Financial Analysts Journal ›

Volume 51, 1995 - Issue 3

FEATURE ARTICLES

The Three Types of Factor Models: A Comparison of Their Explanatory Power

Gregory Connor

Pages 42-46 | Published online: 02 Jan 2019

Cite this article https://doi.org/10.2469/faj.v51.n3.1904

Abstract

Multifactor models of security market returns can be divided into three types: macroeconomic, fundamental, and statistical factor models. Macroeconomic factor models use observable economic time series, such as inflation and interest rates, as measures of the pervasive shocks to security returns. Fundamental factor models use the returns to portfolios associated with observed security attributes such as dividend yield, the book-to-market ratio, and industry identifiers. Statistical factor models derive their pervasive factors from factor analysis of the panel data set of security returns. This paper compares the explanatory power of these three approaches for U.S. equity returns.