Nov 12 (Reuters) — Ironically, the simple truth may be that the world is more complex and less stable than popular smart beta strategies assume.

Smart beta strategies have enjoyed rampant growth, being funds which are a sort of hybrid; passive in nature but with active management tweaks.

But smart beta’s weakness is that the performance factors it is based on are less bedrock and more shifting soil, argue well-known quants Bruce I. Jacobs and Kenneth N. Levy of Jacobs Levy Equity Management.

“Smart beta strategies assume a stock market in which a few chosen factors produce persistent returns,” Jacobs and Levy write in a forthcoming piece in the November/December 2014 Financial Analysts Journal. “This assumption is not a good approximation of what is observed in reality.”

While a classic index fund attempts to capture beta, or market return, by holding all shares in proportion to their market capitalized weight, smart beta funds try to beat the market by making adjustments. Those adjustments are based on ‘factors,’ anomalies, like for example the outperformance of stocks with certain characteristics such as small size which managers hope will persist.

James Montier of fund managers GMO has criticized smart beta for, in what he says is the vast majority of cases, simply giving investors extra exposure to value and small-capitalization shares, but at a higher price.

Jacobs and Levy, who more than 25 years ago were early to catalog and study factors produce persistent returns, go a bit beyond, and to the side, of Montier, in their critique. They argue that not only are these factors, on which a smart beta fund must depend, not stable, but also that managers would do better to spread bets across more types of shares, and be willing to adjust these over time as needed.

It may well be, contrary to some of the marketing of smart beta, that there is no such thing as being “a little bit active” in investment management, just as it is impossible to be a little bit pregnant.

While most smart beta funds over-weight stocks with a few criteria, such as small capitalization, low volatility, momentum and value, these are far from the only characteristics which can lead to outperformance. A recent study by Jeremiah Green, John Hand and Frank Zhang found 24 factors with statistically significant outperformance, but further that size and price-to-book, both popular in smart beta, were not among the leading group.