

Figure 1.3
Factor performance to March 2020 (3 month, 12 month)



Source: MSCI. Past performance is not a guarantee of future results. MSCI World Minimum Volatility Index (low volatility factor), MSCI World Momentum Index (momentum factor), MSCI World Quality Index (quality factor), MSCI World Equal Weight Index (size factor), MSCI World Value Weighted Index (value factor), MSCI All-Cap World Index (World), MSCI USA Index (USA). All in Gross USD terms. An investment cannot be made into an index.

Figure 1.4
Attitudes to the value factor (% citations)

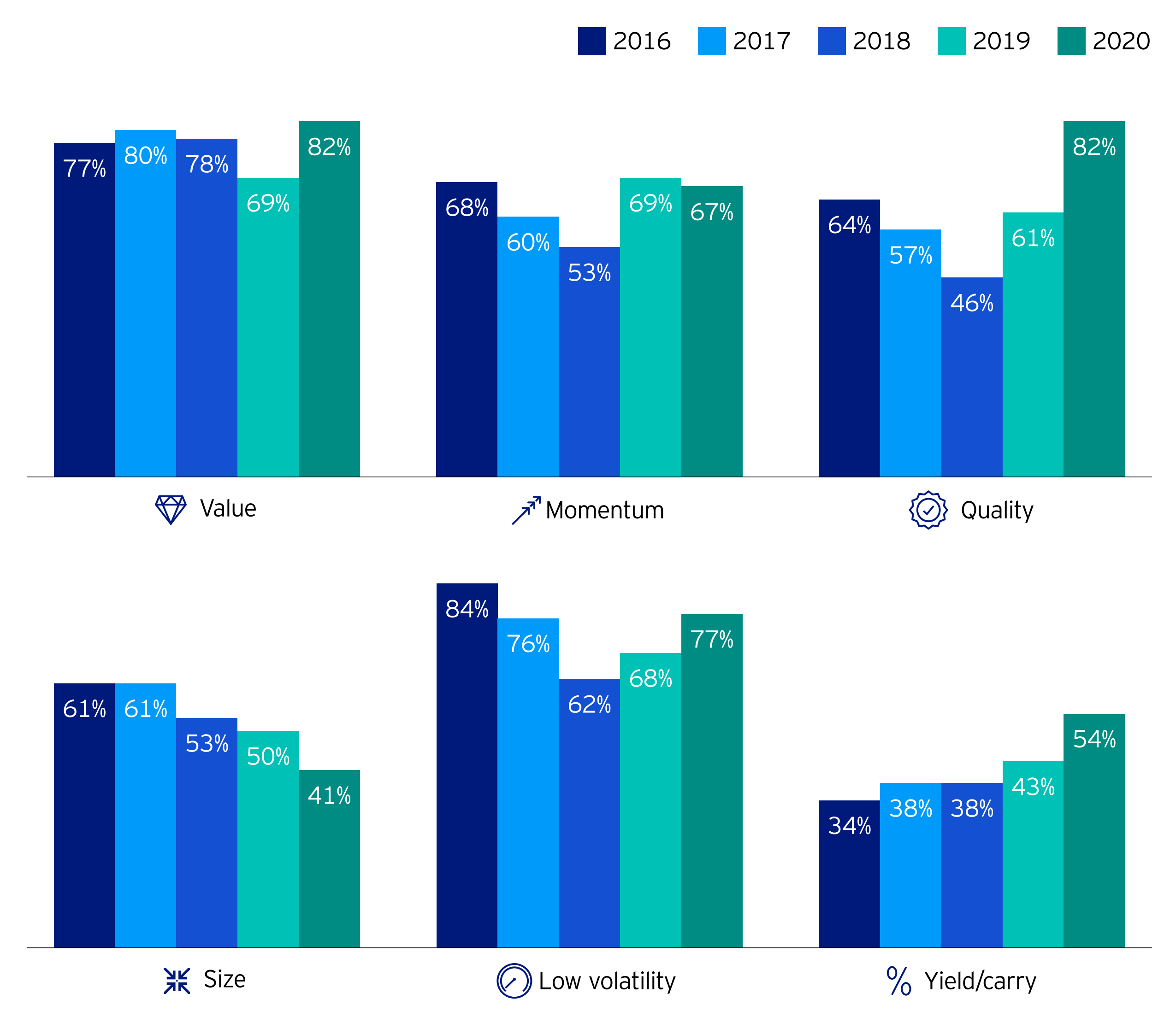


Do you agree or disagree with the following statements?

Sample size: 226

Despite a run of challenging performance, this edition of the study found that most investors remained committed to the value factor, believing its run of underperformance as a temporary phenomenon. However, investors in EMEA are slightly less confident than those in North America and APAC: 54% of EMEA investors continued to believe that value would perform over the full cycle, with 11% disagreeing and 35% taking a neutral position (**Figure 1.4**).

Figure 1.5
Factor exposures sought in the portfolio (% citations)



What factors do you explicitly seek / have exposure to in the portfolio?

Sample size: 2016 = 56, 2017 = 98
2018 = 260, 2019 = 236, 2020 = 237

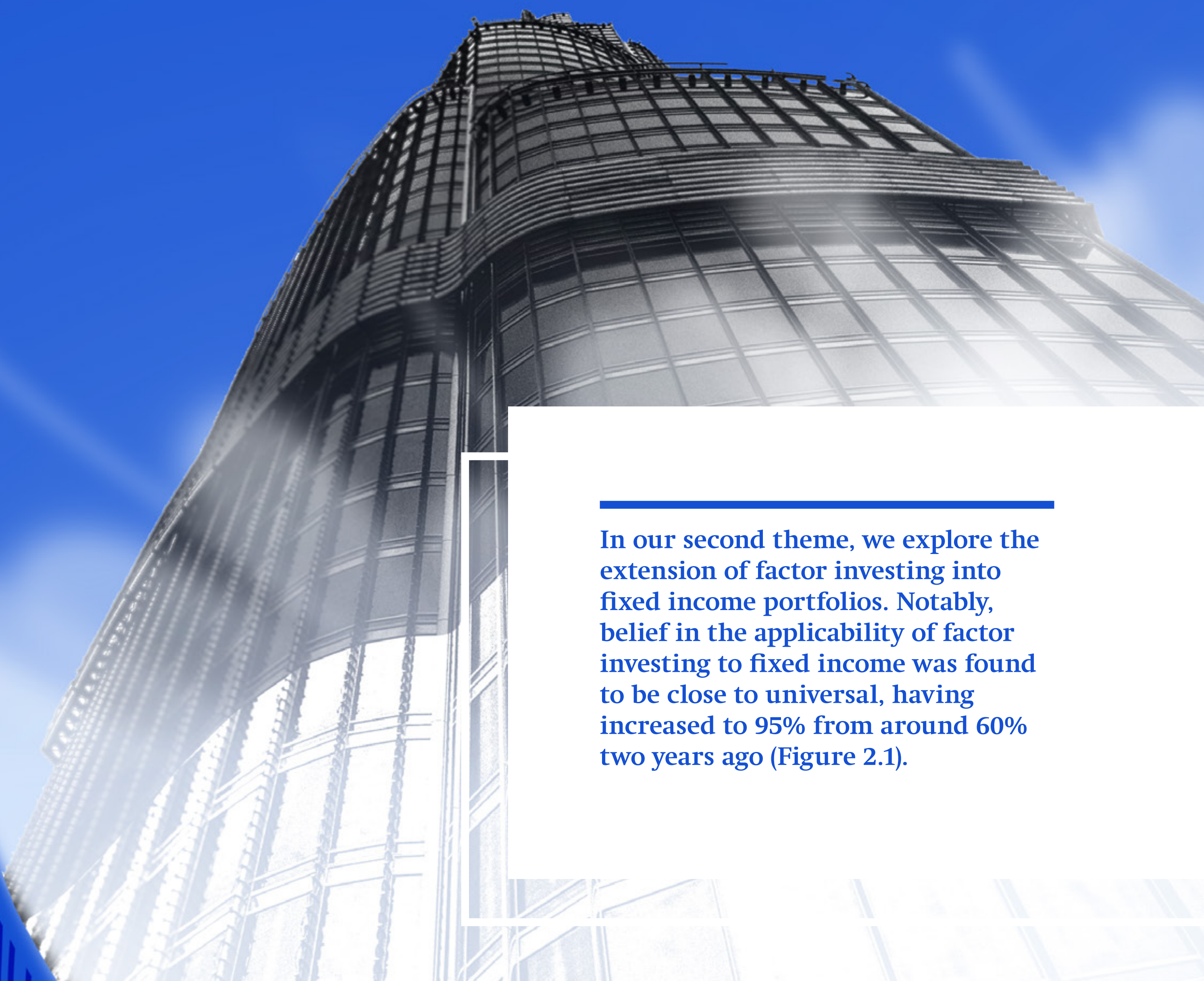
Notably, investors reported increasing their exposures to both the value factor and the quality factor in 2020, relative to 2019, up 13 and 21 percentage points, respectively (**Figure 1.5**).

"We would be more concerned if our factor investments started to behave erratically and didn't do what they should during periods of volatility."

Institutional investor, North America

Theme 2

Fixed income factor investing continues to gain traction through potential for enhanced returns and stronger risk management

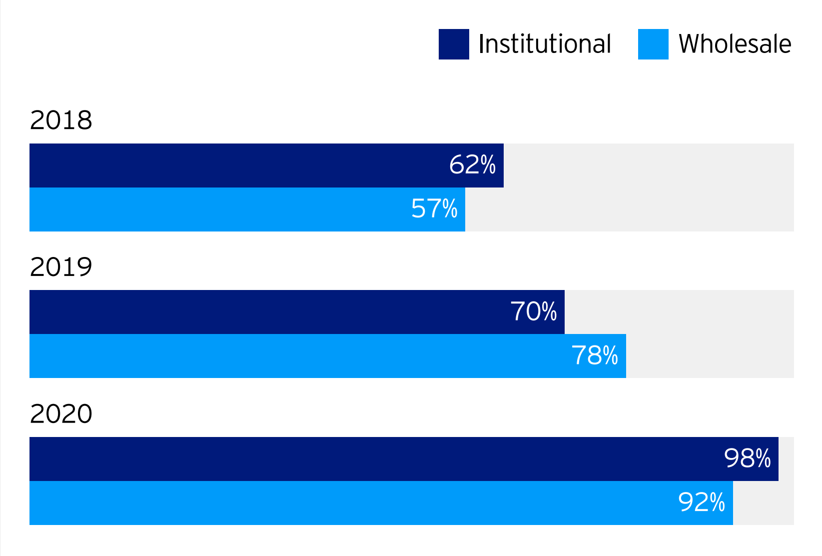


In our second theme, we explore the extension of factor investing into fixed income portfolios. Notably, belief in the applicability of factor investing to fixed income was found to be close to universal, having increased to 95% from around 60% two years ago (Figure 2.1).

Investors cited the potential for a factor approach to shine a spotlight on alpha generation by active fixed income managers and bring more transparency to the market overall, as has been the case with equities. This was also reflected in growing levels of adoption: 40% of the sample were already using factors in fixed income, and more than a third were actively considering its introduction (**Figure 2.2**).

Respondents that saw themselves as 'fixed income factor investors' in fact embraced a broad range of implementation methodologies. This included the targeting of style factors such as value and momentum in line with the approach taken in equities. However, it also included those applying a systematic approach to monitoring and targeting of more traditional fixed income return drivers, such as term and credit.

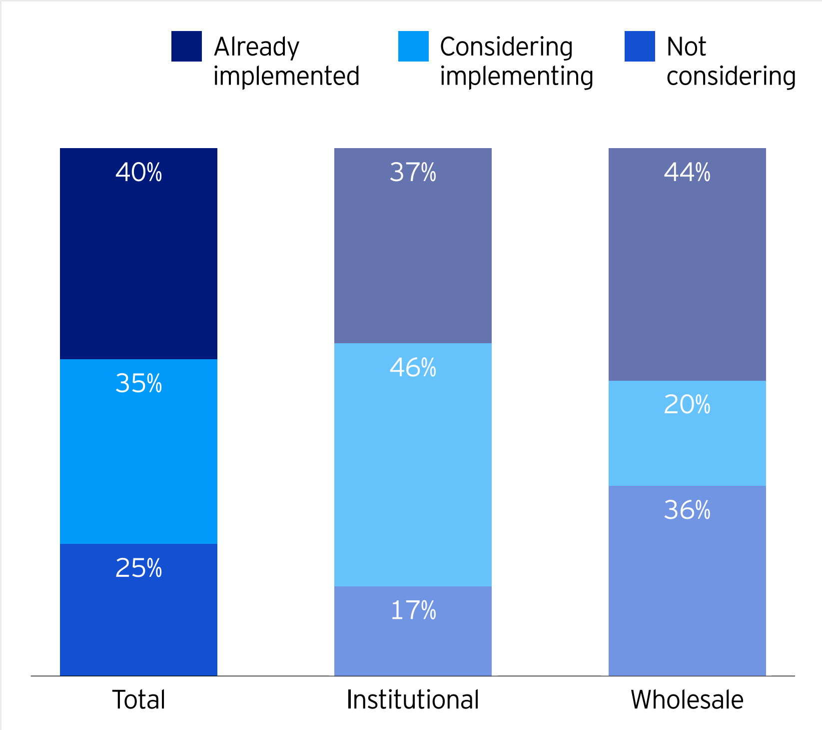
Figure 2.1
Belief that factor investing can be extended to fixed income (% citations)



Do you believe that factor investing can be applied to the following asset classes?

Sample size: 2018 = 284
2019 = 231
2020 = 237

Figure 2.2
Use of factors in fixed income (% citations)

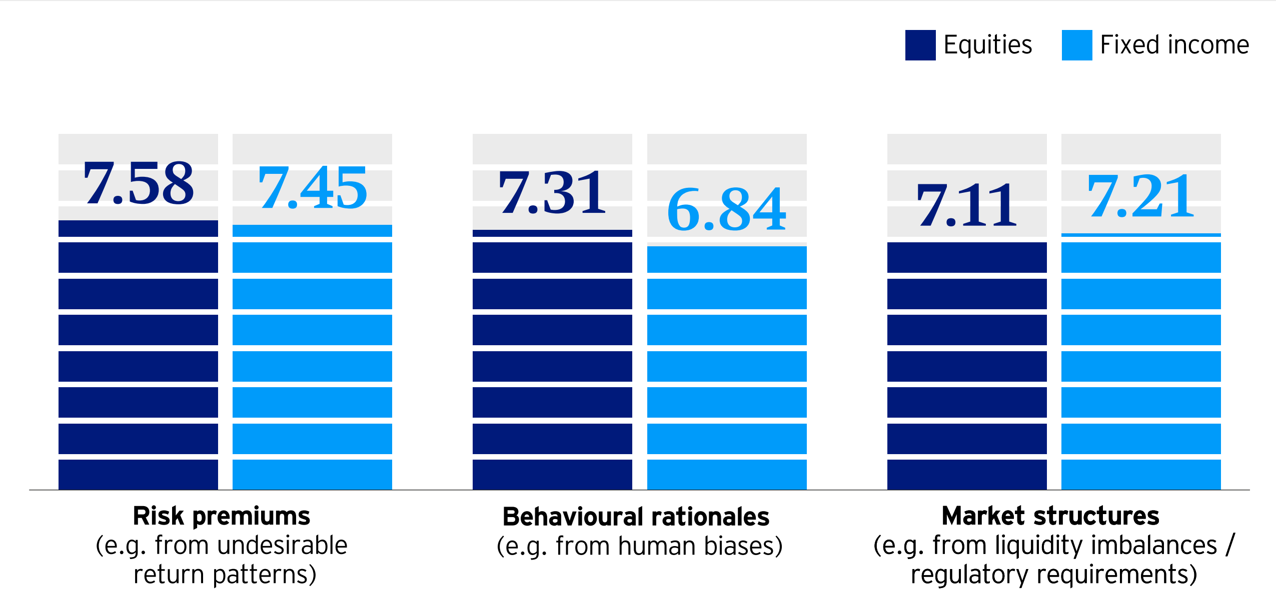


Do you use factors in the following asset classes?

Sample size: Institutional = 135
Wholesale = 91

The rationales for employing a factor approach in fixed income were seen as differing slightly from equities (**Figure 2.3**). Investors recognised risk premia as most important to both but ascribe a larger role to market structure as a driving force behind fixed income factors. For example, some parts of the market, such as high yield bonds, are not accessible for certain types of investors, creating segmentation and giving rise to exploitable opportunities. In contrast, behavioural rationales related to human biases were viewed as less important in fixed income than in equities.

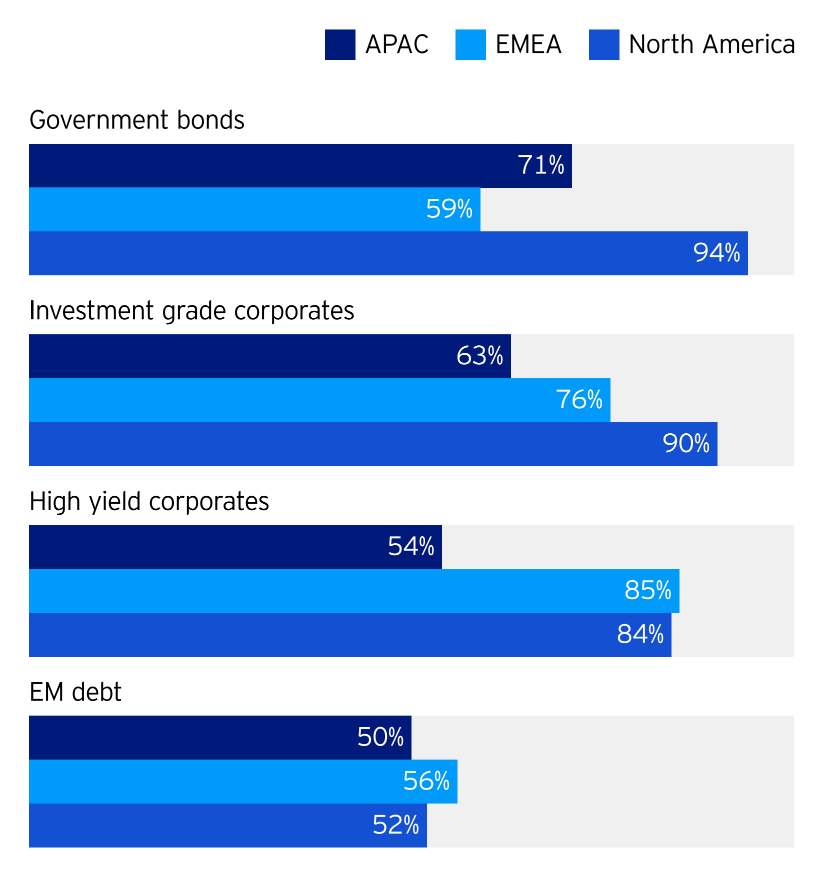
Figure 2.3
Rationale for factor investing in equities vs fixed income (average score /10)



Please rate to what degree the following rationales/explanations for factors apply in (A) Equities and (B) Fixed Income (where 10 is very important)

Sample size: 185

Figure 2.4
Asset classes in which using factor investing (% citations, fixed income factor investors)

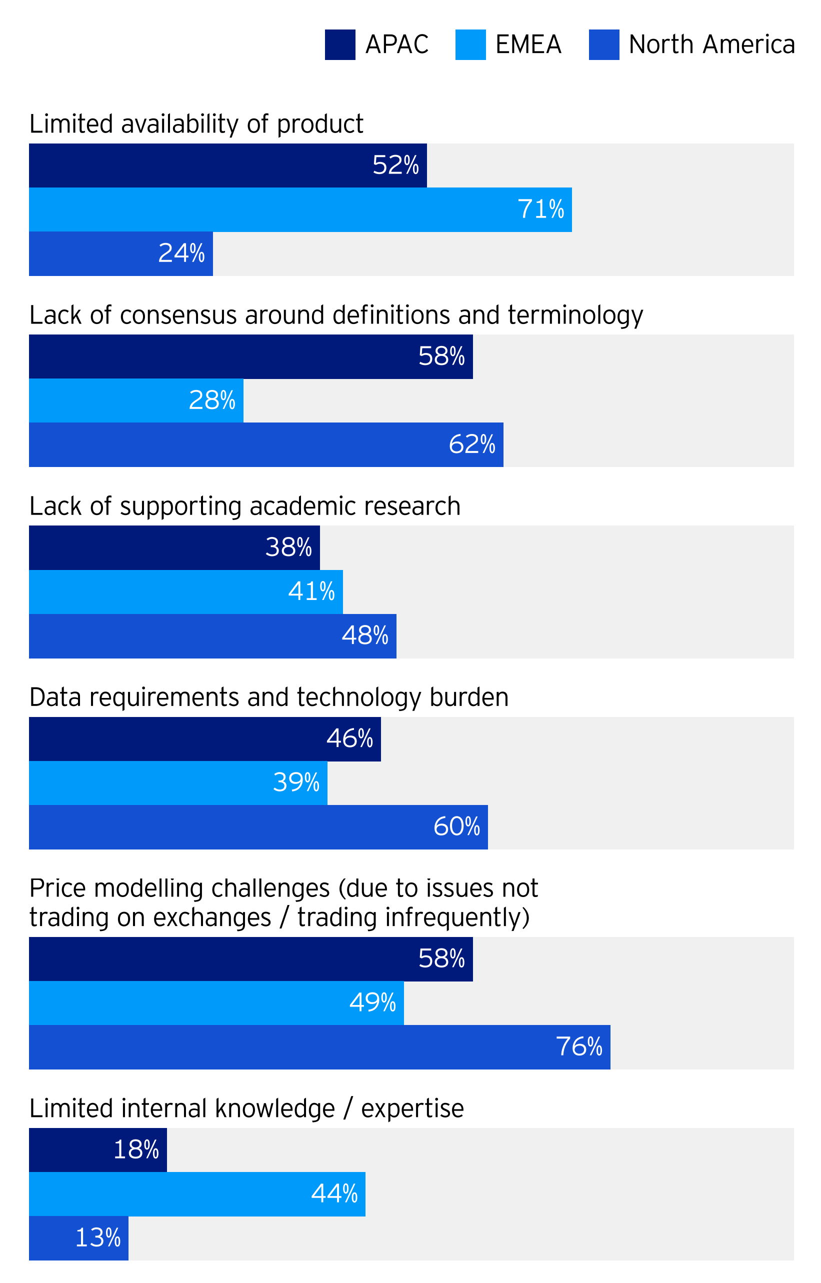


Which fixed income asset classes do you use factor investing for in your fixed income portfolio?

Sample size: 89

EMEA investors were most likely to be applying factors in corporate bonds (both investment grade and high yield), although more than half were also applying factors to government bonds and EM debt (**Figure 2.4**). With systematic factor strategies requiring minimum levels of trading to be viable, the levels of liquidity in each underlying market continued to act as a challenge for factor applications in certain regions and segments.

Figure 2.5
Challenges of implementing factor investing in fixed income (% citations)



What are the challenges of implementing factor investing in fixed income?

Sample size: 193

We also found other barriers to adoption, with the limited availability of product the most pressing challenge for EMEA investors followed by price modelling challenges (**Figure 2.5**). Wholesalers in particular were concerned by a lack of product, suggesting in strategies other than yield a shortage of options (and in particular a shortage of ETFs) meant that they often struggled to find products to recommend to their clients.

> "We are increasing our use of factors in fixed income but face the challenge of not enough data to do everything we want to do."
>
> Institutional investor, North America

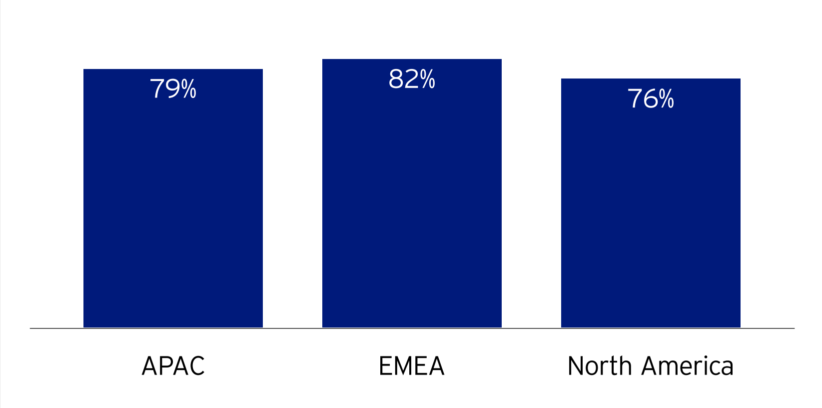
Theme 3

Investors look to the intersection of ESG and factor investing

In theme three, we examine the intersection of factor investing and environmental, social and governance considerations (ESG) with the two continuing to advance independently but in parallel.

This year 84% of institutions, and 71% of wholesalers (all of them factor investors) had an ESG policy in place (**Figure 3.1**) while more than half were already incorporating, or considering incorporating, ESG into their factor portfolio (**Figure 3.2**).

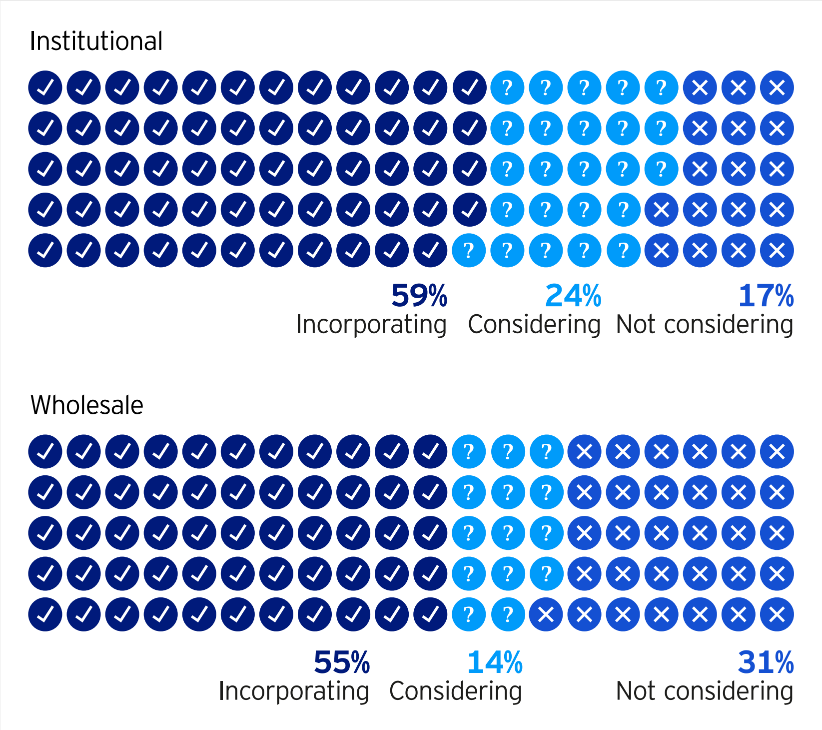
Figure 3.1
Investors with an ESG policy (% citations)



Do you have ESG policy at the organisational level?

Sample size: 224

Figure 3.2
Investors incorporating ESG in factor portfolios (% citations)

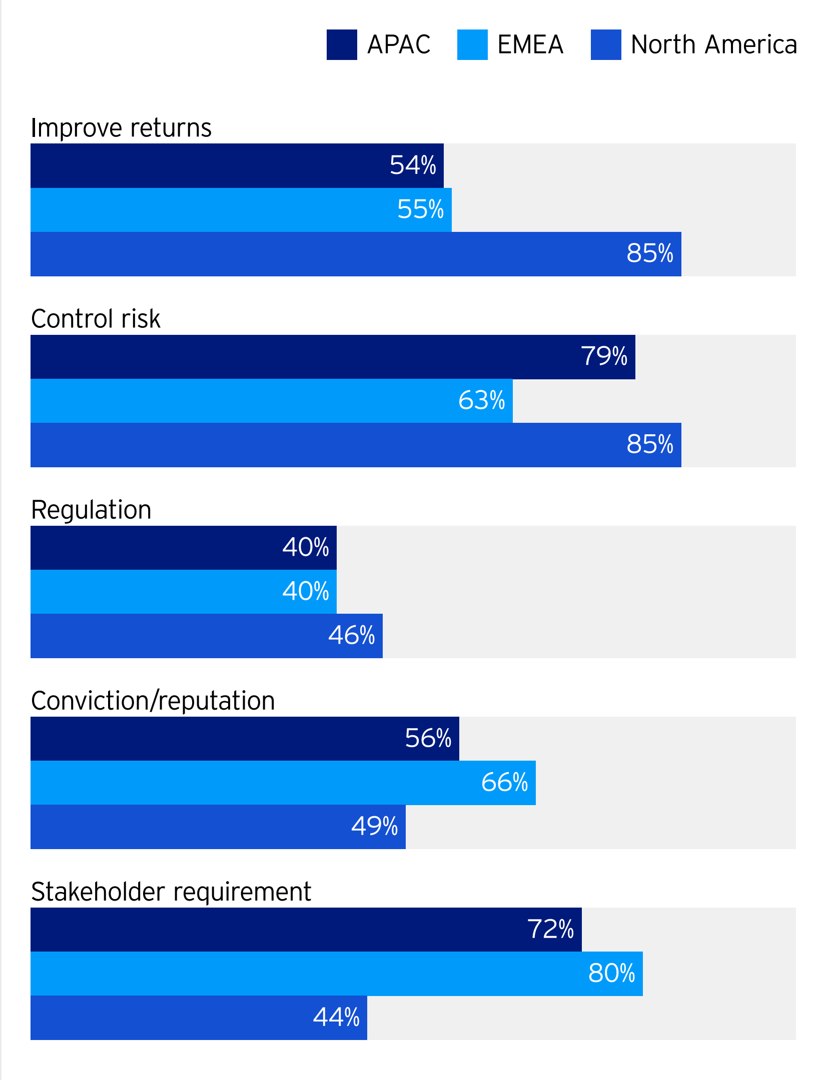


Do you incorporate or are you considering incorporating ESG in your factor portfolio?

Sample size: Institutional = 129
Wholesale = 86

For EMEA investors, stakeholder requirements was the main motivation for incorporating ESG (cited by 80% of respondents). However, for many the decision to incorporate ESG has also been driven by investment factors, with 63% pointing to benefits in relation to risk and 55% citing improved returns. (**Figure 3.3**).

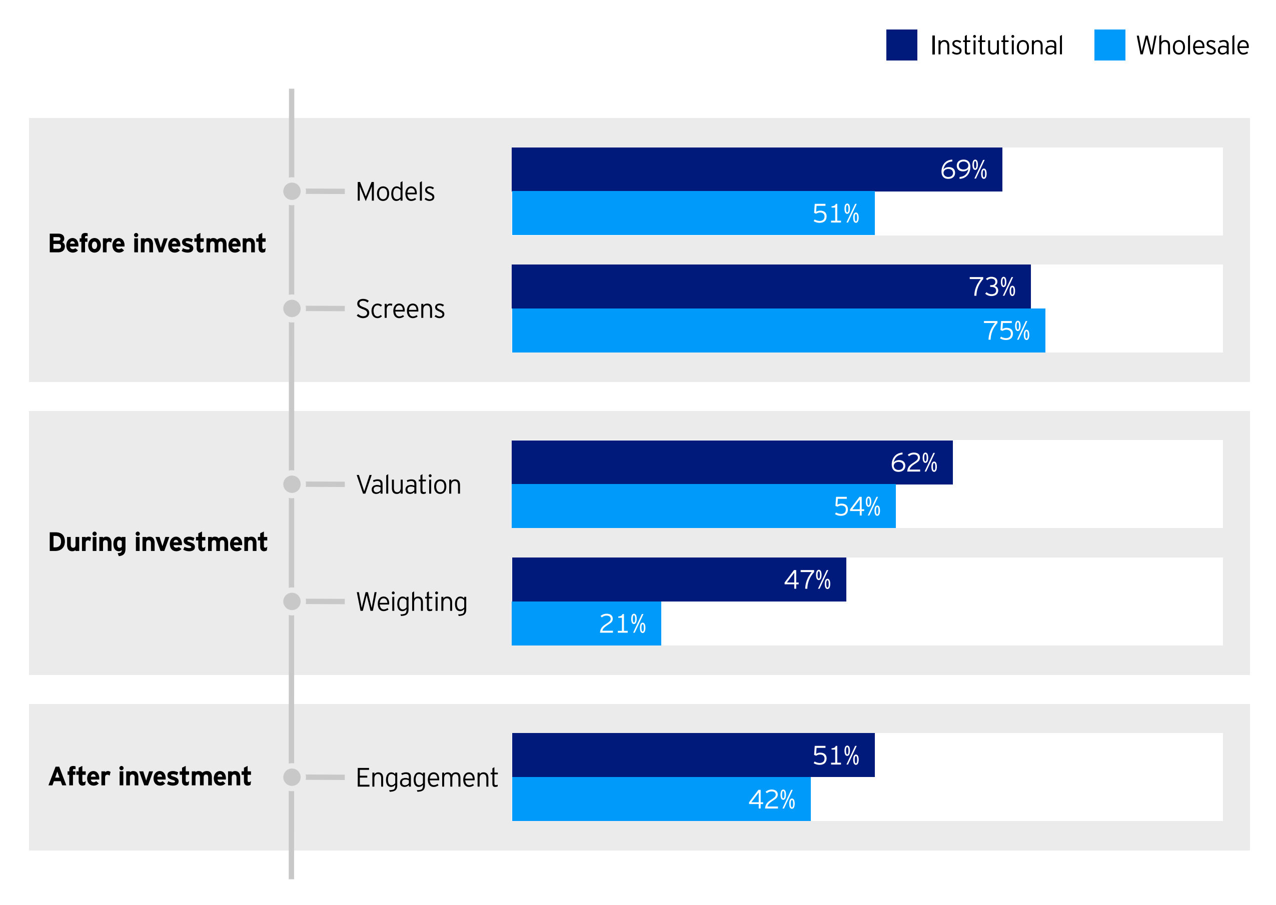
Figure 3.3
Motives for ESG adoption (% citations)



What is your motivation to incorporate ESG into your strategies?

Sample size: 206

Figure 3.4
Stage where ESG was incorporated (% citations)



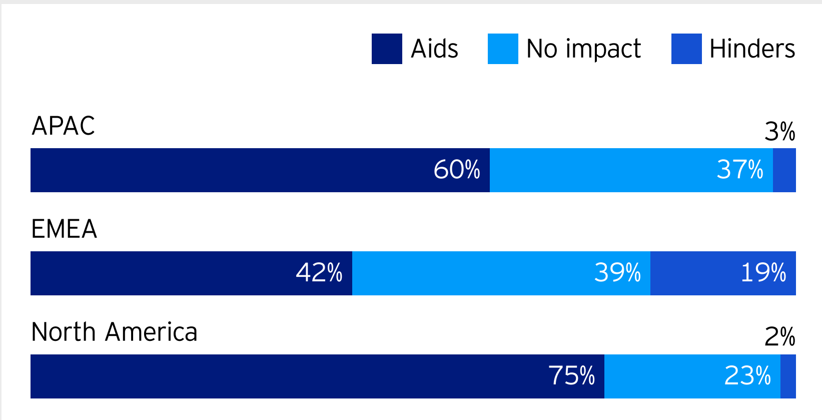
At which stage do you incorporate ESG for your factor mandates?

Sample size: Institutional = 93
Wholesale = 57

Negative screens were the most common form of ESG implementation within factor allocations, although investors also commonly reported incorporating ESG in factor models and as part of the valuation process (**Figure 3.4**).

While ESG and factor investing are generally separate phenomena, implemented independently, the two were often seen to be complementary, with 42% of EMEA investors seeing ESG as an aid to factor investing implementation (**Figure 3.5**). These benefits were wide-ranging, with EMEA investors most commonly citing a potential ESG-related return boost (79%) and better control over factor specific risks (76%).

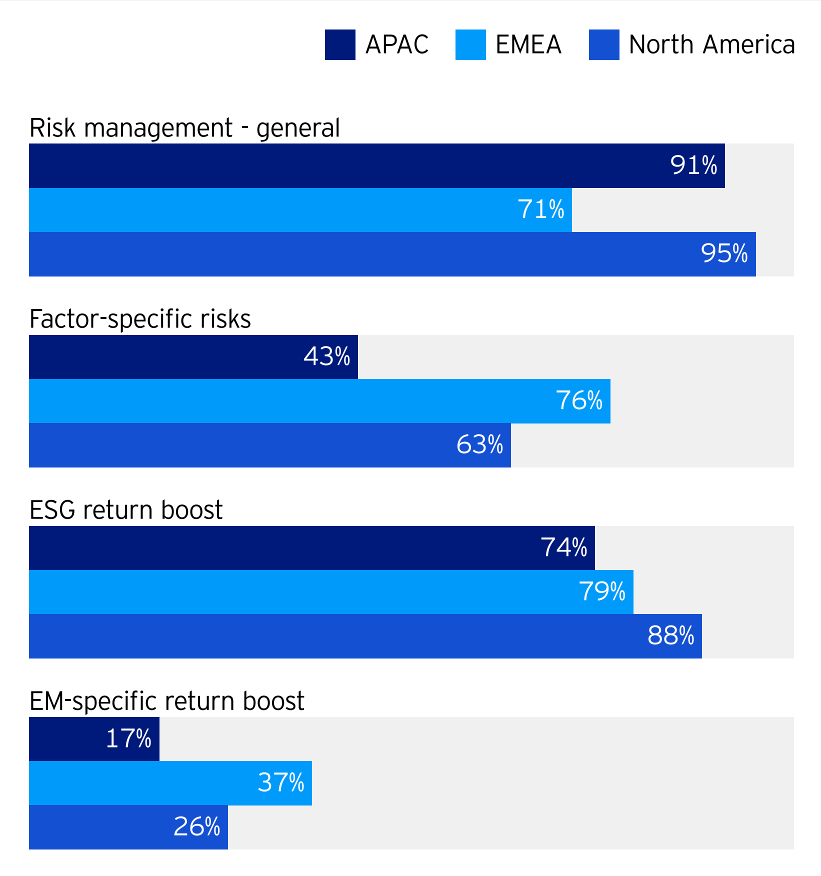
Figure 3.5
Effect of ESG on factor strategies (% citations)



Do you find that ESG hinders, or aids, factor investment strategies?

Sample size: 216

Figure 3.6
Ways in which ESG supports factor strategies (% citations)

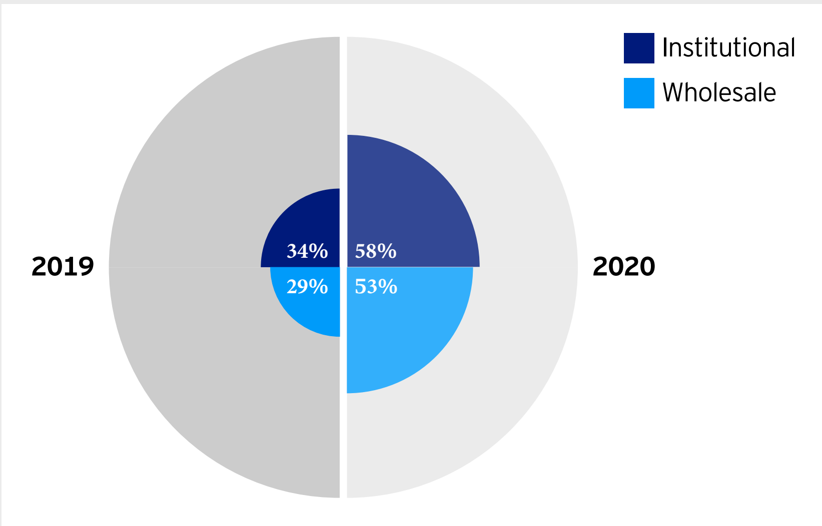


x If aids] Why is this the case?

Sample size: 116

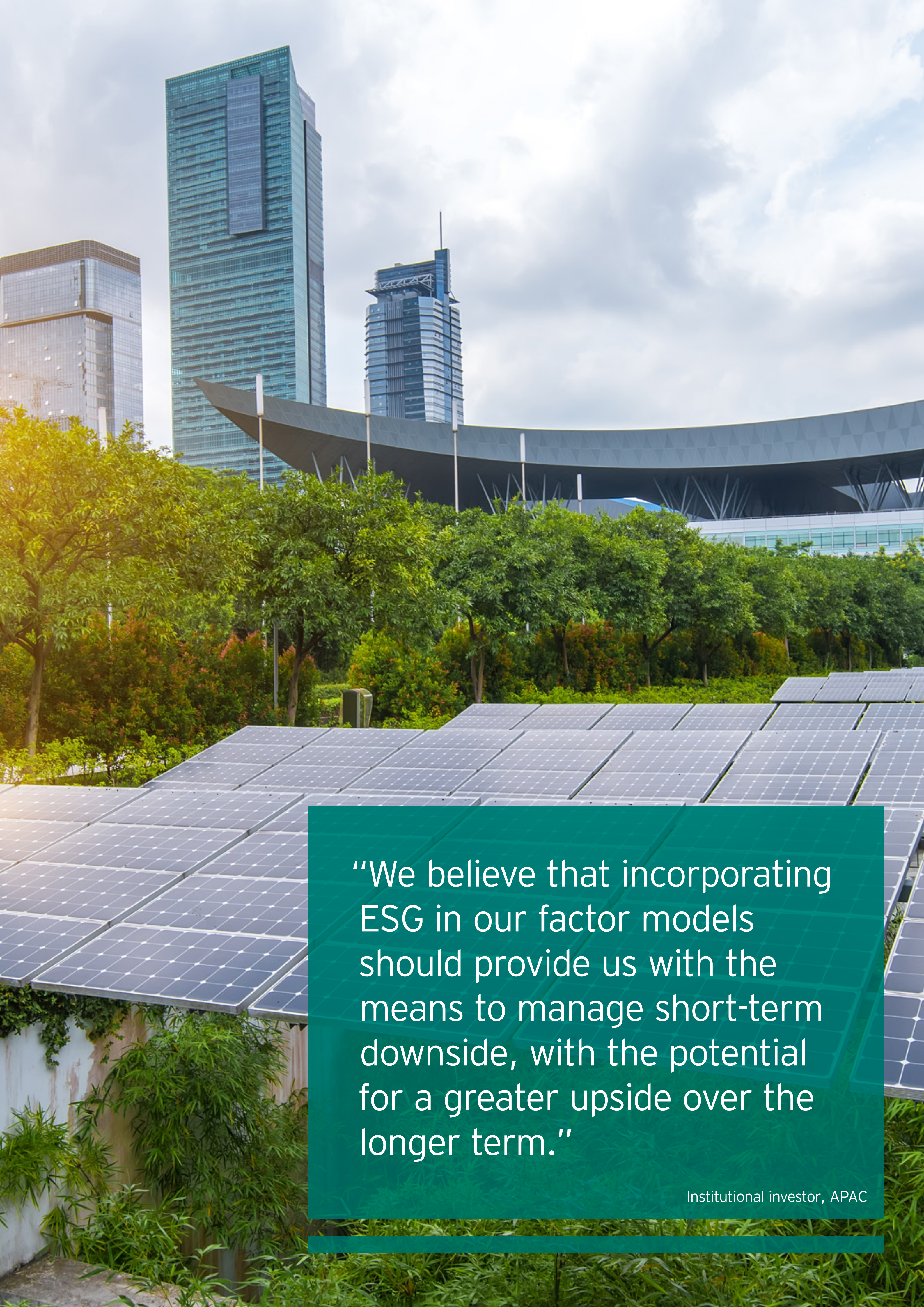
In line with the rising importance of ESG and factor investing, the proportion of investors analysing their ESG portfolios through a factor lens increased this year. Over half of institutional investors (58%) and a similar proportion of wholesale investors (53%) had carried out this analysis, in an effort to better understand the impact of ESG on their factor exposures. (**Figure 3.7**). However, this still leaves significant portion unaware of potential factor biases in an ESG portfolio, with the complexity of this operation being the most frequently cited barrier.

Figure 3.7
Investors who have conducted factor analysis on ESG mandate (% citations)



With regards to your existing ESG mandates, have you conducted a factor exposure analysis on your ESG mandate?

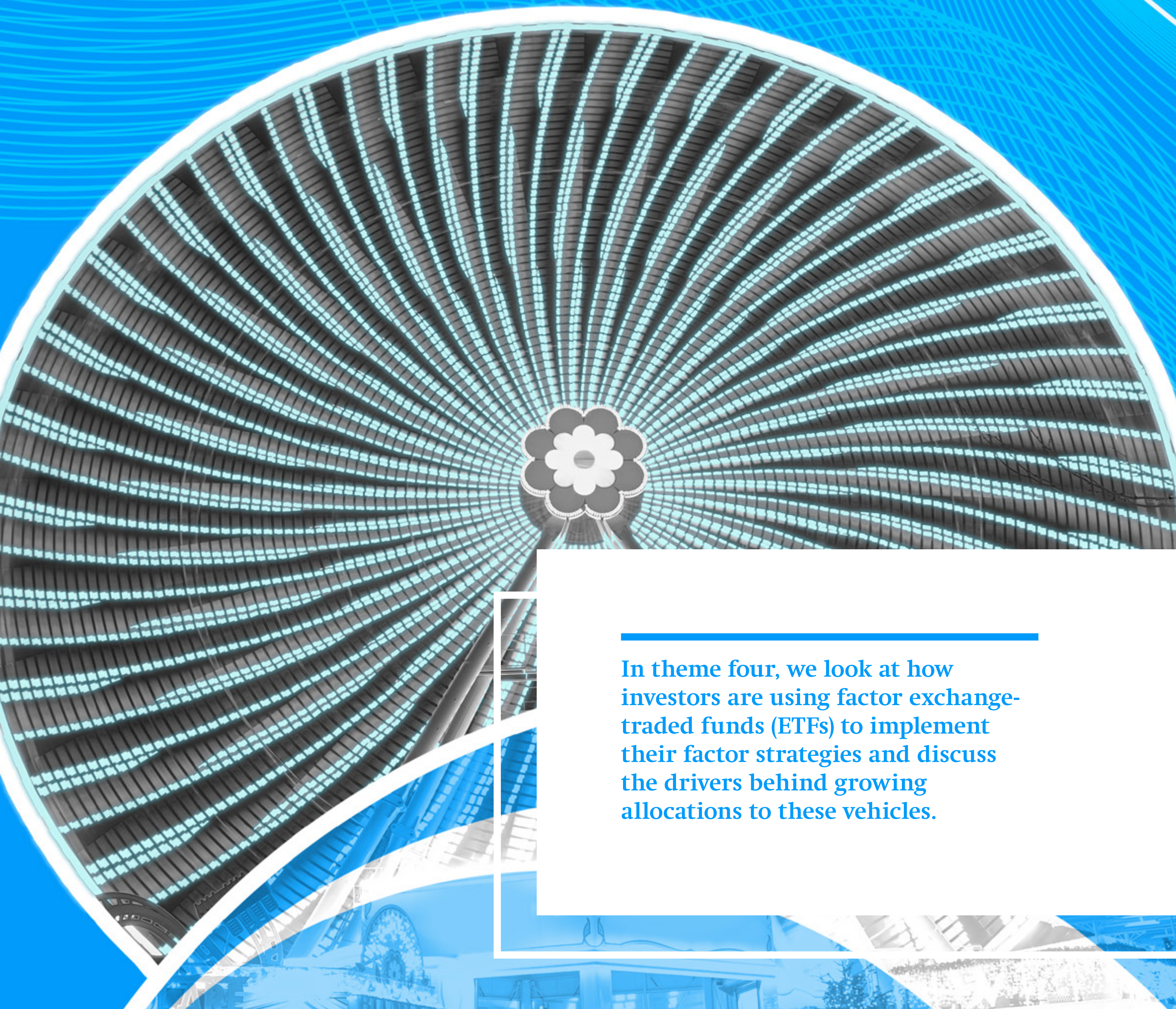
Sample size:
2019 = 218
2020 = 204



> "We believe that incorporating ESG in our factor models should provide us with the means to manage short-term downside, with the potential for a greater upside over the longer term."
>
> Institutional investor, APAC

Theme 4

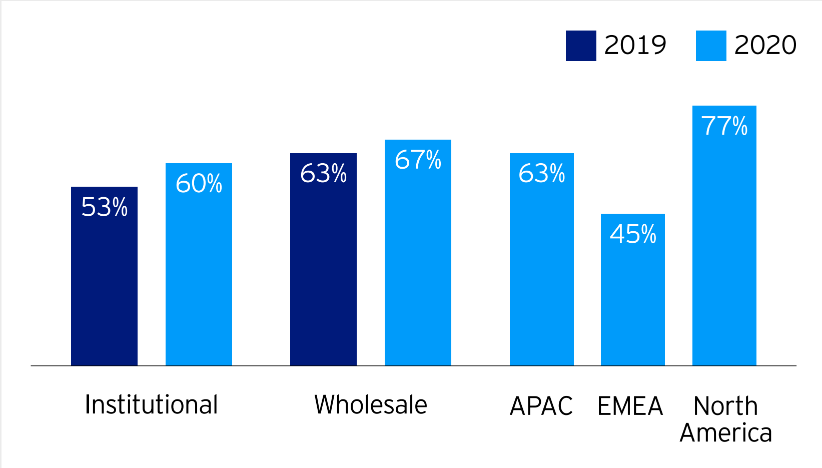
ETFs can offer a familiar and flexible tool for implementing factor strategies



In theme four, we look at how investors are using factor exchange-traded funds (ETFs) to implement their factor strategies and discuss the drivers behind growing allocations to these vehicles.

We found 60% of institutional investors and 67% of wholesale investors were using ETFs as part of their factor implementation, accounting for an average of 14% and 50% of factor portfolios respectively. Levels of use in EMEA were slightly lower than other regions, with just half of EMEA factor investors using ETFs in some form (**Figures 4.1 and 4.2**).

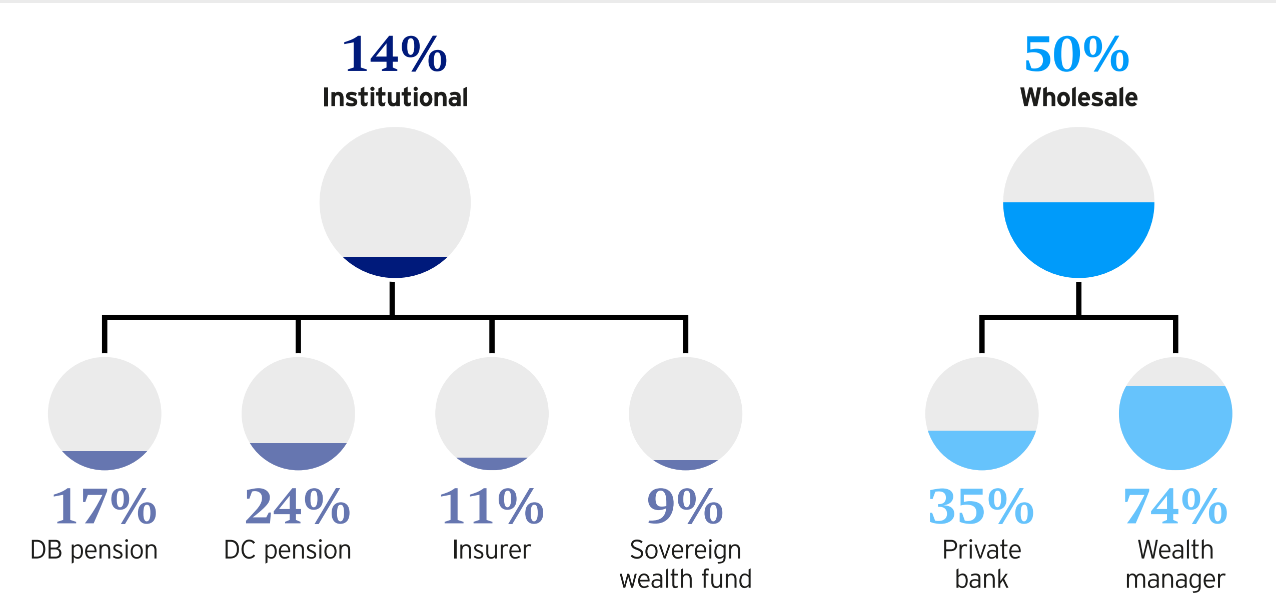
Figure 4.1
Use of factor ETFs (% citations)



How do you execute your factor strategies?

Sample size: 2019 = 214
2020 = 195

Figure 4.2
Percentage of factor allocation held via ETFs (average %, factor ETF users)



What percentage of your factor allocation is held via ETFs?

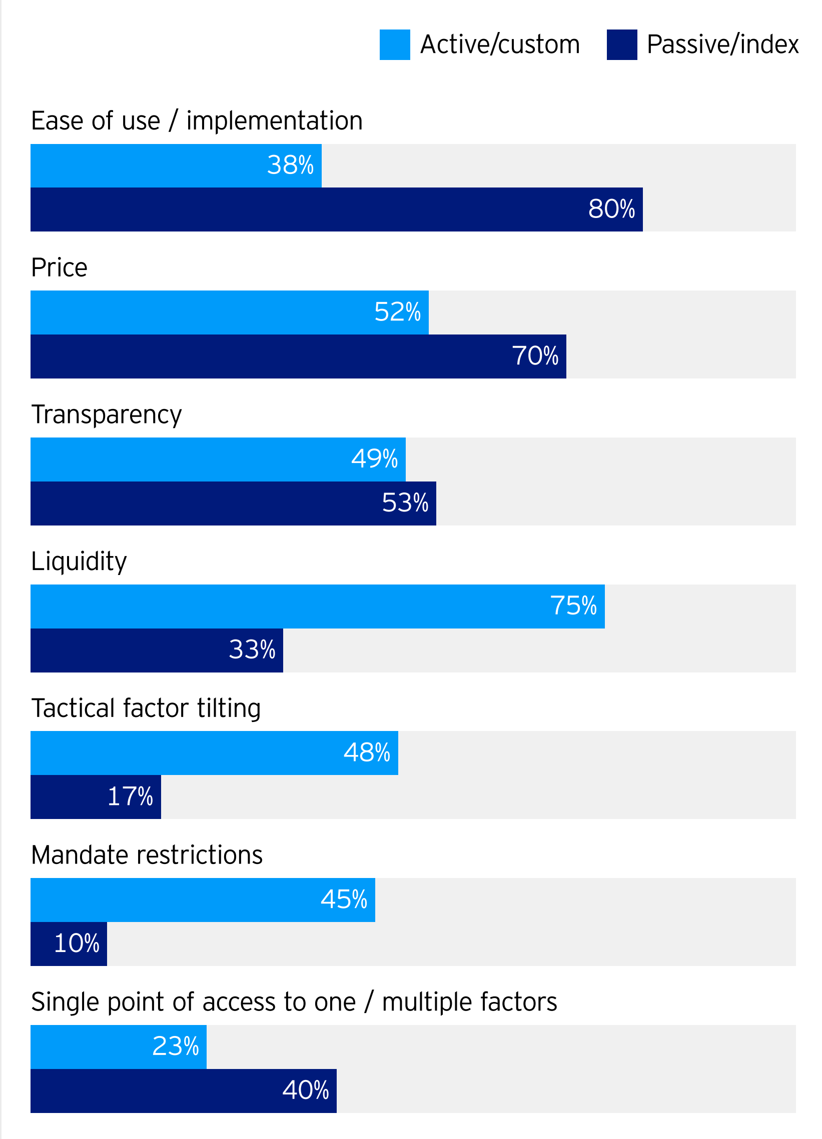
Sample size: 104

For respondents investing in passive indexing factor strategies, ETFs were particularly valued for their ease of use and price (**Figure 4.3**). For these types of 'enhanced' or 'smart' beta applications investors reported being attracted to transparent, rules-based products that could better meet their risk-return objectives than market-weighted allocations. For these applications, factor ETFs were seen as a good tool for building a portfolio and managing risk, particularly when viewed against the more limited option of market-cap weighted products.

However, we found ETFs were also being used widely to implement active strategies, sometimes replacing swaps and other types of derivatives, with investors valuing their liquidity and flexibility as well as reduced counterparty risk (**Figure 4.3**). For some, this shift towards ETFs and away from derivatives was being driven by the additional transparency demands of new or enhanced ESG policy thresholds.

Figure 4.3

Reasons for using ETFs by principal method of factor implementation (% citations, factor ETF users)



[If using ETFs] Why do you use ETFs to target factors?

Sample size: 115

For EMEA investors the most important drivers of ETF use were price and ease of implementation, both cited by 71% of respondents (**Figure 4.4**). For wholesalers, factor ETFs were often seen useful for articulating the advantages of a factor approach, including the ability to offer exposure to active management styles in a more efficient way.

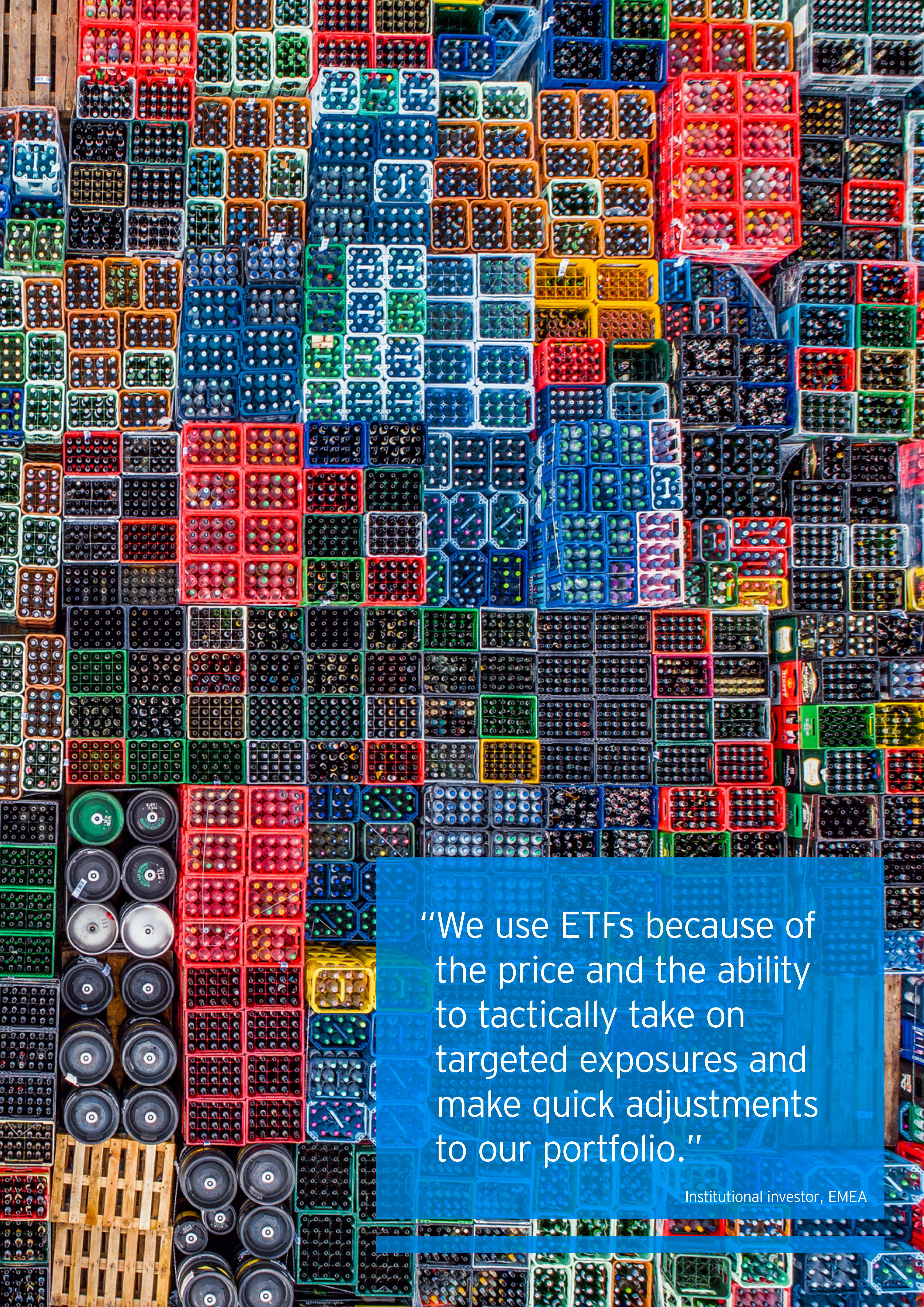
Figure 4.4
Reasons for using ETFs (% citations, factor ETF users)

	Institutional	Wholesale	APAC	EMEA	North America
Ease of use/ implementation	33%	64%	33%	71%	41%
Price	44%	71%	50%	71%	51%
Transparency	51%	48%	61%	42%	46%
Liquidity	77%	52%	69%	42%	80%
Tactical factor tilting	47%	33%	42%	24%	54%
Mandate restrictions	37%	34%	31%	29%	46%
Single point of access to one/multiple factors	23%	31%	28%	37%	17%

≥60% ≥50% ≥40% ≥30% ≥20% <20%

[If using ETFs] Why do you use ETFs to target factors?

Sample size: Institutional = 57
Wholesale = 58



"We use ETFs because of the price and the ability to tactically take on targeted exposures and make quick adjustments to our portfolio."

Institutional investor, EMEA

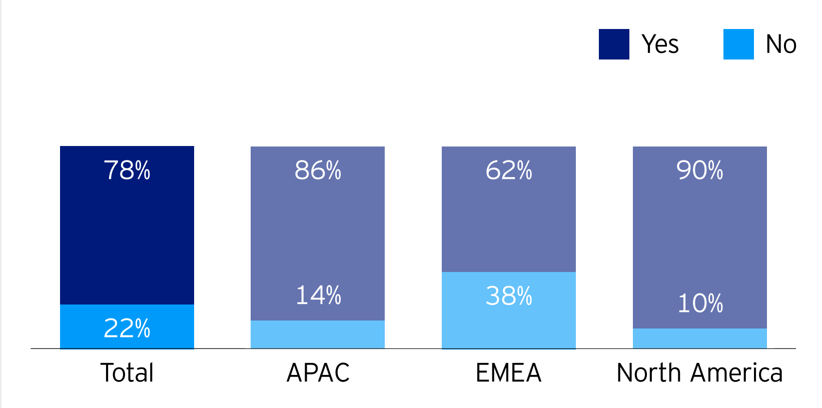
Theme 5

Levelling up: Demand for additional services and improvements in implementation

In our final theme, we discuss the growing sophistication of factor investors and the additional demands that this is placing on external asset managers.

One example of additional services is the adoption of additional factors. Multi-factor strategies were found to be the norm used by 78% of investors in total (**Figure 5.1**). As factor approaches become more complex and dynamic, investors reported putting more effort into monitoring their factor exposures: two-thirds of institutional investors were systematically monitoring factor exposures, up from just under half a year ago (**Figure 5.2**).

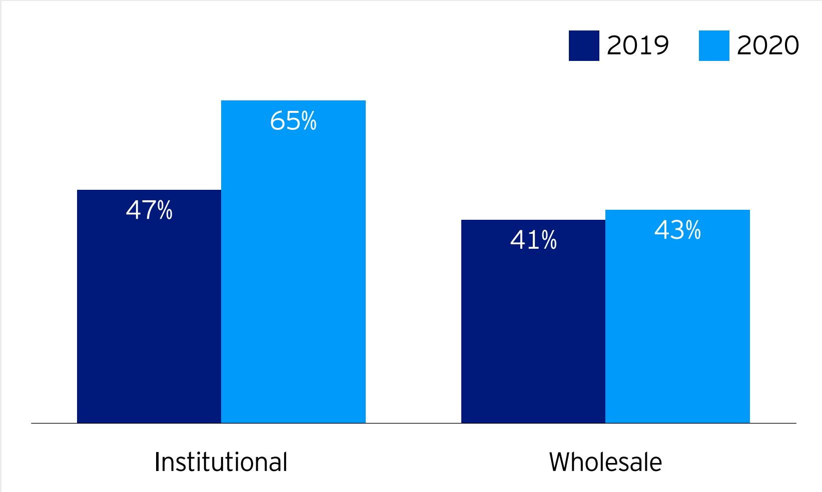
Figure 5.1
Use of multi-factor strategies (% citations)



Do you invest in multi-factor strategies?

Sample size: 224

Figure 5.2
Systematic monitoring of risk factor exposures (% citations)



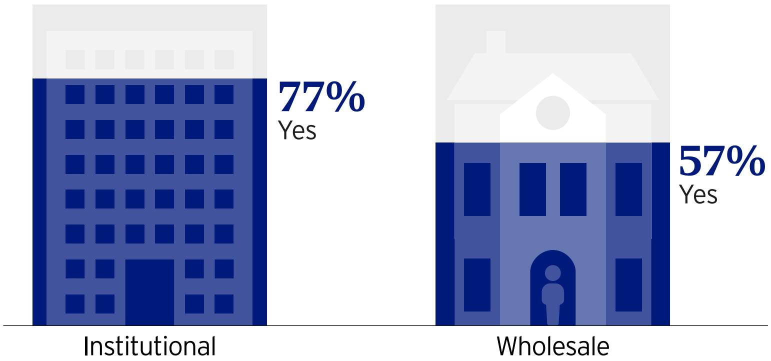
Which approaches to factor investing do you use within your portfolio (or client portfolios)?

Sample size: 2019 = 239
2020 = 234

Monitoring of factor correlations was also seen as a crucial part of the portfolio construction process, with two-thirds of investors were keeping track of how factors are correlated (**Figure 5.3**) with this analysis seen as particularly necessary for avoiding risk concentrations.

Investors were also exploring the possibility of timing factors to generate additional returns. The majority of investors now accepted the possibility of timing allocations, a view particularly strong in North America (92%) but also widely held in EMEA (78%) (**Figure 5.4**). However, a smaller proportion of investors were actually attempting to time suggesting that many are sceptical about the reliability of getting it right over the long-term.

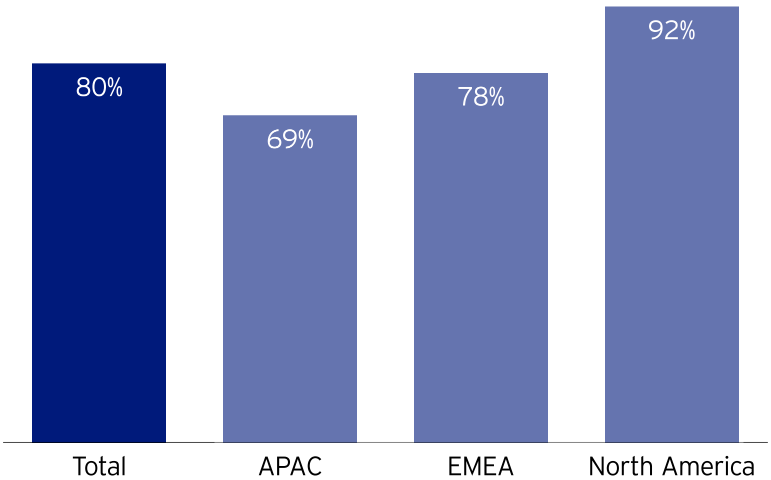
Figure 5.3
Track correlations between factors (% citations)



Do you track correlations between factors?

Sample size: Institutional = 128
Wholesale = 92

Figure 5.4
Investors accepting the possibility of timing (% citations)



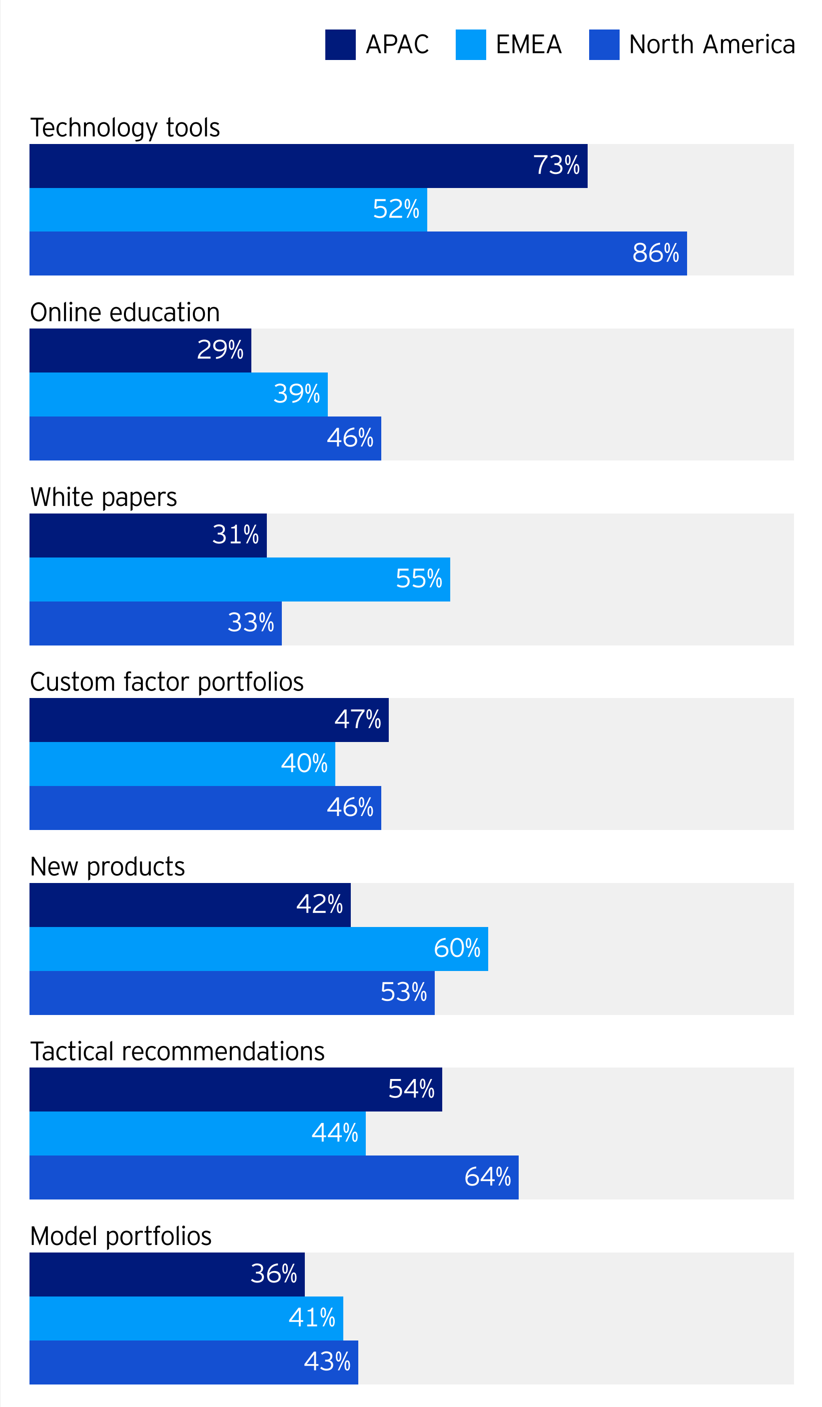
Is it possible to time factors to maximise performance?

Sample size: 223

For EMEA investors, the implementation of factor investing to new asset classes including fixed income, has led to demand for additional products (60%) and white papers (55%) (**Figure 5.5**). Meanwhile, a more dynamic approach to factor allocations is reflected in 44% of EMEA investors saying that they were looking to their external factor managers for tactical recommendations, be that in relation to timing, managing risk or a change in correlations.

Technological innovation was viewed as a salve for a range of challenges related to developing allocations and monitoring exposures. Dissatisfaction with current systems was leading some investors to invest more in developing their own in-house solutions. However, many others were looking for asset managers to take a lead – just over half of EMEA investors said they were looking to external managers for help in developing appropriate tools. Investors cited a desire to monitor factor exposure at the total portfolio level to better target and manage factors that align to their liabilities and/or their investment objectives.

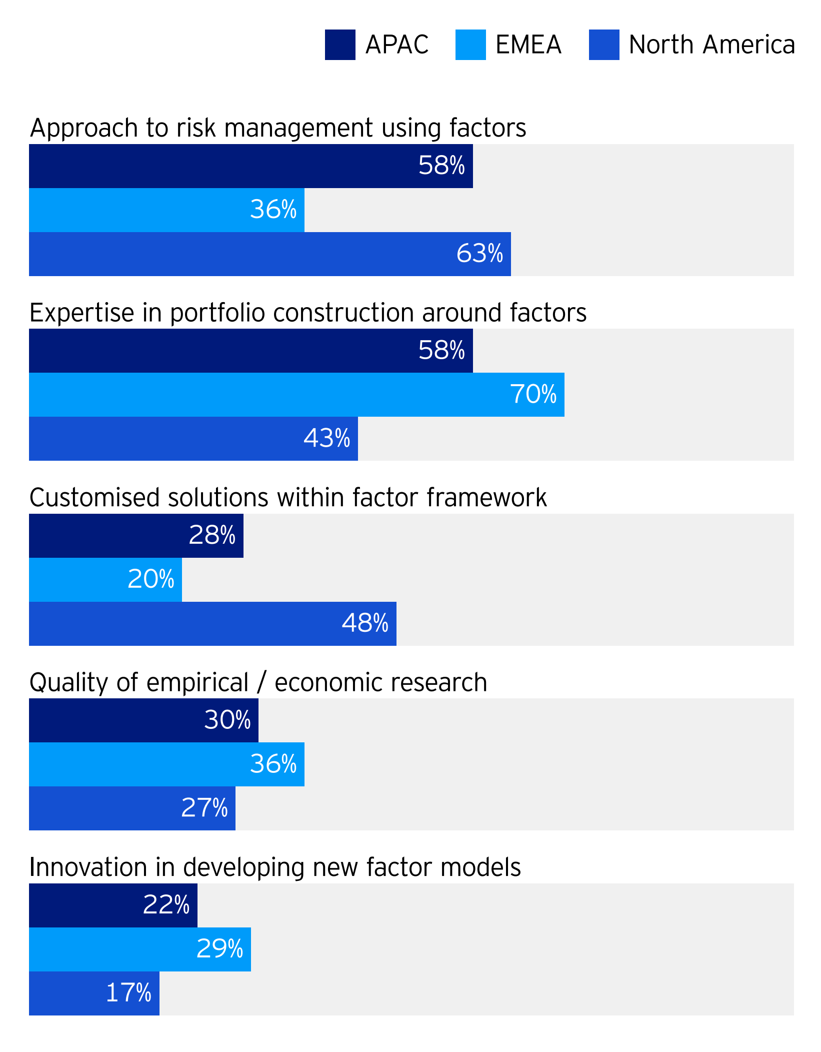
Figure 5.5
Help needed from external asset managers (% citations)



What can external asset managers do best to help you with your use of factor strategies?

Sample size: 225

Figure 5.6
Criteria used to select a factor manager (% citations)



What criteria do you use to select a factor manager?

Sample size: 215

This increased sophistication of factor investors was also reflected in how respondents choose external managers. When selecting a factor manager 70% of EMEA investors reported prioritising a manager's expertise in portfolio construction and 36% focused on a manager's approach to risk management using factors (**Figure 5.6**).

"We started off with a value ETF some years ago and the sophistication of our factor strategy has grown from there."

Wholesale investor, EMEA

Case studies

EMEA Case Study 1 – Institutional Investor

Factor investing is something we have been doing for a long time. Initially it was only long-only equity and fixed income. However, now we see it as something that can be applied across a range of asset classes. We look at equities, bonds, currencies and commodities - anywhere the market is reasonably liquid. We do this across multiple risk premia so are not overly reliant on the performance of any one factor.

When choosing factors, we first need to believe that the factor/risk premium exists and will persist. We then look to diversify across factors. Our general view is that trying to time factors is difficult, but we do make modifications in terms of sizing and tweaks at the edges. For example, for value there is a question mark whether the factor still exists. However, we think it does and the nature of factors is that they ebb and flow. Right now, based on valuations, value looks attractive.

We prefer to take a benchmark unaware approach and allocate across different managers to reduce manager risk. We ultimately compare against the market cap benchmark as this is needed as a proof point. However, we do this over a long timeframe and try and dial down the importance of short-term results.

Our approach to ESG is that sustainability should permeate the entire investment process, and should be an overlay that can be just as easily applied to a factor-based approach. It is not surprising to us that securities that score well on ESG have done well and it reinforces our belief that ESG can help deliver superior performance.

EMEA Case Study 2 – Wholesale Investor

We have been doing factor investing for 15 years but have been doing more over the last 5 years. The trend is replacing fundamental investing and some of our multi-asset portfolios are moving toward a factor-based approach.

Our multi-asset portfolios include fixed income, equities and currencies and within each asset class we are targeting carry, momentum, value and quality, with the definitions for each differing based on the norms for each type of security.

We look for 'momentum' in factors and tilt allocations using a momentum metric that uses intervals of 3 months to 1 year. We have tilted slightly away from value for tactical reasons based on our momentum metrics but not due to fundamental reconsideration of the worth of the value factor.

We track standard cap-weighted indexes and tilt to certain factors. This is done using proprietary metrics but the inspiration is from the academic metrics. We have tried to make the metrics more robust. We also look at active managers with a factors lens and are looking to do more of that -slicing and dicing active portfolios across styles.

We have a range of clients, many of whom are not familiar with factors. However, we also have more sophisticated clients that have been working with factors for many years and choose us because we have expertise in this area.

We manage funds with an ESG overlay and by inputting client constraints. It is relatively easy to do - we have scores to represent ESG values and this can merge with our factor approach. ESG has a typical bias towards quality and we are willing accept a degree of bias in the portfolio.

Appendix

Sample and methodology

The fieldwork for this study was conducted by NMG's strategy consulting practice. Invesco chose to engage a specialist independent firm to ensure high quality objective results. Key components of the methodology include:

- A focus on the key decision makers conducting interviews using experienced consultants and offering market insights.
- In-depth (typically 1 hour) face-to-face interviews using a structured questionnaire to ensure quantitative as well as qualitative analytics were collected.
- Results interpreted by NMG's strategy team with relevant consulting experience in the global asset management sector.

In 2020, the fifth year of the study, we conducted interviews with 238 different pension funds, insurers, sovereign investors, asset consultants, wealth managers and private banks globally. Together these investors are responsible for managing US$25.4 trillion in assets (as of 31 March 2020).

All respondents were 'factor users', defined as any respondent investing in a factor product across their entire portfolio and/or using factors to monitor exposures. We deliberately targeted a mix of investor profiles across multiple markets, with a preference for larger and more experienced factor users. The breakdown of the 2020 interview sample by investor segment and geographic region is displayed in **Figures 6.1, 6.2** and **6.3.**

Institutional investors are defined as pension funds (both defined benefit and defined contribution), sovereign wealth funds, insurers, endowments and foundations. Wholesale investors are defined as discretionary managers or model portfolio constructors for pools of aggregated retail investor assets, including discretionary investment teams and fund selectors at private banks and financial advice providers, as well as discretionary fund managers serving those intermediaries.

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Figure 6.1
Assets under management by segment (US$ trillion, as of 31 March 2020)

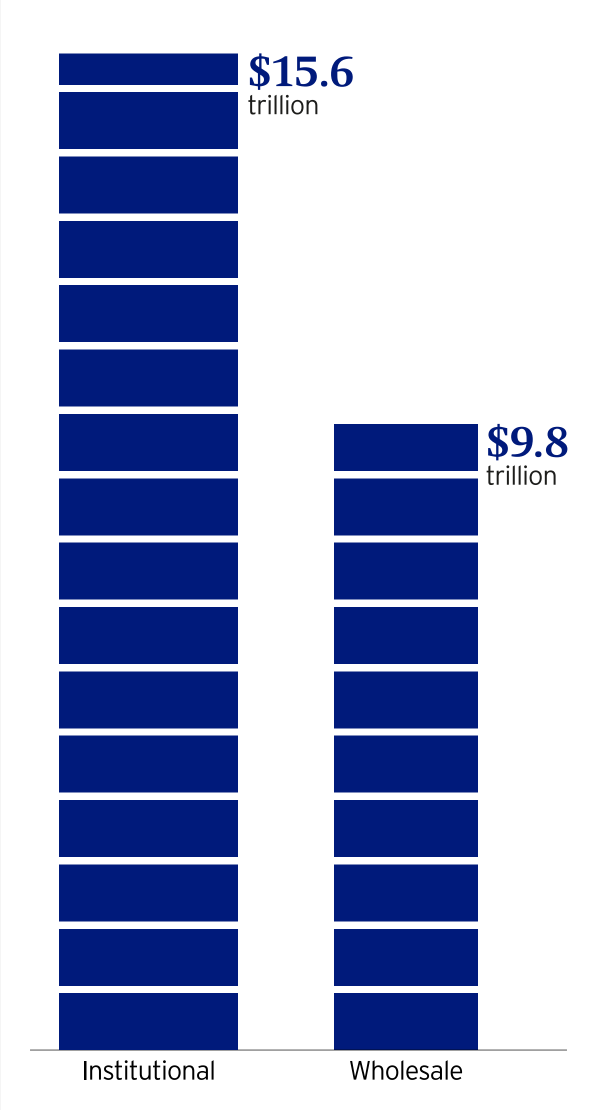


Figure 6.2
Sample by segment

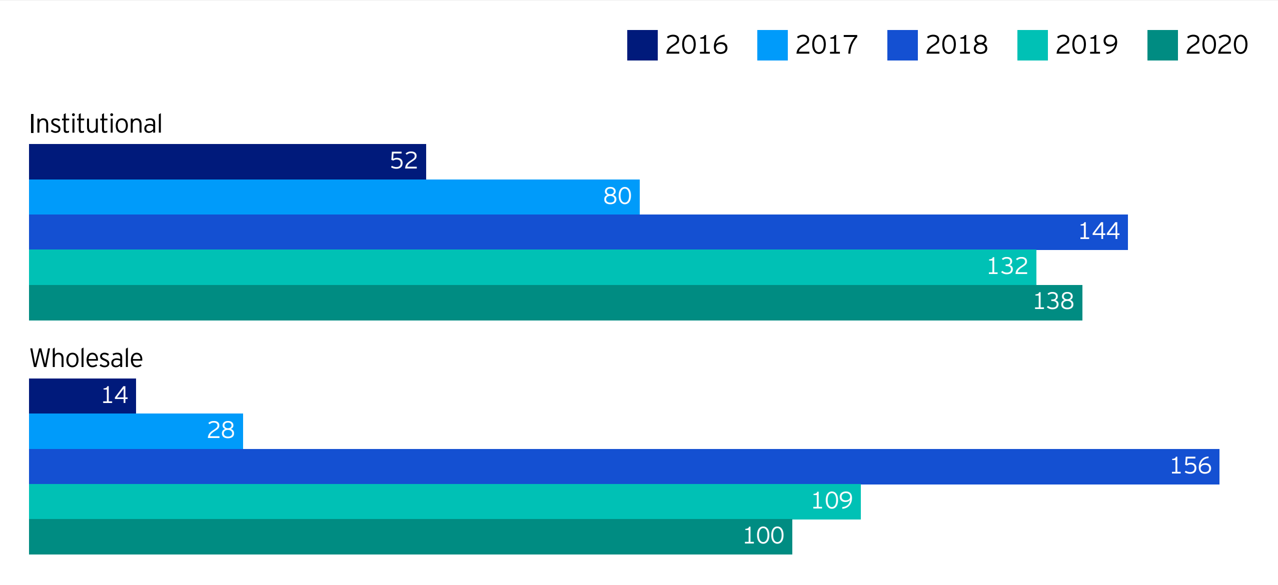
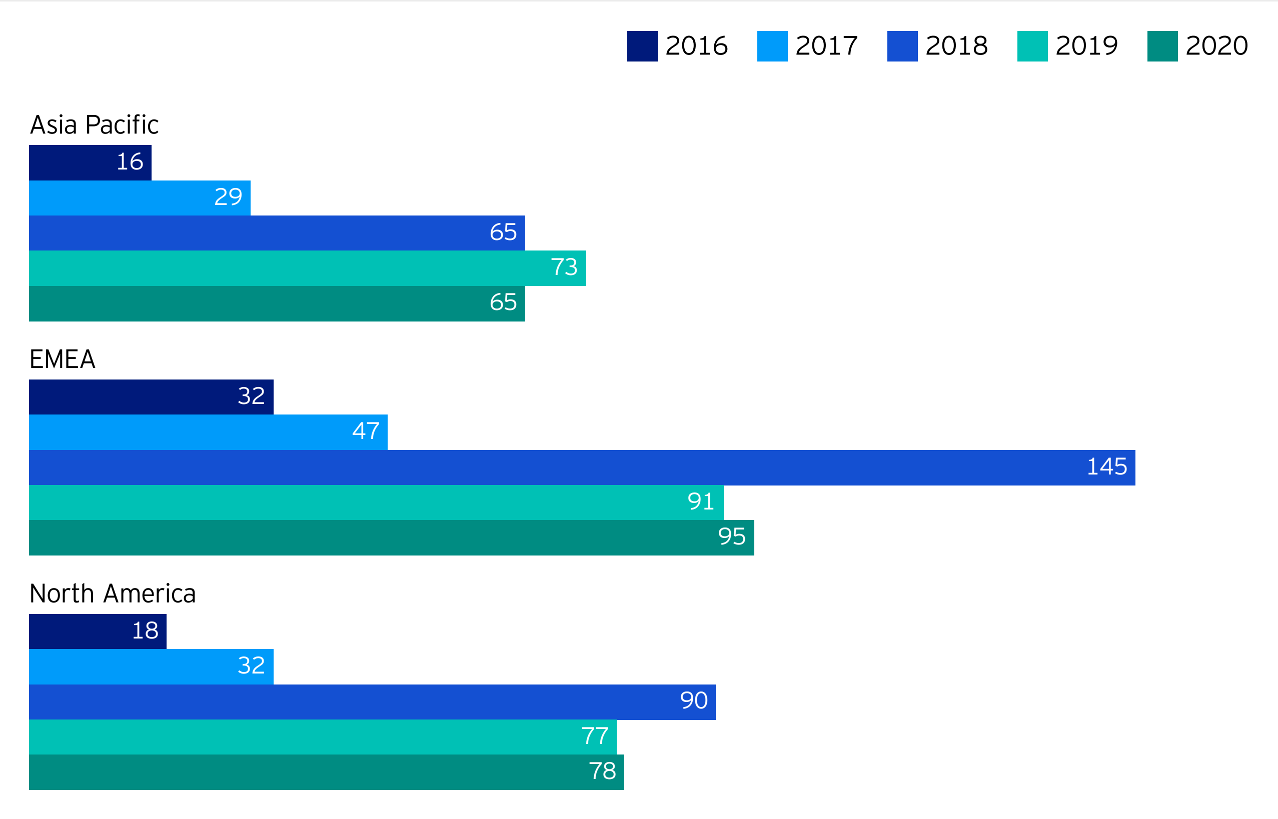


Figure 6.3
Sample by region



Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Factor investing is an investment strategy in which securities are chosen based on certain characteristics and attributes that may explain differences in returns. Factor investing represents an alternative and selection index-based methodology that seeks to outperform a benchmark or reduce portfolio risk, both in active or passive vehicles. There can be no assurance that performance will be enhanced or risk will be reduced for strategies that seek to provide exposure to certain factors. Exposure to such investment factors may detract from performance in some market environments, perhaps for extended periods. Factor investing may underperform market cap-weighted benchmarks and increase portfolio risk. There is no assurance that the factor strategies discussed in this material will achieve their investment objectives or be successful. In general, equity values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Since ordinary brokerage commissions apply for each buy and sell transaction, frequent trading activity may increase the cost of ETFs. ETFs disclose their full portfolio holdings daily. Diversification does not guarantee a profit or eliminate the risk of loss.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The use of environmental and social factors to exclude certain investments for non-financial reasons may limit market opportunities available to funds not using these criteria. Further, information used to evaluate environmental and social factors may not be readily available, complete or accurate, which could negatively impact the ability to apply environmental and social standards.

Alternative strategies typically are subject to increased risk and loss of principal. Consequently, investments such as exchange-traded funds which focus on alternative strategies are not suitable for all investors.

Commodities generally are volatile and are not suitable for all investors.

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