

Q1 2022 FACTOR PERFORMANCE ANALYSIS

The Return of the Quality, Growth and
Momentum Trio

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Market Background

Developed markets rallied as the initial volatility sparked by Russia's invasion of Ukraine subsided in most markets throughout March. US and Australian equities made significant gains with the S&P 500 and All Ordinaries up 3.57% and 6.36% respectively, while MSCI Europe was slightly down, -0.53%. Emerging Market equities extended their losses down -2.52%, while the Russell 2000 edged out higher on the month, up 1.08%.

Investors continue to focus on commodities and interest rates as the two send ripples throughout the global economy. Crude was up another 4.58% and natural gas spiked 21.53% to 5.65. Rates also spiked significantly with the US 10-Year up to 2.32 from 1.83 (26.78%), the 10-year GILT up to 1.69% (19.26%) and the 10-year Bund closed at 0.55, all post-COVID highs.

Factor summary

- US Equities: Return of the familiar Quality, Growth and Momentum trio with large cap
- Europe: Quality, Growth and Momentum outperformance
- Emerging Markets: Solid gains in Value and Yield with some elements of Momentum and Quality
- Australia: Shareholder yield, large caps and Momentum outperformed with limited losses elsewhere

US Equities

Despite a strong rebound with US equities up, investors took a more defensive posturing. Value factors suffered except for EBITDA to EV, while Yield was market neutral, likely owed to its defensive qualities. Growth factors dominated, with both historical earnings and sales growth outperforming significantly. Notably, historical measures of growth tend to outperform forecasted measures of growth in down markets – in this case it may relate to risk-off activity. This activity is highlighted by the signal in Quality, where four out of the five factors also outperformed, and by the underperformance of risky stocks, as measured by market beta in particular. Companies like Walt Disney Co., and AMD were some of the riskier names dragging the high beta portfolio lower. Lastly, large caps and Momentum on a longer-term basis, both 12-1 and earnings revisions dominated similarly to growth. The top contributors to Momentum this month included Tesla, Apple, and NVIDIA.

The combination of Growth, Quality, Momentum (and large cap) is a familiar factor pattern. We saw it commonly throughout 2017 and 2018 with some small periods of outperformance since. This is a distinct pattern from what we saw during the initial COVID recovery. High Momentum, and high Growth both significantly outperformed, but with a risk-on approach, with underperformance in Quality and outperformance in high Volatility.

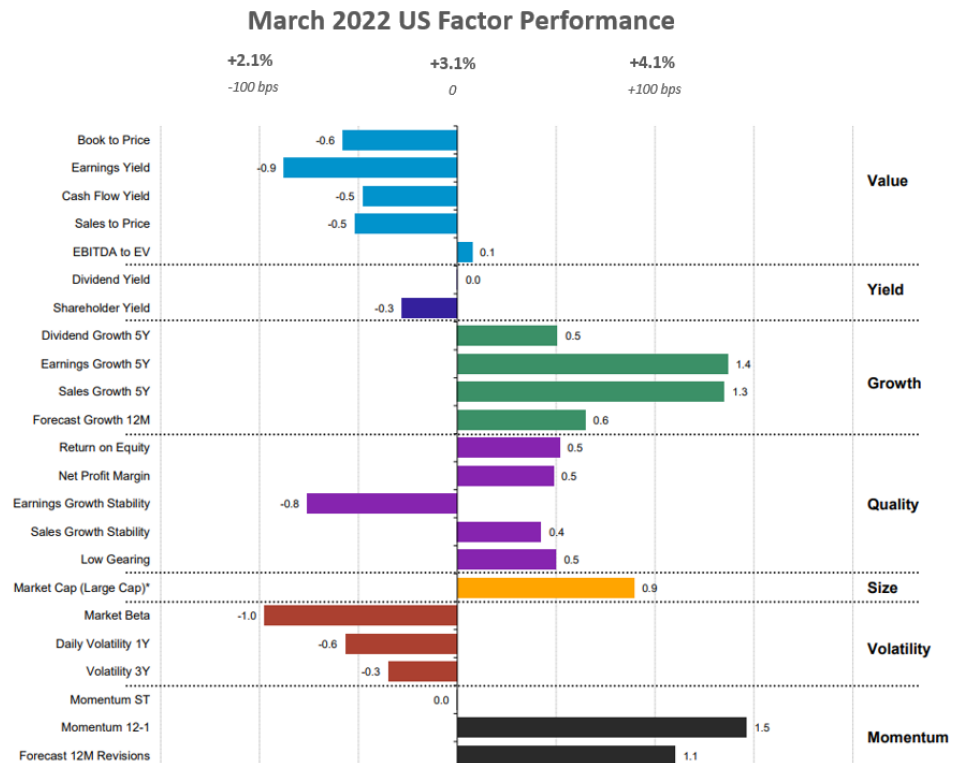


Figure 1: March 2022 US Factor Performance (sector adjusted). Source: Investment Metrics, a Confluence company

Looking at the last quarter, we still see Value dominance driven by its performance in January. More obvious names like Exxon Mobil and Lockheed Martin drove performance higher, but others like Caterpillar Inc. and Deere & Company were also major boosts. We still see some evidence of defensiveness with return on equity, sales growth stability and large caps, while high Volatility lagged.

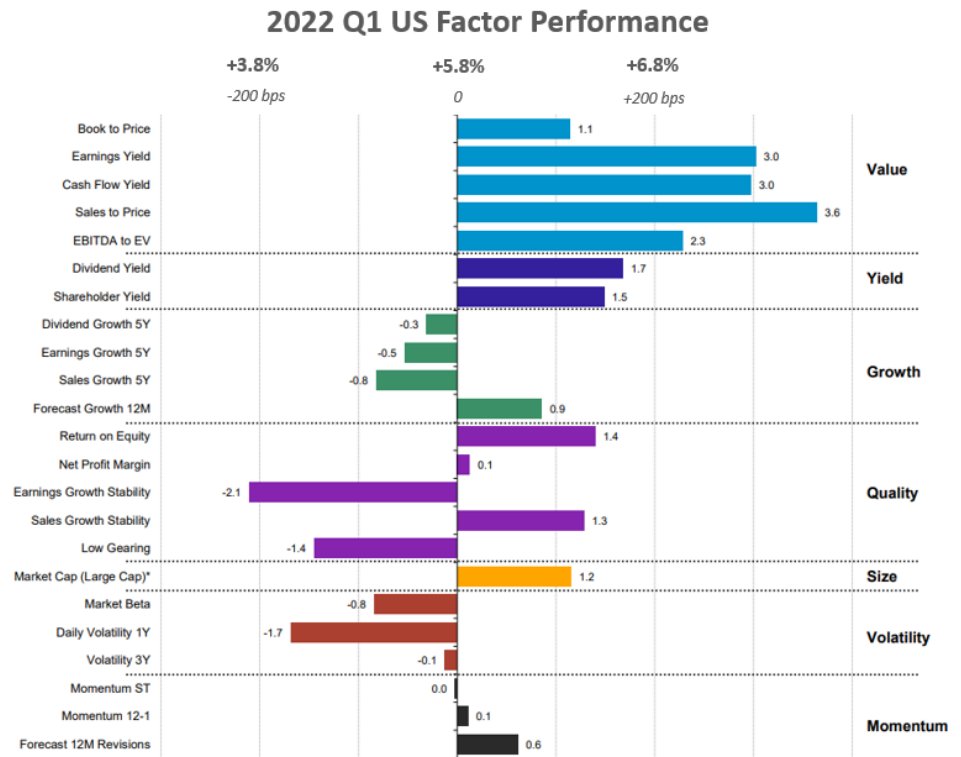


Figure 2: Q1 2022 US Factor Performance (sector adjusted). Source: Investment Metrics, a Confluence company

European Equities

Europe gave us largely the same signals we saw in the US with a lower magnitude across most factors. The same Quality, Growth Momentum picture saw success more recently in 2019 and 2020, but without the underperformance of risky stocks. Again, we see historical growth measures beating forecasted measures, while the losses in Value eclipsed the gains in Growth. Stocks like Kering, Barclays and BMW dragged Value lower. Just like the US, investors focused on profitability-based Quality metrics combined with low debt. The risk-off posturing is also seen in the significant losses among highly volatile stocks while all measures of Momentum outperformed.

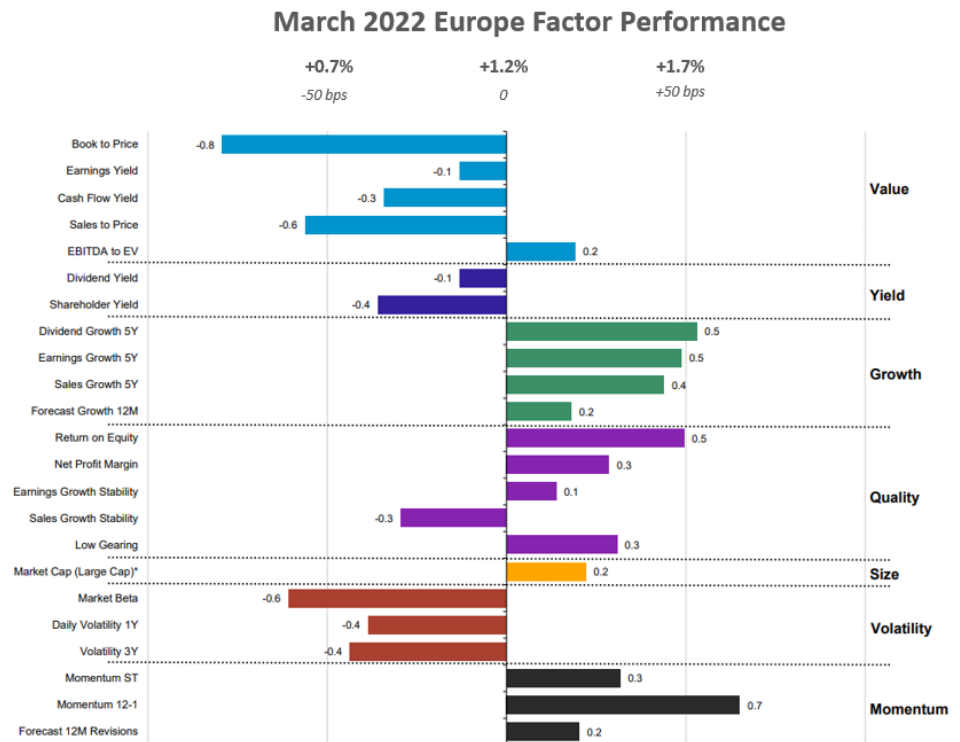


Figure 3: March 2022 European Factor Performance (country and sector adjusted). Source: Investment Metrics, a Confluence company

Despite this recent month's pullback, Value and Yield dominated Q1. Some elements of Growth crept in on a forward-looking basis. Quality was mixed, but large caps outperformed significantly. Depending on your measurement of Volatility, the signal changed significantly with moderate outperformance in high market beta and 3Y volatility, but underperformance for daily volatility.

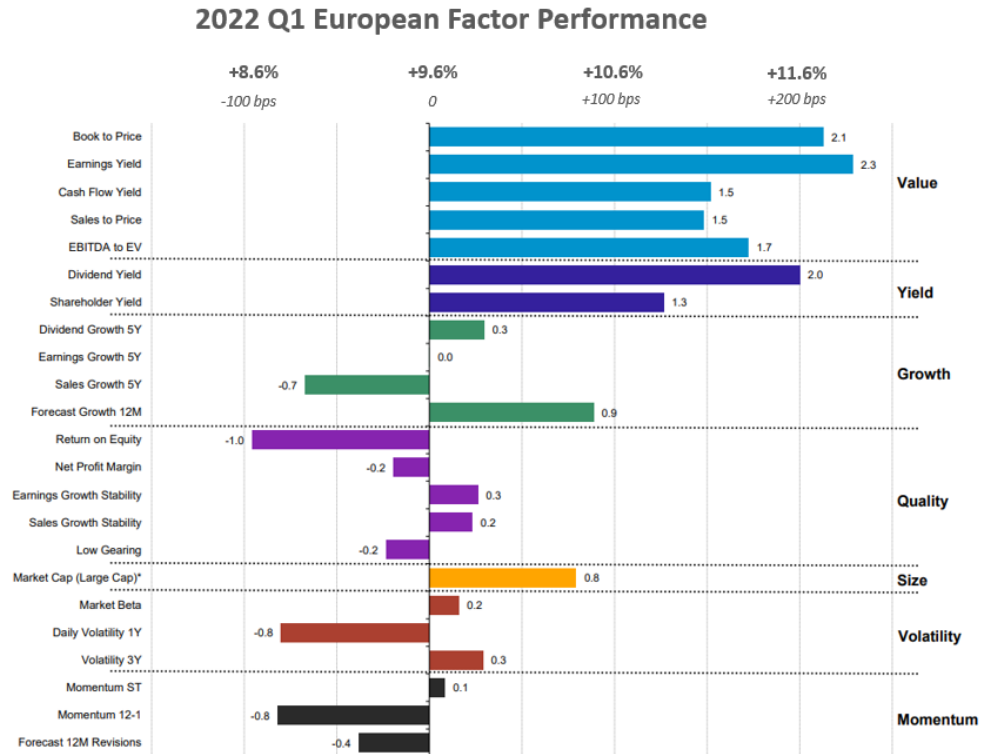


Figure 4: Q1 2022 European Factor Performance (country and sector adjusted). Source: Investment Metrics, a Confluence company

Emerging Markets Equities

Emerging market factors diverged from developed markets in March where Value saw big gains with investors focusing particularly on bottom-line metrics, both earnings, cash flow and shareholder yield. Growth was mostly market neutral with forecast growth 12M, underperforming the worst among all factors driven by significant pullbacks in companies like Tencent, and JD.COM Inc. Quality generally underperformed modestly, but stable earnings growth was significantly rewarded. It appears investors are focusing on fundamentals, both the expensiveness of, and quality of earnings. High volatility suffered while price momentum outperformed.

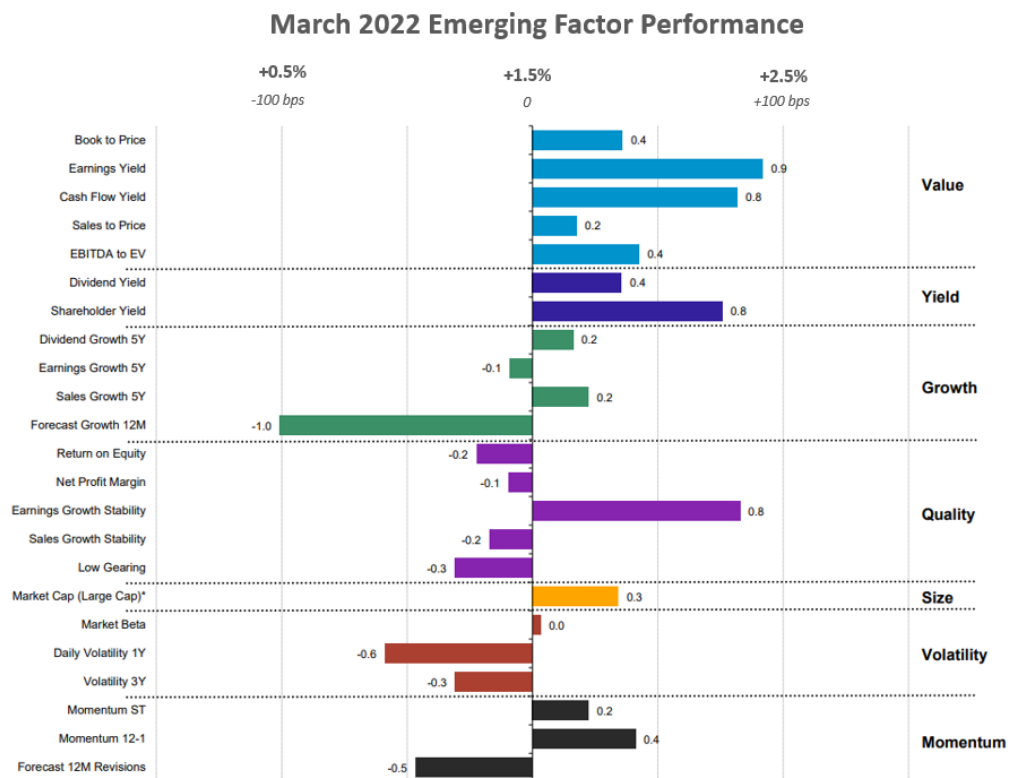


Figure 5: March 2022 Emerging Markets Factor Performance (country and sector adjusted). Source: Investment Metrics, a Confluence company

Australia

March delivered mixed signals, a sharp reversal from the clear factor picture in February. Book-to-price significantly underperformed while other Value factors were slightly positive, or market neutral, and shareholder yield outperformed the most of all factors, closely followed by net profit margin. Like Value, Growth also had conflicting signals with both dividend and earnings growth outperforming while sales and forecast growth underperformed. Australia lacks the defensive undertones present in other markets as high volatility underperformed and some Quality metrics underperformed.

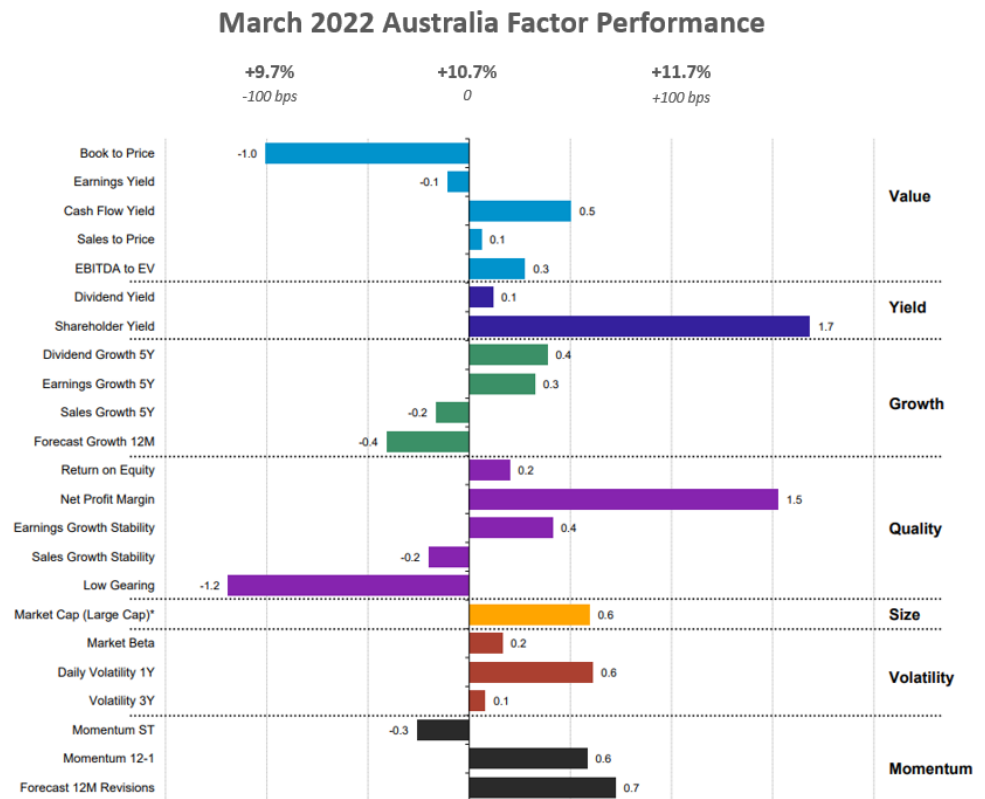


Figure 6: March 2022 Australia Factor Performance (sector adjusted) Source: Investment Metrics, a Confluence company

Appendix: How to read the charts

Each factor's performance is based on the relative performance of the top 50% (by market cap) of that specific factor compared to the overall market (the sole exception is the size factor which uses the top 70%). For example, for the first factor, book-to-price, 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, and market and fundamental data are adjusted so that sector-average (within each country) relative data is used, and the performance measurement isolates the factor's contribution to return. In Figure 1, US stocks with a high book-to-price (i.e., high value stocks as measured by book-to-price) outperformed the broad US market by 110 bps on a country and sector adjusted basis.

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