metric financial

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The Momentum Factor

What is Momentum?

The Momentum factor is based on research and data that shows that investments that have outperformed in the recent past have continued to outperform in the near term. Notable academic work on the factor includes that of Jegadeesh & Titman, as well as Mark Carhart, and Cliff Asness.

How is it captured?

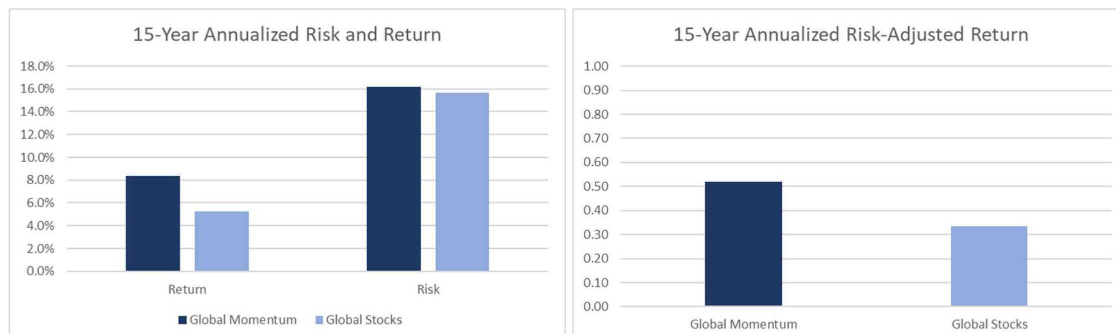
Like other factors (except Market), Momentum can be captured with many metrics, all focusing on various time periods of recent returns. The most common in academia is the data that shows that stocks with strong performance over the most recent 12 months have continued to have it over the next 12 months. However, there is ample work done on 3- and 6-month returns, among others.

Why does it work?

One explanation for Momentum is a behavioral theory, which is that investors herd – they wait for investments to go up before jumping in themselves. Another is more structural to the markets, stating that "bad news travels slowly" such that investments may continue to perform well even without strong fundamentals.

How has it worked?

Over a 15-year period, Momentum (as measured by the MSCI ACWI Momentum Index) has outperformed the market (as measured by the MSCI All Country World Index) on both an absolute and risk-adjusted basis.



Source: Morningstar; As of March 31, 2020

How do we use it in a portfolio?

Metric portfolios currently gain exposure to the Momentum factor in equities by investing in ETFs that track the MSCI USA and World Ex USA Momentum indexes. Both indexes are constructed based on 2 metrics: 6- and 12-month risk-adjusted excess returns. A key benefit of including Momentum in a portfolio, aside from its potential for excess return, is its diversifying impact on other factors, particularly Value.

Disclosures

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