FIELD GUIDE TO **FACTOR INVESTING**

WHAT ARE FACTORS?

Here is a quick look at what factors are and how they work, in theory and in practice.

RETURN DRIVER

THE THEORY

- Stocks with certain distinct characteristics can be grouped into portfolios.
- The return profiles of these diversified portfolios represent a factor-specific risk.
- A large part of stocks' return variation can be explained by their exposure (correlation) to these factors.

IN PRACTICE

- Factor exposures in equity portfolios can be measured by regressing their returns against returns of factor portfolios.
- The measured exposures can then be used to decompose portfolio returns into contributions by different factors.
- Often a significant share of a given portfolio's outperformance can be attributed to factor exposures.

INVESTMENT STYLE

THE THEORY

- Factors can be used to develop an investment style that invests in rewarded factors with higher expected returns.
- Factor investors get extra returns as a compensation for:
  - **A)** taking factor-related risks.
  - **B)** being a contrarian to misconceptions or irrational market behaviour

IN PRACTICE

- Factors can be harvested in practice by constructing factor-based investment portfolios.
- Systematic factor investing offers a cost-efficient and effective replacement, or complement, to both active and passive investors.

Want to know more? Visit **evli.com/factorinvesting**

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