
LOOKING BACK AT EQUITY FACTORS IN Q4 2023 WITH WISDOMTREE

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Equities finished the year with a very strong fourth quarter. Global equities gained 11.4% over the last three months to close the year with a 23.8% positive performance¹. The lowering of the ‘higher for longer’ rates fears, and the awakening of Small Cap stocks after three quarters of lacklustre performance, helped stocks edge higher. Overall, markets finished the year focusing on upcoming rate cuts, combined with decreasing inflation, that led to a reversal of the negative mood observed in Q3.

This instalment of the WisdomTree Quarterly Equity Factor Review aims to shed some light on how equity factors behaved during this reversal and how this may have impacted investors’ portfolios.

- Overall, Quality and Growth continued to dominate but Small Cap joined the party this quarter. In the US and Europe, Small Cap even posted the strongest outperformance
- High Dividend, Value and Min Volatility posted the largest underperformance, suffering from the market’s pivot to optimism
- In Emerging Markets, the picture remained a bit different to the rest of the world, with most factors outperforming. Only Momentum and Min Vol posted underperformance and Quality posted the strongest returns

Looking to 2024, the equity outlook remains positive but quite uncertain. It appears rate cuts are coming, but a notable deterioration in economic data and continued disinflation may be required to validate expectations for significant policy easing in 2024 and to support equity markets. With non-dividend payers having benefitted from an exceptional run over the last decade, compared to high-dividend payers, 2024 may see a net expansion of the breadth of the market leading to some mean reversion in favour of dividend payers. This could play a very important role in the performance of Quality in the year ahead, pushing high Quality dividend growing stocks to outperform high Quality tech stocks.

Performance in focus: a surprise bull run for Q4

In Q4 the MSCI World (+11.4%) and the MSCI USA (+11.8%) performed very strongly. European and emerging markets equities were weaker but still returned high single-digit performance. Overall, Tech Megacaps continued to lead but the market’s breadth increased with Small Caps in the US and Europe performing quite strongly.

Overall Q4 ended up quite positive for factor investing:

- In global developed markets, Growth and Quality continue to post strong returns, in line with the rest of the year. Small Cap finished second in a late revival after three quarters of lacklustre performance
- In the US and Europe, Small Caps posted the strongest outperformance, followed by Growth. Quality performed well in Europe finishing third but in the US Momentum grabbed the third place
- Overall, in Developed Markets, High Dividend, Min Volatility and, to a smaller extent, Value suffered the bulk of the underperformance
- In emerging markets, Quality and Growth dominated but, like in previous quarters, most factors were able to produce outperformance over the quarter. Momentum was the standout loser in the region

Figure 1: Equity factor outperformance in Q4 2023 across regions

	World Q4 2023: 11.4%	USA Q4 2023: 11.8%	Europe Q4 2023: 6.4%	Emerging Markets Q4 2023: 7.9%
High Dividend	-4.4%	-3.8%	-0.6%	1.6%
Minimum Volatility	-4.7%	-4.2%	-2.0%	-1.7%
Momentum	0.7%	0.9%	0.0%	-4.5%
Quality	1.0%	0.1%	1.4%	4.6%
WisdomTree Quality	0.2%	-0.4%	0.5%	4.0%
Size	1.1%	1.9%	3.3%	1.1%
Value	-3.3%	0.2%	-2.8%	2.0%
Growth	1.9%	1.8%	1.9%	2.1%

Source: WisdomTree, Bloomberg. 30 September 2023 to 31 December 2023. Calculated in US Dollars for all regions except Europe, where calculations are in EUR.

Historical performance is not an indication of future performance and any investments may go down in value.

2023 in review

Looking back at the full year, Growth remained the clear winner in developed and US equities with double digit outperformance versus the market. In both regions, only Quality managed to follow its lead outperforming by almost 10% in both markets. All the other factors underperformed with High Dividend, Minimum Volatility and Momentum posting large underperformance.

In Europe, Quality and Growth also dominated the other factors but they did not post large outperformance. Minimum Volatility and Small Cap were the standout losers in that region.

In emerging markets, all factors but Momentum and Min Volatility did quite well in 2023. Small Cap posted the strongest returns followed by Value and Quality.

Figure 2: Equity factor outperformance in 2023 across regions

	World YTD: 23.8%	USA YTD: 26.5%	Europe YTD: 15.8%	Emerging Markets YTD: 9.8%
High Dividend	-14.7%	-20.7%	-1.3%	8.8%
Minimum Volatility	-16.4%	-17.4%	-4.5%	-0.9%
Momentum	-12.0%	-17.5%	-2.4%	-7.1%
Quality	8.6%	9.2%	-0.4%	5.9%
WisdomTree Quality	-5.3%	-7.9%	0.4%	9.4%
Size	-8.0%	-8.6%	-3.1%	14.1%
Value	-4.5%	-13.1%	-1.7%	10.1%
Growth	13.2%	20.0%	0.3%	9.7%

Source: WisdomTree, Bloomberg. 31 December 2022 to 31 December 2023. Calculated in US Dollars for all regions except Europe, where calculations are in EUR.

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Is it time for the revenge of the dividend payers?

Research has shown that across markets, over the long term, big dividend payers tend to outperform low dividend payers or companies that don't pay dividends at all. However, after the strong outperformance of Tech Megacaps including many non-dividend payers in 2023, and over the last decade in general, data from Dartmouth's Ken French shows that over the last 20 years, the companies that paid no dividend outperformed the quintile that paid the highest dividends by the largest amount on record. Assuming some mean reversion, this could point to some resurgence of dividend payers².

This is of particular interest when looking at the Quality factor. Quality continued to do well over the year but over the last two years we have observed a strong divergence in behaviour between high Quality companies that pay dividends and those that don't. In 2022 the Quality dividend payers dominated while the Quality non dividend payers did better in 2023.

To look at the impact of that divergence on 'investable' portfolios we consider:

- the MSCI USA Quality index, which currently allocates a large proportion of the portfolio to tech and non dividend paying high Quality companies
- the WisdomTree US Quality Dividend Growth UCITS index that focuses on high Quality, dividend growing companies and therefore invests only in dividend paying companies leading to smaller allocation to Tech and to the Magnificent Seven

In Figure 3 we observe that the MSCI USA Quality, following the strong rally of Tech and the Magnificent Seven in 2023, is historically expensive compared to the market. On the contrary, with a discount of -2, the WisdomTree US Quality Dividend Growth UCITS is currently quite cheap and getting cheaper.

Figure 3: Historical Price to Earnings ratio Premium/Discount versus the MSCI USA Index



Source: WisdomTree, Bloomberg. 30 April 2013 to 31 December 2023.

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Taken together, this could indicate that high quality with a dividend tilt could be poised to take the lead in 2024.

Valuations increased in Q4

In Q4 2023, developed markets got more expensive following the sharp rally. All factors saw the Price to earnings ratio increase over the quarter except for Momentum in Europe. Growth saw the biggest increase across regions on average. Small Caps and Momentum follow just behind. In Emerging markets, valuations increased across most factors bar Small Caps.

Figure 4: Historical Evolution of Price to Earnings ratios of equity factors

	World		USA		Europe		Emerging Markets	
	P/E Ratio	Δ3Months	P/E Ratio	Δ3Months	P/E Ratio	Δ3Months	P/E Ratio	Δ3Months
Market	19.3	↑ 1.8	22.1	↑ 2.4	13.7	↑ 1.0	14.1	↑ 0.8
High Dividend	13.9	↑ 0.7	15.9	↑ 1.0	10.9	↑ 0.8	8.4	↑ 0.2
Minimum Volatility	17.5	↑ 0.4	19.0	↑ 0.8	15.8	↑ 0.1	15.0	↑ 0.7
Momentum	21.2	↑ 2.8	29.2	↑ 6.5	12.7	↓ -1.2	15.7	↑ 3.3
Quality	24.1	↑ 2.0	25.8	↑ 2.9	19.5	↑ 1.5	18.7	↑ 1.6
Size	19.3	↑ 2.1	23.1	↑ 2.5	14.1	↑ 1.5	14.8	↓ -0.5
Value	9.8	↑ 0.4	7.0	↑ 0.2	8.3	↑ 0.4	6.6	↑ 0.2
Growth	29.4	↑ 3.2	33.8	↑ 5.0	22.9	↑ 1.5	25.4	↑ 4.0

Source: wisdomTree, Bloomberg. As of 30 September 2023.

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Looking forward to 2024

The equity outlook remains positive but quite uncertain. It appears rate cuts are coming, but a notable deterioration in economic data and continued disinflation may be required to validate expectations for significant policy easing in 2024 and to support equity markets. With non dividend payers having benefitted from an exceptional run over the last decade compared to high dividend payers, 2024 may see a net expansion of the breadth of the market leading to some mean reversion in favour of dividend payers. This could play a very important role in the performance of Quality in the year ahead, pushing high quality dividend growing stocks to outperform high quality tech stocks.

World is proxied by MSCI World net TR Index. **US** is proxied by MSCI USA net TR Index. **Europe** is proxied by MSCI Europe net TR Index. **Emerging Markets** is proxied by MSCI Emerging Markets net TR Index. **Minimum volatility** is proxied by the relevant MSCI Min Volatility net total return index. **Quality** is proxied by the relevant MSCI Quality net total return index.

Momentum is proxied by the relevant MSCI Momentum net total return index. **High Dividend** is proxied by the relevant MSCI High Dividend net total return index. **Size** is proxied by the relevant MSCI Small Cap net total return index. **Value** is proxied by the relevant MSCI Enhanced Value net total return index. **WisdomTree Quality** is proxied by the relevant WisdomTree Quality Dividend Growth Index.

Sources

¹ Source: WisdomTree, Bloomberg. in USD. Index used is the MSCI World net TR Index

² Source: Kenneth French data library. Data is calculated at a monthly frequency and as of Oct 2023. Stocks are selected based on dividend yields. Portfolios are rebalanced yearly at the end of June. All returns are in USD. **You cannot invest in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

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