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**EDHEC-Risk introduces a comprehensive investment framework blending liability-driven investing and factor investing**

Factor investing and liability-driven investing are widely recognized as two major advances in asset-liability management. **Factor investing**, which recommends that allocation decisions be expressed in terms of risk factors as opposed to standard asset classes, has blurred the traditional distinction between passive and active investing since investors are now aware that long-term outperformance with respect to cap-weighting indices can be accessed through systematic trading strategies. In parallel **liability-driven investing**, which is based on two fundamental building blocks known as a performance-seeking portfolio and a liability-hedging portfolio, has replaced the traditional concept of a “policy portfolio”, which had long been dominant in institutional money management. Interestingly, both paradigms are tightly connected with advances in research on portfolio optimization and asset pricing.

To explain **what role factors can play in liability-driven investing** is the purpose of a new EDHEC-Risk Institute publication entitled “*Factor Investing in Liability­Driven and Goal­Based Investment Solutions*”, conducted as part of the “ETF, Indexing and Smart Beta Investment Strategies” research chair supported by Amundi. Specifically, the authors analyse the benefits of a factor investing approach at three stages: 1. The construction of a **performance-seeking portfolio** that efficiently harvests factor risk premia across and within asset classes; 2. The construction of a **liability-hedging portfolio** that replicates as closely as possible factor exposures driving changes in the present value of liabilities; 3. The **joint measurement and management of common factor exposures in performance-seeking and liability-hedging portfolios** so as to improve the interaction between the two building blocks.

The authors of the study, Lionel Martellini and Vincent Milhau, draw three major conclusions from their work:

* Factors that have a **robust and economically justified long-term premium** are of particular interest for the construction of a performance-seeking portfolio. A multi-factor portfolio based on the 6 most popular factors (value, size, momentum, low volatility, investment and profitability) enjoys a significantly higher reward than the standard cap-weighted index or a single-factor portfolio;
* In the liability-hedging portfolio, the relevant factors are the **risk factors** that explain time variation in the value of liabilities, including notably **the level and the slope of interest rates**. To secure replacement income for retirement, it is much safer to hold a bond portfolio with controlled duration than to invest in cash, although cash is often wrongly regarded as the “safe asset”;
* By choosing **a performance-seeking portfolio with better liability-hedging properties** than a standard broad cap-weighted index, investors can allocate a bigger fraction of their assets to equities without taking the risk of larger deviations or larger losses with respect to their liabilities. Starting from a 40% allocation to the broad index, the equity allocation can be increased up to about 50% without increasing the size of drawdowns with respect to liabilities, and the result is a gain in performance that ranges approximately from 20 to 120 basis points per year.

Commenting on this research, Lionel Martellini, Director of EDHEC-Risk Institute, said, “In this study we document the benefits of factor investing in both the performance-seeking and liability-hedging portfolios. We also argue that adopting a factor investing perspective offers useful new insights with a view to improving the interaction between these two portfolios. In this process we introduce a comprehensive investment framework blending liability-driven and factor investing, widely recognized as the two most significant advances in institutional money management over the last two decades.”

Bruno Taillardat, Head of Smart Beta and Factor Investing Solutions at Amundi, added: “We are pleased to support this study, which brings together factor investing and liability-driven investing into a single, comprehensive framework. Our partnership with the EDHEC-Risk Institute continues to help cement Amundi’s position as a thought leader in investment management and enhance Amundi’s strong engagement with investors looking to meet their asset allocation goals.”

A copy of the publication can be downloaded via the following link:

[EDHEC-Risk Institute Publication: Factor Investing in Liability ­Driven and Goal ­Based Investment Solutions](https://risk.edhec.edu/sites/risk/files/pdf/eri_publication_factor_investing_in_ldi_and_gbi_2020.pdf)

You can access an exclusive 2-page summary of the publication outlining the authors’ main insights here: <https://risk.edhec.edu/factor-investing-liability-driven-and-goal-based>

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**About EDHEC-Risk Institute**

**Academic Roots & Practitioner Reach**

Since 2001, EDHEC Business School has been pursuing an ambitious policy to produce academic research that is both practical and relevant. This policy, known as “Research for Business” and now labelled “Make an Impact”, aims to make EDHEC an academic institution of reference for the investment industry in a small number of areas in which the school has reached critical mass in terms of expertise and research results. Among these areas, investment management has occupied a privileged position, leading to the creation in 2001 of EDHEC-Risk Institute, which has developed an far-reaching ambitious portfolio of research and educational initiatives in the domain of investment solutions for institutional and individual investors.

This Institute boasts a team of permanent professors, engineers and support staff, as well as a large number of affiliate professors and research associates from the financial industry among its ranks. EDHEC-Risk Institute is located on campuses in the City of London (United Kingdom) and Nice (France). Its philosophy is to validate its work by publishing in international academic journals, as well as to make it available to the sector through position papers, published studies and global conferences.

To ensure the distribution of its research to the investment industry, EDHEC-Risk also provides professionals with access to its website, <https://risk.edhec.edu>, which is devoted to asset and risk management research, with a focus on investment solutions. Finally, its quarterly newsletter is distributed to over 100,000 readers.

In addition to the EDHEC Alternative Indexes, which are used as performance benchmarks for risk analysis by hedge fund investors, and the EDHEC-IEIF Monthly Commercial Property index, which tracks the performance of the French commercial property market through SCPIs, EDHEC-Risk has recently launched a series of new initiatives:

* The [EDHEC-Princeton Retirement Goal-Based Investing Index Series](https://risk.edhec.edu/indices-investment-solutions#tab_372), launched in May 2018, which presents asset allocation benchmarks for innovative mass-customised target date solutions for individuals preparing for retirement;
* The [EDHEC Bond Risk Premium Monitor](https://risk.edhec.edu/bond-risk-premium-monitor), designed to offer investment and academic communities a tool with which to quantify and analyse the risk premium associated with Government bonds;
* The [EDHEC-Risk Investment Solutions (Serious) Game](https://risk.edhec.edu/edhec-risk-investment-solutions), intended to facilitate engagement with graduate students or investment professionals enrolled on one of EDHEC-Risk’s various campus-based, blended or fully-digital educational programmes.

EDHEC-Risk Institute also has highly significant executive education activities for professionals, in partnership with prestigious academic partners.

In 2012, EDHEC-Risk Institute signed two strategic partnership agreements. The first was with the Operations Research and Financial Engineering department of Princeton University to set up a joint research programme in the area of investment solutions for institutions and individuals. The second was with Yale School of Management to set up joint certified executive training courses in North America and Europe in the area of risk and investment management.

As part of its policy of transferring know-how to the investment industry, in 2013 EDHEC-Risk Institute also set up ERI Scientific Beta, which is an original initiative that aims to favour the adoption of the latest advances in smart beta design and implementation by the whole investment industry. Its academic roots provide the foundation for its strategy: offer, in the best economic conditions possible, the smart beta solutions that are most proven scientifically with full transparency of both methods and associated risks.

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**About Amundi ETF, Indexing & Smart Beta**

With more than €133 billion1 in assets under management, Amundi ETF, Indexing and Smart Beta is one of Amundi’s strategic business areas and is a key growth driver for the Group.

Amundi ETF, Indexing and Smart Beta business line provides investors - whether institutionals or distributors - with robust, innovative, and cost-efficient solutions, leveraging Amundi Group’s scale and large resources. The platform also offers investors fully customized solutions (ESG, Low Carbon, specific exclusions, risk constraints, etc.).

With over 30 years of benchmark construction and replication expertise, Amundi is a trusted name in ETF & Index management among the world’s largest institutions. The team is also recognized for its ability to develop Smart Beta & Factor Investing solutions, with more than 10-year track-record.

1- All figures and data are provided by Amundi ETF, Indexing & Smart Beta at 31/12/2019