

10 Smart Questions Investors Should Be Asking About Smart Beta

1

What are smart beta strategies?

Smart beta is simply a catch-all term used to define non-market capitalization weighted strategies. Many different strategies fall under this umbrella, including equal weight, low volatility and fundamentally weighted strategies, among others.

2

Why have these strategies become so popular?

These strategies originally became popular with institutional investors. In recent years, they've been embraced by advisors and retail investors because they're now easily accessible through mutual funds and exchange-traded funds (ETFs), and many of these strategies now have a track record that tends to support the historical research.¹

3

Are all strategies really “smart”?

Not all smart beta strategies are created equally. It's not wise to group all smart beta strategies together and expect the same outcomes. We believe it's important for all types of investors to dig deeper when considering if smart beta – and which type – is appropriate to help them meet their investment goals.

4

How can investors distinguish among the myriad of strategies?

Although they're often grouped together, smart beta strategies can differ depending on the underlying index construction methodology. Investors should start with a short checklist:

- ✓ *What is the methodology for screening and weighting securities?*
- ✓ *What is the underlying index?*
- ✓ *What are the sector allocations, and does this introduce some unintended risks?*
- ✓ *What is the market capitalization break-down of the strategy?*
- ✓ *What are the allocations across value, growth and core stocks?*

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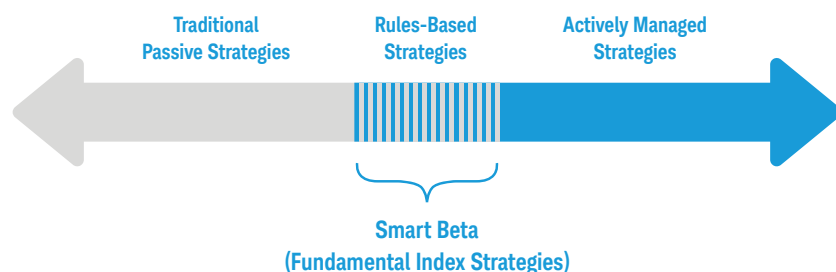
What is it about Fundamental Index® strategies that the Schwab Center for Financial Research likes?

We like the fact that Fundamental Index strategies have real data over the last decade to support our beliefs, and that a lot of academic rigor went into their development. Our research has shown that these strategies have delivered attractive risk-adjusted returns over the last decade.²

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Are Fundamental Index strategies active or passive?

Fundamental Index strategies capture many of the positive attributes of traditional passive strategies and active management. Like traditional passive strategies, they tend to be cost-effective ways of investing in segments of the market. Like active management, they employ a disciplined investment process designed to improve upon the market experience.



10 Smart Questions Investors Should Be Asking About Smart Beta (contd.)

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How are smart beta strategies different from market-cap strategies?

Market-cap strategies provide the largest weighting to the largest companies based on the stock's market capitalization. Fundamental Index strategies break the link with price and screen and weight securities based on factors like sales, cash flow and dividends + buybacks.

[View Chart](#)

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How should investors use them?

We believe Fundamental Index strategies are complementary to market-cap strategies and active management. Each strategy plays a specific role, and combining them can provide a better diversified portfolio.

Key Lever ²	Market Cap	Fundamental	Active
Tracking error	Little or no tracking error	Higher tracking error	Varies by manager
Loss aversion	No downside protection	No downside protection	May provide a level of downside protection
Alpha	No	Potential alpha	Varies
Cost	Lowest Cost	Low Cost	Varies by manager and vehicle

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How should investors allocate amongst active, market-cap and Fundamental Index strategies?

We believe that these strategies can serve as a valuable complement to market-cap and active management strategies. Investors should begin by understanding the role each strategy plays in a portfolio.

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Is now the right time for Fundamental Index strategies?

Over the long-run, Fundamental Index strategies have historically delivered excess returns.¹ Based on our research, we believe that Fundamental Index strategies will likely outperform their market-cap equivalent in the coming year.² In today's volatile market environment, do you want to overweight a high Price/Earnings ratio stock that has already experienced a significant run-up, or would you rather overweight a stock with attractive fundamental characteristics? Fundamental Index strategies systematically identify and weight securities based on their financial health – not their popularity.

[View Chart](#)

¹ See ["Strategic beta strategies: An evaluation of different approaches"](#) for more information.

² See ["Why Fundamentals – Why Now"](#) for more information.

10 Smart Questions Investors Should Be Asking About Smart Beta (contd.)

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Past performance is no guarantee of future results.

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Definitions:

Alpha. A measure of fund performance on a risk-adjusted basis. Alpha compares the risk-adjusted performance of a fund to a benchmark index (such as the S&P 500). The excess return of the fund relative to the return of the benchmark index is a fund's alpha. A positive alpha means the fund has outperformed the index on a risk-adjusted basis.

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