Q&A

FTSE ACTIVEBETA INDEX SERIES QUESTIONS & ANSWERS

FTSE THE INDEX COMPANY

Q. Why FTSE ActiveBeta Indices?

A. The FTSE ActiveBeta Index Series provides an efficient, transparent, and cost-effective vehicle for capturing the systematic sources of active equity returns through diversified country, regional, and global momentum, value and combined momentum and value indices.

Q. What are Active Betas?

A. A significant portion of active equity returns (alpha) appears to come from systematic sources and not managers' stock selection skill. These sources of active equity returns, namely, momentum and value, arise from the systematic behavior of short-term and long-term earnings growth expectations and discount rates. Because they are distinct from the market return, yet still systematic in nature, these sources are referred to as Active Betas.

Q. How are Active Betas captured?

A. The FTSE ActiveBeta Indices are designed to take advantage of two levels of diversification: 1) broadly diversified momentum and value indices provide higher probability of capturing the average systematic tendency of earnings expectations to trend and mean revert, respectively, and 2) a combined capture of momentum and value offers a more efficient, in a risk-adjusted sense, capture of the systematic sources, or Active Betas, as momentum and value independently have positive after-cost active returns, and these returns are negatively correlated. The negative correlation of these returns allows a combined capture to provide greater consistency and stability of active returns over time, compared to the independent capture of either momentum or value.

Q. Why momentum and value?

A. The virtues of momentum and value have been known for decades. Momentum captures the systematic sources of active equity returns associated with the trending behavior of short-term earnings growth and better represents the investment process of so-called growth managers. Value captures the systematic source of return associated with the reversion of long-term earnings growth and stock-specific risk, and thus provides positive active returns in the long run. Until now, these sources have only been delivered together in traditional active strategies. FTSE ActiveBeta Indices are the next step forward in the evolution of passive investing. This advancement allows investors to capture a second layer of betas, previously unavailable in a passive vehicle.

Q. Is this index series cap-weighted?

A. The FTSE ActiveBeta Indices are market cap-weighted and, therefore, offer nearly unlimited capacity, complete investability, and replicability.

Q. What is the universe coverage?

A. The FTSE ActiveBeta Momentum and FTSE ActiveBeta Value Indices target 50% market cap coverage of the selection universe upon which they are based. However, the combination of momentum and value produces a much higher coverage of the selection universe. The combined FTSE ActiveBeta Momentum and Value Indices cover, on average, around 80% to 85% of the names and 75% to 80% of the market cap of the underlying selection universe.

Q. How often are the indices rebalanced and how is turnover controlled?

A. The FTSE ActiveBeta Index Series requires monthly rebalancing to ensure the transfer of information contained in the relatively more fluid momentum signal (i.e., to maximize transfer coefficient). Turnover is kept at a reasonable level through the use of market cap-based buffers (buy and sell thresholds) to rebalance the indices.

Q. What is the transfer coefficient?

A. The transfer coefficient (TC) measures the correlation between risk-adjusted active returns and active weights. Indices should reflect the most recent readings of a signal, especially in the case of momentum. This will allow the index to deliver the true return potential of a high-turnover investment style, by transferring the information contained in the fast-moving signal into the index. The degree to which the information contained in a signal is transferred into the index is measured by the TC statistic. When an index is rebalanced, the relationship between signal ranks and active weights is strong, and the TC is high. Between rebalancings, the TC can drop significantly, depending on the volatility of the signal, which could have an important impact on the return generation capability of the index.

Q. What have the results been like on historical data?

A. The simulated back history of the index series has shown that the indices outperformed their underlying universes across all markets and regions, with the exception of the FTSE Japan ActiveBeta Momentum Index, which modestly underperformed the relevant index. The FTSE ActiveBeta Indices offer not only positive active returns, but do so at reasonable levels of active risk. The information ratios produced compare favorably to those of traditional style indices.

Q. What is the information ratio?

A. The information ratio is a useful metric for evaluating relative returns and risk. The return is measured in terms of the return in excess of the relevant benchmark index, or active return. Risk is measured in terms of the volatility of the active return. A high ratio of active return to active risk is favorable.

Q. What indices are part of the FTSE ActiveBeta Index Series?

A. FTSE is launching an index series called the FTSE ActiveBeta Index Series. Based on the constituents of the corresponding FTSE All-World Index Series, the indices cover All-World, Developed Markets, Developed ex US, Developed ex North America, Developed ex UK, Developed ex Europe, Developed ex Japan, Developed Europe, Developed Europe ex UK, Eurobloc, Emerging Markets, US, and Japan. Based on the constituents of the corresponding FTSE Global Small Cap Index Series, the indices will cover US Small Cap, Developed Europe Small Cap, and Japan Small Cap. Based on the constituents of the corresponding FTSE All-Share Index Series, the indices will cover UK Large Cap, Mid Cap, and Small Cap. The indices will also cover Australia based on the constituents of the FTSE ASFA Australia All-Share Index.

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