

## Scientific Beta white paper examines crowding risk of smart beta strategies

Thinking about the economic rationale behind a specific premium should provide ample answers to allay crowding concerns

In a new white paper entitled “Crowding Risk in Smart Beta Strategies,” Scientific Beta’s researchers have failed to find evidence that smart beta strategies have been adversely affected by a crowding effect.

As smart beta strategies gain in popularity, there are concerns that flows into these strategies will ultimately cancel out their benefits. However, such claims are rarely based on solid empirical evidence. The academic literature has not only documented risk premia for the standard factors but has also provided theoretical explanations for persistence, notably if factors are compensation for taking on additional types of risk. Moreover, precautions against crowding risks can be taken by proper implementation of factor investing and smart beta indices. In particular, the best precaution against crowding seems to be diversification.

It is possible that smart beta and factor strategies can be subject to adverse effects due to a wide following but one can only conclude that this is the case if there is evidence for it. Losses in a given strategy, meanwhile, are not evidence of crowding. Periodic underperformance may be due to normal fluctuations in prices.

Commenting on the paper, Professor Noël Amenc, CEO of Scientific Beta and a co-author of the paper, said, “Claiming that there must be crowding in a factor because it suffers from losses completely ignores the nature of risk premia. A risk premium corresponds to a higher average return that is the compensation for taking on additional risk. Therefore, losses to any factor strategy over any particular period do not imply that the long-term premium has disappeared because of “crowding”. Such losses may simply suggest that the reward for holding the factor comes with associated risk. In addition, not only our work, but also work from other researchers shows that factor premia do not disappear when the research that justifies the premia is published.”

The Scientific Beta white paper can be accessed through the link below:

[Crowding Risk in Smart Beta Strategies, April 2020, Scientific Beta Publication](#)

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## About Scientific Beta

Scientific Beta aims to be the first provider of a smart beta indices platform to help investors understand and invest in advanced beta equity strategies. Established by EDHEC-Risk Institute, one of the top academic institutions in the field of fundamental and applied research for the investment industry, Scientific Beta shares the same concern for scientific rigour and veracity, which it applies to all the services that it offers investors and asset managers. On January 31, 2020, Singapore Exchange (SGX) acquired a majority stake in Scientific Beta. SGX will maintain the strong collaboration with EDHEC Business School, and principles of independent, empirical-based academic research, that have benefited Scientific Beta's development to date.

The Scientific Beta offering covers three major services:

- **Scientific Beta Indices**

Scientific Beta Indices are smart beta indices that aim to be the reference for the investment and analysis of alternative beta strategies. Scientific Beta Indices reflect the state-of-the-art in the construction of different alternative beta strategies and allow for a flexible choice among a wide range of options at each stage of their construction process. This choice enables users of the platform to construct their own benchmark, thus controlling the risks of investing in this new type of beta (Smart Beta 2.0).

Within the framework of Smart Beta 2.0 offerings, Scientific Beta provides access to smart factor indices, which give exposure to risk factors that are well rewarded over the long term while at the same time diversifying away unrewarded specific risks. By combining these smart factor indices, one can design very high performance passive investment solutions.

- **Scientific Beta Analytics**

Scientific Beta Analytics are detailed analytics and exhaustive information on its smart beta indices to allow investors to evaluate the advanced beta strategies in terms of risk and performance. The analytics capabilities include risk and performance assessments, factor and sector attribution, and relative risk assessment. Scientific Beta Analytics also allow the liquidity, turnover and diversification quality of the indices offered to be analysed. In the same way, analytics provide an evaluation of the probability of out-of-sample outperformance of the various strategies present on the platform.

- **Scientific Beta Fully-Customised Benchmarks and Smart Beta Solutions** is a service proposed by Scientific Beta, and its partners, in the context of an advisory relationship for the construction and implementation of benchmarks specially designed to meet the specific objectives and constraints of investors and asset managers. This service notably offers the possibility of determining specific combinations of factors, considering optimal combinations of smart beta strategies, defining a stock universe specific to the investor, and taking account of specific risk constraints during the benchmark construction process.

With a concern to provide worldwide client servicing, Scientific Beta is present in Boston, London, Nice, Singapore and Tokyo. As of December 31, 2019, the Scientific Beta indices corresponded to USD 59.2bn in assets under replication. Scientific Beta has a dedicated team of 52 people who cover not only client support from Nice, Singapore and Boston, but also the development, production and promotion of its index offering. Scientific Beta signed the United Nations-supported Principles for Responsible Investment (PRI) on September 27, 2016.

On November 27, 2018, Scientific Beta was presented with the Risk Award for Indexing Firm of the Year 2019 by the prestigious professional publication Risk Magazine. On October 31, 2019, Scientific Beta received the Professional Pensions Investment Award for “Equity Factor Index Provider of the Year 2019.”



**Scientific Beta**  
Indexing firm  
of the year



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**WINNER**  
Equity Factor Index  
Provider of the Year

Scientific Beta

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