Street Speak

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September 30, 2016

Keeping up with all of the new financial products and acronyms is like trying to stay up to date with the latest social media app. I have just begun using Instagram; forget about Snap Chat and this New Pokémon Game! In the financial world, we have a wave of new "Smart Beta" products being launched every day, each one promising better performance, lower risk, lower fees, or some combination of the three. So what is all the rage about Smart Beta? And is it actually "smarter" than the market?

While the name smart beta has recently caught on over the past few years, it has actually been around much longer. According to Morningstar, Smart Beta strategies have grown to approximately $447 billion in total which represents a 250% growth since 2010. You may have come across the term in the WSJ or on CNBC and have asked yourself what does it mean? In the most simplistic form, Beta is a common measurement used to standardize an investment's volatility as it relates to the broad market. Without getting too deep in the weeds, Beta helps explain how sensitive an investment may be relative to the movements of the stock markets. For example, if you have 3 stocks with the following betas you can expect the following historical returns:

	Beta	Stock Market	Historical Stock Return due to Beta
Stock#1	0.5	+10%	+5%
Stock #2	1.0	+10%	+10%
Stock#3	1.5	+10%	+15%

This information is hypothetical and is provided for informational purposes only. It is not intended to represent any specific return, yield, or investment, nor is it indicative of future results.

There are other factors such as company specific risk and industry specific risk that may add or subtract from the actual performance but with all else being equal the beta of a stock can help explain how an investment should perform relative to the broad market.

Smart Beta is Wall Street's attempt to provide you with alternative ways to get stock market exposure that are "smarter" than the traditional market cap weighted index like the S&P. The S&P500 is an index that is compromised of the largest 500 companies in the United States and the index provides a larger weighting to the biggest companies and a smaller weighting to the smaller

companies. Instead of using size of the company to provide weightings, Smart Beta strategies construct weightings in a variety of different ways in efforts to provide a better investment solution. Some examples of smart beta strategies would be weighting the index by actual revenue generated by the company

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or equally weighting each stock regardless of size. Some other common exposures in smart beta strategies are providing more exposure to companies with the lowest price to book ratio, lowest price to earnings ratios, highest dividend yield, or fastest dividend growth rate. By weighting the index differently, these strategies are adjusting the construction of your portfolio and attempting to enhance performance or lower risk to provide you with a "smarter" investment.

Now that you know what smart beta is, I am sure you are wondering if the strategies are actually "smarter" than the market and if it is something you should use in your portfolio. When it comes to investments, unfortunately there is no free lunch and every strategy or solution comes with its pros and cons. With the recent rise in popularity of passive investments, Smart Beta strategies have also gained interest because they are often viewed as a blend of active and passive management. The Finlay Group has embraced a select few smart beta strategies, but being selective is the key. Many smart beta solutions are built on back tested data without having ever been actually implemented while other strategies provide exposure to factors active managers have utilized for decades. With a plethora of "smart" beta strategies out there and more being developed, it's important to understand the objective and if it fits with your objectives.

The solutions discussed may not be suitable for your personal situation, even if it is similar to the example presented. Investors should make their own decisions based on their specific investment objectives and financial circumstances. All investing involves risk, including the possible loss of principal.
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CAR-0522-01417

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