

TIME FOR BETA PRIME

Equity markets are being polarised. There is now a time-crunch on investors forced to deal with greater regulation, new accounting rules, a sharper focus on liabilities, and product proliferation. High performance expensive alpha and low-governance cheap beta are on opposite ends of a spectrum which is rapidly losing its middle ground. Active managers purporting to deliver alpha in the guise of beta populate the middle ground and are losing mandates because they aren't providing the returns that their high fees warrant.

So how does the average institutional investor – scarce on time and money – find extra alpha?

While traditional beta is offered through tracking market cap indices in the hope that markets are efficient, there are new strategies that take advantage of short term market inefficiencies to systematically capture alpha. These are being referred to by some consultants as 'beta prime' – beta with systematically added alpha.

Wealth weighted strategy indices are an example of a 'beta prime' product. They offer a rules based approach to identifying discrepancies between the current market cap weight of a stock compared to its intrinsic valuation

weight. By re weighting the constituents of existing market cap benchmarks using each security's share of the index total net profit, cash flow and book value, the portfolio reflects the parallel behaviour of prices and wealth in the long-term.

GWA is one of those leading the financial services industry by offering their strategy through what has been referred to as a platform company in the manufacturing industry. Outsourcing the distribution and implementation of the strategy allows these indices to be allocated to core portfolios at very low cost. These strategy indices are offered for licensing through FTSE, making it easy to implement by any market tracker.



Combining a clear investment philosophy that offers beta prime with strategic alliances to drive down cost makes this an appealing proposition for pension funds. Wealth weighted indices are transparent, rules based, widely diversified, high capacity and liquid, just like the underlying performance benchmark. Their broad market scope and implementation in an index mean that they are low risk and low governance.

By David Morris

