Understanding the components of investment return

Colin Moore, Global Chief Investment Officer

COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

We've been discussing this concept of unbundling for some time.

There are really three things that make up the return that you get from an equity product. There is nothing new in this. Perhaps our ability to analyze and identify them is better, but these conditions have existed for all the decades that I've been in this industry.

So the first one is known as beta. And all that is is really the sensitivity to any equity product, to what's going on in the broad marketplace. The easiest one to think about is the S&P 500. If the S&P 500 rises by 10%, and your product generally rises by 110% of that, i.e. 11%, then you've got a beta of 1.1.

There's another element which is today known as smart beta, but for many decades was simply known as factor investing. That is less common. It is less prevalent in the return. But it is there and it's fairly persistent. Easiest way to think about that is a lot of funds have bias towards value versus growth or size. A small cap fund versus a large cap fund. But there are other factors such as momentum or quality that are all there. Less visible to many investors, but they've been there for many years and certainly they are things that we exploit in our day-to-day business in trying to help our clients.

Then there's this other element to it which is much more rare, but also much more valuable, called alpha. And that is where you create part of the return that's not based on these market sensitivities or factor sensitivities that I mentioned earlier, like value or growth. There is something unique about the investment you make that creates this what's known as idiosyncratic return. It's not explained by anything else, and also it tends not to be correlated to other things that are going on.

So what we're realizing now is that we need to be able to offer those services to people in the same way that other industries are beginning to break apart their packaged offerings. The analogy we've used is the cable TV industry, that people don't necessarily just buy the full package any more. People now buy the internet service and add what other elements they want for their entertainment. We will increasingly see investment products in the market place that are unbundled.

The views expressed are as of July 2016, may change as market or other conditions change and may differ from views expressed by other Columbia Management Investment Advisers, LLC (CMIA) associates or affiliates. Actual investments or investment decisions made by CMIA and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Since economic and market conditions change frequently, there can be no assurance that the trends described here will continue or that any forecasts are accurate.

Investment products are not federally or FDIC-insured, deposits or obligations of or guaranteed by any financial institution and involve risks, including possible loss of principal and fluctuation in value.

Securities products offered through Columbia Management Investment Distributors, Inc., member FINRA. Advisory services provided by Columbia Management Investment Advisers, LLC.

Columbia Threadneedle Investments (Columbia Threadneedle) is the global brand name of the Columbia and Threadneedle group of companies.

©2016 Columbia Management Investment Advisers, LLC. All rights reserved.

1637054