4th floor
Ropemaker Place
25 Ropemaker Street
London
EC2Y 9LY
United Kingdom

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Markit Commentary

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Momentum strategies power ahead

Momentum investing has proven to be a winning strategy since the start of the year, which has seen investors clamour to gain exposure to the factor.

- The two US momentum ETFs have seen their AUM more than double in 12 months
- The iShares MSCI USA Momentum Factor has outperformed the S&P 500 by 6.7% ytd
- US shares with the worst momentum have underperformed by 30% in the last 12 months

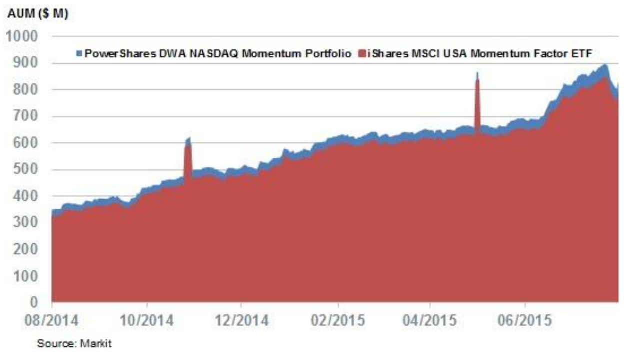
Mark Carhart **demonstrated** in his 1997 paper that "high momentum" shares, those which experienced the most positive price movements, continued their upward climb in the near term. The factor proved so consistent that using it in conjunction with the value and size factors identified by Fama-French "almost completely explain persistence in equity mutual funds' mean and risk-adjusted returns". All three factors are now the bedrock of academic research.

While the strategy has proved a hit with the academic community, uptake in the ETF landscape has been a little longer coming. To this end, only two US focused equity ETFs currently aim to maximise investors' exposure to the momentum factor.

Funds prove popular

The two momentum focused funds that currently invest in US equities, the iShares MSCI USA Momentum Factor and the PowerShares DWA NASDAQ Momentum Portfolio, currently manage $840m. This figures pales in comparison to funds that track other fundamental factors such as size and style. Despite their relatively small size, the two ETFs have proved popular with investors as this AUM has more than doubled in the last 12 months to a hit a new all-time high.

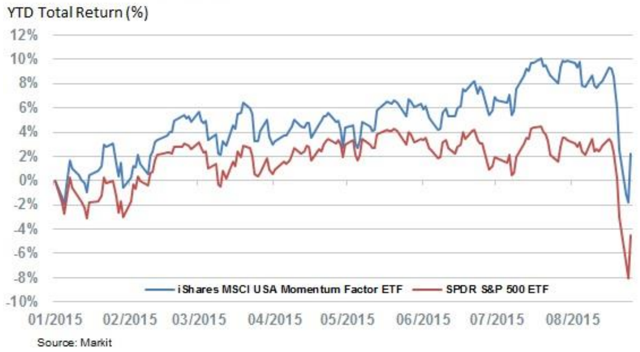
Momentum ETF AUM



This rise in asset value was driven in large parts by large inflows as the two funds have attracted $322m of new assets so far this year.

These inflows have no doubt been spurred on by the fact that momentum has performed well in the current market environment; demonstrated by the fact that the largest momentum ETF, the iShares MSCI USA Momentum Factor has outperformed the S&P 500 index by over 6.5% since the start of the year.

Momentum Total Return

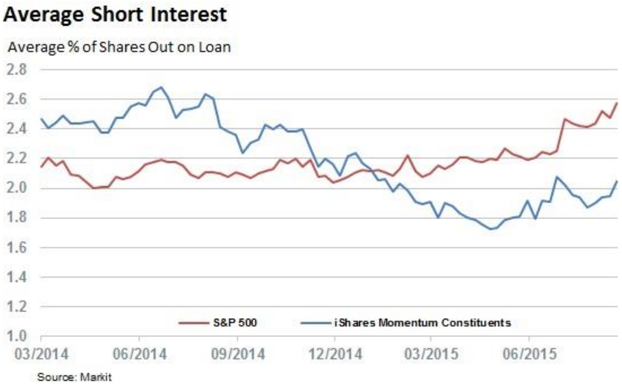


While the fund has seen its NAV fall over the last week, this has been in line with that of the broader market and its relative performance to the SPDR S&P 500 ETF has been flat over August. This is driven in large part by the fund's sector exposure, in which less than 1% of its current holdings are made up of oil & gas and basic materials firms.

Amazon, which has been relatively immune to the recent selloff, is the fund's current top holding with a 6.5% weight.

Short sellers steer clear

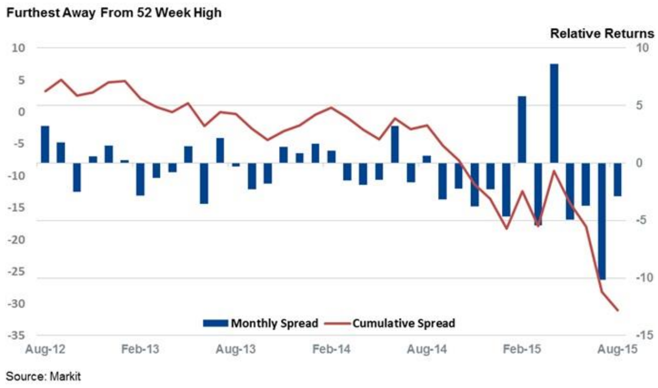
The factors strong performance has also seen short sellers stay away, with the iShares MSCI USA Momentum Factor constituents seeing their average short interest come down in recent months. This covering runs against the run of play as the constituents of the S&P 500 index have seen short selling increase to recent 18 month highs over the last few weeks.



Flip side underperforming

While shares with high momentum have outperformed in the current market, those on the other end of the momentum spectrum have performed dismally. The 10% of stocks which are the furthest away from a 52 week high have underperformed the ten of the last 12 months. This means that the cumulative underperformance of the shares with the worst momentum is approaching 30% for the last 12 months.

This trend is driven in large part by the recent collapse in commodities prices, as the oil and gas sector is heavily represented among the shares with the worst momentum.



Simon Colvin

Analyst

Markit

Tel: +44 207 260 7614

Email: **simon.colvin@markit.com**

For further information, please visit **www.markit.com**