STYLE ANALYTICS
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Report

2023
Factor Performance Analysis

US Growth stands out amongst global Value and Yield

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Prepared by:

Alex Lustig
Senior Client Consultant, Investment Metrics, a Confluence Company

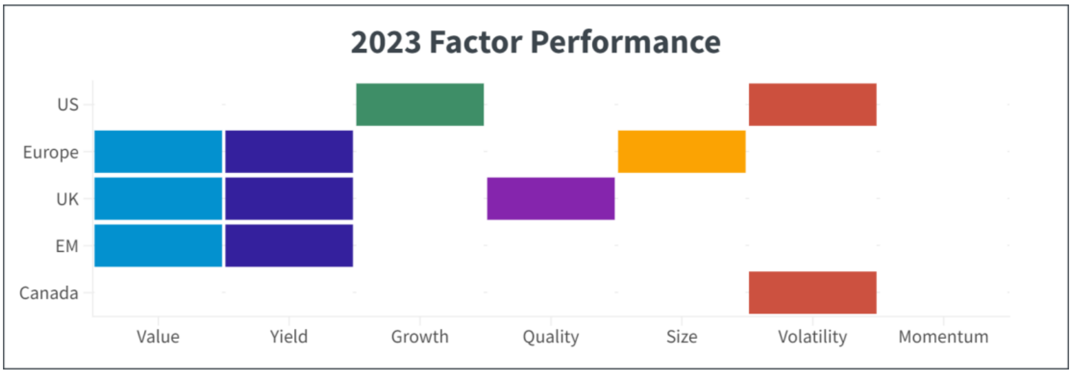
Market Background

Among substantial challenges, including rising geopolitical tensions in Ukraine and Israel and persistent inflationary pressures on the global economy, the third quarter of 2023 witnessed a loss of momentum in equity markets. However, the scenario shifted dramatically in Q4, especially on December 15th. In the US, the Federal Reserve's optimistic comments sparked an unexpected "everything rally" to close out the year strong, propelling equity markets to the last all-time high seen in December 2021. Powell's acknowledgment of "clear progress" towards their long-term 2% goal and the Fed's awareness of the risk of holding policy too tight for too long has injected significant optimism into global markets. As a result, the MSCI ACWI closed the year at +22% in 2023.

As seen last quarter, the annual trend where the US diverged from other developed markets has persisted through Q4 and the end of the year. The US continues to favor Growth and Volatility, while it appears to be in a similar market environment as in 2020 and 2021, the situation now is more pragmatic, based less on forecasts and more on realized growth. Europe, the UK, and Emerging Markets all continue to prefer Value and Yield, as seen in 2022 with some caveats. Canada has a neutral factor performance trend overall, again with an emphasis on Volatility.

Although oil prices surged by 30% in Q3, they have begun to stabilize down at $70/barrel, persistent with the average observed in late 2022-early 2023 but still above the $60/barrel pre-pandemic level. Bitcoin and other risk-on assets surged on the news of potential rate cuts, reaching levels last seen at the end of 2021. Gold closed the year out with +7% at $2,060/TOz.

Factor Summary



- **US Equities**: Growth and Volatility outperformed both in Q4 and for 2023.
- **Europe:** Surge in Q4 led Volatility and Forecast Growth to outperform, but Value, Yield, and Large Cap outperformed in 2023.
- **UK**: Value, Yield, and Quality outperformed in 2023, especially Low-Gearing in December and Q4.
- **Emerging Markets**: Value, Yield, and Dividend Growth outperformed in 2023.
- **Canada**: Forecast growth outperformed in Q4, which led to Volatility, low gearing, and sales growth to outperform in 2023.

US Equities

In the US, the Federal Reserve's comments on December 15th catalyzed a sweeping "everything rally," closing equity markets on a positive note. Market discussions shifted from chronic recession concerns to the timing and scale of 2024's potential rate cuts after Powell finally indicated the "clear progress" to reaching the Fed's long-term 2% inflation goal that had been made in 2023. This positive disinflation update, paired with robust US consumer spending data propelled equity returns to match 2021's all-time high. Powell's acknowledgment of risks in holding rates too tight for too long fosters a glass-half-full market outlook for 2024 as the Federal Reserve threads the needle out of the post-Covid era.

Despite recent optimism, the recent market surge is concentrated, with the majority being attributed to the "Magnificent 7" tech stocks. Signs suggest a potential rally broadening, as Invesco's equal-weighted S&P 500 ETF recorded a record $10B net inflow in 2023, $3B of which occurred just in December. However, without any material changes to anti-trust laws in the US, the Large Cap rally may continue further.

Concentration risk is evident in the factor performance trends for Volatility and Large Cap, but the overall trend reflects optimism. In December and Q4, Volatility surpassed other subfactors to lead in the quarter and for all of 2023. The trends closely echo 2020 but are more conservative. The current emphasis on realized earnings and sales growth, with interest rates above 4%, diverges from 2020's focus on high-beta and forecasted growth. This shift in subfactor performance signals a maturing and pragmatic approach to a promising 2024.

Daily volatility over one year (or short-term volatility) outperformed the other Volatility subfactors, led by tech stocks like AMD and Broadcom, which respectively returned 43% and 35% in Q4, two-thirds of which occurred in December.

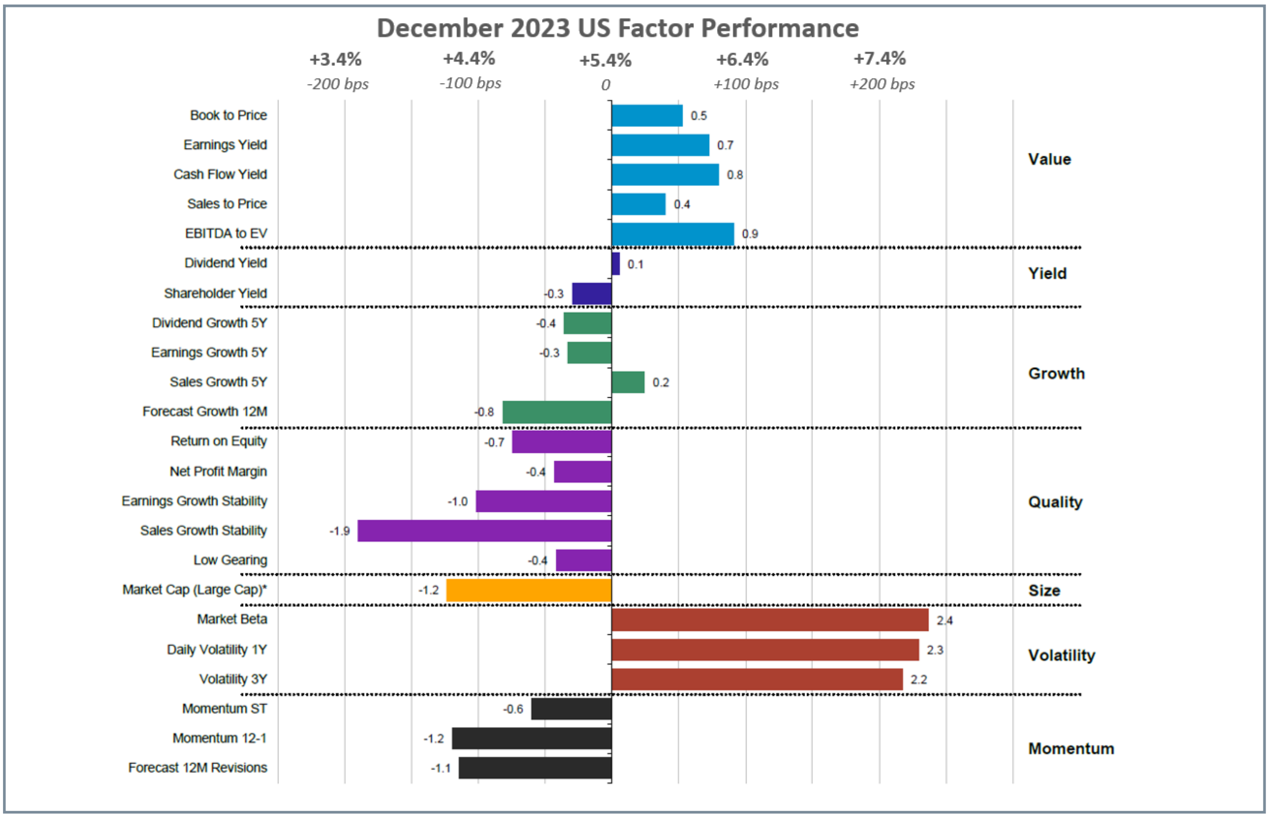


Figure 1: December 2023 US Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

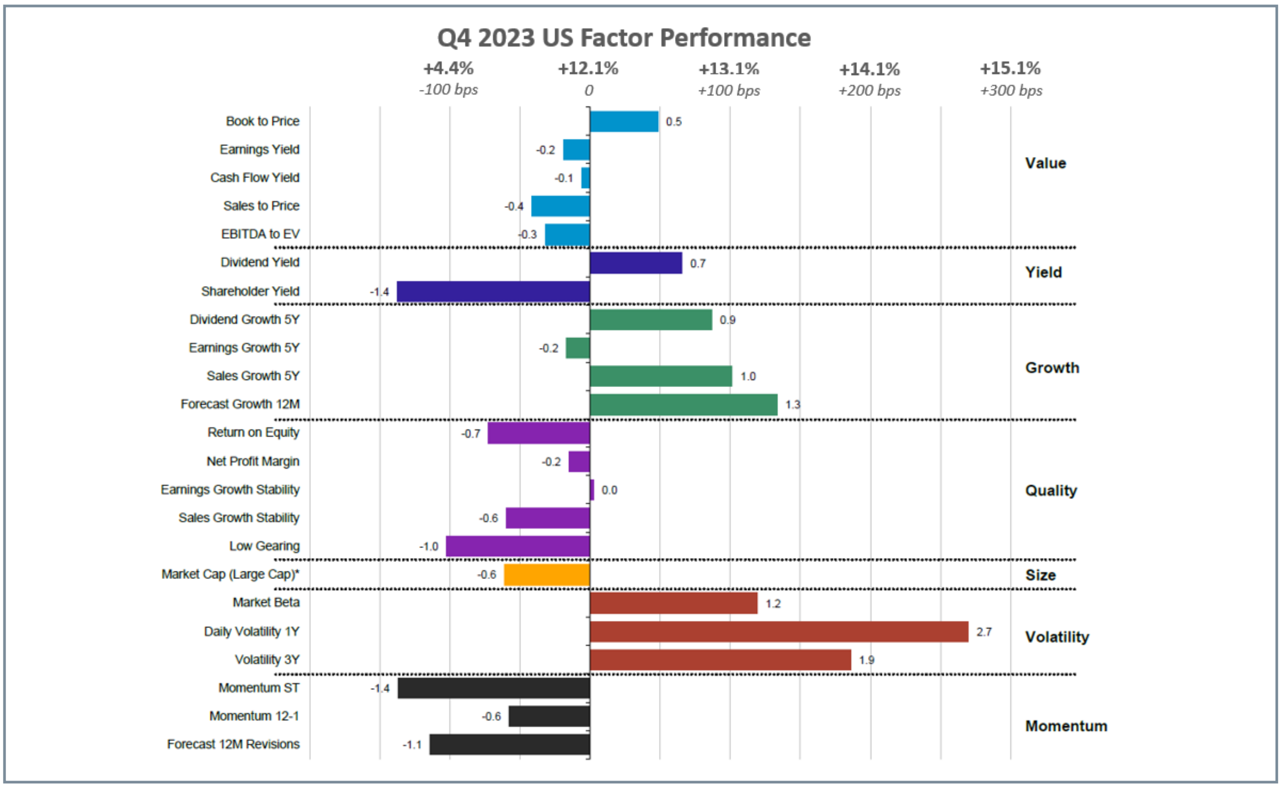


Figure 2: Q4 2023 US Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

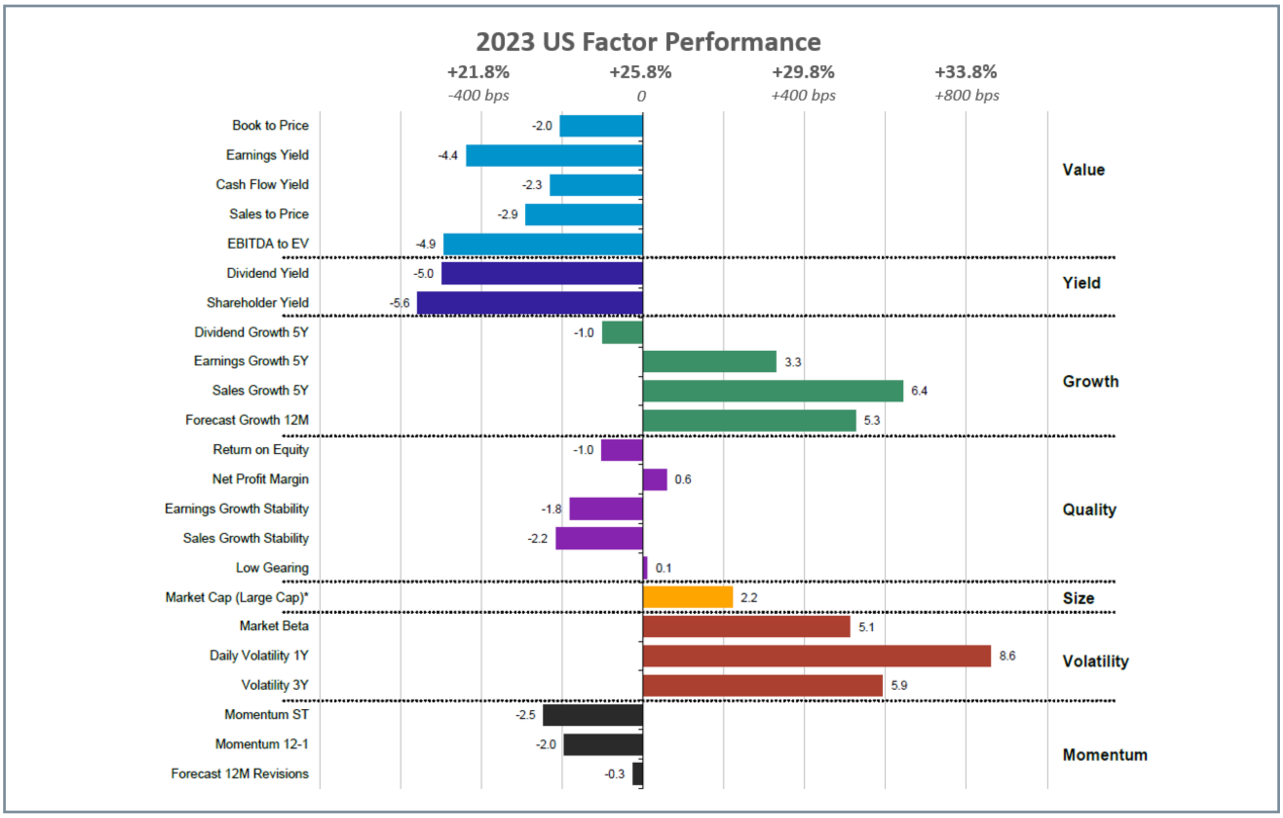


Figure 3: Q4 2023 US Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

European Equities

In December, Europe's market performance closely mirrored that of the US, yet it underperformed by 100bps in Q4 and, more significantly, by 600bps for the entire year. This can be compared with central bank morale when they announced their optimistic views on future rate cuts on "Super Thursday" earlier this month. The ECB was notably less dovish about market outlooks than the Federal Reserve was.

A noticeable contrast with the US emerges when examining the factor performance trend in Europe, the UK, and Emerging Markets. Value and Yield maintained dominance throughout 2023, aligning with patterns observed in 2022. The spotlight on shareholder yield performance indicates investors' focus on companies with robust balance sheets actively reducing debt, repurchasing stock, and offering competitive dividend yields.

The factor trend lines up with economic indicators, as the European Union's inflation rate has consistently decreased each month in 2023, starting at 10% in January and closing off the year at just 3.1%, resulting in an average inflation rate of 2.43% between 2000-2023. Core inflation, though more intricate, has also receded during Q3 and Q4, declining from 6.19% in June to 4.12% in November.

While the German Manufacturing PMI remains in contractionary territory, its upward trend suggests that the worst of that sector's downturn is likely behind us. In contrast to the US, consumer spending in Germany has stagnated through 2023. However, there are positive signs as building permits, after a year-long slump, have started to pick up, although they remain below pre-pandemic averages.

Additionally, European energy prices remained stable and even decreased from just above €100/MWh to approximately €95/MWh by November. This stability reflects a more controlled and predictable environment going into 2024, in contrast to the chaos from 2022.

Notable outperformers include many German companies like tech firm Siemens (+30% in Q4), shipping company Hapag Lloyd (+19% in December), and chemical producer BASF SE (+15% in December and +18% in Q4).

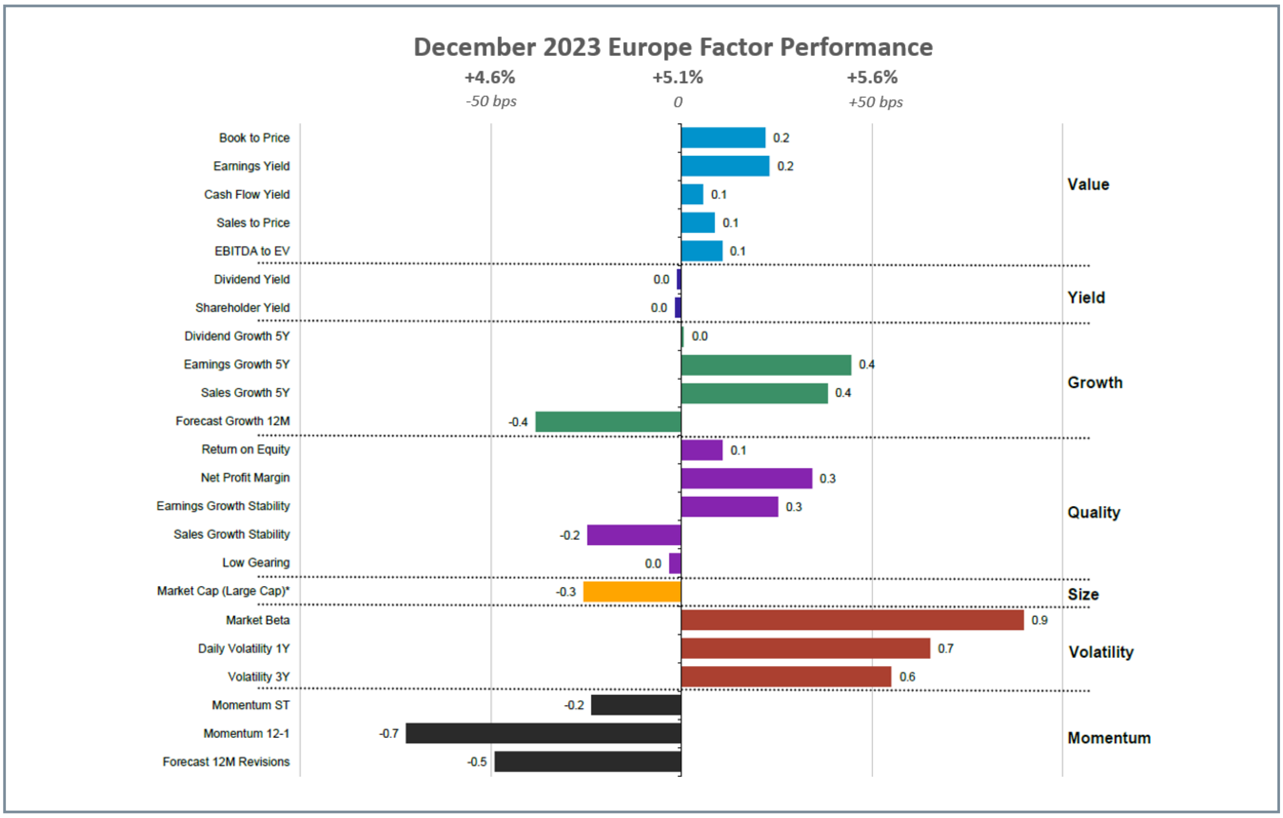


Figure 4: December 2023 Europe Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

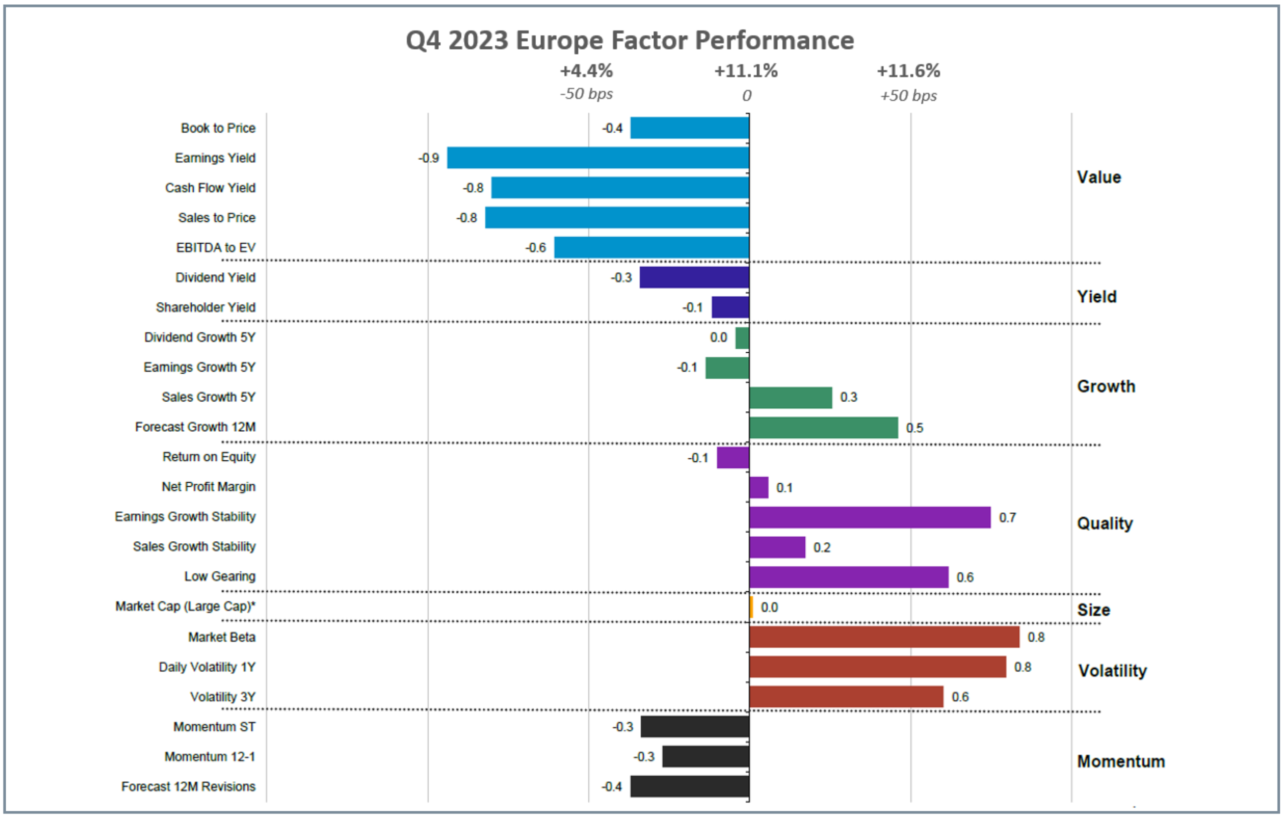


Figure 5: Q4 2023 Europe Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

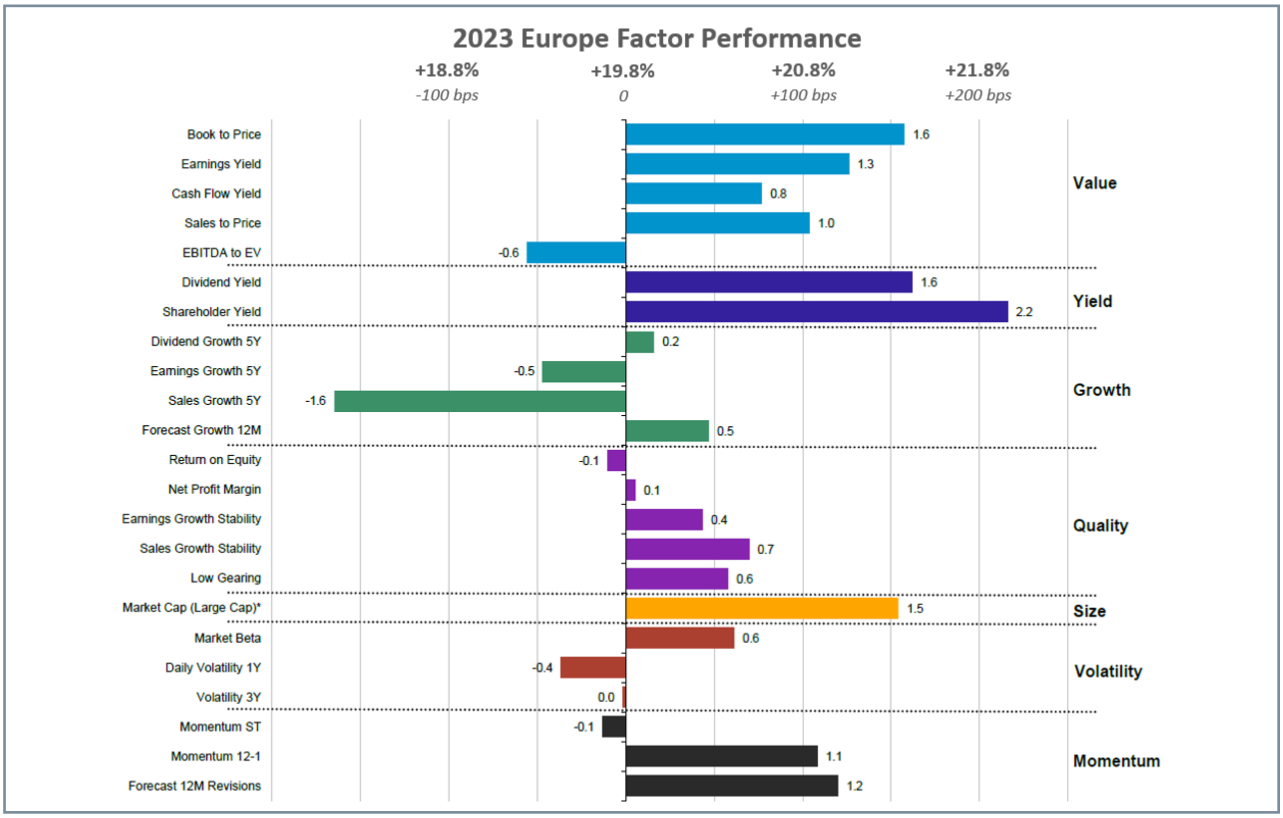


Figure 6: 2023 Europe Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

UK Equities

The UK has infamously lagged behind its developed counterparts, a trend that continued in 2023, with the region underperforming the US by over 18% and Europe by more than 12%. Like its European neighbors, the UK maintained a defensive positioning since 2022, although with a similar factor trend as Europe, notably emphasized factor premiums.

In contrast to Europe's factor agnostic Q4, the UK exhibited more pronounced factor premiums, reaching up to 300bps compared with Europe's 50bps. The spotlight on the low-gearing subfactor, present throughout the year in many regions, became particularly prominent in December and Q4, as few other factors offered substantial premiums in the UK market. On an annual basis, Growth, proxied by sales growth, and Value, proxied by sales to price, emerged as perfect substitutes, with the former underperforming by 300bps while the latter outperformed by 300bps.

Like the European Central Bank, the Bank of England (BOE) was less dovish than the Federal Reserve regarding its potential rate cuts next year. Despite this, the BOE's outlook remained positive. The comments mirror the situation in terms of inflation since the UK economy is still running hotter than the US or Europe, boasting an inflation rate of 4.1% and a core rate of 5.1% as of November. Inflation data suggests that the UK is still navigating the "soft landing," albeit slightly lagging behind its developed counterparts.

Value equities from a sales-to-price perspective that helped Value outperform in the region include Rolls Royce (+41% in Q4); Airspace company BAE Systems (+18% in Q4); energy firm SSE PLC (+20% in Q4) and grocery retailer Tesco (+17% in Q4).

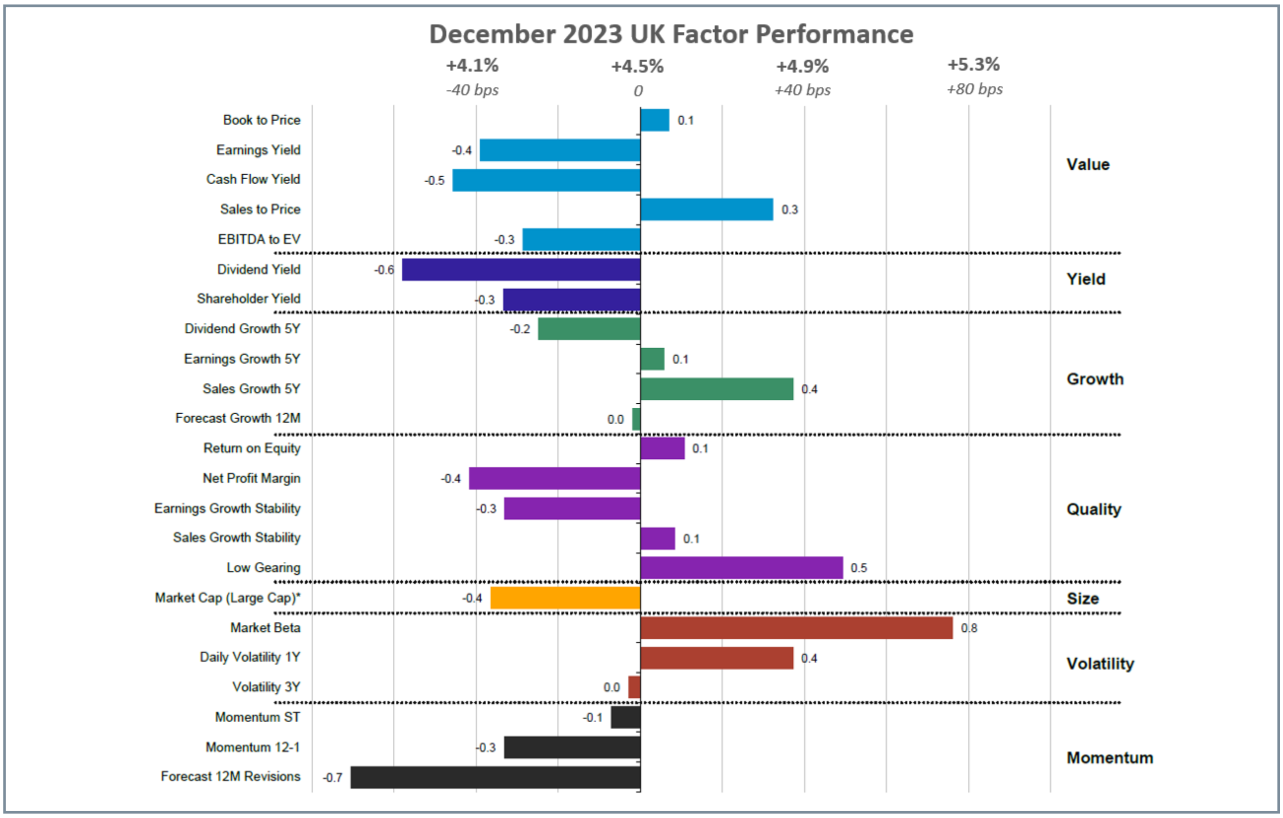


Figure 7: December 2023 UK Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

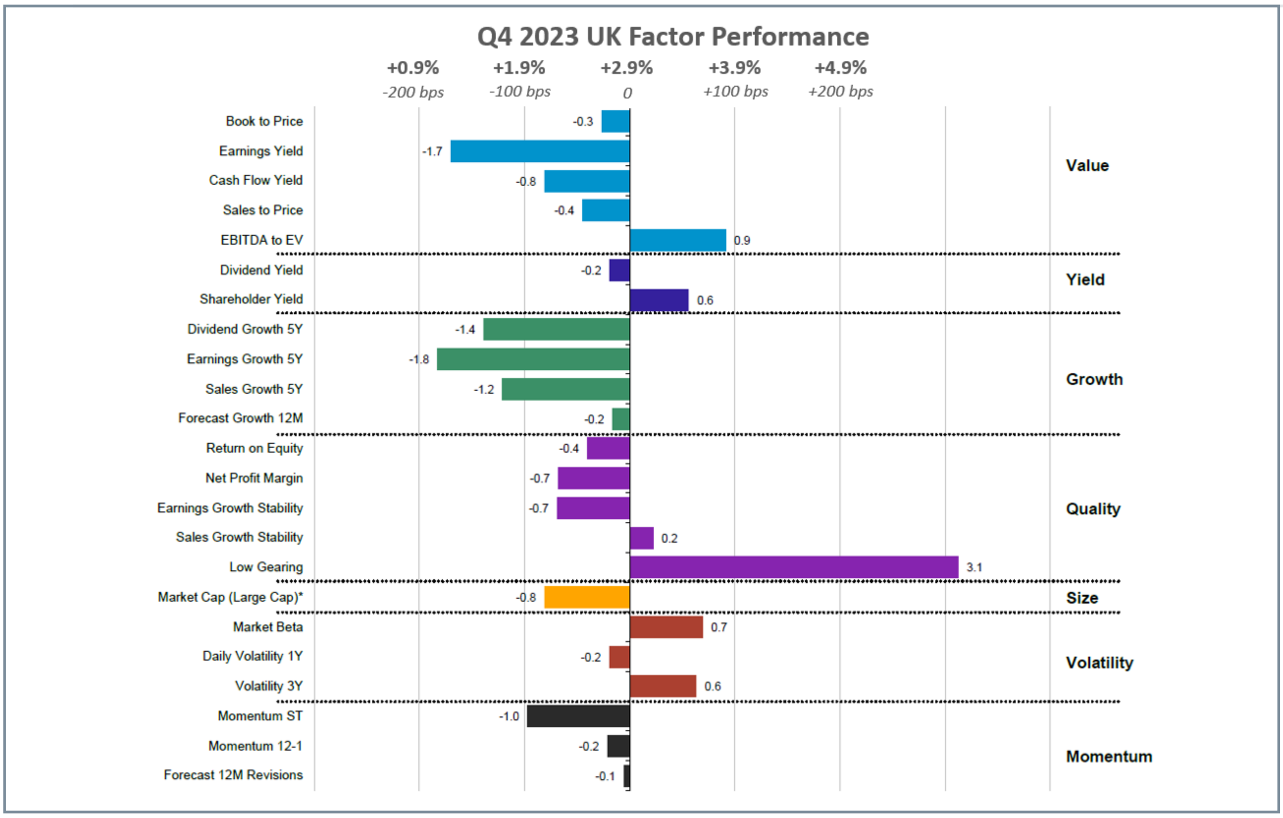


Figure 8: Q4 2023 UK Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

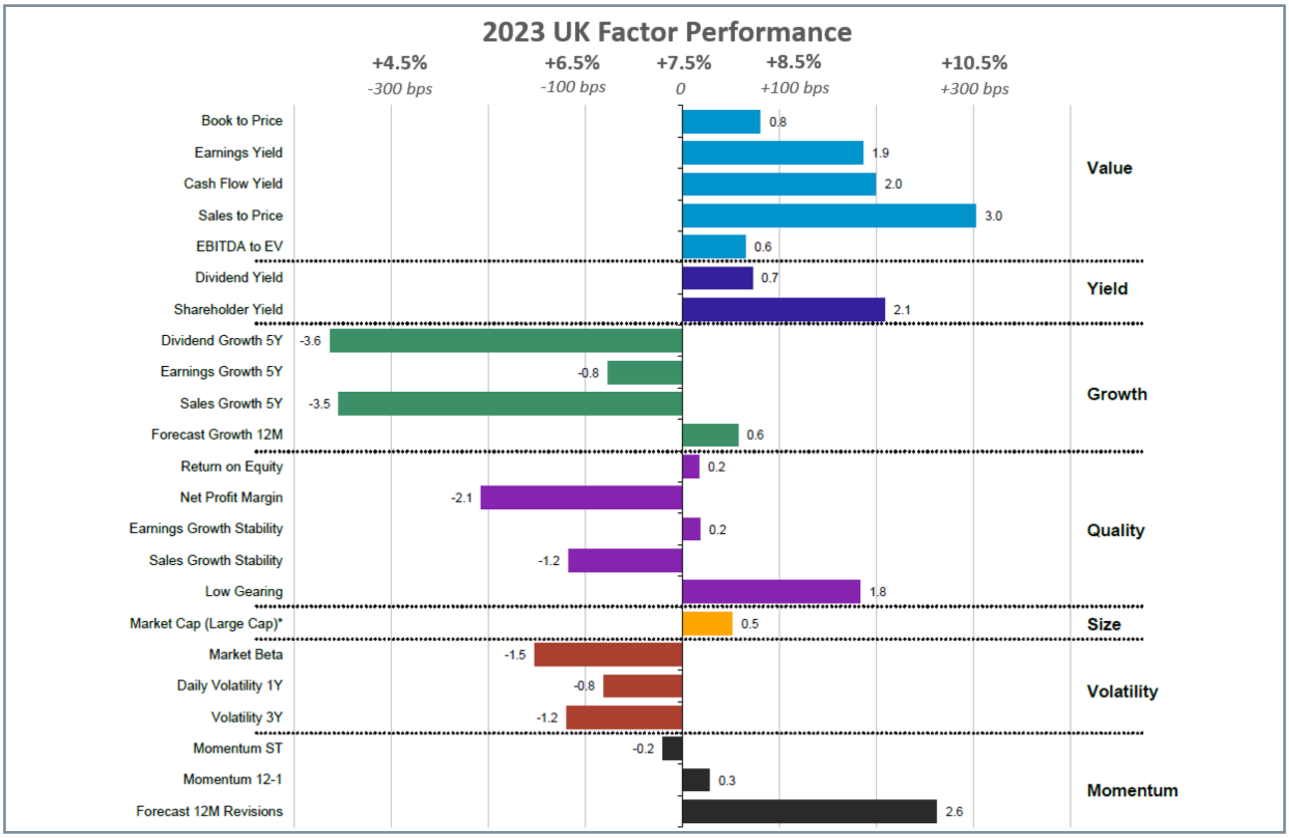


Figure 9: 2023 UK Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

Emerging Markets Equities

In Emerging Markets, the triumvirate of Value, Yield, and dividend growth, aka the "three musketeers" dominated throughout December, Q4, and 2023 mirroring patterns from past years. A notable departure from this consistent trend was the emergence of Quality, particularly stocks exhibiting steady earnings growth and sales growth.

Consistent with the region's trend over the last few years, the factor premium tends to be positive. It's only when viewed annually that a significant factor discount becomes apparent, which in 2023 takes the form of Growth and Volatility, which underperformed by approximately 120-220bps.

Investors seem to be focused on smaller Value companies that also have robust dividend yields. Unlike Europe and the UK, investors in Emerging Markets are steering clear of shareholder yield, which includes net buybacks and debt paydown, placing a greater focus on companies capable of making consistent dividend payments. A notable development in the last quarter has been an increase in stocks with high sales growth. This renewed focus on Growth comes with a key caveat - an emphasis on the stability of the said sales growth, unlike what was observed in the US during the onset of the Covid pandemic.

From a book to price perspective, companies like Chinese tech manufacturer Xiaomi Corp (+30% in Q4);

Indian defense company Hindustan Aeronautics (+45% in Q4); Taiwanese semi-conductor manufacturer MediaTek Inc (+45% in Q4) and Indian Oil Corporation (+49% in Q4) led the outperformance observed in Emerging Markets Value equity.

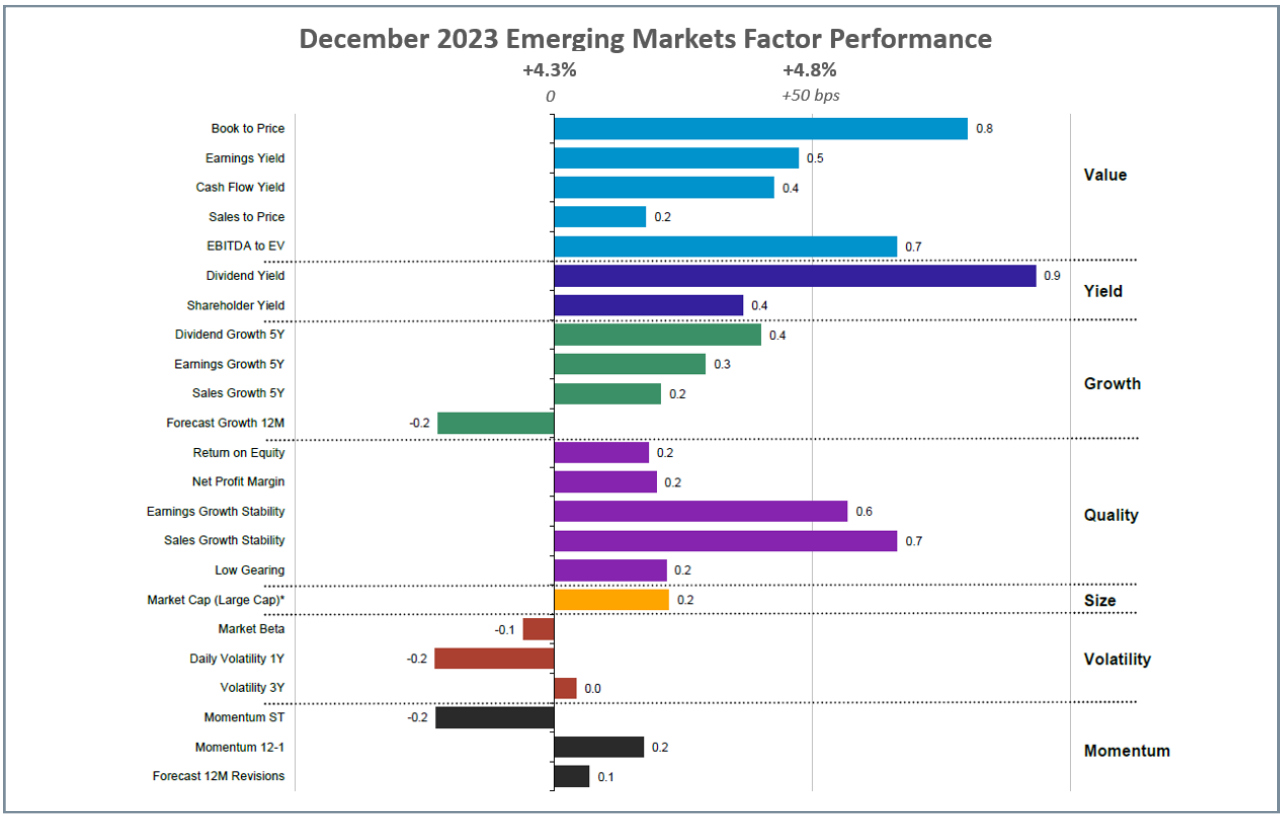


Figure 10: December 2023 Emerging Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

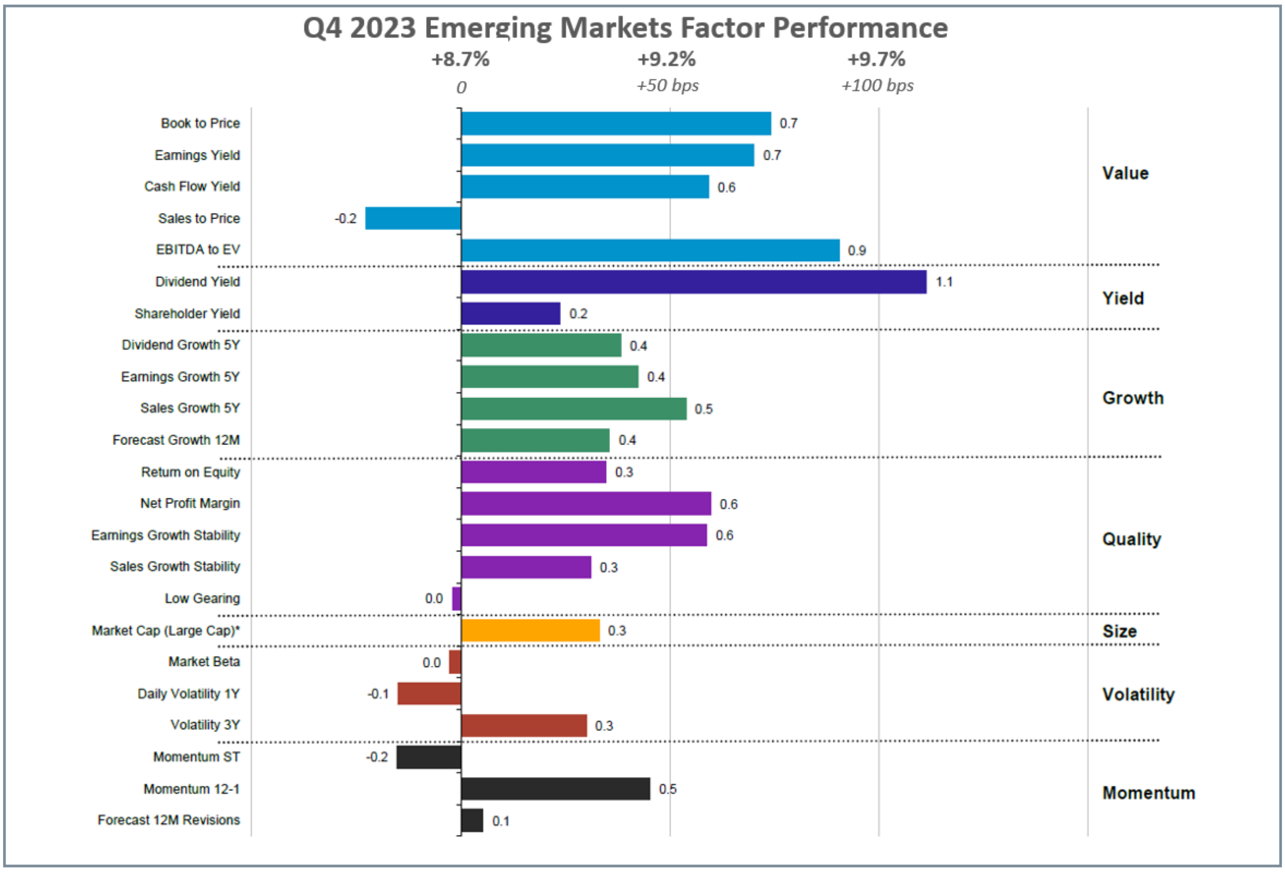


Figure 11: Q4 2023 Emerging Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

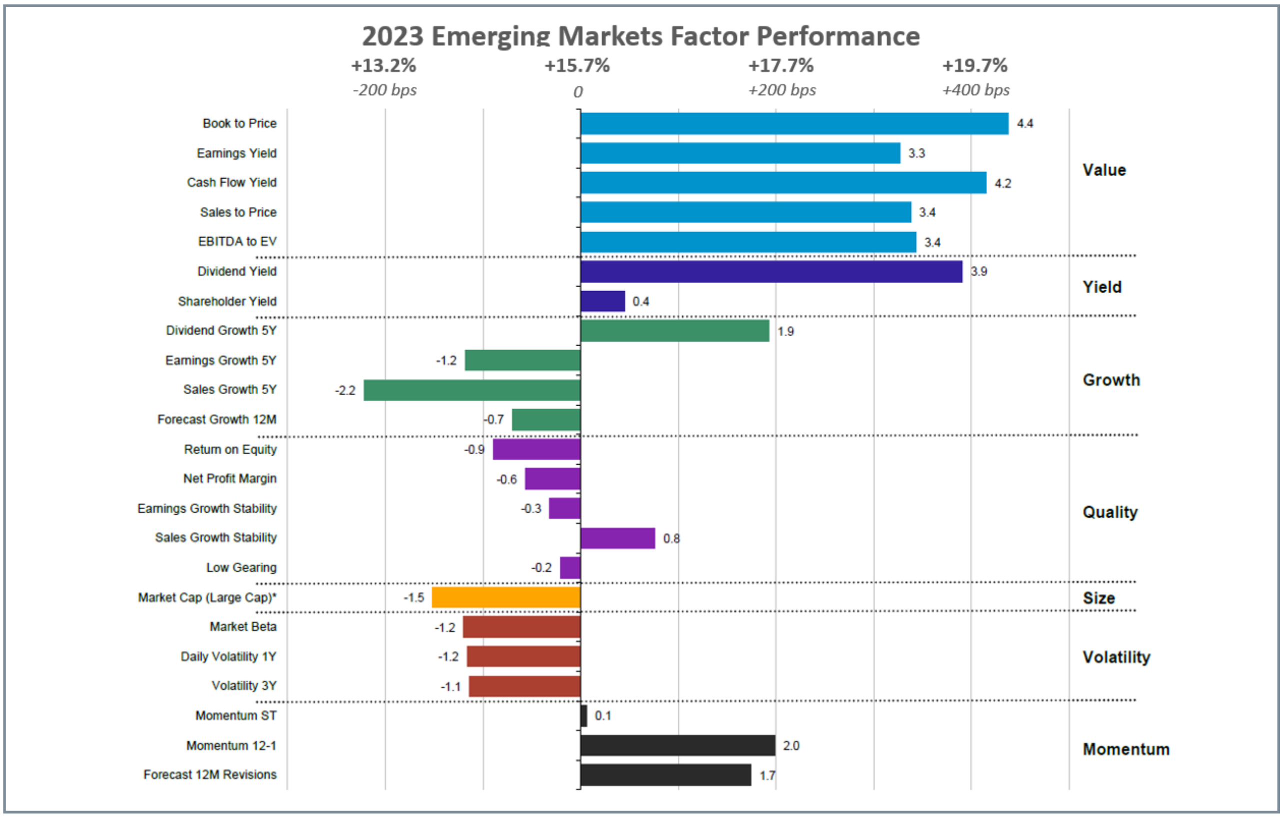


Figure 12: 2023 Emerging Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company.

Canadian Equities

In Q4 and December, the Canadian factor performance trend reveals a nuanced picture. Value slightly outperforms when looking at the book to price and sales to price ratios, and only dividend yield outperforms within the Yield category. Most growth metrics fall short, except for the noteworthy performance of the classic Growth subfactor, sales growth over five years, which is the second most aggressive subfactor of the primary four growth metrics, behind forecast earnings growth. This outperformance aligns with the focus on Volatility seen during most of the year.

Despite Value's marginal outperformance in December, this does not translate when examined from a quarterly or annual perspective. Quarterly data supports the growth picture, with the forecast growth subfactor outperforming by 210 bps. However, even with this robust pattern, the Canadian market underperformed even the UK in 2023, which lagged the US, Europe, and Emerging Markets.

Beyond Volatility, despite a general underperformance by the remaining factors, a distinctive trend emerges from the annual data. Companies with impressive book to price ratios and strong sales growth over five years have outperformed the market. Notably, these two subfactors are the only in their category to do so. Similarly to the UK, Canadians also preferred companies with low levels of debt relative to their equity.

The companies that led Canadian Volatility to outperform include banks like Bank of Montreal (+21% in

December); Canadian Imperial Bank of Commerce (+26% in Q4, +18% in December); Brookfield Corp (+28% in Q4); Shopify Inc. (+42% in Q4).

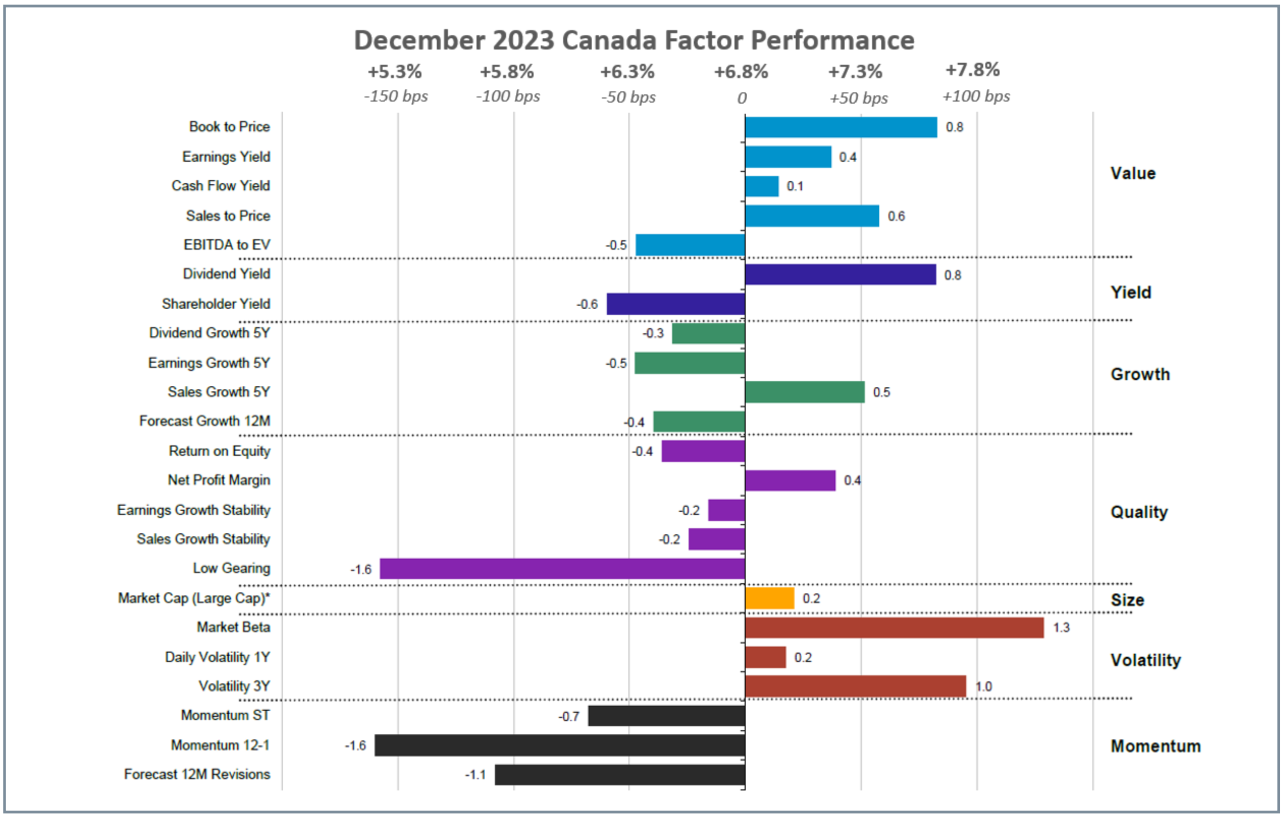


Figure 13: December 2023 Canada Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

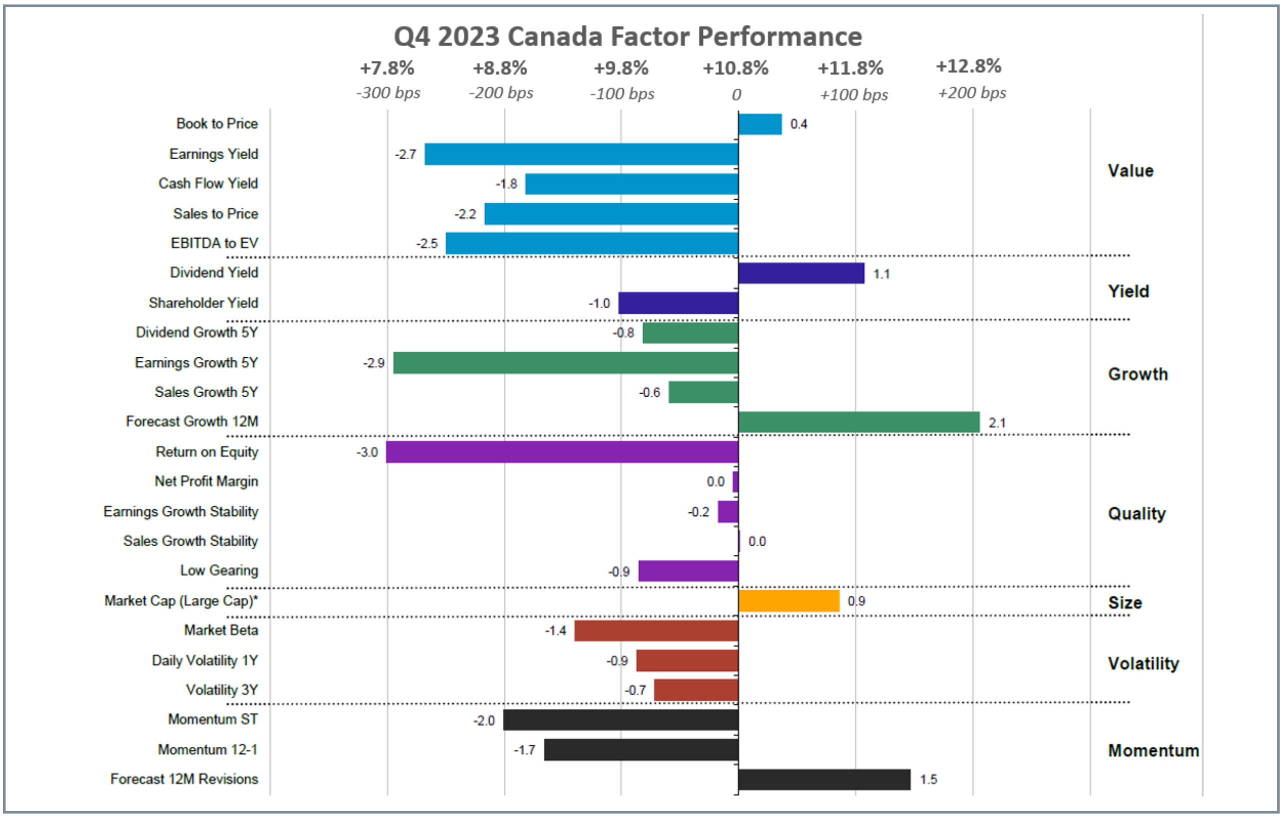


Figure 14: Q4 2023 Canada Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

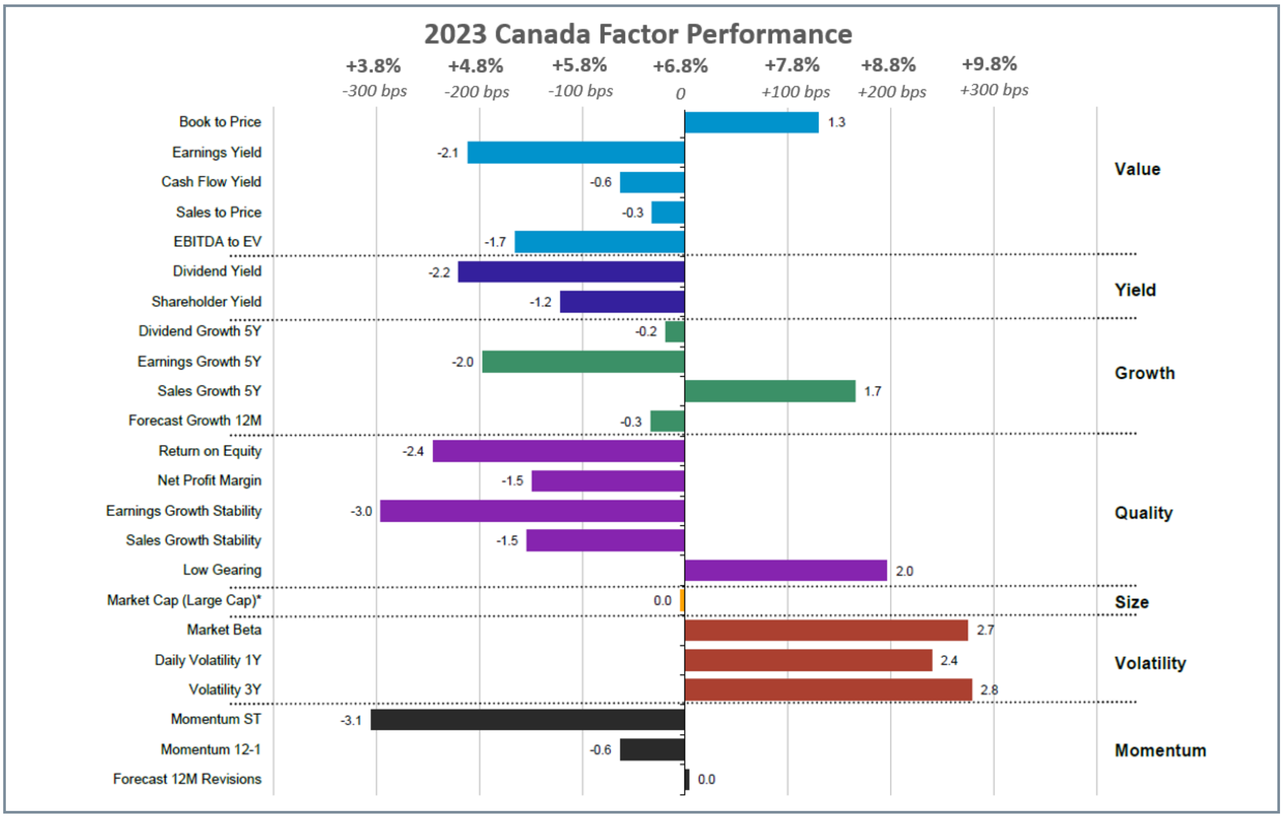


Figure 15: 2023 Canada Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company.

Appendix: How to read the charts

Each factor's performance is based on the relative performance of its top 50% of stocks by market cap, compared to the overall market. The Size factor uses the top 70% of stocks, as the only exception.

For example, for the book-to-price factor, we determine the period's performance of the basket of stocks with the highest book-to-price values, relative to the total market. Each factor is analyzed independently, market and fundamental data are adjusted to enable sector-average (within each country) relative data to be used, and the performance measurement isolates the factor's contribution to return.

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Contact Us

confluence.com
info@confluence.com
+44 (0)20 8410 9876
@Confluence_News
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