Fact, Fiction and Momentum Investing

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Momentum is the phenomenon that securities which have performed well relative to peers (winners) on average continue to outperform, and securities that have performed relatively poorly (losers) tend to continue to underperform.

The existence of momentum is a well-established empirical fact. The return premium is evident in 212 years of U.S. equity data (from 1801 to 2012) — as well as U.K. equity data dating back to the Victorian age in over 20 years of out-of-sample evidence from its original discovery, in 40 other countries and in more than a dozen other asset classes. Some of this evidence predates academic research in financial economics, suggesting that the momentum premium has been a part of markets for as long as there have been markets.

However, as momentum strategies have grown in popularity, so have myths around them. Some of the most common myths are that momentum is too "small and sporadic" a factor, works mostly on the short side, works well only among small stocks and doesn't survive trading costs. Furthermore, some argue that momentum is best used as a "screen," not as a regular factor in an investment process. Others will go so far as to say that momentum investing is like a game of "hot potato," implying that it isn't a serious investment strategy, with no theory or reasonable explanation to back it up.

In this essay we address and refute these myths using both widely circulated academic papers and data from Kenneth French’s publicly available website, a standard dataset used by both academics and practitioners.
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