What a difference a year makes – Value's resurgence

January 2020

Research Signals

2019 was a spectacular year for US equity markets, as multiple new highs were recorded and stocks soared to solid double-digit returns, their best performance since 2013. This contrasts starkly with the outlook at the start of the year when investors had positioned for an economic recession spurred by Federal Reserve tightening and the US-China trade war. Alas, over the course of the year, the Fed lowered interest rates three times to move more in line with other central banks around the world and trade tensions eventually de-escalated. With this backdrop, we present several key themes from 2019 factor performance.

- The latter months of 2019 saw greater inflows into Value ETFs compared with that of growth and momentum, helping to overcome a returns deficit throughout much of the year
- Book-to-Market exemplified surges in value factor performance in September and, to a greater extent, in December, where it reached its highest performance since mid-2009
- Increased signs of risk taking are developing in cross-asset signals from CDS markets, while, for most of the bull market run in 2019, some hedging from securities lending market signals was found

Contacts

Research Signals · MK-ResearchSignals@ihsmarkit.com

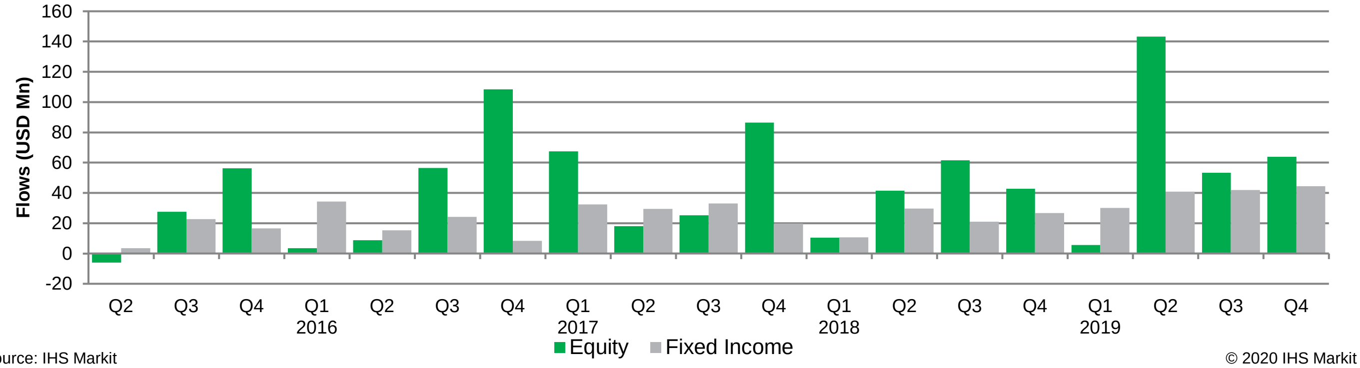
IHS Markit

Market overview

We begin with a top-down view of equities based on flows and style returns in the ETF market using the IHS Markit ETF Analytics database. First we compare recent flows into equity and fixed income funds (Figure 1). Both asset classes saw a decrease in inflows at similar clips in 2018, at -25% and -21%, respectively, yet a rocky finish to equity markets in 2018 led to a noticeable shift to safe haven assets at the start of 2019. However, a surge in risk appetites at the start of Q2 2019, fueled by the Fed's dovish pivot to a more patient stance on interest rate hikes, helped equity ETF flows outpace fixed income for the year, at rates of 76% and 63%, respectively.

Figure 1

US ETF flows



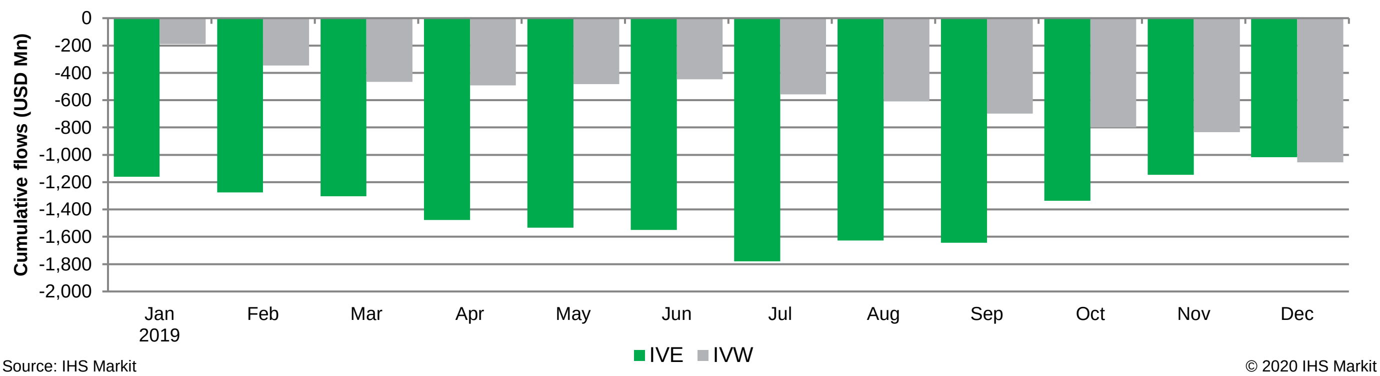
Source: IHS Markit © 2020 IHS Markit

Hidden beneath market returns in 2019 was unusual trading activity between value and other style strategies, most notably growth and momentum, that we **reported** on in September following an extended period of **struggles** for value factors. Thus we drill down further into the equity asset class ETFs to evaluate value, growth and momentum style activity. For this analysis we compare the iShares S&P 500 Value ETF (IVE) with the iShares S&P 500 Growth ETF (IVW), in addition to the iShares Edge MSCI USA Value Factor ETF (VLUE) with the iShares MSCI USA Momentum Factor ETF (MTUM).

Both the value and growth ETFs (Figure 2) saw outflows for the most part in the first half of 2019. However, the value strategy was clearly more favored over growth by retail investors with aggregate inflows from August forward. Cumulative flows into value and momentum ETFs (Figure 3) straddled the zero line through September, with momentum the preferred strategy. Interestingly, beginning in August, a dramatic reversal in trends ensued, with value ending the year with a cumulative inflow while momentum breached into negative territory.

Figure 2

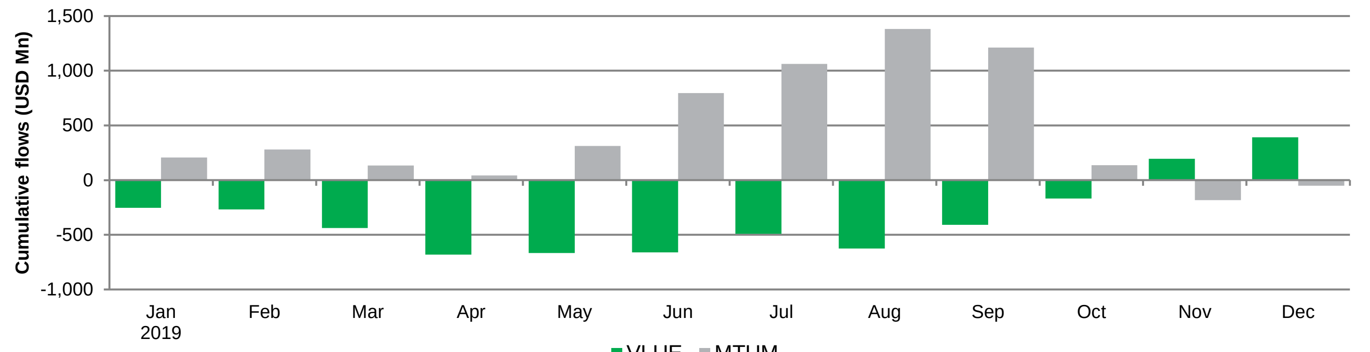
Style ETF flows



Source: IHS Markit © 2020 IHS Markit

Figure 3

Style ETF flows

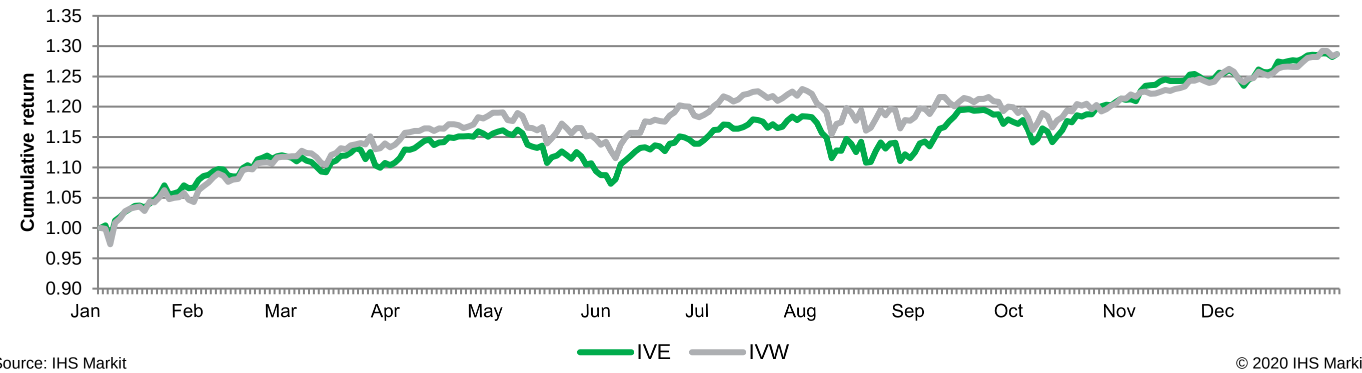


Source: IHS Markit © 2020 IHS Markit

From a return perspective, value began to chip away at growth's longer term outperformance early in the year (Figure 4), though growth remained dominant on a cumulative basis through the end of October. Since that time, value has kept stride with growth, finishing the year slightly in the lead. Value also had success versus momentum in the first quarter (Figure 5), while the opposite was seen mid-year. As mentioned above, September was characterized by a strong resurgence in value, and the strategy surpassed momentum for a short period in early November, with another surge to round out the year in December.

Figure 4

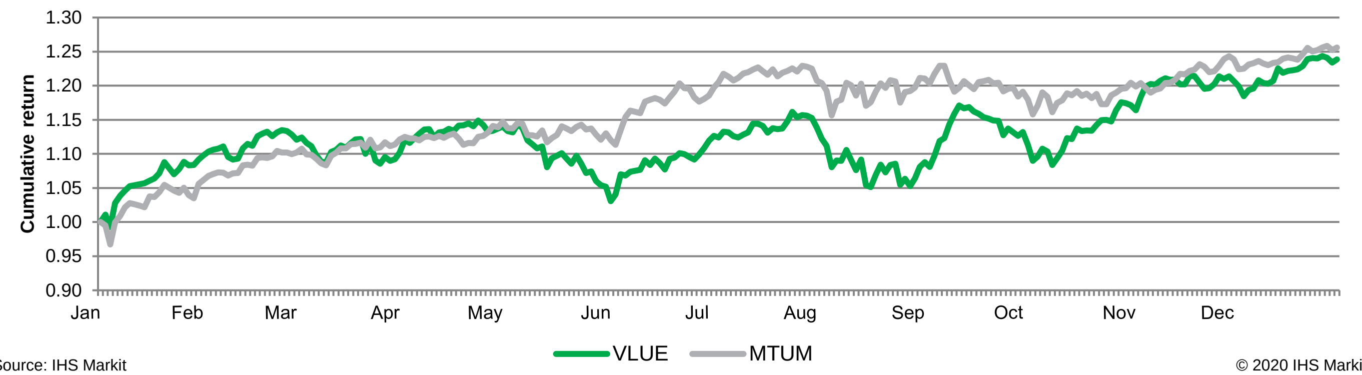
ETF NAV price return, 1 Jan 2019 - 31 Dec 2019



Source: IHS Markit © 2020 IHS Markit

Figure 5

ETF NAV price return, 1 Jan 2019 - 31 Dec 2019



Source: IHS Markit © 2020 IHS Markit

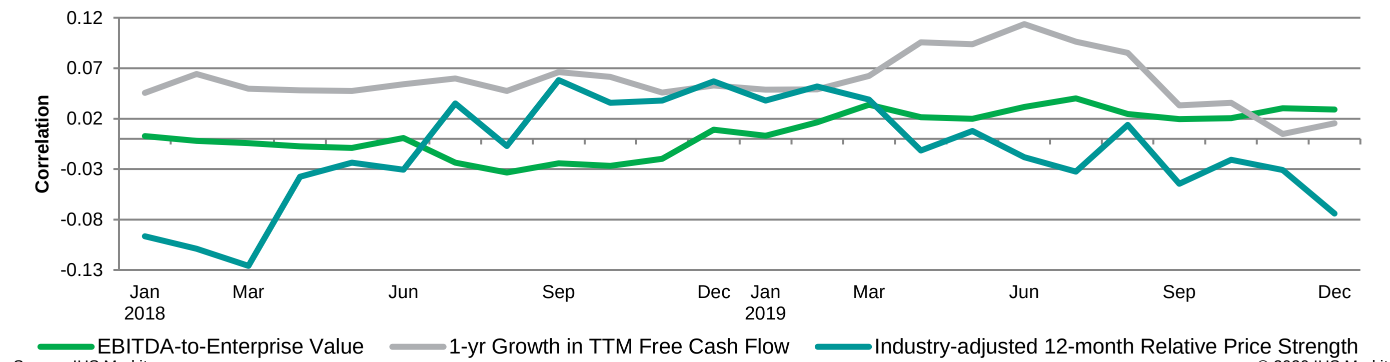
Having focused thus far on retail investors, we round out this overview section with a couple of snapshots of institutional investor sentiment. For this analysis, we use our Lending Supply factor from the **Short Sentiment suite** sourced from our proprietary Securities Finance dataset, with daily data capturing the supply, demand and borrow cost of individual securities in the lending market. Lending Supply measures the total quantity of stock made available by custodians in their lending programs relative to the total shares outstanding. It can be used as a higher frequency proxy of institutional ownership as much of the lendable supply comes from the custodians of pensions and mutual funds.

To assess the trend in borrow supply, we examine the correlations in monthly cross-sectional factor percentile ranks with representative value, growth and momentum factors from our Consolidated Factor Library, namely EBITDA-to-Enterprise Value, 1-yr Growth in TTM Free Cash Flow and Industry-adjusted 12-month Relative Price Strength, respectively. Factor statistics in the remainder of this report are based on our US Large Cap universe, which consists of approximately 1,000 of the largest cap names.

Correlations with the value signal hovered below zero in the second half of 2018, but has increased since that time, suggesting a higher institutional investor preference for undervalued names. The opposite is seen with Industry-adjusted 12-month Relative Price Strength, a sign of decreased holdings in stocks with high momentum characteristics. Lastly, institutional investors were more heavily weighted in growth stocks gauged by 1-yr Growth in TTM Free Cash Flow in the first half of 2019, before sharply reverting in the second half of the year.

Figure 6

Rank correlations with Lending Supply



Source: IHS Markit

© 2020 IHS Markit

2019 factor performance

Next we review factor performance for the full year across our 400+ US factor library. Performance is based on average monthly decile return spreads, where the spread is computed as the difference in the equal-weighted return at the top (decile 1) and bottom (decile 10) tails.

First, the top average performers for the year (Table 1) were led by short-term price reversal metrics. 1-Month Active Return topped the list with an average monthly decile spread of 2.58% (Figure 7), with a positive spread in seven months, suggesting that investors tended to favor recent underperforming stocks as markets surged throughout the year. Indeed, compared with 2018 when markets finished in the red, the cumulative spread moved from negative territory to a positive spread of 30.9% in 2019. Other recurrent positive signals for the year include high analyst agreement on earnings outlook, captured by Std Dev of FY1 EPS Estimates-to-Price (1.50%), and high quality, as gauged by Equity Turnover Ratio (1.13%), each with positive spreads in two-thirds of months for the full year.

Table 1

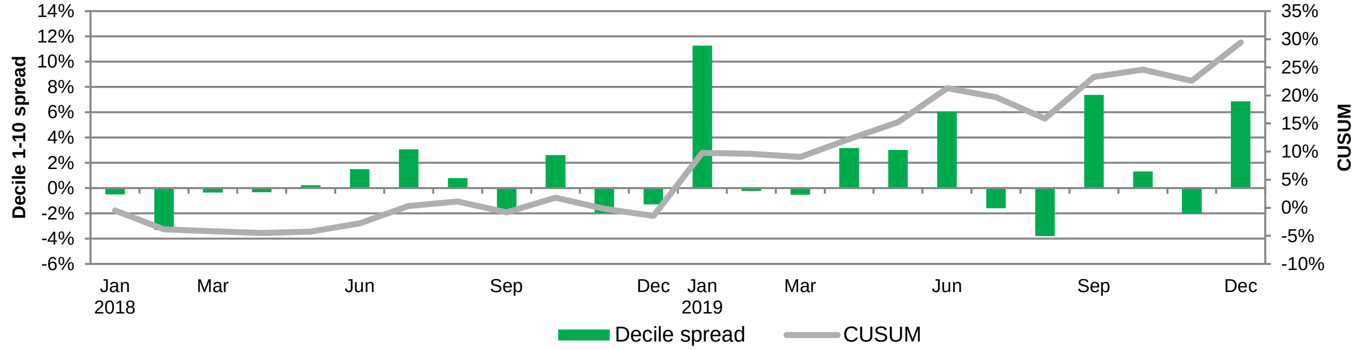
Top monthly average decile return spread factor performance, Jan 2019 - Dec 2019

Factor	Decile spread (%)	Factor group
1-Month Active Return	2.58	Price Momentum
4-week Industry Relative Return	2.01	Price Momentum
2-Month Active Return	1.97	Price Momentum
14 Day Relative Strength Index	1.93	Price Momentum
Long-term Debt-to-Equity	1.59	Liquidity, Risk & Size
Asia-Pacific Sales Exposure	1.55	Macro
Std Dev of FY1 EPS Estimates-to-Price	1.50	Earnings Momentum
FY1 EPS Estimates Dispersion	1.17	Earnings Momentum
Equity Turnover Ratio	1.13	Management Quality
Forward Return on Equity	1.06	Management Quality
TTM Capital Expenditures-to-Price	1.03	Deep Value
The Visibility Ratio	1.02	Price Momentum
Price Above Last 260-day Lowest Trading Price	1.01	Price Momentum
5-yr Relative Book-to-Market	1.00	Relative Value
Earnings Torpedo	0.98	Earnings Momentum

Source: IHS Markit

Figure 7

1-Month Active Return decile return spreads



Source: IHS Markit

At the opposite end of spectrum, the weakest average performers for the year (Table 2) include long-term price reversal metrics, with 60-Month Active Return with 12-Month Lag (-1.90%) trailing by the largest margin. While this factor struggled on a cumulative basis the prior year, the bull run of 2019 saw more extreme disfavor to stocks with more persistent underperformance, as the factor posted a cumulative spread of -22.8% with negative spreads in two-thirds of months. We also draw attention to the underperformance of 1-yr Growth in TTM Earnings per Share (-1.20%), suggesting investors were indifferent to **flat earnings growth** for the year, as multiple expansion as opposed to earning growth drove market valuations higher.

Table 2

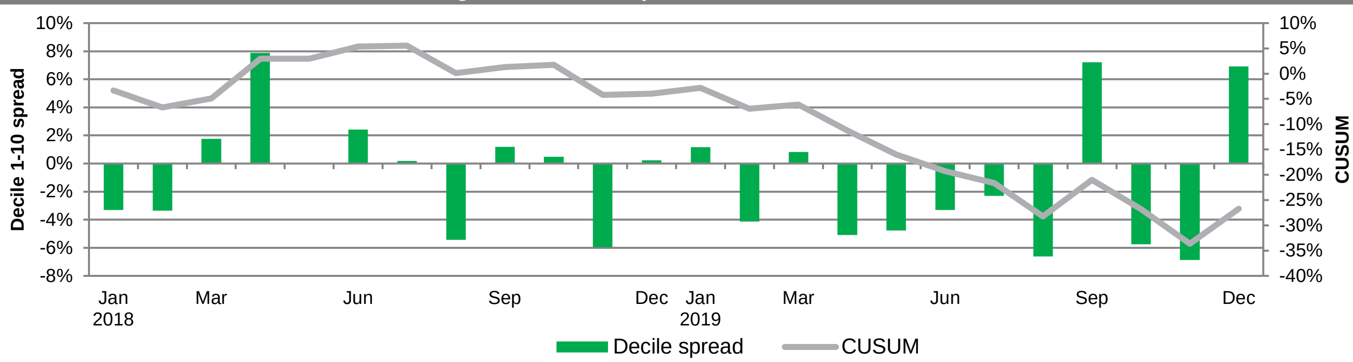
Bottom monthly average decile return spread factor performance, Jan 2019 - Dec 2019

Factor	Decile spread (%)	Factor group
60-Month Active Return with 12-Month Lag	-1.90	Price Momentum
Housing Starts Sensitivity	-1.89	Macro
Short Loan Concentration	-1.69	Short Sentiment
60-Month Active Return with 1-Month Lag	-1.65	Price Momentum
Lagged Inverse of PEG Ratio	-1.40	Earnings Momentum
Current Ratio	-1.39	Liquidity, Risk & Size
Working Capital-to-Total Assets	-1.28	Management Quality
TTM Cash Flow-to-Price	-1.23	Deep Value
1-yr Growth in TTM Earnings per Share	-1.20	Historical Growth
TTM EBITDA-to-Enterprise Value	-1.19	Deep Value
Dividends- to-Cash Flow	-1.18	Management Quality
20-Day Volume Volatility to Price Volatility	-1.18	Liquidity, Risk & Size
TTM Operating Cash Flow-to-Enterprise Value	-1.17	Deep Value
Quick Ratio	-1.14	Liquidity, Risk & Size
Distress Measure	-1.12	Liquidity, Risk & Size

Source: IHS Markit

Figure 8

60-Month Active Return with 12-Month Lag decile return spreads



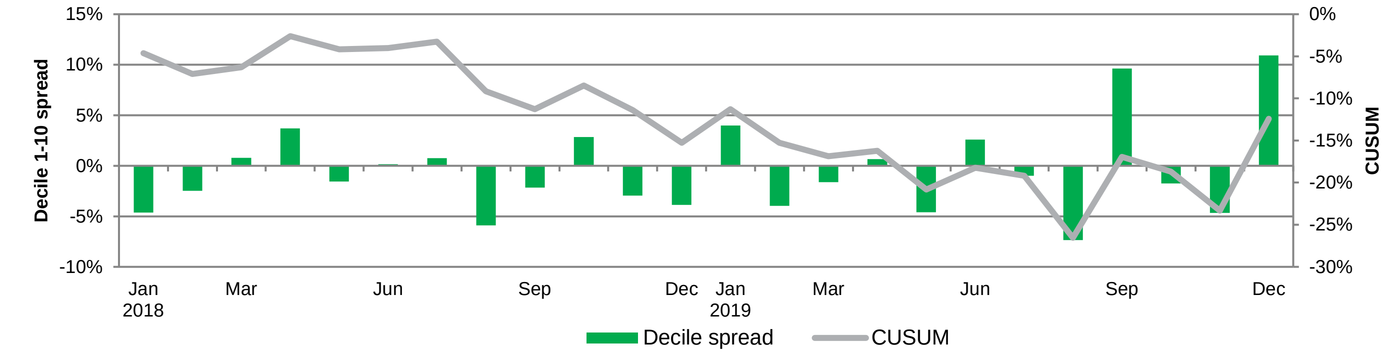
Source: IHS Markit

Other key factors of interest

We wrap up the report with a look at additional factors capturing key themes in 2019. First, Book-to-Market (Figure 9) is a traditional value factor whose return spread behavior over the past two years demonstrates value strategy's extended period of struggles and, in turn, the sharp reversal in Septemer. What is more, the factor finished out the year with a surge to the top performing factor across our entire factor library, outpacing September's anomalous return with a solid double-digit gain reaching its highest level since mid-2009.

Figure 9

Book-to-Market decile return spreads



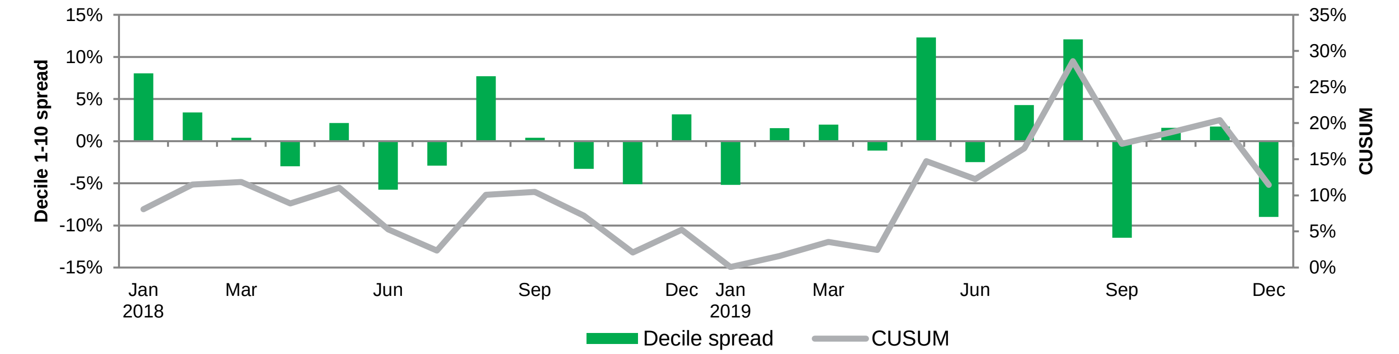
Source: IHS Markit

© 2020 IHS Markit

Staying with factors long-established in the industry, we turn to Fama-French Momentum (Figure 10), a traditional Price Momentum signal which sat at the opposite extreme of September's historic market event. Following a year of more cyclical behavior, mid 2019 was characterized by strong performance and an increased correlation with declining interest rates, before abruptly reversing in the one-week period ending 9 September, coincident with an 8.7% increase in interest rates. We also note that, while Book-to-Market and Fama-French Momentum have a tendency to trade in opposite directions (10-year monthly spread correlation: -71%), as expected of value and momentum strategies, 2019 saw more extreme behavior with negative co-movement at -91%.

Figure 10

Fama-French Momentum decile return spreads



Source: IHS Markit

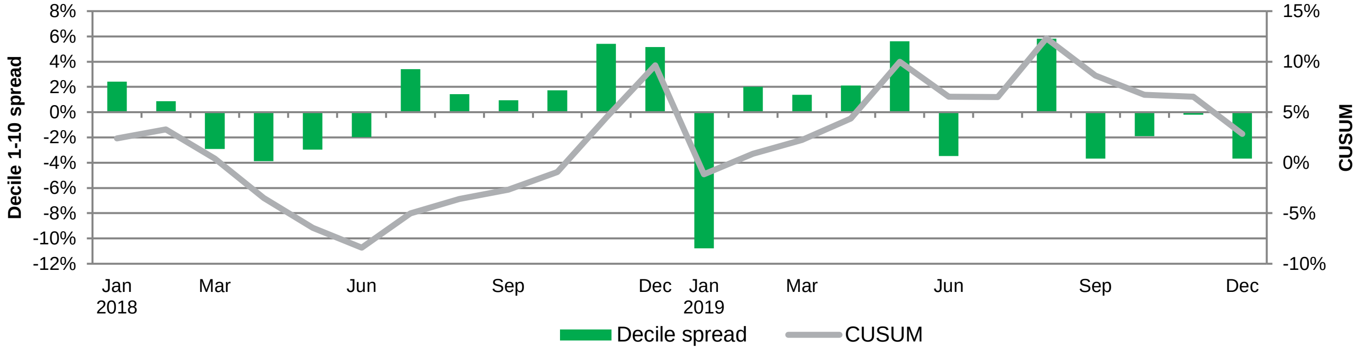
© 2020 IHS Markit

Next we turn to credit markets to take the pulse of investor risk aversion by comparing the level of risk priced in the credit market with that of the equity market. For this analysis, we examine the performance of Credit Risk, a proprietary **CDS-based indicator** which draws directly on the CDS spread level, where lower risk is preferred. (We remark that coverage for this factor tends to be sparse, but we still expect the general risk tendencies to be captured by those stocks covered.)

Amid the onset of trade conflicts and a significant drawdown in equities in Q4 2018, risk-off was a primary trading theme, pushing Credit Risk performance to a 12.3% cumulative spread for the quarter. A January market melt-up resulted in a sizable -15.9 percentage point month-on-month decline in spread performance. However, the remainder of 2019 was characterized by a shift from higher risk aversion to more aggressive positioning at the tail end of the year.

Figure 11

Credit Risk decile return spreads



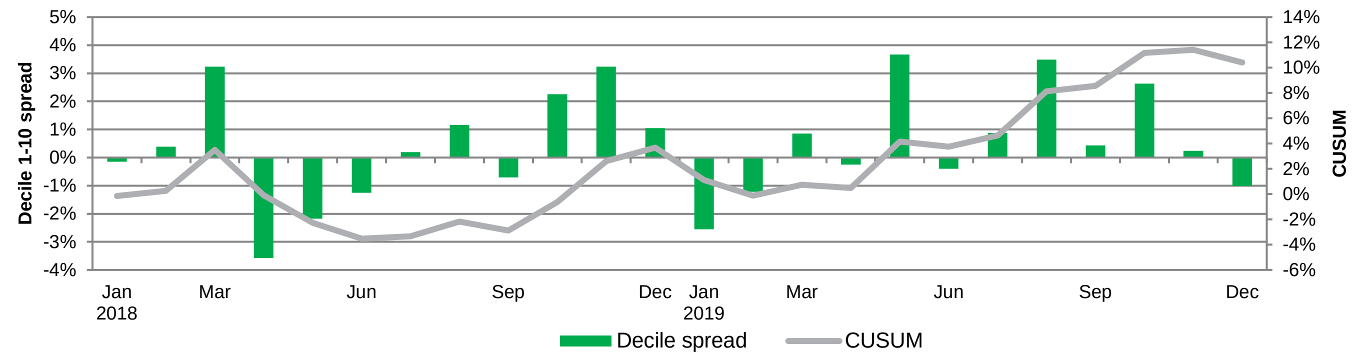
Source: IHS Markit © 2020 IHS Markit

Lastly, we look for interactions between equity and securities lending markets to gain insights into institutional sentiment from short sale data. We focus on Implied Loan Rate (Figure 12) which measures the cost of borrowing a particular stock, where a high Implied Loan Rate suggests more negative sentiment for a stock.

Again in Q4 2018, we find a higher level of risk aversion suggested by a string of positive months in factor performance. While some reversal was seen in the first two months of 2019, the general trend for the remainder of the year was to avoid the most highly shorted stocks, with Implied Loan Rate proving to be a useful signal even during a bull market run, posting a cumulative spread of 6.7% over the full year.

Figure 12

Implied Loan Rate decile return spreads



Source: IHS Markit © 2020 IHS Markit

IHS Markit Customer Support:

Support@ihsmarkit.com
Americas: +1 877 762 7548
Europe, Middle East, and Africa: 00800 6275 4800
Asia and the Pacific Rim: +65 6922 4210