



# *'Smart Beta' ETFs: Definitions Framework*

*Updated: May 2015  
Report Scope: US*



## Framework Summary

The table below summarizes the smart beta categories for each asset class as defined by First Bridge. The rest of the document details the approach and field definitions.

Equities	Fixed Income	Commodities	Other
<b>Traditional Beta</b>			
Broad/Size – Cap Weighted	Broad Market	Agricultural	MLP
Growth/Value - Cap Weighted	Convertible	Diversified Commodities	Listed Private Equity
Industry Sector - Equal or Cap Weighted	Corporate	Energy	Currency
Broad/Size – Price Weighted	Covered	Metals	Preferred Stock
	Inflation Protected	Livestock	Target Date / Multi-Asset
	Mortgage		
	Municipal		
	Treasury & Government		
<b>Smart Beta</b>			
Dividend	Alternative Credit Scoring	Commodity Rotation	Hedge Fund Replication
Growth/Value - Factor Weighted	Duration Optimized	Dynamic Futures Roll	Currency – Carry Strategy
Equal Weighted Size	Factor Weighted	Options Overlay	
Multi Factor Equity	Laddered Portfolio	Physical Delivery Option	
Momentum	Strategy - Other		
Low Volatility	Yield Spread		
High/Low Beta			
Quality			
Options Overlay			
Revenue Weighted			
Thematic			
VIX / Risk Control			
Strategy - Other			
<b>Excluded:</b> Active Leveraged/Inverse Proprietary Model*			

\* Defined as cases where the underlying index methodology or security selection criterion is not fully transparent or the strategy does not involve targeting specific investment risk factors.

## Principles underlying the Smart Beta Definitions Framework

The following principles and objectives were used to develop the framework.

### 1. Captures only 'smart beta' dimension, not entire investment objective

A good smart beta framework should help directly answer the question: "Is this a smart beta ETF, and if so, what type of smart beta". It is not designed to capture every element of the ETF's investment objective. For e.g. a China Financials sector ETF that uses a momentum strategy to pick stocks will be classified as 'Momentum'. The fact that it is a China and financials sector ETF will be captured in other fields of the First Bridge database, not in its smart beta classification. These fields can then be used in combination to find and analyze ETFs.

This multi-dimensional tagging (where smart beta type is just one of the dimensions) is very important, since the analysis of ETFs could start on any dimension i.e. by region, asset class, strategy type etc. It is also the most practical approach since capturing the multi-dimensionality of ETF exposure in one field is unwieldy.

### 2. Identifies alternative approaches, not alternative asset classes

This framework is not designed to distinguish alternative asset classes from traditional ones. Rather, within each asset class, it identifies ETFs that use an alternative security selection or weighting methodology relative to the widely adopted norm. So, even if a product is the first ETF to provide access to an asset class (e.g. bank loans), it will still be classified as traditional beta, unless it attempts to use non-traditional security selection or weighting methodologies.

### 3. A practitioner's approach

In theory, only a total or broad market cap weighted index should qualify as traditional 'beta'. Taking this definition very literally, even an ETF that tracks the S&P 500 wouldn't be 'pure' beta exposure, since the S&P 500 screens stocks for profitability prior to inclusion. Instead, we take a practitioner's approach, where we have to make a reasonable judgment as to what should differentiate traditional from smart (or non-traditional) beta. This document lays out the definitions for the categories that we consider as 'traditional' beta.

### 4. 'Smart Beta' is not a term of endorsement

It is widely understood, but bears repeating, that just because an ETF is labeled 'smart' does not mean that is superior to traditional indexing approaches. Factors and themes will usually go through cycles where they out/under perform traditional broad indices.

### 5. Extensible framework

New types of ETFs that we did not anticipate are consistently being brought to market. It is therefore important to have a flexible database where new 'tagging' fields can be easily added. We monitor the ETF universe daily and add new fields as appropriate, while maintaining consistency on existing fields.

## Equity ETFs – Traditional & Smart Beta Definitions

These tables list each of the traditional and smart beta categories by asset class, with accompanying definitions and comments.

Traditional Beta ETF Category	Definition Criterion	Comments
Broad/Size – Cap Weighted	Provides exposure to either the broad market or specific size segments (e.g. large, mid or small cap) in a country or region, through a market cap weighted index.	Includes modified cap weighting where the capping is designed to comply with regulatory requirements or to prevent stock concentration (rather than as a specific strategy).
Growth/Value - Cap Weighted	Provides exposure to either growth or value stocks, as defined by the index provider, through a market cap weighted index.	Growth or value indices that are weighted by factor scores are not included here.
Industry Sector - Equal or Cap Weighted	Provides exposure to sectors or industries in a country or region, through an equal or market cap weighted index.	Equal weighting for sectors is defined as ‘traditional’, since it is typically used to prevent single stock concentration rather than to access the size risk factor.
Price Weighted Size	Provides exposure to either the broad market or specific size segments (e.g. large, mid or small cap) in a country or region, through a price-weighted index.	

Smart Beta ETF Category	Definition Criterion	Comments
Dividend	Index components are selected based on dividend yield or payments, using a rules based approach.	
Growth/Value - Factor Weighted	Provides exposure to either growth or value stocks, as defined by the index provider, where the index components are weighted by style based scores.	
Equal Weighted Size	Provides exposure to either the broad market or specific size segments (e.g. large, mid or small cap) in a country or region, through an equal weighted index.	Aims to include those ETFs where equal weighting is an intended alternative to market cap weighting (rather than being incidental to the design).

Multi Factor Equity	Index components are selected based on multiple risk factors (e.g. value, volatility, momentum etc.) using a rules based approach, irrespective of weighting scheme.	Multi-factor ETFs specifically focused on growth/value are included in the 'Growth/value' categories.
Momentum	Provides targeted exposure to securities exhibiting price momentum characteristics, as defined by the index provider, using a rules based index.	
Low Volatility	Provides targeted exposure to securities exhibiting low or minimum volatility characteristics, as defined by the index provider, using a rules based index.	
High/Low Beta	Provides targeted exposure to securities exhibiting high or low beta characteristics, as defined by the index provider, using a rules based index.	
Quality	Provides targeted exposure to equity securities exhibiting high quality characteristics, as defined by the index provider, using a rules based index.	Quality may in turn depend on multiple factors (earnings stability, dividends etc.), but is considered a single factor for classification purposes.
Options Overlay	Rules based index strategies that overlay options on the underlying equity exposure (e.g. buy-write strategies to generate income)	VIX and Target risk strategies that use options are included in the 'VIX / Risk Control' category.
Revenue Weighted	Provides exposure to either the broad market or specific size segments (e.g. large, mid or small cap) in a country or region, where each index component is weighted in proportion to its revenues.	
Thematic	Index based investment themes that cut across both traditional GICS sectors and the above market-based risk factors.	Examples: Infrastructure, Clean Energy, Corporate Governance, Natural resources.
VIX / Risk Control	Index based strategies that either hold VIX futures or use volatility weighting and/or downside hedging to outperform traditional indices.	
Strategy - Other	Specialized index strategies that don't yet have enough ETFs to warrant a separate category.	Examples: Buyback strategy, sector rotation, Insider sentiment.

## Bond ETFs – Traditional & Smart Beta Definitions

Traditional Beta ETF Category	Definition Criterion	Comments
Broad Market	Provides index based exposure to the broad bond market in a country or region. Broad market bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	
Convertible	Provides index based exposure to the convertible bond market in a country or region. Convertible bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	
Corporate	Provides index based exposure to the corporate bond market in a country or region. Corporate bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	
Covered	Provides index based exposure to the covered bond market in a country or region. Covered bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	
Inflation Protected	Provides index based exposure to the inflation protected bond market in a country or region. Inflation protected bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	
Mortgage	Provides index based exposure to the mortgage bond market in a country or region. Mortgage bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	

Municipal	Provides index based exposure to the municipal bond market in the US. Municipal bond ETFs of varying maturity and credit quality are all included in this category.	
Treasury & Government	Provides index based exposure to the treasury & government bond market in a country or region. Treasury & government bond ETFs of varying maturity, credit quality and currency denomination are all included in this category.	

Smart Beta ETF Category	Definition Criterion	Comments
Alternative Credit Scoring	Index based exposure to strategies that emphasize credit scoring of the underlying bonds that is not based on traditional credit ratings.	
Duration Optimized	Index based exposure to a target bond duration range, using long / short strategies.	Examples: Zero or Negative duration bond ETFs  Note: Bond ETFs that hold long only positions in short maturity bonds (e.g. 1-3 years) are classified as traditional beta.
Factor Weighted	Rules based exposure to bonds, where the index components are weighted by fundamental factors (e.g. ability to service debt) rather than traditional cap weighting (i.e. by debt outstanding).	
Laddered Portfolio	Index based strategies that provide exposure to bonds maturing in a sequential ('laddered') structure.	
Strategy - Other	Specialized index strategies that don't yet have enough ETFs to warrant a separate category.	
Yield Spread	Index strategies that exploit yield differences between bond types or between bonds of varying maturities in the term structure.	Example: TIPS/Treasury bond spread

## Commodity ETFs – Traditional & Smart Beta Definitions

Traditional Beta ETF Category	Definition Criterion	Comments
Agricultural	Index based exposure to agricultural commodities via underlying futures or physical holdings.	Exposure to commodity stocks is classified as equities.
Diversified Commodities	Index based diversified exposure to commodities via underlying futures or physical holdings.	
Energy	Index based exposure to energy commodities via underlying futures or physical holdings.	
Metals	Index based exposure to metals via underlying futures or physical holdings.	
Livestock	Index based exposure to livestock via underlying futures or physical holdings.	

Smart Beta ETF Category	Definition Criterion	Comments
Commodity Rotation	Index based exposure to strategies that rotate between commodities using a rules based methodology.	
Dynamic Futures Roll	Index based commodity exposure that attempts to optimize the yield from rolling out of expiring futures contracts.	
Options Overlay	Rules based index strategies that overlay options on the underlying commodity exposure (e.g. covered call strategies)	
Physical Delivery Option	Commodity exposure that gives investors the option to take physical delivery of the underlying commodity.	



## Other Asset Class ETFs – Traditional & Smart Beta Definitions

Traditional Beta ETF Category	Definition Criterion	Comments
MLP	Index based exposure to Master Limited Partnerships (MLPs).	
Listed Private Equity	Index based exposure to listed private equity companies.	
Currency	Index based exposure to exchange rate movements between currencies.	
Preferred Stock	Index based exposure to preferred stock securities.	
Target Date / Multi-Asset	Index based exposure where no single asset class accounts for > 80-90% of the assets.	This may include both Target Date ETFs as well as other multi-asset strategies.

Smart Beta ETF Category	Definition Criterion	Comments
Hedge Fund	Index based exposure that replicate hedge fund strategies such as market neutral, global macro, merger arbitrage etc. using rules based methodologies.	Classified under smart beta since hedge funds implement specific types of strategies rather than representing a homogeneous 'asset class'
Currency – Carry Trade	Index based exposure to strategies that invest in high yielding currencies by borrowing in low yielding currencies (“carry trade”).	

## **About Us**



First Bridge provides ETF data and analytics to reputed institutional clients. Our ETF data sets include daily ETF holdings, global ETF product classifications, historical distributions and risk metrics. Our clients include asset managers, financial software providers and research firms that use ETF data as a critical input into their system & workflow. We often provide 'high touch' services to our clients in the form of ETF data sets customized to their needs with related support. The First Bridge team combines deep expertise in the Indexing & ETF domain with skills in statistical programming and data visualization.

Email: [support@firstbridgedata.com](mailto:support@firstbridgedata.com)

Phone: (650) 762-9270

Web: <http://www.firstbridgedata.com>



## **Important Disclaimers**

First Bridge Data LLC does not intend this document to provide investment advice, and the information provided in this document is not and should not be considered investment advice. First Bridge Data LLC shall not be liable for any actions or decisions made based on the information provided in this document, and the reader assumes all risk associated with any investment decision made based on information contained in this document. First Bridge Data LLC is not a registered investment advisor or broker, and does not recommend specific securities, funds, or investment strategies, nor does it advocate the purchase or sale of any individual investment vehicle. Discussion or references to specific securities or investment products in this book should not be considered endorsements or offers to buy or sell those products. The past performance of a mutual fund or exchange-traded fund (ETF), security, or investment strategy cannot guarantee its future performance.

First Bridge Data LLC has no obligation to update this document or to correct any errors or omissions that might be contained in this document. First Bridge Data LLC disclaims all warranties of any kind, expressed or implied, and hereby disclaim and negate all other warranties, including—without limitation—implied warranties or conditions of merchantability, fitness for a particular purpose, or non-infringement of intellectual property or other violation of rights. First Bridge Data LLC does not guarantee the completeness, accuracy, or timeliness of any data in this document, including any data sourced through third-party content providers. Neither First Bridge Data LLC nor its employees, third-party content providers, nor any person through whom the First Bridge Data LLC makes this document available, shall be liable for any direct, indirect, incidental, punitive, special, or consequential damages (including, without limitation, attorneys' fees), whether in an action of contract, negligence, or other tortious action, that result from the use of this book. Neither First Bridge Data LLC nor its content providers shall be liable for any punitive, special, indirect, or consequential damages arising from or relating to the foregoing, whether in contract or tort or otherwise, even if First Bridge Data LLC has been advised of the possibility of such damages.