How Factor Investing Is Changing: Three Structural Shifts

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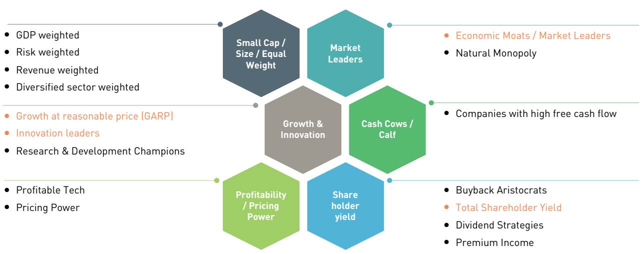
Factor investing has long been a cornerstone of systematic portfolio construction, particularly within the ETF ecosystem. In European UCITS ETFs, its relevance has grown significantly: factor ETF assets have reached over USD 80 billion and have now surpassed those in sector ETFs, signalling a structural change in investor behaviour. Still, they represent only about 5% of the overall UCITS market . A key driver behind this trend is the rise of equal-weighted investment strategies, which have become a simple and efficient tool for investors to navigate current market challenges, now accounting for roughly a quarter of all factor allocations.

The reasons behind this rise are straightforward: unlike sector investing, factor investing is not a zero-sum game—blending factors can enhance rather than dilute returns.

The rise of equal weighting as a factor is notable because it does not fit neatly into a single factor box; rather, it combines a low-size tilt, less growth exposure, and an anti-momentum effect driven by frequent rebalancing. We view equal weight as part of a family of "next-generation" factors—approaches designed to remain relevant in a changing market by blending established factor signals with newer insights and market dynamics that have become more salient recently. In the following section, we investigate three additional hybrid factor signals that have gained increasing attention from investors in light of a changing investment landscape.

Figure 1: Next generation of factor signals



Source: DWS International GmbH, as of August 2025

1.Winner-Takes-All Dynamics: Beyond Simple Momentum

Scale, network effects, and control of intangible assets have created markets where leadership is both concentrated and persistent. Index concentration metrics, such as the share of the top 10 constituents in the S&P 500, have reached levels last seen in the early 1970s. While technology often dominates the discussion, this pattern extends across sectors: in most industries, the largest companies have consistently outperformed their smaller peers. For example, over the past two years, being equally weighted across 9 of the 11 US GICS sectors would have underperformed a market-cap-weighted allocation. This is unusual, particularly given that over longer horizons the equal-weighted alternative has outperformed the market cap-weighted index .

Equating this trend with traditional momentum is misleading. Their ability to sustain high returns on invested capital, monetise innovation, and maintain dominant market positions has allowed them to defy the gravitational pull that typically drags top performers back toward the mean. While index leadership inevitably changes over time, these firms have so far exceeded expectations and resisted the usual cycle of underperformance.

Recent data underscores this distinction. In Q2 2025, traditional momentum strategies were almost entirely divested from these market leaders following their brief underperformance in April 2025. Yet their underlying strength—anchored in pricing power, reinvestment capacity, and strategic control of emerging technologies—remains intact, and resulted in a robust 10% outperformance versus the broader S&P 500 index between "Liberation Day" in April and the end of August 2025 . This highlights a critical point: 6-month or 12-month momentum factors, as typically defined in traditional models, do not necessarily capture structural leadership.

From a factor perspective, this creates an interesting opportunity set. Strategies that systematically target market leaders across industries—using metrics such as sustained free cash-flow margins, ROIC, and market-share stability—can provide exposure to companies that may be better positioned for resilience and growth, including those beyond the well-known "Magnificent Seven."

Advances in data availability make this increasingly investable. In particular, detailed market share at granular business line level help to quantify competitive dominance and enable passive implementations of leadership-focused indices. In effect, these strategies codify what active managers have long pursued—durable competitive advantage—into systematic, rules-based frameworks.

2. Value Lags: Income and Yield Take Centre Stage

The prolonged underperformance of value is almost the logical consequence of the dynamics described above. In markets dominated by structural winners, traditional value exposures—often concentrated in sectors with limited pricing power—have struggled to deliver. Despite intermittent rallies, value indices have persistently underperformed growth, now trailing over 10-, 20-, and 30-year horizons—underscoring the reality that "cheap" does not necessarily equate to "poised for recovery".

Flows however suggest investors still choose exposure to value, but the approach is changing.. Value factor ETFs attracted around USD 18.8 billion in net inflows over the past 12 months, while yield-focused strategies added an even larger USD 23.2 billion—evidence that investors are favouring income and capital discipline over pure valuation screens . By focusing on firms that return cash through dividends, buybacks, and debt reduction, these strategies separate sustainable value from speculative recovery plays.

The rise of dividend-focused products has been a key part of the evolution of factor investing, but the corporate action palette today is broader. In Europe, , share buybacks have grown significantly as a share of total cash returns , and debt reduction has become an important signal of financial strength in a higher-rate environment. This shift mandates a new approach to factor design—one that captures the full spectrum of shareholder distributions rather than relying solely on dividend yield.

Approaches such as "Resilient Shareholder Yield" exemplify this thinking. They prioritise companies that combine income generation with balance sheet discipline,. Empirical evidence supports this

Figure 2: Annual excess returns of “next generation factors” vs. S&P 500

Horizon	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Outperformance	EW 11.5	RSHY 12.4		EW 6.1	RSHY 3.4				EW 19.8			
	RSHY 12.4	EW 3.9		GARP 3.2	EW 3.1	RSHY 5.3	GARP 15.7		GARP 17.4	EW 6.8	GARP 10.0	
	GARP 0.1	GARP 1.9	EW 12.3	RSHY 0.5	GARP 0.4	EW 0.0	RSHY 5.7	RSHY 2.5	RSHY 3.8	RSHY 4.7	RSHY 5.6	EW 1.7
Underperformance			RSHY -4.2			GARP -3.8	EW -4.0	GARP -1.5		GARP -5.6	EW -2.2	GARP -2.0
			GARP -5.4					EW -2.7				RSHY -3.3
S&P 500 (TR)	-11.89	-22.10	28.68	10.88	4.91	15.79	5.49	-37.00	26.46	15.06	2.11	16.00

Horizon	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Outperformance	GARP 6.9	GARP 2.1			ML 7.8	ML 3.3			GARP 9.9			
	EW 3.8	EW 0.8		RSHY 5.5	GARP 4.4	GARP 0.7	GARP 5.1	GARP 2.7	ML 5.0	RSHY 11.5	ML 12.4	
	RSHY 3.6	ML 0.4	ML 5.3	EW 2.8	RSHY 2.0	RSHY 0.6	ML 2.7	ML 0.8	EW 0.9	EW 6.7	GARP 11.5	ML 1.8
Underperformance		RSHY -2.5	RSHY -2.1	ML -3.1	EW -2.9	EW -3.3	EW -2.2	EW -5.6	RSHY -3.4	GARP -0.8	RSHY -7.5	GARP -3.1
			GARP -2.4	GARP -4.1			RSHY -4.8	RSHY -6.0		ML -1.6	EW -12.4	RSHY -11.1
			EW -3.6									EW -12.0
S&P 500 (TR)	32.39	13.69	1.38	11.96	21.83	-4.38	31.49	18.40	28.71	-18.11	26.29	25.02

Source: S&P Dow Jones Indices, from 31/12/1999 to 31/12/2024. Past performance is not a reliable indicator of future performance.

approach: shareholder yield strategies have outperformed traditional book-to-price screens over the past five years, particularly in markets where governance and capital allocation quality are key differentiators. In short, value is not obsolete—but its definition must evolve to reflect how companies create and return value today.

3. Growth Fatigue: When Discipline Matters More Than Ever

Finally, growth investing has rarely been more popular—or more expensive. The question is not whether growth companies are worth the risk but rather whether they are worth the price. Today, the MSCI USA Growth Index trades at roughly 32x forward earnings—about 1.9x the multiple of Value—placing the current growth premium near dot-com era extremes .

This is where “Growth at a Reasonable Price” (GARP) can provide a qualifying element. Unlike traditional growth strategies that reward expansion at any cost, GARP targets companies with credible growth prospects supported by strong fundamentals, avoiding the extremes of speculative hype on one side and deep-value traps on the other. Systematic GARP indices, such as the S&P 500 GARP 100, operationalise this by screening for earnings and sales growth, return on equity, and reasonable price-to-earnings ratios, often combined with leverage and cash flow metrics.

The appeal is not theoretical. Historical evidence suggests that GARP-style portfolios have captured a disproportionate share of market upside while limiting participation in drawdowns. For example, back-tested results for systematic GARP indices show upside capture ratios above 100 and downside capture below 95 relative to the S&P 500—an asymmetry that matters when volatility returns . This pattern reflects the structural advantage of combining growth with valuation and quality filters: participation in innovation without full exposure to the excesses of crowded trades.

Factor Investing in a Market Defined by Structural Pressures

The recent persistent upward momentum in risk assets has made its mark on investors who now appear to command a return to restraint. This shift and the accompanying strategies of identifying structural leadership, a redefinition of the value factor and the return of disciplined growth—are symptoms of a broader regime change.

For over a decade, passive exposure to broad indices has been the default solution, but the concentration risk embedded in these benchmarks is now harder to ignore. At the same time, active stock-picking faces its own hurdles in delivering consistent alpha under these structural constraints. The evolution of factor indices—whether targeting market leadership, shareholder yield, or growth with valuation controls—marks the beginning of what could be considered a second generation of factor investing. These strategies aim to balance today’s market realities with systematically rewarded factors. For allocators navigating a regime where traditional beta is harder to own without compounding risk, these innovations may prove essential.

Xtrackers by DWS

1Source: DWS International GmbH, Morningstar, as of August 2025
2Source: DWS International GmbH, S&P Global, as of August 2025
3Source: DWS International GmbH, Bloomberg, as of August 2025
4Source: DWS International GmbH, US and European ETFs, based on Morningstar data, as of August 2025.
5In 2024, STOXX 600 firms announced approximately €290 billion in buybacks, marking it the third-highest volume ever recorded. Source: DWS International GmbH
6Source: MSCI, as of August 2025
7See also Indexing GARP Strategies: A Practitioner’s Guide