60 SECONDS
WITH THE FUND MANAGER

CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

SHAKING UP THE WORLD OF ETFS

Exchange-Traded Funds (ETFs) don't just have to follow mainstream market-cap weighted benchmarks. Candriam has launched IndexIQ – a range of highly innovative, smart beta equity and bond ETFs that only invest in sustainable issuers. **KOEN VAN DE MAELE**, Global Head of Investment Solutions at Candriam and a member of the company's Executive Committee, explains how a multi-factor approach to sustainable investing can improve a portfolio's risk-return profile.

What makes your ETFs stand out from the crowd?

IndexIQ ETFs combine ESG and factor investing in one product, setting them apart from other ETFs on the market. The combination of ESG and factors means that we can offer investors not only well-diversified, sustainable portfolios, but also attractive, risk-adjusted return potential. The ETFs build on our expertise and experience in both sustainable and factor investing. Candriam is a pioneer in sustainable investing and one of the world's leading SRI managers. We have also been a strong advocate for the systematic exploitation of market anomalies since the early 2000s.

Why should investors choose to allocate to factor ETFs?

Research shows that cap-weighted indices are sub-optimal investments as they over-weight expensive stocks or the most highly indebted bond issuers. What's more, they provide limited exposure to style factors that have been shown to have long-term outperformance potential, such as value, quality, (small) size and low-volatility. In fact, cap-weighted indices actually have implicit biases towards expensive and large-cap stocks, which means they're unable to capture the value and (small) size factor premiums. Factor strategies, on the other hand, give investors targeted exposure to rewarded factors, thereby offering them the potential to outperform market-cap weighted portfolios. Offering these strategies in an ETF wrapper provides investors with additional benefits. Due to the passive nature of ETFs, their annual fees are typically lower than that of mutual funds. Moreover, ETFs usually provide more transparency than mutual funds. Prices are available in real time and holdings are disclosed more frequently, for example. Although ETFs have major benefits, investors should be aware of the transaction costs when trading ETFs.

Do factors work in fixed-income investing?

Factor-based investing has been used in equity markets for over twenty years and has gained a lot of popularity, mainly in smart beta strategies. Factor investing, however, seems to have left a much smaller footprint in fixed income than in equities. Recent academic research has demonstrated that both multi-factor corporate and sovereign portfolios have higher absolute and risk-adjusted returns than their corresponding market-cap weighted bond portfolios. The factor premiums that have the potential to deliver higher risk-adjusted returns are value, momentum, quality, (small) size and low-volatility. We have built our bond ETFs based on this empirical evidence. Our bond ETFs are highly innovative, as there are not many other providers of factor-based bond ETFs in the market at this point.

What are the benefits of multi-factor investing?

There is substantial academic research that demonstrates proof of factor premiums that tend to enhance risk-adjusted returns in the long run. Nonetheless, single-factor portfolios have a higher active risk than multi-factor portfolios and could underperform market-cap weighted indices for a considerable period of time. Multi-factor portfolios have significantly lower relative drawdowns and cyclicality than individual factors and are therefore more suitable as a replacement for core equity and bond allocations. It may be tempting to engage in factor timing, but then you lose the diversification benefits and, if you also miss the regime in which the financial markets will be operating in the future, your portfolio may encounter some problems.

How many ETFs are available in the IndexIQ range?

IndexIQ includes three sustainable equity ETFs investing in European and Japanese stocks, and two sustainable bond ETFs investing in Euro-denominated corporate and sovereign bonds. With these five innovative ETFs, we cover some of the most important building blocks of any diversified global investment portfolio. We are actively looking to develop our ETF range with additional important building blocks so that our clients will have more tools with which to improve their yields in a sustainable way.

Which factor premiums do the IndexIQ ETFs capture?

Our ETFs target the following style factors: value, low volatility, quality, momentum and (small) size. Our equity ETFs are exposed to the value, quality, low-volatility and (small) size factors, which fundamentally capture different dimensions of a company and, when combined, provide excellent diversification benefits. The factors identify smaller, undervalued, stable and profitable companies. We deliberately avoid the momentum factor in our equity indices, as it generates a relatively high turnover in the portfolio. The Euro Sovereign bond ETF is exposed to the same factors as our equity ETFs except (small) size, and, for the Euro Corporate bond ETF, we decided to target the factors of value, low volatility, (small) size and momentum. The momentum factor has proven to be a great diversifier in the corporate bond market, with only a marginal portfolio turnover increase in a multi-factor framework.

Which indices do the ETFs track?

Our IndexIQ ETFs track indices that have been built by Solactive using Candriam's ESG and factor investing expertise and experience. Solactive is an award-winning, independent index provider that offers tailor-made indices and is growing rapidly; it currently has more than 400 clients, including top-tier investment banks and asset managers. We also selected Solactive because it offers its products at a competitive cost, which means lower expense ratios – and ultimately higher returns – for our investors.

How do the ETFs replicate the indices they follow?

They're all replicated physically. This is, in our opinion, more intuitive and less risky than synthetic swap-based replication and means that our ETFs are not exposed to counterparty risk, unlike synthetic ETFs. Physical replication has become the standard for ETFs that replicate equity and bond indices.

FIND OUT MORE ABOUT OUR FUNDS AND THEIR RISK PROFILES:

www.indexIQ.eu