

ABSTRACT

The Capital Asset Pricing Theory (CAPM) theory stated that only market risk (beta) could generate risk premium for investors. Investors just need to hold market portfolio or capitalization-weighted portfolio. But the capitalization-weighting method may expose investors with potential drawbacks such as: concentration, volatility and the tendency to invest in the expensive stocks. In the following years, many scholars have identified other risk factors besides beta market risk that can bring higher returns to investors than market capitalization-weighted indices. The most common risk factors are size factor, value factors, quality factor, momentum factor and low volatility factor. Based on the research, these well-known factors can outperform the market. The investors then tried to capture these factors more directly, by creating portfolio based on these factors called Smart Beta Investing.

The purpose of this thesis is to construct the Smart Beta portfolios using Indonesia's stocks and then test, whether the portfolios can generate excess return during the period 2015-2020 with the Indonesia Composite Index as the benchmark.

The research show that Smart Beta portfolios can outperform the Indonesia Composite Index in term of Sharpe ratio and Treynor ratio. The Smart Beta portfolios also generate the positive alpha in the Jensen's Alpha measurement. This research also show that Smart Beta Value strategy has the best performance compare to other Smart Beta counterparts.

Keywords: *smart beta investing, market capitalization-weighted method, Capital Asset Pricing Model (CAPM).*