Amundi | Smart Beta
ASSET MANAGEMENT

Viewpoint

Equity factor behaviour in Q1 2020

Amundi Factor Investing Solutions

April 2020

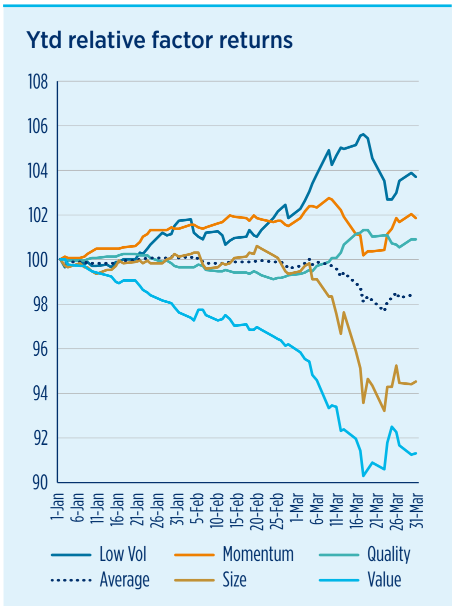
General Commentary:

The concerns around the Coronavirus outbreak and its impact on the global economy triggered a significant Equity sell-off. During the first part of the bear market, dispersion was quite low but in March, factors exhibited a higher dispersion and very different performance patterns. The market crash created a massive spike in volatility. It also had some collateral effects on Liquidity risk as well as Credit risk. The correlation between stocks increased to a very high level offering few diversification opportunities. The exposure of some factors such as Value and Size to Liquidity and Credit risk as well as the lack of benefit from diversification penalised the performance of multi-factor strategies over this period.

Factor Behaviour:

During this negative market movement, Low Volatility and, to a lesser extent, Quality outperformed due to their defensive nature. Size (small- and mid-caps) and Value factors were the most negative. Value is highly exposed to the Energy sector and has a high Beta. In this current context, its underperformance was a significant drag on performance. Large cap stocks resisted much better than the small and mid-caps and, as a consequence, the Size factor exhibited a negative performance. Due to its shorter-term horizon, the Momentum factor navigated between positive and negative territories.

The chart below shows the factor performance in Global Equities, from 31/12/2019 to 31/03/2020

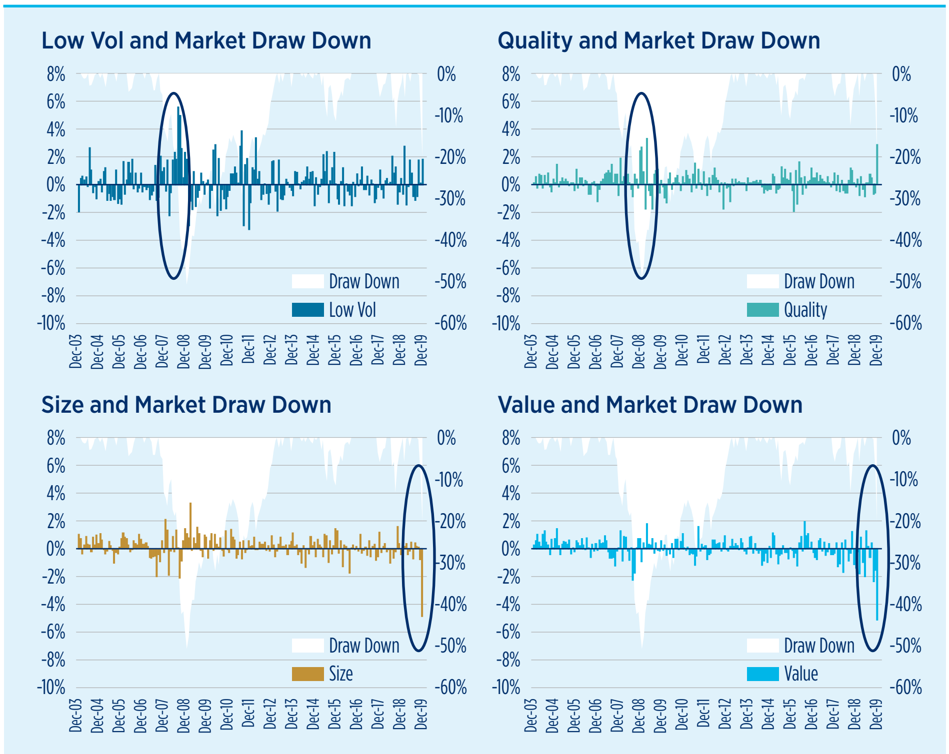


Largest amplitude in factor performance for Value and Size

In 2008, we also experienced a significant equity sell-off, but the magnitude of the positive performance from defensive factors such as Low Volatility and Quality offset the negative performance of risky factors such as Value and Size (e.g. small and mid caps).

In Q1 2020, the negative performance of Value and Size was extreme and was not compensated by the performance of defensive factors.

The chart opposite shows the monthly performance of the factors since 2003 and the Equity market cumulative drawdown based on the MSCI World index.



Analysis based on Amundi equity factors - Sources: Amundi, Factset, MSCI.

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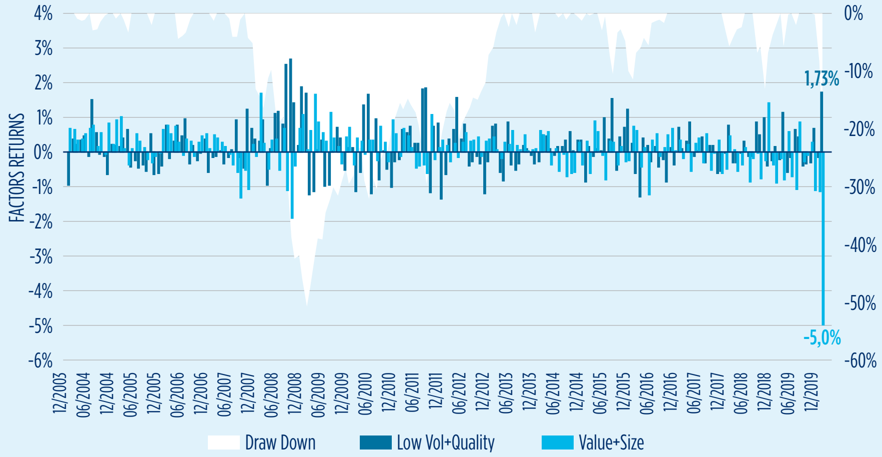
When we split the factors into two categories: "defensive" consisting of Low Volatility and Quality and "risky" being composed of Value and Size, what happened in March 2020 can be seen as an extreme pattern compared to the last 17 years.

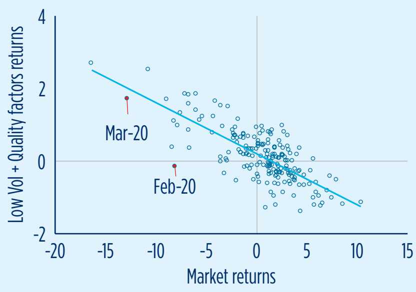
In the perspective of the payoff analysis, we can see that February 2020 and March 2020 look extreme on the different factors.

In the charts opposite, we focus on "defensive" factors (Low Vol and Quality) versus "risky" factors (Value and Size). ■

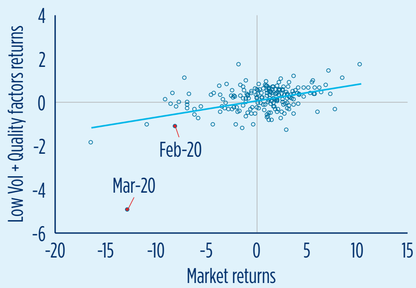
(Low Vol+Quality) vs (Value+Size) monthly factors returns



Risk off payoff



Risk on payoff



Sector exposure of the factors

The exposure of Value to highly cyclical names and Energy has been extremely penalizing in terms of performance, especially in North America.

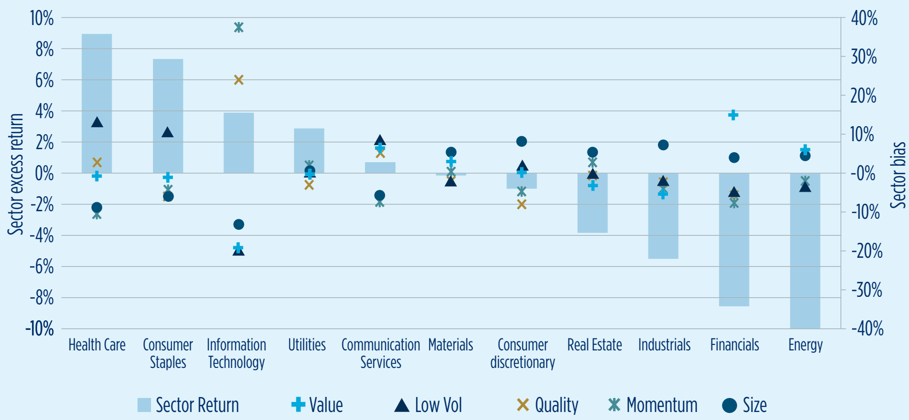
The exposure of mid caps stocks to Credit risk and Liquidity risk was the trigger for the negative performance of the Size factor.

In addition, the under-exposure of these two factors to the IT and Health Care sectors in the US was a cost in terms of missed opportunities.

Companies in these sectors were perceived as less impacted by the global economic downturn and as being a good source of liquidity. For example, the perceived resilience of Amazon's business model resulted in positive results for the stock over a couple of days where the broad market was retrenching.

The chart opposite shows the performance of each sector in March 2020 (bar chart) as well as their factor exposure (on the right axis) in North America. ■

North America



Analysis based on Amundi equity factors - Sources: Amundi, Factset, MSCI.

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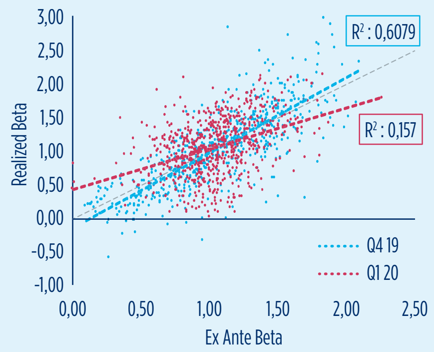
Beta analysis

During the negative market movement in Q1 2020, realized Beta was much higher than the ex-ante Beta. This is typical of an Equity sell-off where the correlation between equities increases dramatically providing very few diversification opportunities.

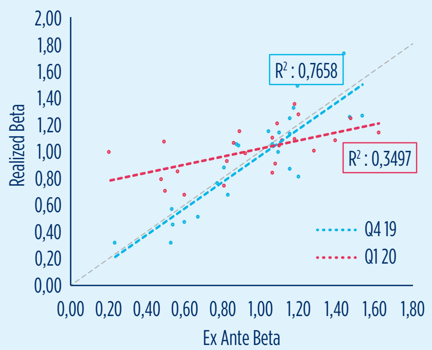
The chart below shows a comparison between ex-post and ex-ante Beta on the whole Equity market (based on the MSCI USA index) in Q1 2020 vs. Q4 2019. The ex-ante measures are sourced from the MSCI Barra risk model.

Ex ante vs realized beta Q4 19 and Q1 20



We did the same analysis on an industry level (GICS 2 from the MSCI USA index):

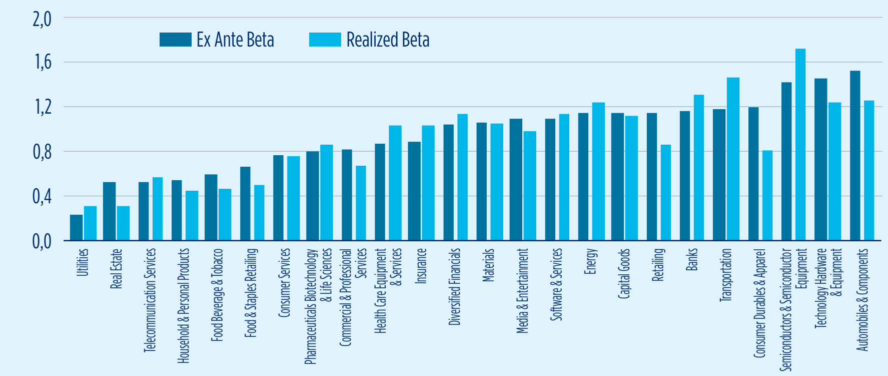
Ex ante vs realized beta Q4 19 and Q1 20



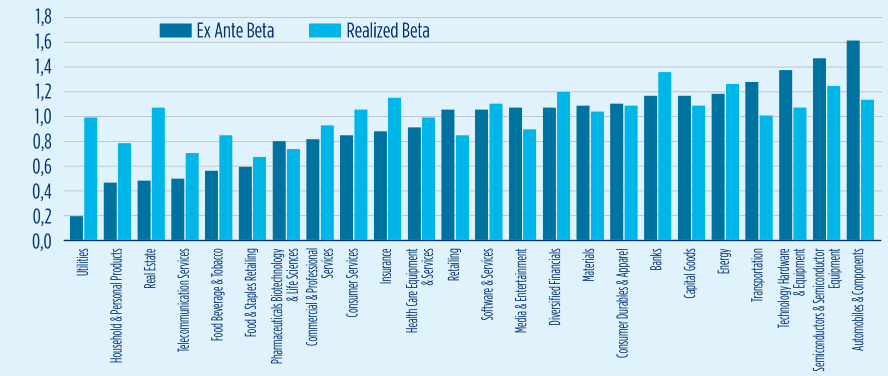
We can see that over Q1 2020, the ex-post Beta (realized) has increased as a consequence of higher correlation (between stocks or sectors). There is much less dispersion between low beta and high beta names on an ex-post basis than ex-ante.

Another way to look at it is to measure the ex-ante (provided by the MSCI Barra risk model) and ex-post beta of the different industries in the MSCI USA, in Q4 2019 compared to Q1 2020.

Q4 2019



Q1 2020



During the market turmoil of Q1 2020, equity factors exhibited different performance patterns depending on their underlying characteristics. Besides, the increasing correlation between stocks and sectors during the recent crisis has reduced the benefits of diversification over the short-term.

In the current uncertain environment, portfolio diversification should remain a key focus for investors. Equity factors which exhibit different payoffs and performance patterns over time should offer a good ground for diversification. At Amundi, we believe that a well-diversified portfolio across factors is well equipped to deliver consistent performance in the long-term. ■

Analysis based on Amundi equity factors - Sources: Amundi, Factset, MSCI.

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