
LOOKING BACK AT EQUITY FACTORS IN Q1 WITH WISDOMTREE

Pierre Debru – Head of Quantitative Research and Multi Asset Solutions, WisdomTree Europe.
19 Apr 2021

This first quarter saw the continuation of the equity rally which began at the end of the first quarter of 2020, almost exactly a year ago, and the continuation of the cyclical recovery which began with the US election in November 2020. While most trends remained similar to those observed in Q4, March saw some cracks appear in the value and Small-Cap driven rally.

In this instalment of the WisdomTree Quarterly Equity Factor Review¹, we aim to shed some light on how equity factors behaved over the last three months and how this may have impacted investors' portfolios.

- In Q1, Value led the way across the board, followed closely by Size. They both continued to benefit from the cyclical recovery;
- Momentum delivered the largest underperformance in most regions;
- while Quality and High Dividend underperformed over the quarter, March saw them recover, beating Size as well as Momentum

Looking forward to Q2, it's possible to see the value-driven recovery continuing on the back of a successful Covid-19 vaccination rollout and increasing fiscal stimulus from the US. However, as exemplified by recent lockdowns in Western Europe the situation is still pretty fragile. Investors could benefit from being prepared for other scenarios when more defensive factors or more-rounded could do well.

Performance in focus: Value and Size continue to lead

After a slight pause in January, markets continued to rally in the first quarter of 2021 on the back of successful vaccination campaigns around the world and continued fiscal stimulus. The MSCI World gained 4.9% over the period. Contrary to 2020, Europe led the way with a performance of +8.4%, followed by the US (+6.1%) and Emerging Markets (+2.3%).

For factors, Q1 2021 looked pretty similar to Q4 2020:

- Value and Size dominated across all regions;
- Momentum suffered the most in all regions but Europe;
- Minimum Volatility also underperformed in all developed markets, posting the largest underperformance in Europe;
- In a slight reversal, Value led in all regions this quarter when Size was the dominant factor in the last quarter.

Figure 1: Equity factor outperformance in Q4 2020 across regions

	World Q1 2021: 4.9%	USA Q1 2021: 6.1%	Europe Q1 2021: 8.4%	Emerging Markets Q1 2021: 2.3%
High Dividend	1.2%	1.5%	-1.4%	5.4%
Minimum Volatility	-3.7%	-3.9%	-5.0%	0.5%
Momentum	-4.5%	-6.3%	-2.3%	-6.0%
Quality	-2.1%	-2.3%	-3.1%	0.1%
Size	4.5%	6.7%	1.3%	5.4%
Value	8.6%	12.2%	5.5%	5.4%

Source: WisdomTree, Bloomberg. 31st December 2020 to 30th March 2021.

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

Despite this appearance of continuity it's interesting to note that in March the landscape started to shift. Since November, most factors have behaved homogeneously:

- High Dividend, Minimum Volatility and Quality all underperformed in November, December, January and February
- whereas Size & Value outperformed in November, December, January and February

However, in March these behaviours changed slightly:

- Size underperformed;
- Quality, Minimum Volatility and High Dividend gained and beat the benchmark

Since this change occurred late in Q1, it wasn't enough to change the dynamics of the whole quarter. In fact, it might be a sign of things to come. With some of western Europe entering lockdown once again, after failing to contain a variant-driven third wave of coronavirus infections, defensive or more-rounded factors may start to benefit.

Figure 2: Monthly outperformance of equity factors versus the MSCI World since November 2020



Source: WisdomTree, Bloomberg. 30th October 2020 to 31st March 2021.

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

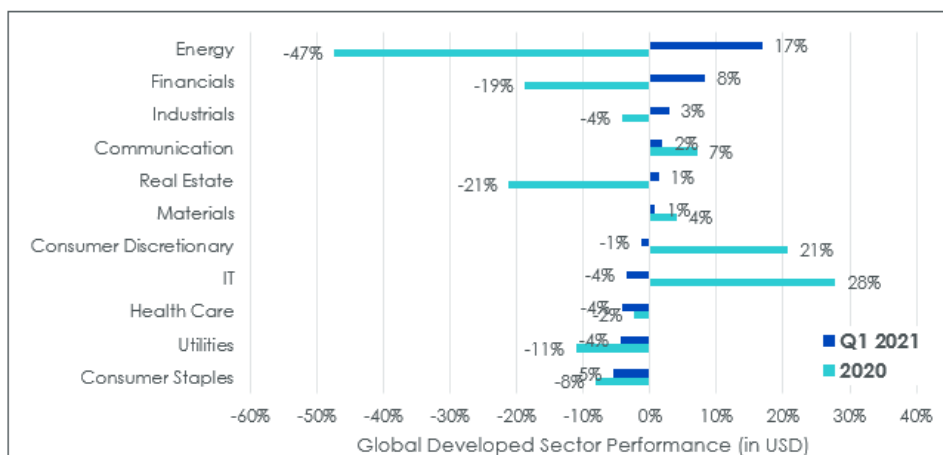
The sector rotation is impacting the factor rotation as well

Similarly to equity factors, sectors performance also continued on the trend set in Q4 2020. Sectors that suffered the most in 2020, like Energy and Financials, have rebounded the strongest. Sectors that had led 2020, like Consumer Discretionary and Information Technology, are falling behind but despite this are still posting positive performance for the quarter. At present the stand out losers are Utilities and Consumer Staples, which failed to rebound in Q1 after a very difficult 2020. This explains, in part, the difficulties experienced by Minimum volatility over the same period.

It is also worth noting that despite the focus on vaccines and the companies producing them, the performance of the Healthcare sector continues to trail behind the market.

Coming back to factors, this sector rotation contributed to the muted performance of Momentum and Quality, which both suffered from their underweight in Financials and Energy.

Figure 3: Performance of GICS² sectors during Q1 2021 and the whole of 2020 in developed global equities



Source: WisdomTree, Bloomberg. 31st December 2019 to 31st March 2021.

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

Valuations are coming down on the back of improved earnings

In Q1 2021 valuations have decreased significantly. Following solid earnings, the market’s price to earning ratio has lowered despite the continued bull run. For factors, we observe that:

- All the factors have seen their price to earning ratio decrease across regions;
- Size saw the largest move downward;
- Momentum benefited from a very significant rebalancing of stocks in the basket, leading to the cheapening of the factor;
- The remaining factors, while getting cheaper in absolute terms, got slightly more expensive compared to the market.

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	21.2	↓ -4.2	23.0	↓ -4.0	17.4	↓ -5.4	15.6	↓ -4.4
High Dividend	14.5	↓ -1.0	16.1	↓ -0.8	12.7	↓ -1.9	9.1	↓ -2.0
Minimum Volatility	21.8	↓ -1.8	21.4	↓ -2.0	20.4	↓ -1.6	16.8	↓ -1.6
Momentum	31.8	↓ -6.6	35.5	↓ -9.6	29.4	↓ -2.2	29.1	↓ -23.9
Quality	23.3	↓ -1.9	23.6	↓ -1.8	21.7	↓ -1.8	22.2	↓ -2.3
Size	25.4	↓ -14.1	28.3	↓ -16.7	23.0	↓ -11.7	13.5	↓ -16.6
Value	11.9	↓ -1.3	13.1	↑ 0.0	11.5	↓ -3.3	7.7	↓ -1.7

Source: WisdomTree, Bloomberg. As of 31st March 2021.

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

Looking forward to Q2, it is possible to see the value-driven recovery continuing on the back of the successful rollout of Covid-19 vaccinations and increasing fiscal stimulus coming from the US. However, the situation remains pretty fragile. Countries in western Europe like France and Germany had to enter another lockdown in the face of a variant-driven third wave of Covid-19 infections. Countries with a high vaccination rate, like Chile, are still suffering from a very high number of daily deaths. March showed that such an accumulation of bad news could lead to another rotation among factors. Investors may benefit from being prepared for a panel of scenarios when more defensive factors or more-rounded could do well.

Sources

- ¹ Definitions of each factor are available below
- ² GICS stands for The Global Industry Classification Standard

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- + [A moment in markets – Navigating equity markets in the year ahead](#)
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