
IQS Research Brief

Is Factor Diversification Beneficial in 2009?

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In this IQS Research Brief, we tackle the question of factor diversification.

The IQS model is built upon the belief that the more investment ideas included in the model, the better the Sharpe ratio for your portfolio. Traditionally, this has worked very well because of negative correlation between factors. As shown in a recent IQS Brief, factor persistence has recently stopped and correlation between factors is not consistent with past performance.

The chart below shows the cumulative return to a long-short strategy for the various IQS factor categories.

	Momentum	Value	Balance Sheet	Improving Financials	Sentiment
First 2 weeks of May 2009	-10.3%	6.7%	-1.4%	2.4%	-2.4%
Year to Date 2009	-41.4%	4.8%	15.5%	11.7%	-11.4%

Strategy:

The best strategy for 2009 (and with good performance) would have been a combination of Balance Sheet and Improving Financials, with Value only recently showing some positive performance. What's especially noteworthy of combining only Balance Sheet and Improving Financials is that, for these two factor categories, stock price has little influence over the resulting score. Together these two factors measure Financial Sustainability, not if the stock is priced correctly.

IQS Factor Definitions:

Momentum: combination of short-term and long-term price momentum.

Value: various price versus earning measures.

Balance Sheet: measures the strength of a company's Balance Sheet using ratios.

Improving Financials: analyzes trends of company's financials.

Sentiment: changes in earnings estimates.