



# ActiveBeta Strategies Overview

December 2010



PATENT PENDING

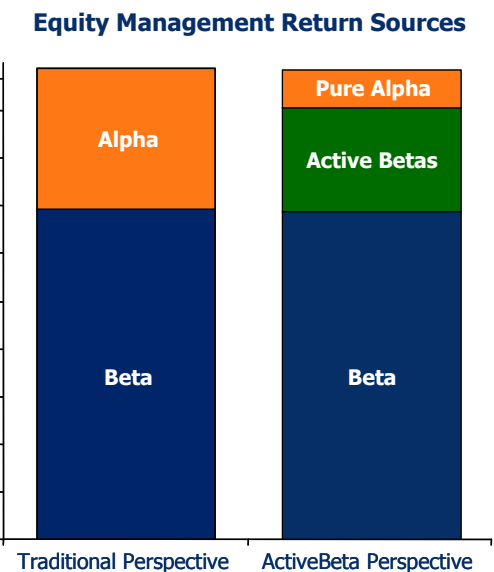
## CONCEPTUAL FRAMEWORK

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### Defining Active Betas

A significant portion of active equity management returns (traditionally referred to as alpha) appears to come from sources arising from common stock characteristics, rather than managers' stock selection skill. We refer to these return sources as Active Betas.

- Active – Returns in excess of the market or benchmark
- Beta – Common characteristics-based return; not linked to manager skill
- Active Betas – Active returns arising from common stock characteristics, as opposed to manager skill



ActiveBeta® Strategies have been designed to capture the active returns arising from two well-known characteristics – Momentum and Value. ActiveBeta Strategies offer a “beta capture” of these returns, as opposed to the “alpha capture” offered by traditional active management.

### Meeting a Need

Certain stock characteristics are associated with significant market outperformance in the long run. Momentum and Value are two such characteristics. Asset owners are exposed to Momentum and Value through their investments in active equity managers. However, active equity management may not be the best method of obtaining these characteristics-based return premia. Asset owners need a passive alternative focused on the capture of Momentum and Value long-term outperformance. ActiveBeta Strategies fulfill this demand by providing an efficient, transparent, cost-effective capture of Momentum and Value, independently and in combination.

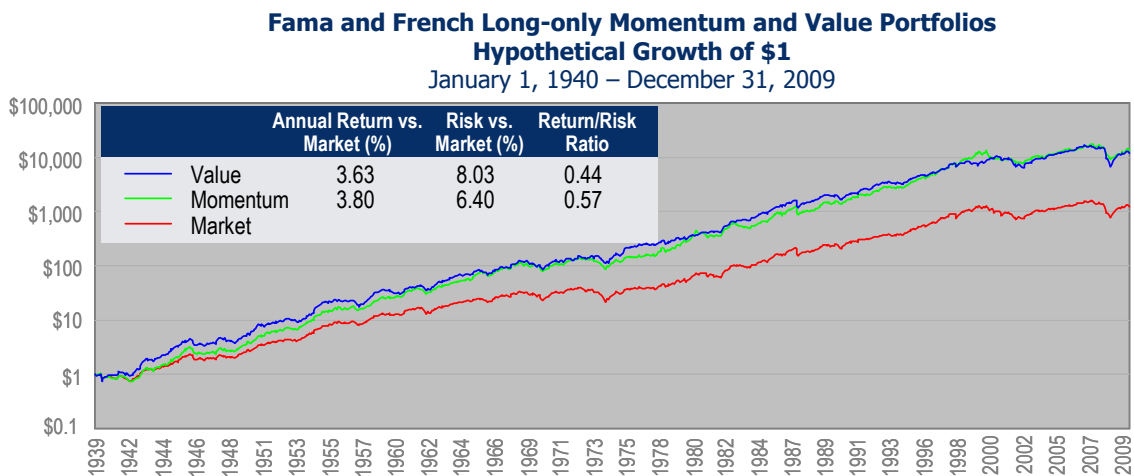
## CONCEPTUAL FRAMEWORK

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### Documented Sources of Outperformance

Momentum and Value are two powerful and persistent sources of market outperformance in the long run. These sources have been documented in academic research over several decades.

- Value – Basu (1977, 1983); Stattman (1980); Rosenberg et al. (1985)
- Momentum – Jegadeesh and Titman (1993); Asness et al. (1996)



Momentum is a market capitalization-weighted long-only portfolio containing stocks which are 1) above the NYSE median market cap and 2) in the top 30% of stocks based on most recent 11-month return lagged by 1 month. Value is a market capitalization-weighted long-only portfolio containing stocks which are 1) above the NYSE median market cap and 2) in the top 30% of stocks based on book/market ratio. Market is the market capitalization-weighted return on all NYSE, AMEX and NASDAQ stocks.

Source: Westpeak. Momentum and value returns derived from the website of Kenneth R. French at [http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

Past performance is no guarantee of future results.

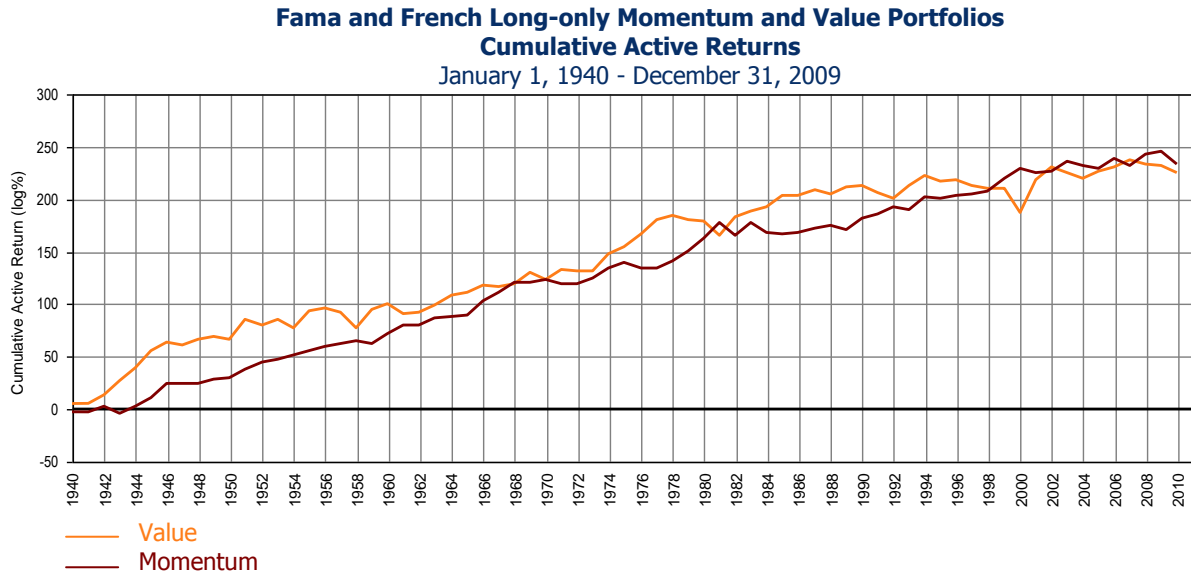
### Helping Investors “Stay the Course”

ActiveBeta Strategies combine the well-documented stock characteristics of Momentum and Value to create a strategy that seeks to limit short-term underperformance and retain the potential for long-term market outperformance. By limiting short-term underperformance, ActiveBeta Strategies can help investors stay the course.

## CONCEPTUAL FRAMEWORK

### A Diversification Opportunity

Momentum and Value active returns are negatively correlated. The correlation of Momentum and Value annual returns from January 1, 1940 through December 31, 2009 was approximately -20%.



Momentum and Value rarely underperform simultaneously.

**Fama and French Portfolios**  
**Momentum and Value Performance**  
January 1, 1940 – December 31, 2009

	Number of Years	% of Time
One underperforms Other outperforms	39	55
Both outperform	27	39
Both underperform	4	6
<b>Total</b>	<b>70</b>	<b>100</b>

Source: Westpeak. Momentum and value returns derived from the website of Kenneth R. French at [http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

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The independent power of Momentum and Value, and their negative correlation, offers an opportunity for diversification, without sacrificing returns. A combined capture of these sources can substantially mitigate their individual underperformance. This enables investors to stay invested by limiting underperformance in the short run. By improving the ability of investors to stay the course, the likelihood of realizing the full extent of Momentum and Value outperformance is significantly increased.

### **The ActiveBeta Solution**

ActiveBeta Strategies offer a “beta capture” alternative to delivering the inherent return and risk benefits of a combined Momentum and Value strategy.

- High Efficiency – Attractive risk-adjusted returns
- More Diversification – Mitigated stock-specific risk
- Completely Transparent – Straightforward, rules-based construction
- Reduced Drawdown – Maximum underperformance significantly reduced

The ActiveBeta framework allows asset owners to implement a diversified Momentum and Value approach through a single investment vehicle.

## ACTIVEBETA APPLICATIONS

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### ActiveBeta Strategies: Two Implementation Options

The capture of Active Betas is offered through a variety of solutions, which are suitable to different client needs and risk tolerances. These offerings include public indices, and tailored versions of the indices that allow clients to specify custom universes and levels of universe coverage. In addition, other customization alternatives incorporate refined signal specifications and a more efficient portfolio construction methodology.

**ActiveBeta Indices** offer a straightforward, high-capacity vehicle for capturing the systematic sources of active equity returns through diversified market capitalization-weighted Momentum and Value indices. Although such indices already exist for Value, until recently, no diversified market cap-weighted family of Momentum indices existed for global equity markets and market segments. The ActiveBeta Framework directly addresses the justification and implementation issues that have been impediments to the creation and market adoption of a momentum index.

**ActiveBeta Portfolios** provide a more informationally-efficient capture of the characteristics-based sources of active equity returns through an innovative and patent-pending portfolio construction technique. The primary objective of this technique is to maximize the transfer of information from the Momentum and Value signals into the portfolio by minimizing other structural constraints (i.e., market cap-weighting). ActiveBeta Portfolios offer complete transparency and a more efficient and cost-effective alternative to traditional active management.

#### **ActiveBeta Indices** *Higher Capacity*

- Traditional, market capitalization-weighted methodology
- Public indices offered in partnership with FTSE
- Cover global equity markets

#### **ActiveBeta Portfolios** *Higher Efficiency*

- Patent-pending, signal-weighted methodology
- Significantly increases transfer coefficient<sup>\*</sup>, resulting in higher Information ratio<sup>\*\*</sup>
- Customizable and based on any benchmark designated by an investor

\* Transfer coefficient is a measure of the transfer of information into the portfolio, defined as the correlation of the security rankings and the security active weights in the portfolio.

\*\* Information ratio is a measure of return versus risk, defined as the active return divided by the active risk (or tracking error).

## ACTIVEBETA APPLICATIONS

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### ActiveBeta Indices: The “Cap-Weighted” Approach

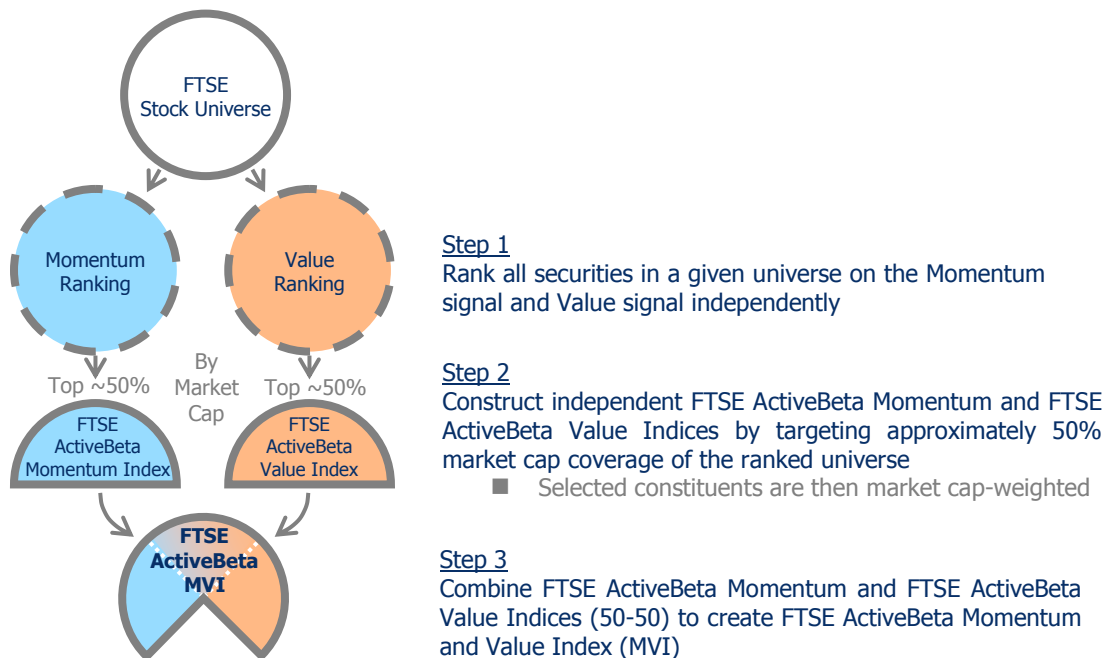
Westpeak redefines the growth investment style as momentum since it is a more accurate reflection of the selection universe of growth managers. The opportunity sets of Momentum (growth) and Value managers are specified independently of each other, which makes each opportunity set more reflective of its style. The core investment style is redefined as a blend of Momentum and Value.

The ActiveBeta Momentum and Value Index (MVI) is a more reasonable reflection of the investment process for core managers than simply the market. The index provides a better reflection of their activities by combining stocks that have positive Momentum or Value attributes, and overweighting stocks that have both high Momentum and high Value scores. The indices are rebalanced on a monthly basis in order to properly reflect the investment process of active managers.

In order for the indices to be relevant in the marketplace, the construction methodology must be replicable, investable, and economical. The index construction process is fully transparent, using straightforward and commonly-used definitions of Momentum and Value, simple construction methods, and liquid stock universes. Because the indices are market capitalization-weighted, they offer unlimited capacity, complete investability, and replicability.

Public ActiveBeta Indices are available in partnership with FTSE. Separate mandates against other indices are available from Westpeak.

### ActiveBeta Index Construction Process Overview



## ACTIVEBETA APPLICATIONS

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### ActiveBeta Portfolios: The “Signal-Weighted” Approach

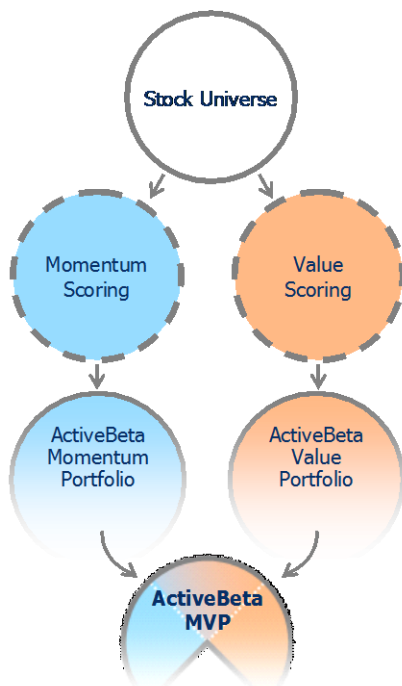
ActiveBeta Portfolios offer more informationally-efficient portfolios which have added complexity. ActiveBeta Portfolios have the potential to deliver higher after-cost active returns (per unit of risk) than ActiveBeta Indices.

The capture of Active Betas is made more efficient through a series of refinements, including alternative specifications of the momentum and value signals, and the use of an innovative and patent-pending portfolio construction technique.

Our proprietary portfolio construction methodology maximizes the transfer coefficient of the portfolio by converting ordinal security ranks directly into active portfolio weights in order to implement a pure capture of any given signal. ActiveBeta Portfolios achieve a very high level of transfer coefficient by significantly limiting the concentration in individual securities and taking a large number of small active bets. The construction methodology does not employ an optimizer, thus providing complete transparency to investors.

The construction process begins by first constructing the ActiveBeta Momentum and Value Portfolios, independently, using a proprietary portfolio construction technique. These two portfolios are then combined in equal proportions (50/50) to create the ActiveBeta Momentum and Value Portfolio (MVP).

### ActiveBeta Portfolio Construction Process Overview



#### Step 1

Score all securities in a given universe on the Momentum signal and Value signal independently

#### Step 2

Construct independent ActiveBeta Momentum and ActiveBeta Value Portfolios by scaling the security active weights proportional to their scores

- For example, scores <0 are underweight, scores >0 are overweight

#### Step 3

Combine ActiveBeta Momentum and ActiveBeta Value Portfolios (50-50) to create ActiveBeta Momentum and Value Portfolio (MVP)

## ACTIVEBETA APPLICATIONS

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### Summary

ActiveBeta Indices offer a “beta capture” alternative to deliver the inherent return and risk benefits of a combined Momentum and Value strategy.

- High Efficiency – Attractive risk-adjusted returns
- More Diversification – Mitigated stock-specific risk
- Completely Transparent – Straightforward, rules-based construction
- Reduced Drawdown – Maximum underperformance significantly reduced

ActiveBeta Portfolios seek to provide a high-efficiency capture of Momentum and Value, implemented through a patent-pending approach developed by Westpeak.

- Establishes a direct link between signal ordinal ranks and security active weights
- Provides significant increase in transfer coefficient, resulting in higher information ratio
- Minimizes stock-specific risk
- Provides high diversification
- Offers full transparency
- Significant reduction in maximum underperformance; improved ability to stay the course

### FOR FURTHER INFORMATION

Visit [www.Westpeak.com](http://www.Westpeak.com), email [Info@Westpeak.com](mailto:Info@Westpeak.com), or call 303 786 7700.

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