Multi-factor investing

A complement to any investing strategy, designed to harness incremental returns while seeking to manage risks and costs.

Factors are the underlying characteristics that drive returns of stocks, bonds and other assets. For instance, Value, Momentum, Quality and Low Volatility are four common equity factors that have the potential to deliver excess returns over the broad market. Factor investing targets exposure to these factors to help maximize a portfolio’s return and manage its risk.

Active investment managers have for decades used strategies to target factors, such as specializing in value or momentum equities. Technological and research developments now allow managers to provide more precise exposure to factors in a portfolio, harnessing these powerful tools to help meet client objectives.

**Value** investment strategies involve identifying companies that are trading at a discount to fair value of the broader market.

**Quality** investment strategies focus on identifying companies that deliver sustainable returns to shareholders. Typically characterized by high profitability, low leverage and low earnings volatility.

**Momentum** investment strategies focus on identifying those stocks with strong performance, with the expectation that the strong performance will continue.

**Low-Volatility** based investment strategies focus on identifying companies that have more stable return patterns than the broader market.

And...

**Growth** strategies focus on stocks that exhibit higher historical and forecasted growth rates, as measured by fundamental measures such as earnings and sales, relative to the broader market. Size strategies focus on stocks with a lower market capitalization.
The quest for generating incremental returns while managing portfolio risk can be challenging. In response, many investors are seeking additional, cost-effective investment approaches to complement their active or passive allocations. Factor investing is one such approach that can efficiently help manage risk and enhance returns.

Our factor investing approach

At Russell Investments¹, we understand factor investing—it’s been one of our core capabilities for more than 40 years. We believe there are three key components to a successful multi-factor strategy: 1) Identifying and understanding multiple factors 2) Thoughtful portfolio construction and 3) Dynamically managing factor exposures.

Multiple factors

Early adopters of factor investing focused on portfolios targeting a single factor to more reliably realize a desired exposure. However, factors can be volatile and present unique risks to investors given their highly cyclical nature.

Although each individual factor’s excess returns are expected to be positive in the long run, they are not consistently positive over shorter time horizons and fall in and out of favor at different times throughout the market cycle.

Combining multiple factors in a single portfolio may help provide more consistent performance over time, especially given that the performance cycles of the most common factors have not historically coincided with each other — when one factor is underperforming, another factor may be outperforming.

Combining multiple factors: Diversifying return patterns

1-Year Rolling Excess Return of factors vs. Russell Global Large Cap Index

Source: Russell Investments. Based on monthly data from August 1996 – December 2017. Returns represented by Russell Investments Growth, Quality, Momentum, Low Volatility and Value factors relative to the Russell Global Large Cap Index (as a proxy for global equity). Indexes are unmanaged and cannot be invested in directly. Past performance is not indicative of future results. The factor returns do not reflect any Russell Investments Canada Limited’s product or any investment fund. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. For illustration purposes only.

¹ Russell Investments Canada Limited, backed by the larger Russell Investments, benefits from these global capabilities.
**Thoughtful portfolio construction**

Combining multiple factors within a portfolio requires careful consideration — just as diversifying across various asset classes does — so that the components complement each other. A simplistic multi-factor portfolio would equally weight each factor. However, our research shows that optimizing risk-adjusted returns requires an understanding of each factor’s behavior under different economic regimes. For example,

- The *Value* factor has tended to start performing well at market bottoms.
- The *Momentum* factor has typically started performing well at or near market peaks.
- The *Quality* factor has been the most stable in terms of returns, though it tends to perform better during recessions.
- The *Low Volatility* factor has demonstrated the strongest counter-cyclical pattern.

We use this insight to thoughtfully construct the strategic factor weights for our multi-factor portfolios: 40% Value, 30% Momentum, 20% Quality and 10% Low Volatility. These weights become the starting point for our Portfolio Managers to dynamically manage our multi-factor portfolios.

**Strategic factor weights**

- **Value** 40%
- **Momentum** 30%
- **Quality** 20%
- **Low Volatility** 10%

Actual weights may vary from the strategic allocation depending on the market environment.

**Dynamic active management**

Markets are not static and conditions are constantly evolving, causing the attractiveness of any one factor to vary. Therefore, our Portfolio Managers actively adjust individual factor weights, based on our manager research insights and strategists’ capital market views on the business cycle, valuations and market sentiment. For example, the Portfolio Managers may increase the *Value* exposure near market bottoms as equities are seemingly set to rebound. Conversely, *Quality* may be emphasized in a weak or recessionary environment.

**Dynamically managed factor exposures based on market cycle**

<table>
<thead>
<tr>
<th>Market cycle</th>
<th>Downturn</th>
<th>Recession</th>
<th>Recovery</th>
<th>Boom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio shift</td>
<td>Balanced transition to defensive posture</td>
<td>Defensive transition to balanced posture</td>
<td>Balanced transition to risk strategies</td>
<td>Risk strategies transition to balanced posture</td>
</tr>
<tr>
<td><strong>Value</strong></td>
<td>--</td>
<td>+/-</td>
<td>++</td>
<td>+/-</td>
</tr>
<tr>
<td><strong>Momentum</strong></td>
<td>--</td>
<td>+/-</td>
<td>+/-</td>
<td>++</td>
</tr>
<tr>
<td><strong>Quality</strong></td>
<td>+</td>
<td>++</td>
<td>--</td>
<td>+/-</td>
</tr>
<tr>
<td><strong>Low Vol</strong></td>
<td>+</td>
<td>++</td>
<td>--</td>
<td>-</td>
</tr>
<tr>
<td><strong>Growth</strong></td>
<td>+</td>
<td>--</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td><strong>Size</strong></td>
<td>--</td>
<td>+/-</td>
<td>++</td>
<td>+</td>
</tr>
</tbody>
</table>

Russell Investments (RI) does not believe in a return premium to the Growth factor through the entire cycle, so it is not included in our ‘strategic factors’ above. However, RI believes there are appropriate times to allocate to Growth within certain phases of the cycle as a valuable analogue to allocations to the Value factor. RI does not believe in a premium to smaller size, but does believe that active management, and factor exposures, are more powerful in smaller cap stocks.
INVESTMENT OBJECTIVE:
RUSSELL INVESTMENTS MULTI-FACTOR INTERNATIONAL EQUITY POOL
To provide long-term capital growth by investing principally in equity securities of issuers outside of Canada and the U.S. using multiple factors to select investments.
RISK LEVEL:
LOW LOW-LOW MEDIUM MEDIUM HIGH
Fund Codes
Series B (Front Load) FRC 454 Series F FRC 464

INVESTMENT OBJECTIVE:
RUSSELL INVESTMENTS MULTI-FACTOR U.S. EQUITY POOL
To provide long-term capital growth by investing principally in equity securities of U.S. issuers using multiple factors to select investments.
RISK LEVEL:
LOW LOW-LOW MEDIUM MEDIUM HIGH
Fund Codes
Series B (Front Load) FRC 584 Series F FRC 514

INVESTMENT OBJECTIVE:
RUSSELL INVESTMENTS MULTI-FACTOR CANADIAN EQUITY POOL
To provide current income and long-term capital growth by investing principally in Canadian equity securities using multiple factors to select investments.
RISK LEVEL:
LOW LOW-LOW MEDIUM MEDIUM HIGH
Fund Codes
Series B (Front Load) FRC 647 Series F FRC 667

Purchase options above are for CAD. Also available in USD. Account minimums: $25,000, subsequent purchase: $500. Trailer fee 1.00% (Series B). Management Fee 1.40% (Series B), 0.40% (Series F.)

Russell Investments Multi-Factor Global Balanced

INVESTMENT OBJECTIVE:
To provide long-term capital growth with some income, primarily through exposure to Canadian and foreign equity securities and, to a lesser extent, exposure to fixed income investments using multiple factors to select investments. The Fund may invest in other mutual funds.
RISK LEVEL:
LOW LOW-LOW MEDIUM MEDIUM HIGH
Fund Codes
Series B FRC 260 Series F FRC 560

Trailer fee 1.00% (Series B). Management Fee 1.45% (Series B), 0.45% (Series F).

FOR MORE INFORMATION
For more information about our multi-factor solutions, please contact your advisor or visit russellinvestments.com/ca

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Diversification does not assure a profit and does not protect against loss in declining markets.

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