

Confluence Style Analytics

January 2024

Factor Performance Analysis

Quality, Momentum, and Size equities kick off 2024

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Market Background

January continued the momentum observed in December, leading to new all-time highs in equity markets across the world, but especially in the United States. Although there has been no official news from the Fed with details regarding potential rate cuts, the market seems to have priced this in. Furthermore, equities have never been narrower than today, as a substantial portion of the returns have been led by the Magnificent 7 stocks in the US: the equally weighted S&P 500 index returned only 1.2% while the market cap weighted return was above 3% in January.

As a result of this persistence, the factor trend has stayed relatively consistent from December to January, captured by the emphasis on Momentum this month. The largest change observed was the reversal from Volatility to Quality stocks globally. 2023 was an exciting year for volatile equities, but as markets moved into the final month of the year and now the beginning of 2024, investors are rewarding net profit margins, gross profit-to-asset ratios, and stability within both earnings and sales growth over Volatility.

Europe's factor premium and discount were marginal this month. Still, notably, Value underperformed for the first time in months there and in the UK, both of which had favored Value equity consistently for the last couple of years. Although Value underperformed, high-yield stocks held their ground throughout the month in these regions. Growth and specific Quality metrics were favored in the US, but the Quality outperformance was more prominent in UK, Canada, and Emerging Markets.

Crude oil peaked at \$78/barrel in January, and although it decreased to \$71/barrel by month's end, the price has climbed back to the \$75/barrel mark as of the first week of February.

Gold surged in Q4 alongside most equities and risk-on assets, rising from the \$1850-\$1950/t.oz range to breaking \$2,000/t.oz and stabilizing above that price point throughout January. After increasing by 40% in Q4, alternative risk-on assets like Bitcoin stabilized above the \$40,000/BTC mark, opening and closing the month at \$42,000/BTC.

Factor Summary

- ▶ US Equities: Growth and Momentum outperformed.
- ▶ European Equities: Momentum outperformed.
- ▶ UK Equities: Yield, Quality, and Momentum outperformed.
- ▶ Emerging Markets Equities: Value, Quality, and Momentum outperformed.
- ▶ Canadian Equities: Quality and Momentum outperformed.



US Equities

After a strong year in 2023, Growth equity in the US also started off this year strongly. Stocks with a high forecast growth over 12 months outperformed the market by over 200bps, a significant monthly factor premium. Typically, this factor performs in line with Volatility subfactors such as market beta and daily volatility over one year, but this was not the case as those subfactors slightly underperformed the market.

Quality subfactors, particularly sales growth stability and earnings growth stability, outperformed by bps 40-100 bps as well, and large caps outperformed the market again by 90bps, indicating how narrow the US equity market is with the interest in AI and the tech sector. On the other hand, Value and Yield stocks underperformed yet again, lagging the market by 80-140bps. Alongside forecast growth, momentum drove the US market in January as we saw repeating trends to the last quarter, and even six months.

Apart from the reversal in volatility, all other factors closely reflect the 6-month trend, thereby contributing to the robust monthly momentum observed over the past year. This momentum, captured by the 12-1 Momentum indicator, highlights the consistency of performance trends. From a macroeconomic perspective, the persistence in Growth's outperformance could be linked to positive economic data, as consumer spending, manufacturing, non-farm payrolls, and consumer confidence all hit a yearlong high in January.

The Magnificent 7 drove the US Growth surge in January, led by Nvidia (+24%); and Meta (+10%). Outside of that, Eli Lilly (+10%), Netflix (+15%), AMD (+13%), and Super Micro Computer (+86%) all had strong forecast earnings growth over the next 12 months.

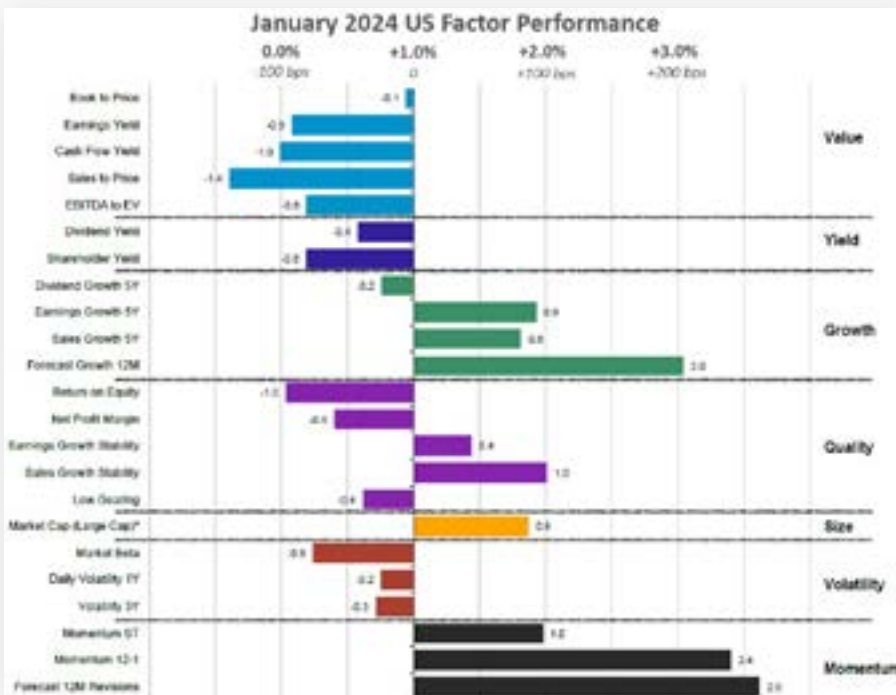


Figure 1: January 2024 US Factor Performance (sector adjusted)

Source: Investment Metrics, a Confluence company

European Equities

In Europe, Value stocks had been outperforming for months, but that came to an end in 2024 as all Value subfactors underperformed the market by 20–50 bps. Although Value was down, Yield and dividend growth over five years showed promise and outperformed a negative market by 30bps.

Similarly to the US, both sales growth stability, monthly momentum over the last year, and forecast growth over 12 months outperformed, but to a much smaller extent, as European equities tend to have smaller factor premiums than their American counterparts. Likewise, Volatility also underperformed after a strong trend in 2023.

Europe had overtaken the US in the disinflation race last year, a trend which may have persisted into 2024 as the Euro Zone’s inflation rate slightly decreased to 2.8%. While the US hasn’t posted CPI data for January as of this report, their December rate of 3.4% would need to decrease significantly to beat Europe’s to the 2% target. Likewise, after hitting a high of 2.96% in October, the German 10-year Bund hit a low of 1.89% on December 27th before closing January out at 2.31%.

Key drivers of high-Quality European stocks with stable sales growth this month include German weapons manufacturer Heckler & Koch (+15%); French lottery organizer Francaise des Jeux (+12%), Italian bank Banca Popolare Di Sondrio (+18%) and Siemens Energy (+14%).

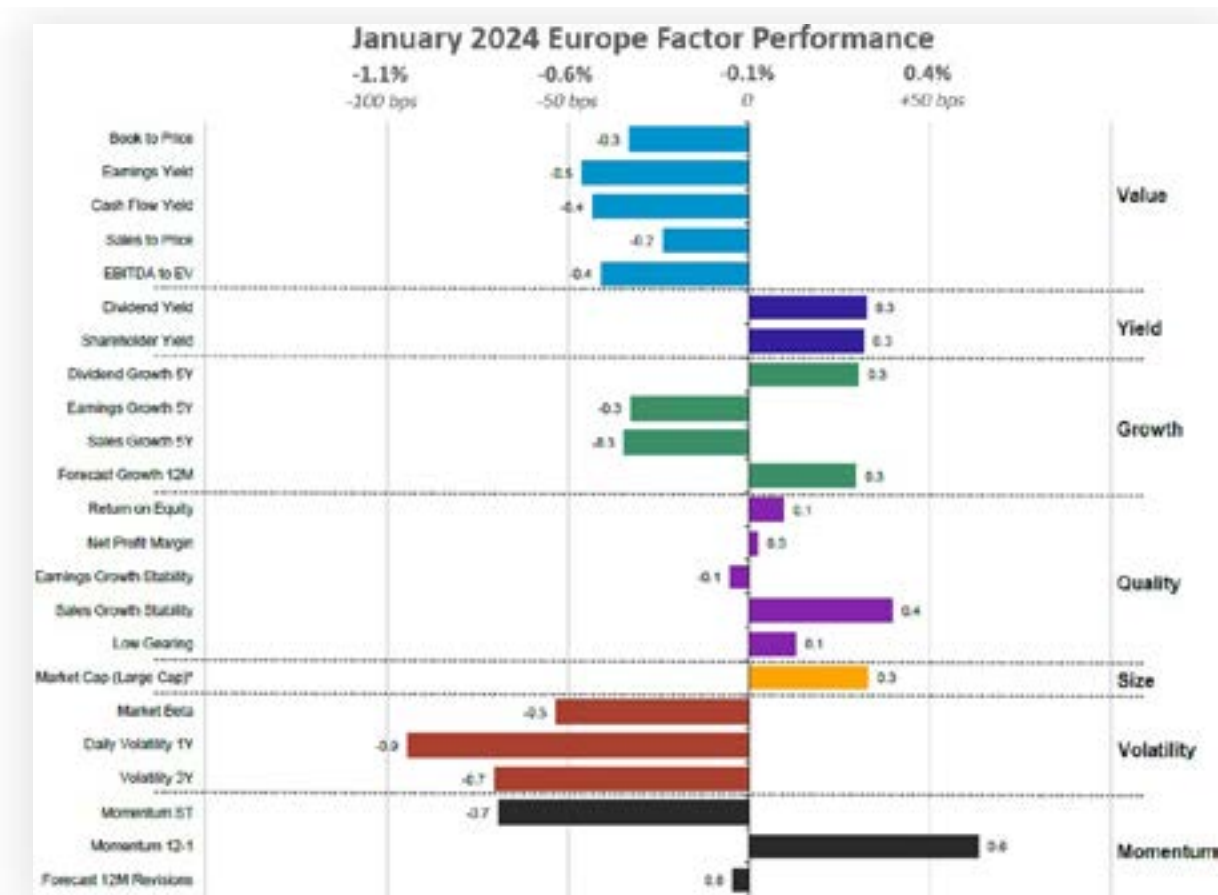


Figure 2: January 2024 Europe Factor Performance (country and sector adjusted)

Source: Investment Metrics, a Confluence company

UK Equities

Similar to its American and European counterparts, the United Kingdom observed Value stocks declining in January, underperforming the market by approximately 50 bps. Again, Yield also outperformed by a notable margin, about 80bps. Forecast growth over 12 months outperformed, and within Quality, stocks with a strong net profit margin beat the market by 70bps.

The UK market’s performance shadowed that of other Developed Markets again this month, decreasing by 1.2%, underperforming European equities by roughly 1% and US equities by 2%.

Examining economic indicators, the unemployment rate decreased slightly from 4.0% to 3.9%, the S&P Manufacturing PMI and the S&P Construction PMI both slowed their contraction but continued shrinking for the fifth consecutive month. Retail sales also fell by 3.2% in December, but this was partly due to a higher revised figure for November, indicating shoppers purchased gifts earlier in the 2023 holiday season. However, when examining the full year, retail sales have hit their lowest point since 2018, declining by 2.8% for the year.

British stocks with a strong net profit margin that outperformed this month include pharmaceutical company Indivior (+16%); videogame label Team17 Group (+45%); financial software provider Alfa (+22%), and biopharma company GSK PLC (+8%), the latter of which has returned over 41% in the past 3 months.

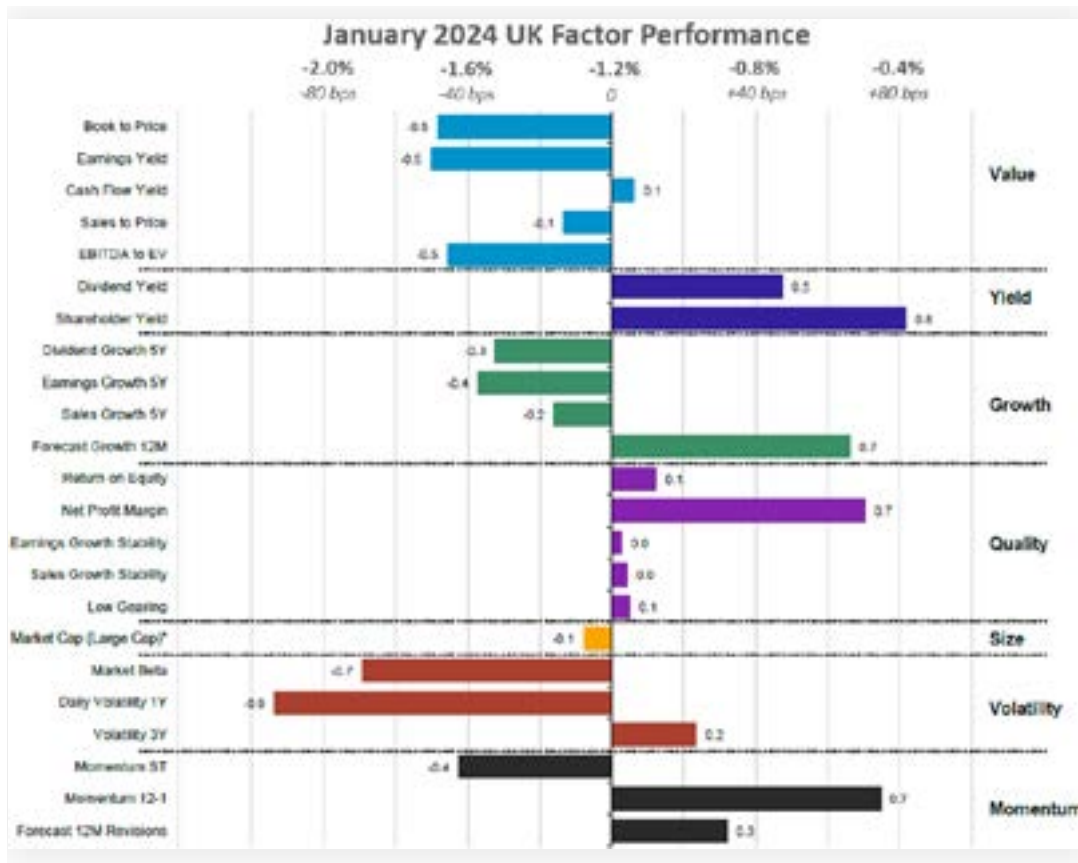


Figure 3: January 2024 UK Factor Performance (sector adjusted)

Source: Investment Metrics, a Confluence company

Emerging Markets Equities

The factor trend in Emerging Markets remained consistent with the trends observed over the last few months, where Value stocks continue to provide an active return against the market. In January, we observed a conservative trend, favoring stocks with strong shareholder yields, net profit margins, and stability in the form of both earnings and sales growth stability. These trends were captured in the momentum 12-1 subfactor, largely driven by strong equity returns in specific Indian sectors this month. Growth and Volatility stocks underperformed the market, consistent with the trends observed in the last two years.

Emerging Markets equities that outperformed consistently on a monthly basis over the last year, captured by the Momentum 12-1 subfactor, include Indian energy company Oil & Natural Gas Corporation (+23% in January, +40% in the last three months); another Indian energy firm Reliance Industries (+10% in January, +25% in the last three months); Indian automobile manufacturer Tata Motors (+13% in January, +41% in the last three months); Indian tech firm HCL Technologies (+8% in January, +24% in the last three months) and Indian utilities company NTPC Limited (+2% in January, +36% in the last three months)

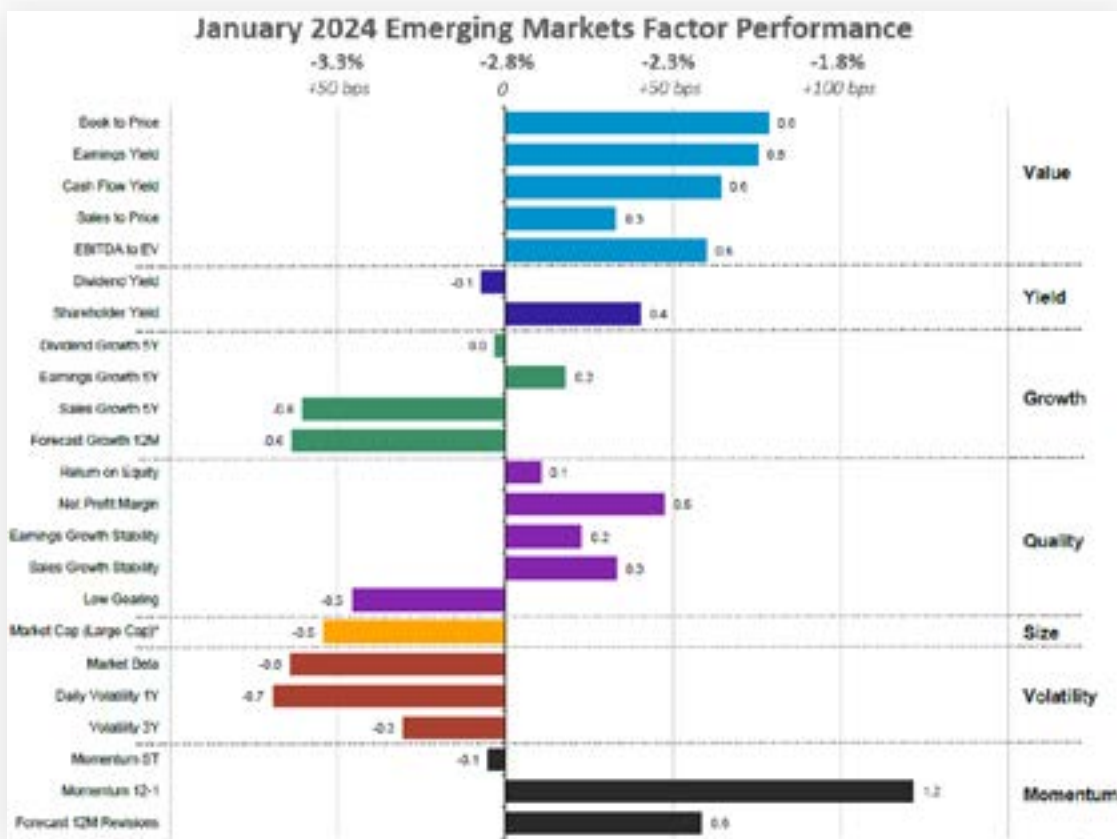


Figure 4: January 2024 Emerging Factor Performance (country and sector adjusted)

Source: Investment Metrics, a Confluence company

Canadian Equities

The factor performance trend was more mixed in Canada, with neither value nor growth delivering significant premiums. In Value, stocks with a high EBITDA-to-EV ratio outperformed, but stocks with strong Book-to-price ratios drowned out that active return. Likewise, within Growth, although companies with good earnings growth delivered a 30bps premium, stocks with strong sales growth and dividend growth underperformed overall.

A notable trend in Canada, like in other Developed Markets, was the outperformance of stocks with solid Quality fundamentals. The trend here was stronger in Canada, where all Quality subfactors outperformed, particularly stocks with a favorable return on equity, low debt/equity ratios, and, most profoundly, stable sales growth.

Stocks with a steady sales growth stability in the region that outperformed include companies like tech company Constellation Software (+11% in January, +38% in the last three months), energy firm Cameco Corp (+10% in January, +17% in the last three months); Fairfax Financials (+14% in January, +29% in the last three months); food and drug retailer George Weston Limited (+2% in January, +18% in the last three months) and materials company Ivanhoe Mines (+8% in January, +40% in the last three months).

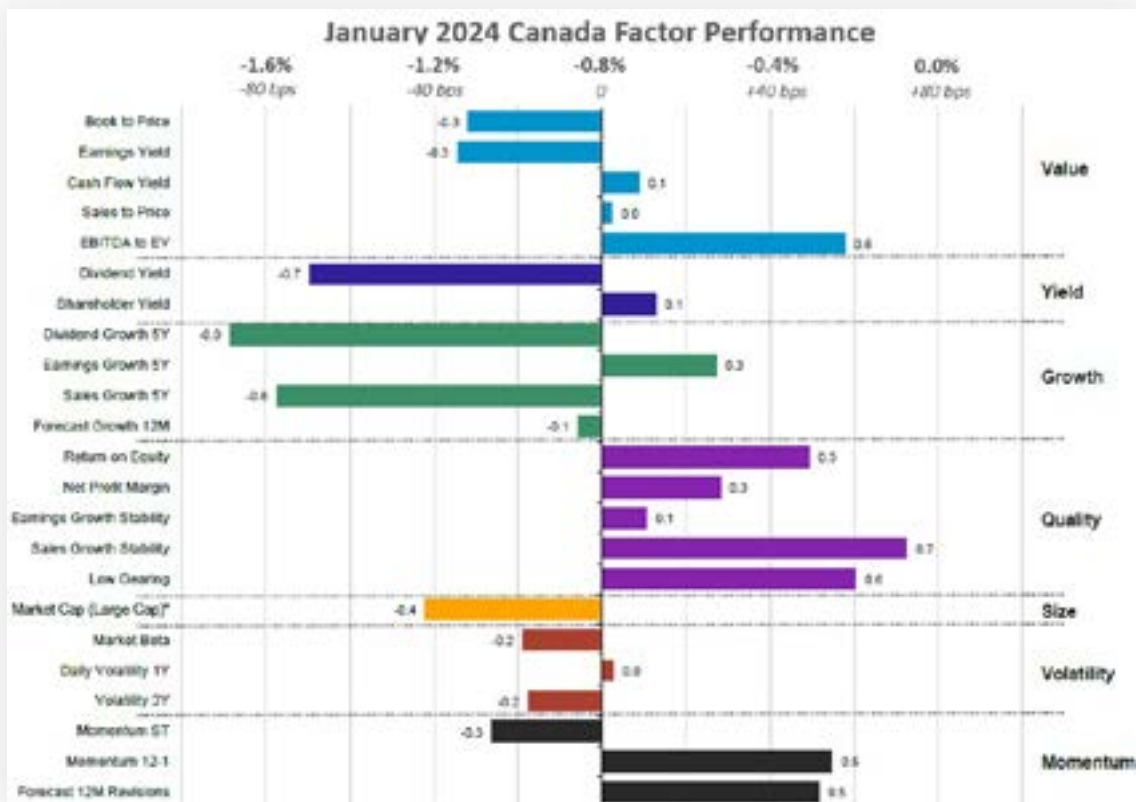


Figure 5: January 2024 Canada Factor Performance (sector adjusted)

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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