

Academic Alpha

A (Re)Introduction to Style Premia Investing

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Well-constructed alternative risk premia (ARP) strategies have delivered positive, uncorrelated returns at modest fees over the long run. They first became popular in the 2010s, with investors attracted by their academic grounding, diversification properties, transparency and low fees. However, a number of ARP strategies suffered losses during the "Quant Winter" of 2018-2020, and some investors lost faith in the concept as a result. Although some products closed, others continued and experienced a strong recovery. We continue to believe the category can make a valuable contribution to many portfolios.

In this short article, we review the concept and benefits of style premia investing and explore the latest innovations in harvesting these premia, more widely dubbed "academic alpha."

The Alpha Spectrum

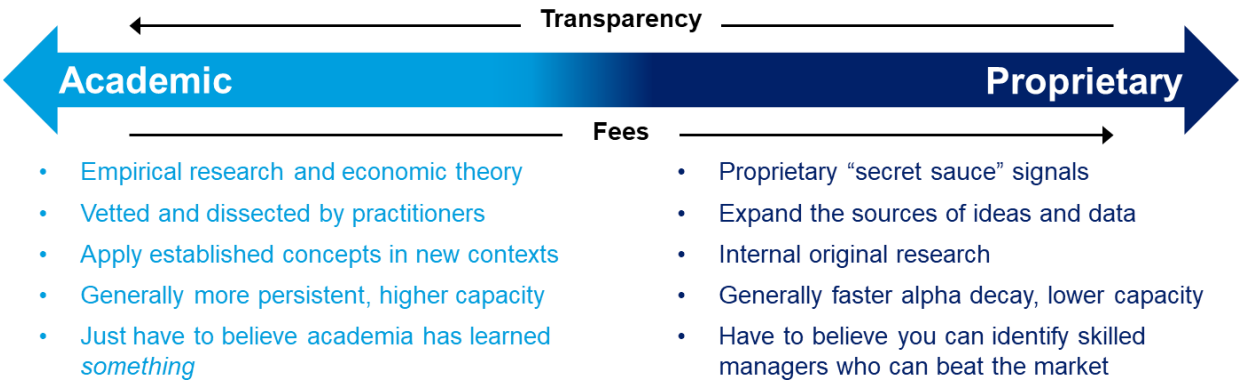
Many active strategies are well-known and well-documented, while others are an expression of a manager's unique skill and insights in identifying mispriced securities or anticipating macroeconomic developments. The former group can still generate attractive returns if there is a persistent "other side" in the form of investors swayed by behavioral biases, willing to pay for a transfer of risk, or acting with non-profit-maximizing motives (see **Exhibit 1**).[2] These sources of return are often called "alternative risk premia" but we like the term **academic alpha**, which emphasizes their grounding in well-established research without getting into the debate between risk-based and behavioral explanations.

Academic alpha can be just as beneficial to investor portfolios as other forms of alpha, and harvesting these valuable sources of return requires substantial manager skill. For example, not all academic

[1] The authors thank Jordan Brooks, Chris Doheny, Jorge Fernandez-Cuervo, Dan Heffernan, and Antti Ilmanen for helpful comments.
[2] For more details and literature reviews on particular styles or factors, see for example Asness et al. (2015) and Ilmanen (2022).

research is implementable in real portfolios: skill is required to identify the most valuable insights, measure them effectively, and apply them in practice. The most profitable applications of academic research often extend the concepts far beyond the scope of the original studies: we'll elaborate shortly.

Exhibit 1: A Spectrum of Approaches to Identify Market Inefficiencies



Source: AQR.

Academic alpha has some clear advantages over the more elusive proprietary alpha. First, because the ideas themselves are not "secret sauce" – though some of the measures and implementations might be – investors are likely to receive a higher level of transparency into the strategy, and therefore a deeper understanding of where the returns come from and why. Second, a large body of independently published research exists to support the investment concepts – typically with longer data sets than are available for proprietary alpha backtests – providing greater investor confidence and conviction, and encouraging patience during challenging episodes.[3] Finally, fees tend to be substantially lower.

What about possible disadvantages? One is that since these strategies tend to be well-documented, investors may already have some exposure to them. But our analysis suggests many investors could benefit from more, especially if skillfully implemented. Another common concern is that the strategies could become crowded, reducing expected premia and raising the risk of sudden unwinds. While crowding of any strategy is always a possibility, it can be monitored, for example using value spreads that show whether a rules-based strategy has become more expensive than normal. In fact, crowding is easier to monitor if the rules behind the strategy are better known. Academic alpha strategies do not appear crowded at the time of writing, and the "Quant Winter" losses were not caused by unwinds of crowded trades, but rather by risks of value strategies materializing as wide value spreads got wider.

[3] There will be challenging episodes, as we discuss later. Academic alpha strategies tend to be highly liquid and lowly correlated to other investments, which can make them vulnerable to "line-item thinking." A deep body of supporting research provides an important defense, making it easier for investors to harvest the long-term rewards.

Identifying True Pedigree in the Factor Zoo

Academic research has identified a notoriously large number of factors that are associated with outperformance in historical data, often referred to as the "factor zoo." Some are likely the result of overfitting or selection biases. Others are highly correlated to previously documented factors and are likely tapping into the same underlying pattern. Yet others are simply not implementable at meaningful size and after transaction costs. Managers seeking to harvest academic alpha must assess the whole body of research and have the ability to identify the small number of factors or characteristics that are likely to offer persistent alpha and be additive or diversifying to a broad investment strategy. Making this assessment requires skill and understanding.

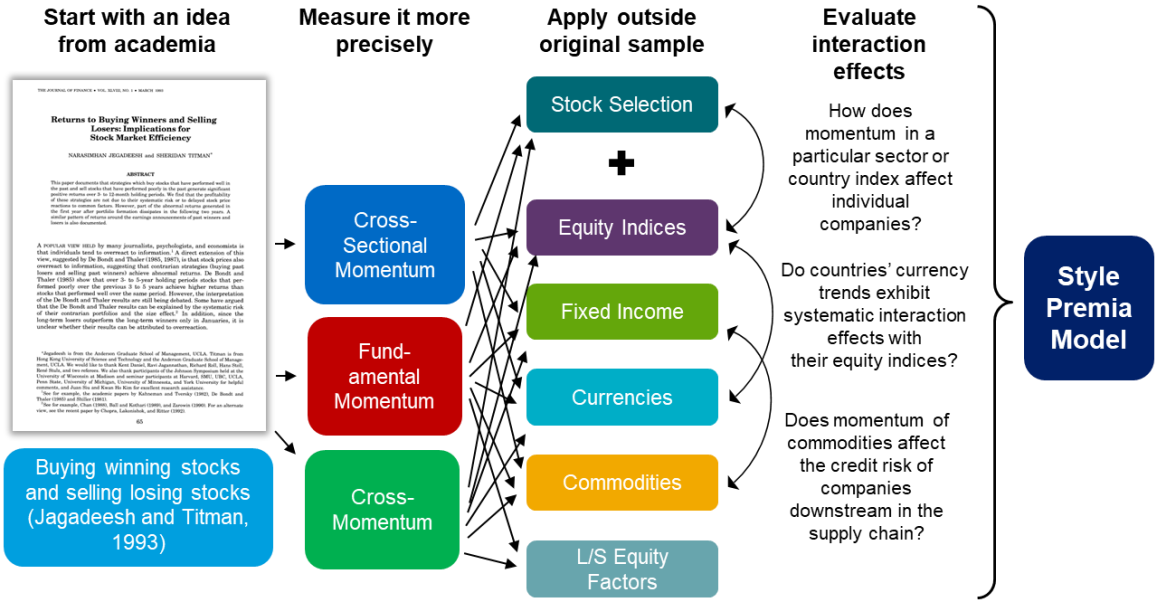
Beyond Identification – Improving and Expanding Signals

Beyond just identifying which academic concepts are valid, reliable, and implementable, the best research improves and expands upon these ideas. For example, take the concept of price momentum, first introduced in academia by Jegadeesh and Titman (1993) and Asness (1994). The basic idea is that markets are slow to respond to news as proxied by the past 6- to 12-month return of an asset relative to its peers. However, this concept of slow information diffusion can be captured in many different ways and applied much more broadly. For example, using market-adjusted returns or volatility-adjusted returns to measure momentum can improve predictive power. Momentum can be measured not only in prices, but also in relevant fundamental drivers such as analyst revisions, known as "fundamental momentum." Furthermore, an asset's price may not only underreact to its own news, but also to tangential news from other related assets like stocks in the same industry, or those with customer-supplier links or other economic connections – this is known as "cross-momentum."

Finally, all of these ideas can be applied in different asset class contexts – going beyond the original academic studies that typically only examined U.S. equities. Price, fundamental, and cross-momentum concepts can be applied equally well to equity index futures, bonds, currencies and commodities. Interactions between these markets, where momentum "spillovers" from one asset class impact another, can also be measured. **Exhibit 2** illustrates how the intuition behind this single strand of academic research has been developed and extended by some practitioners into a broad and robust set of signals.

This process requires a deep understanding of the research, extensive experience in markets, and a broad implementation platform. There is plenty of room for unique manager value-add under the "academic alpha" umbrella. Indeed, many of these innovations begin as unique manager alpha signals before migrating into an academic alpha strategy as a constant stream of small (and not so small) improvements.

Exhibit 2: How Academic Ideas Are Transformed into "Academic Alpha": Momentum Example



Source: AQR. For illustrative purposes.

Implementing Academic Alpha as a Multistrategy

Academic alpha concepts are sometimes applied as tilts within equity portfolios. However, as they identify both attractive and unattractive assets, and can be applied in multiple asset classes, they are most efficiently implemented in long/short and multi-asset frameworks. Converting an intuitive set of signals into a dynamic market-neutral multi-strategy portfolio with hundreds or thousands of positions requires substantial expertise in portfolio construction and risk management. There are many design choices relating to position sizing, risk allocation across styles and asset classes and over time, controlling unintended risk exposures, and maximizing transaction cost efficiency.

Each academic alpha strategy can suffer periods of stress – examples include so-called "growth bubbles" (as occurred during 2018-2020), "junk rallies" and "momentum crashes" – but these may be the very risks that are compensated over the long run. While some volatility is inevitable with an academic alpha strategy, the most experienced managers have learned from previous challenging episodes, improving their processes and risk management as they seek to deliver a smoother and more profitable ride.

A multi-strategy academic alpha strategy delivered by an asset manager offers many of the same advantages as other multistrategy investments – capital efficiency, internal diversification, macroeconomic resilience and continuous innovation – but with greater transparency, more favorable liquidity terms and lower fees. While there are many investment vehicles that can give some exposure to styles and academic research, not all provide the same benefits as a multistrategy fund. For example, bank indices offering exposure to quantitative investment strategies often focus on very simple style metrics and elementary portfolio construction, with little potential for ongoing research innovation.

Looking Ahead: The Role of Innovation

The most valuable academic alpha signals have a demonstrated ability to deliver returns even when they are well-documented and well-known to market participants. How? Because each has a persistent "other side." However, academic alpha managers cannot afford to stand still. Investors, and a competitive market landscape, demand constant evolution and enhancement to maintain attractive target returns. Expanded asset universes, new signals that were once considered "proprietary alpha", and portfolio implementation are all fertile areas for new research and improved academic alpha.

Proprietary quant strategies have seen rapid innovation in the 2020s, driven by machine learning, large language models, computing power, and new data from an ever-expanding digitized world. Academic alpha strategies may be more deeply rooted in academic research, with a greater emphasis on transparency, but they, too, are benefitting from a wave of innovations in signal measurement, new ideas and techniques, portfolio construction, and implementation. Indeed, the boundary between proprietary and academic alpha has blurred as the latter strategies get smarter. While a manager's very latest proprietary signals may be reserved for its premium "full model" strategies, its style premia strategies are likely to benefit from the same research engine and to be offered at significantly lower fees.

Even relatively basic style premia or academic alpha strategies have added value to traditional investment portfolios over the long term. More sophisticated strategies, with improved measurement, new signals, expansion of concept, and multiple asset classes can increase the benefits even further. The best managers continue to innovate along these lines, making academic alpha an attractive option as a powerful diversifier that offers liquidity, transparency, and a source of uncorrelated returns.

One final note: true diversifiers with near-zero market beta can be difficult to hold on to. By definition, diversifiers tend to "zig" when the rest of the portfolio "zags", which can make them stand out among more correlated investments and therefore vulnerable to "line-item risk". To harness the long-term benefits of diversification, a patient approach is required (see Ilmanen and Maloney (2025) for more discussion).

References and Further Reading

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