



FACTOR / STYLE INVESTING

My Factor Philippic

June 22, 2016

[Here](#) is a link to my latest on the ongoing issue of style timing and the very legitimacy of some of the factor strategies. To whet your appetite, below is the abstract of the paper:

Arnott, Beck, Kalesnik, and West (2016) (ABKW) study smart beta or factor-based strategies and come to the following conclusions: (1) Aside from value, most popular factor strategies currently look expensive. (2) These expensive factor valuations portend lower future returns and a strong possibility of a future “factor crash” in which they go “horribly wrong.” And (3) many of these non-value factors were never real to start with because their historical performance was due to factor richening. That is, researchers mistook the one-time returns from factor richening for truly repeatable “structural alpha.” ABKW’s implied bottom line (their many protestations to only making modest recommendations aside): stick with value, dump the other factors. This essay elaborates on my response in Asness (2016). In summary: (1) I find non-value factor valuations moderately expensive, but not as expensive as ABKW. (2) I argue that ABKW exaggerate the power of factor timing by improperly using long-horizon regression techniques. More proper short-horizon regressions suggest some weak factor timing ability and given this predictability, I construct value-based tactical factor timing strategies to test them. Unfortunately, these strategies add little to portfolios that are already invested in the value factor. It turns out that this “newly” discovered timing tool is, yet again, mostly just a version of regular old value investing. And (3) I examine ABKW’s claim that factor richening drives much of non-value long-term factor performance and find that this very serious allegation about other researchers’ work is totally without merit. Overall, these results suggest that one should be wary of aggressive factor timing. Instead, we believe investors should identify factors they believe in, and staying diversified across them, unless we see far more extreme pricing than we do today.

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