

# Coronavirus infects factor performance

March 2020

## Research Signals

The final week of February was afflicted with a bout of volatility not seen since September 2011. This latest market tumult marked the worst weekly loss for US stocks since the financial crisis, as stocks entered correction territory amid intensifying fears surrounding the coronavirus' impact on the global economy. Given this extreme level of volatility, in this special report we review daily factor and style model performance to highlight key developments in the course of the market rout.

- Low beta and positive earnings revisions were two highly rewarded themes in the final week of February
- Small caps, value stocks and high bankruptcy risk firms suffered the most as volatility escalated
- Among our style models, the Historical Growth Model weathered the storm the most successfully

## February style model and factor returns

We review daily factor and style model performance in February across a representative group of our 400+ US factor library in addition to our style models – Deep Value, Earnings Momentum, Price Momentum, Historical Growth, Relative Value and Value Momentum Analyst II. Performance is based on daily 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. The universe is our US Large Cap universe, which consists of approximately 1,000 of the largest cap names.

First, from a factor perspective, we focus our results on several factors of interest (Figure 1) covering value, momentum, size, risk and short sentiment signals, namely Book-to-Market, TTM EBITDA-to-Enterprise Value, 3-M Revision in FY2 EPS Forecasts, Industry-adjusted 12-Month Relative Price Strength, Natural Logarithm of Market Capitalization, 60-Month Beta, Altman Z-score and Demand Supply Ratio.

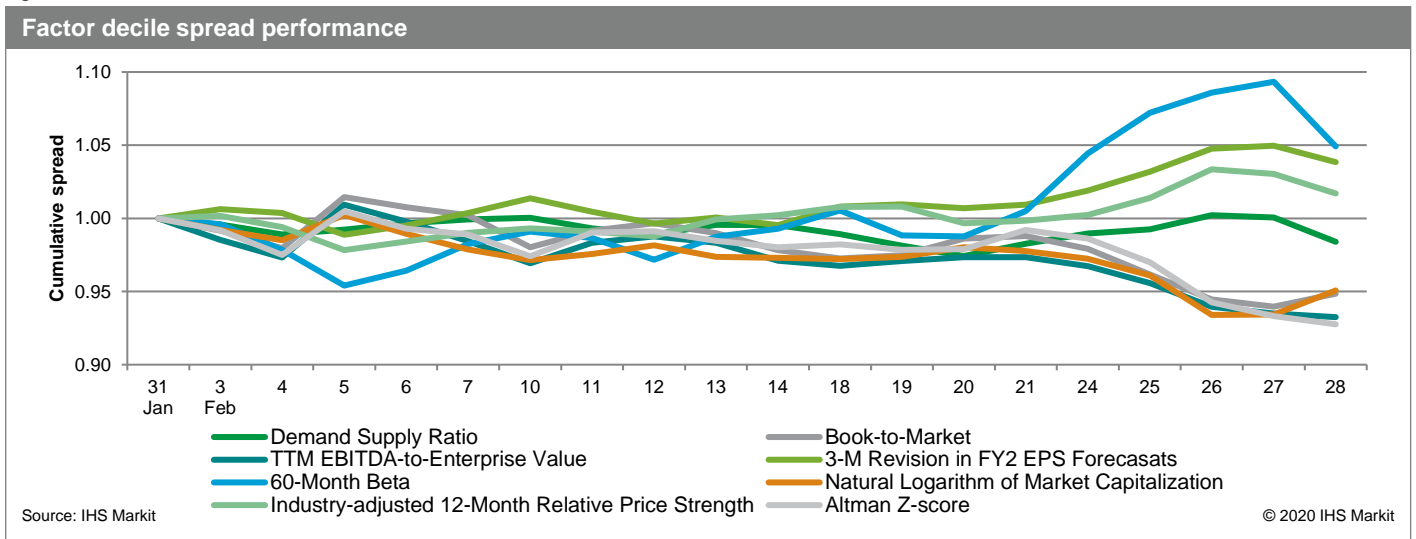
Through 21 February, factor performance was fairly stable, with 3-M Revision in FY2 EPS Forecasts taking a slight lead over 60-Month Beta on a cumulative basis, two themes that carried over from the prior month. Likewise, TTM EBITDA-to-Enterprise Value and Natural Logarithm of Market Capitalization extended January's underperformance into the first three weeks of February.

However, the extreme volatility in the final week of February had a significant impact on factor performance. The risk-off trade, captured by 60-Month Beta, catapulted into the lead. Investors also turned to analyst outlook, gauged by 3-M Revision in FY2 EPS Forecasts, to search for firms whose earnings were forecasted to best weather the effects of the coronavirus. At the opposite extreme, high bankruptcy, value and small cap stocks suffered the most, as confirmed by Altman Z-score, TTM EBITDA-to-Enterprise Value and Natural Logarithm of Market Capitalization, respectively.

## Contacts

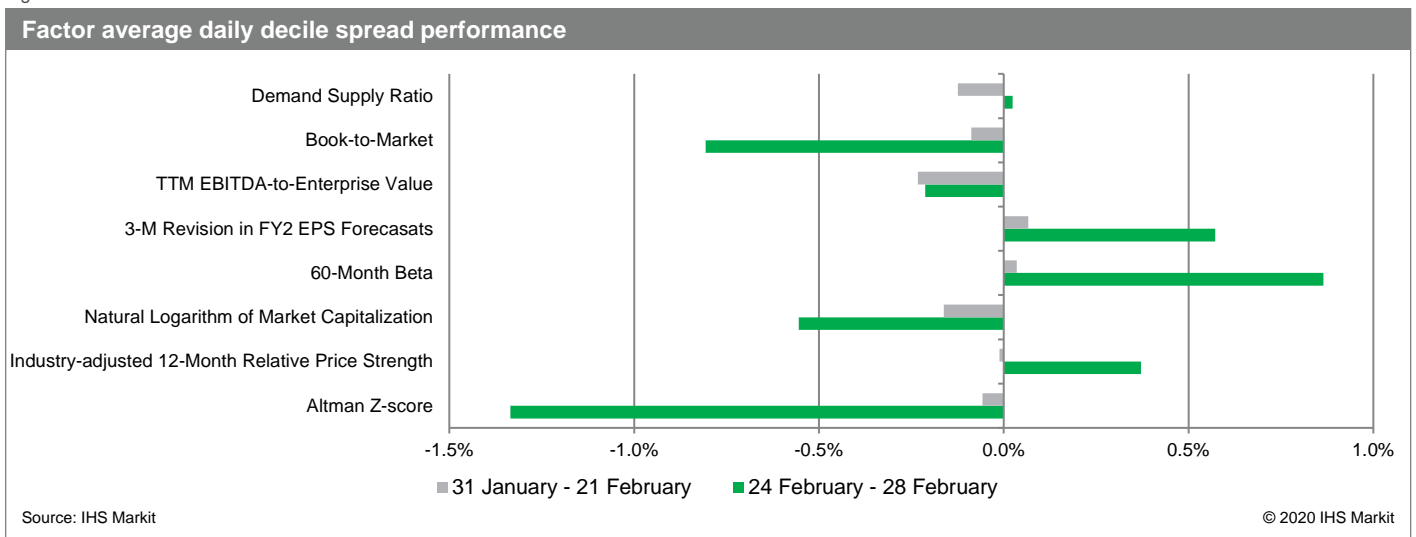
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Figure 1



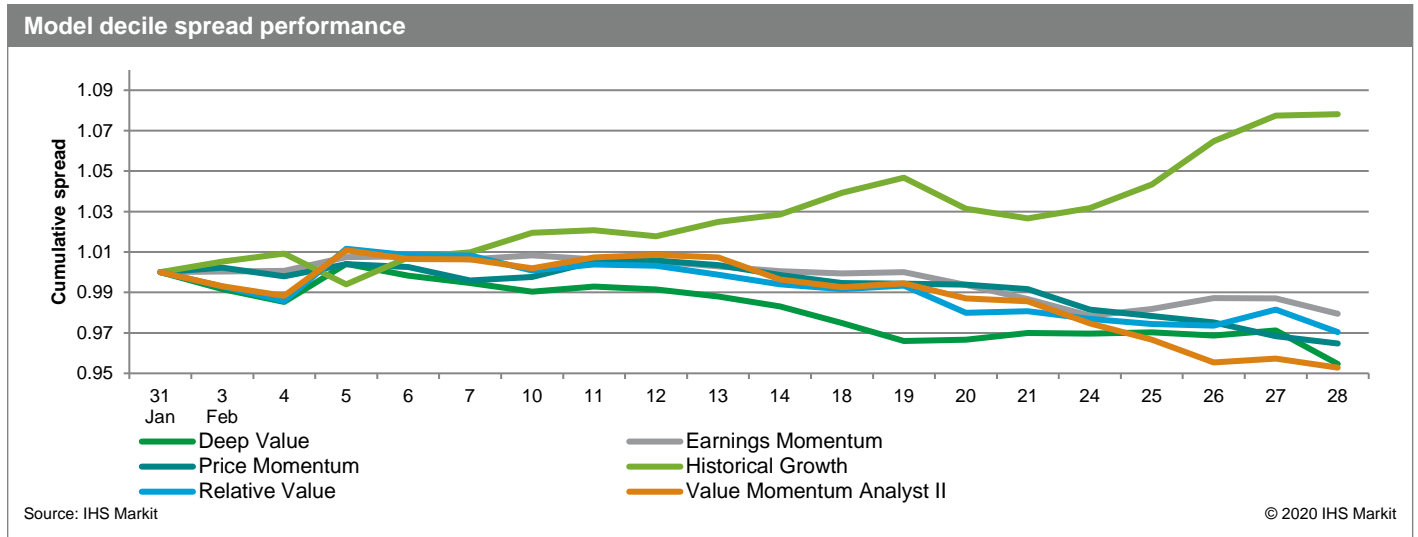
For another perspective, we compare average daily decile spreads month-to-date through 21 February with those in the last week of the month (Figure 2) to provide a more focused view of the extreme behavior between the two periods. From this vantage point, the results more clearly highlight the fact that investors traded in droves out of high bankruptcy risk names into low beta stocks. Consistent with the above findings, high momentum also benefited at the expense of value, where Book-to-Market, the more traditional value measure, took the brunt of the trade. Furthermore, firms with the highest earnings revisions outperformed and small caps lagged, while investors mostly disregarded sentiment conveyed in the securities lending market.

Figure 2



Lastly, turning to style model performance (Figure 3), cumulative spreads through 21 February resided in negative territory for all models with the exception of Historical Growth, which far outshined the other styles, suggesting that strong corporate fundamentals were a key driver of performance. As expected given our above observations, the Deep Value Model was the weakest performer through the 21<sup>st</sup>. Interestingly, during the last week of February, the Historical Growth Model expanded its outperformance relative to the other models, while Value Momentum Analyst II declined the most.

Figure 3



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