

Investing in Smart Beta

A Conversation with AXA Investment Managers



What is Smart Beta?

There are many different types of Smart Beta strategies, but what they have in common is the objective to move away from the weighting approach followed by traditional market capitalization weighted indices. Instead of weighting companies purely according to the price and number of stocks outstanding, these strategies focus on other attributes – such as their historical price volatility, or fundamental characteristics, like profits – when determining the weight of each company in the index.

What has driven the growth in Smart Beta strategies and how could they be used within a diversified portfolio?

Investors are increasingly viewing Smart Beta as an alternative to a passive allocation to a market capitalization weighted equity index. One consequence of the global financial crisis was to bring the shortcomings of these indices into sharper focus, such as company weightings that are based on past (and not necessarily future) success, poor levels of diversification and exposure to other uncompensated risks. In response, index providers created a range of alternatively weighted indices (see graphic) that caught the attention of investors looking to improve the risk-adjusted returns generated by their core equity allocation. These indices can be thought of as the first generation of Smart Beta; the second generation adopts many of the same tools, while also seeking to manage their drawbacks. This is the approach we take in our Smart Beta strategies, which aim to avoid a range of unrewarded risks associated with equity investment.

Examples of First Generation Smart Beta

Alternative Index Method	Description	Drawbacks
Equal Weighting	Each individual stock has the same weight	Increased liquidity risk and volatility
Fundamental Weighting	A number of metrics related to the financial performance of the company other than share price performance are used to determine a stock's weight in the index	Introduce value and small cap biases, which may both lead to increased volatility. Also, does not address concentration risk.
Minimum Variance or Maximum Diversification	Rely upon the past behavior of stocks relative to each other using a risk model as a single input	Concentration risk. Overly reliant on mathematical models. Do not directly take stocks' fundamental characteristics into account.

Source: AXA Investment Managers, December 2015

What is meant by an 'unrewarded risk' in equity markets and can you give an example?

It is a generally accepted investment principle that if an investor accepts a higher degree of risk, they should be compensated with a higher return. However, we believe the expectations around the risk/return trade-off should be readjusted. We have identified additional risks within the equity market that we believe over a full investment cycle go 'unrewarded' and thus should be mitigated. One example of these additional risks is price volatility. Our analysis of the historical risk and return characteristics of stocks has demonstrated that high volatility stocks, in the aggregate, have delivered lower annual returns than both mid and low volatility stocks at a significantly higher level of risk. To us, this means that investors have not historically been sufficiently compensated for taking on the higher risk associated with high price volatility stocks.

How should a Smart Beta equity strategy address diversification?

The problem with market cap indices and many alternative market cap index approaches is the concentration of weighting in the very largest names. Take for example the S&P 500. With 500 constituents this would seem to be diversified but actually the largest 30 stocks represented nearly 38% of the index at the end of 2015.

As such, a Smart Beta equity strategy should incorporate diversification that addresses the problem of 'concentration' in the largest stocks; it should be responsive to the varying presence of concentration risk over time, rather than a naïve diversification approach that comes at the expense of liquidity or creates other investment risks.

How do you see the Smart Beta market evolving over the next two to three years?

We expect that the market for Smart Beta will continue to grow, but as investors become more aware of the investment drawbacks of many alternative market cap indices, we expect greater demand for second generation Smart Beta strategies.

In our opinion, an effective Smart Beta strategy should provide flexibility to build portfolios that deliver beta in an improved way, according to the desired outcomes of the investor. We believe that Smart Beta is already becoming an established part of the investment landscape. However, in our view, only those approaches that are designed to provide long-term added value (more predictability and control over investment outcome) will become permanent fixtures in an investor's toolkit.

Q&A with Jonathan White, Deputy Head of Client Portfolio Management, AXA Investment Managers

Jonathan joined AXA Investment Managers in 2007 as a portfolio manager and is currently deputy head of client portfolio management. Prior to joining the firm, Jonathan was a strategist with the global equity strategy team at Credit Suisse. Before then, he was a research analyst with the global asset allocation team at UBS.

Risks

An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-888-310-0416 or download the file from www.1290funds.com. Read the prospectus carefully before you invest.

Investing involves risks, including loss of principal. Diversification does not eliminate the risk of experiencing investment losses.

Information provided in this document is general in nature, is provided for informational purposes only, and should not be construed as investment advice. The views and opinions expressed are those of the interviewee and do not necessarily represent the views of their affiliated investment advisors, AXA Equitable Funds Management Group, LLC or its affiliates. Any such views and opinions are subject to change at any time based on market or other conditions and are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Securities and sectors referenced should not be construed as a solicitation or recommendation or be used as the sole basis for any investment decision. It is not possible to invest directly in an index.

Past performance is not a guide to future performance.

No guarantee or representation is made that investment objectives and/or opinion stated will be achieved. Each specific client or investor's experience may vary.

The information has been established on the basis of data, projections, forecasts, anticipations and hypothesis which are subjective. This analysis and conclusions are the expression of an opinion, based on available data at a specific date. Due to the

subjective aspect of these analyses, the effective evolution of the economic variables and values of the financial markets could be significantly different for the projections, forecast, anticipations and hypothesis which are communicated in this document.

1290 Funds is part of the family of mutual funds advised by AXA Equitable Funds Management Group, LLC (FMG, LLC), doing business in this instance as 1290 Asset Managers. FMG, LLC is a wholly owned subsidiary of AXA Equitable Life Insurance Company (AXA Equitable), NY, NY. AXA Distributors, LLC is the wholesale distributor of the 1290 Funds. AXA Advisors, LLC (member FINRA, SIPC) offers the 1290 Funds to retail investors.

"AXA" is the brand name of AXA Equitable Financial Services, LLC and its family of companies, including AXA Equitable, AXA Advisors, LLC, and AXA Distributors, LLC. AXA S.A. is a French holding company for a group of international insurance and financial services companies, including AXA Equitable Financial Services, LLC.

1290 Funds® is a registered service mark of AXA Equitable Life Insurance Company, New York, NY 10104.

The Funds are not insured by the FDIC; are not guaranteed bank deposits; and are subject to investment risks, including loss of principal.

Funds distributed by ALPS Distributors, Inc. ALPS Distributors, Inc., is not affiliated with FMG, LLC, AXA Equitable, AXA Distributors, AXA Advisors, or AXA Investment Managers.

© 2015 AXA Equitable Life Insurance Company. All rights reserved.
1290 Avenue of the Americas, New York, NY 10104

AXA000365 123117