

Momentum is gaining momentum

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We all know that it's been a difficult couple of years for investment managers prompting some investors and IFAs alike to steer towards passive investments and/or cash. However, it seems that times they are a changing. Evidence suggests that investment markets turned a corner towards the tail end of 2023 and active MPS portfolios that favour momentum-based investment strategies appear to be on the up compared to their passive peers and cash alternatives. So, what is momentum investing?

Momentum investing is a powerful strategy that has gained popularity among investment managers seeking to maximise returns for their clients. By riding the wave of momentum, investment managers can capture the upward trend and achieve higher returns. It is based on the concept that funds or assets that have performed well in the past will continue to perform well in the future. This approach goes against the traditional "buy low, sell high" strategy and instead focuses on buying high-performing funds and selling underperforming ones.

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Understanding the Concept of Momentum

The concept of momentum is derived from the observation that assets that have performed well in the past tend to continue their upward trend. This is based on the belief that investors tend to underreact to positive news, causing the price of the asset to rise gradually over time. Momentum can be measured using various technical indicators such as average 6 and 12 month performance. These indicators help identify funds that are gaining strength and have the potential for further price appreciation.

Momentum investing is not without its risks. The strategy relies on the assumption that the market trend will continue, which may not always be the case. It is important for investment managers to regularly and systematically analyse sector and fund performance.

The Benefits of Momentum Investing

Momentum investing has several benefits that make it an attractive strategy for investors looking to maximise their returns. One of the more obvious advantages is the potential for higher returns. By investing in assets that have already shown strong performance, investors can capture the upward trend and benefit from further price appreciation.

Another benefit of momentum investing is the ability to outperform the market. Studies have shown that momentum strategies have consistently outperformed traditional buy-and-hold strategies over the long term. This is because momentum investing focuses on identifying funds with strong performance, which tend to continue their upward trend.

“By including assets with different levels of momentum, investors can reduce the overall risk and volatility of their portfolio.”

Key Factors to Consider in Fund Selection for Momentum Investing

When implementing a momentum investing strategy, selecting the right funds is crucial. Here are some key factors investment managers should consider when choosing funds for momentum investing:

- 1. Past Performance:** Funds that have consistently outperformed their benchmarks and have a proven track record of capturing momentum and generating positive returns.
- 2. Initial fund charges:** High fees can eat into returns, where-as funds with low expense ratios can help to maximise your investment gains.

Exploring Momentum Portfolio Strategies

Momentum Portfolio Strategies are systematic approaches to momentum investing that aim to capture the performance of assets with strong momentum. These strategies use quantitative models and algorithms, like our own **CleverEngine**, to identify assets with the highest potential for price appreciation.

One popular strategy is the relative strength strategy, which ranks funds based on their relative performance compared to a benchmark index. Assets with the highest relative strength are included in the portfolio, while underperforming funds are excluded. This strategy allows fund managers to focus on the strongest-performing funds and maximise their returns.

Another strategy is the time-series momentum strategy, which looks at the performance of funds over a specific time period, for example 6, 12 and/or 36 months.

Funds that have shown positive momentum over the chosen period are included in the portfolio, while those with negative momentum are excluded. This strategy aims to capture the trend of funds and benefit from their continued performance.

The importance of asset allocation in momentum investing

As you know, asset allocation is a fundamental aspect of **any** investment strategy, and momentum investing is no exception. Proper asset allocation is crucial for maximising returns and managing risk in a momentum focused investment portfolio.

One key aspect of asset allocation in momentum investing is diversification. Diversification involves spreading investments across different asset classes, sectors, and geographic regions to reduce the impact of any single investment on the overall portfolio. By diversifying their investments, investors can mitigate the risk of being overly exposed to a single asset or sector and increase the potential for positive returns.

It's important to note that momentum investing is just one of many investment styles, and combining it with other styles, such as value investing or growth investing, can help create a well-rounded portfolio. This can provide investors with exposure to different market trends and increase the potential for consistent returns.

In summary, asset allocation plays a crucial role in maximising returns and managing risk in a momentum investing portfolio. Diversification, combining different investment styles, and aligning the allocation with risk tolerance and investment goals are key considerations in asset allocation for momentum investing.

Common mistakes to avoid in momentum investing.

While momentum investing can be a profitable strategy, there are common mistakes that portfolio managers should avoid to maximise portfolio returns. Here are some of the most common mistakes made:

1. Ignoring risk management: Momentum investing can be a high-risk strategy in the short term, as it involves investing in funds that have already shown positive price momentum. It's important to have a risk management strategy in place to protect against potential losses. This can include diversifying the portfolio effectively, systematic asset allocation, and regularly monitoring and reassessing funds.

2. Lack of discipline: Momentum investing requires discipline and sticking to a predetermined strategy and process. It's important to avoid making impulsive investment decisions based on short-term market fluctuations or emotions. Having a clear investment strategy and sticking to it can help avoid costly mistakes.

Resources for learning more about momentum investing:

There are several resources available that can provide valuable insights and guidance. Here are some resources to consider:

Investment forums and communities: Participating in investment forums, such as our own, soon to be launched **CleverCommunity**, can provide opportunities to learn from other financial planners and share experiences. Other social communities like NextGen Adviser are also popular forums for discussing such investing strategies and other relevant topics.

Research papers: Academic research papers, such as [Returns to Buying Winners and Selling Losers by Narasiman Jegadeesh and Sheridan Titman](#), provide in-depth analysis and empirical evidence on the effectiveness of momentum investing.

Conclusion: Unleashing the power of momentum investing

Momentum investing is a strategy that has the potential to generate significant returns for investors. By focusing on funds that have shown positive price momentum and avoiding or selling funds that have shown negative price momentum, investors can ride the wave of market trends and capture the gains.

However, it's important that investment managers approach momentum investing with caution and to carefully consider the key factors discussed in this article. Systematic fund selection, asset allocation, and avoiding common mistakes are all crucial aspects of maximising returns in momentum investing.

By conducting thorough research, developing a disciplined investment process, and continuously monitoring and reassessing investments, investment managers can unleash the power of momentum investing and potentially achieve their clients' financial goals.

The CleverEngine puts momentum theory into investment practice as it is designed to systematically run the winners and sell the losers.

Now is the time to act!

[**Find out more about our quantitative and disciplined investment process.**](#)

Risk Warnings

The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest. Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our funds invest for the long-term and may not be appropriate for investors who plan to take money out within five years. The fund will be exposed to stock markets and market conditions can change rapidly. Prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events.

