MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

Asset Allocation and Factor Investing: An Integrated Approach

Factor investing is a relatively new concept that continues to gain acceptance among market participants. Despite that, there remains much debate over how factors can best be incorporated into the investment process. Some investors even view the factor approach to portfolio construction as a preferred alternative to traditional methods of asset allocation.

This summary will provide some background on factor investing and insight into the Mackenzie Asset Allocation Team's innovative approach to using factors. As you will discover, factors can complement traditional methods of portfolio construction, especially when they are properly integrated as a component of a larger risk management and asset allocation framework. For a more detailed read, please refer to the full article published in The Journal of Portfolio Management, Third Edition 2018, at jpm.iijournals.com, titled *"Asset Allocation and Factor Investing: An Integrated Approach"*. Full article is available in English only.

What are factors?

- Factors are the underlying drivers of risk and return across assets and asset classes.
- They can be macro oriented (GDP, inflation etc.) or style oriented (e.g., Value, Quality, etc.).
- Factors are not directly investable, but factor exposures are a byproduct of investing in assets.
- Some factors perform better than others depending on the market environment.

Why should I care?

- Factor exposures contribute to the risk/return characteristics of your portfolio, whether or not you consider them explicitly in portfolio construction.
- Harnessing factors allows for an enhanced set of risk-management and return-generating tools.
- Understanding and managing factor exposures is emerging as an important element in total portfolio management.
- It has become a necessary component of any advanced asset allocation practice.

How are investors using factors today?

- Many institutional investors have embraced factor investing in the last decade or two.
- The proliferation of strategic or "smart" beta products has put the spotlight on factor investing and made it more accessible in the form of ETFs and mutual funds.
- The reality is that factor exposures have always come along with any investment portfolio or strategy. These exposures, however, are not always very clear and often drift over time.
- Investors may attempt to use certain factors to achieve a specific investor outcome, permanently tilt their portfolios in favor of factors they believe will outperform, or try to trade factors to take advantage of a short-term market view.
- How best to incorporate factors into total portfolio management, and what that means for traditional methods of asset allocation, remains a highly debated topic.
- Useful as they may be, deliberately managing portfolio factors adds a layer of complexity to the portfolio management process.
- For those who intend to use factors effectively, it is imperative to do so according to a process grounded in thorough research that is complementary to a robust risk management system.

What is Mackenzie doing in factor investing?

- The Mackenzie Asset Allocation Team is committed to incorporating best practices into all areas of multi-asset portfolio management, including this dimension of factor investing.
- To that end, we have implemented an approach that integrates factor investing with strategic and tactical asset allocation and manager selection.
- In recognition of our leadership in this field, The Journal of Portfolio Management recently published an article written by our team entitled: "Asset Allocation and Factor Investing: An Integrated Approach".
- In our view, investors should continue to use asset classes as the building blocks for forming portfolios, but they should combine them in a way that balances expected asset class risk, return, and correlations with adherence to a preferred set of factor exposures.
- Our approach preserves the benefits of investing in observable and directly accessible asset classes while permitting us to express a factor view and account for the risk in that factor view.
- In short, we have added factors to our tool kit in a way that is quantifiable, accountable and consistent with our risk management and asset-allocation framework.
- This is just one example of how we are continuously enhancing our tool kit and practices to deliver the best possible experience for our clients and partners.

For a deeper dive, please consult the full paper: "Asset Allocation and Factor Investing: An Integrated Approach" at jpm.iijournals.com. Of note, the paper is a treatise of the concepts that underlie our approach and contains a simplified case study illustrating its practicality. It is not a direct description of the process we use to manage portfolios.

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