30,000-foot view of US equity markets

December 2020

Research Signals

The Dow Jones Industrial Average closed above 30,000 for the first time on 24 November 2020. For the month, the benchmark also recorded its best return in 33 years. We present an overview of noteworthy developments in US equity markets during this historic month.

- The recent rotation to value and small cap stocks was underscored by the highest monthly return for the iShares Russell 1000 Value ETF and iShares Russell 2000 ETF since their inception
- Energy companies have seen a reduction in negative outlook from stock analysts at the expense of Information Technology, while some early signs of a turn in credit analyst sentiment emerged for Energy
- Negative earnings revisions were also more prevalent among small caps relative to large caps for most of the year, but a noticeable reversal in this trend surfaced in November

Top-down view of recent market trends

We begin with a macroeconomic view of various segments of the market, including large and small caps and value and growth stocks. We use the iShares Russell 1000 ETF (IWB), iShares Russell 2000 ETF (IWM), iShares Russell 1000 Growth ETF (IWF) and iShares Russell 1000 Value ETF (IWD), respectively, sourced from the IHS Markit ETF Analytics database, to represent each theme.

In Figure 1, we present the time series of NAV cumulative returns for each fund over the past five years. Growth was the clear winner over the period with a 150% cumulative return, outpacing large caps by a spread of 52% and value by 94%. Growth also experienced a larger bounce relative to large caps and value off the 23 March low at the onset of the coronavirus pandemic, though small caps were the most highly rewarded segment with a 90% return compared with 80% for growth.

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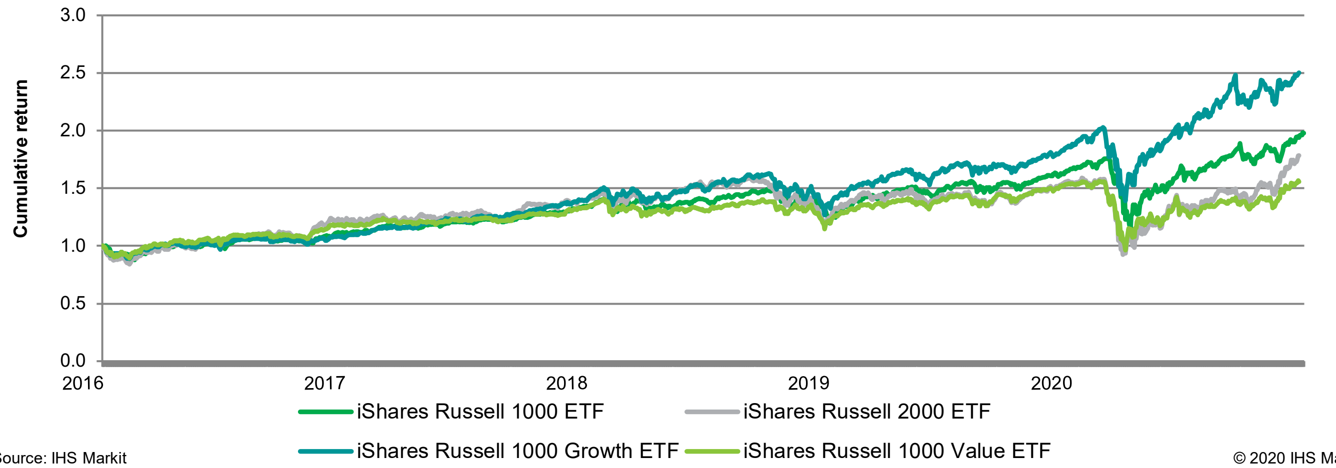
Figure 1

ETF NAV performance

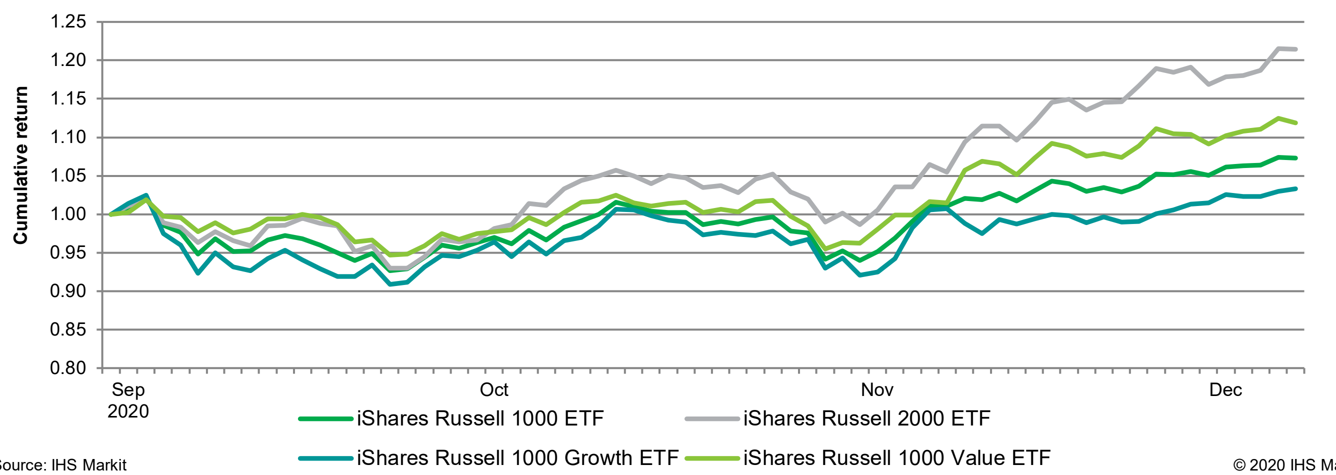


Source: IHS Markit

However, focusing closer on recent performance (Figure 2), positive vaccine developments, coupled with reduced uncertainty with the US election in the rear-view mirror, drove solid double-digit gains for the month across each category. While the trend in small cap outperformance started the prior month, performance of the other styles diverged more significantly in November. Small caps led with an 18.4% return, followed by a style shift to value resulting in a 13.4% return, with both funds recording their highest monthly performance since inception.

Figure 2

ETF NAV performance

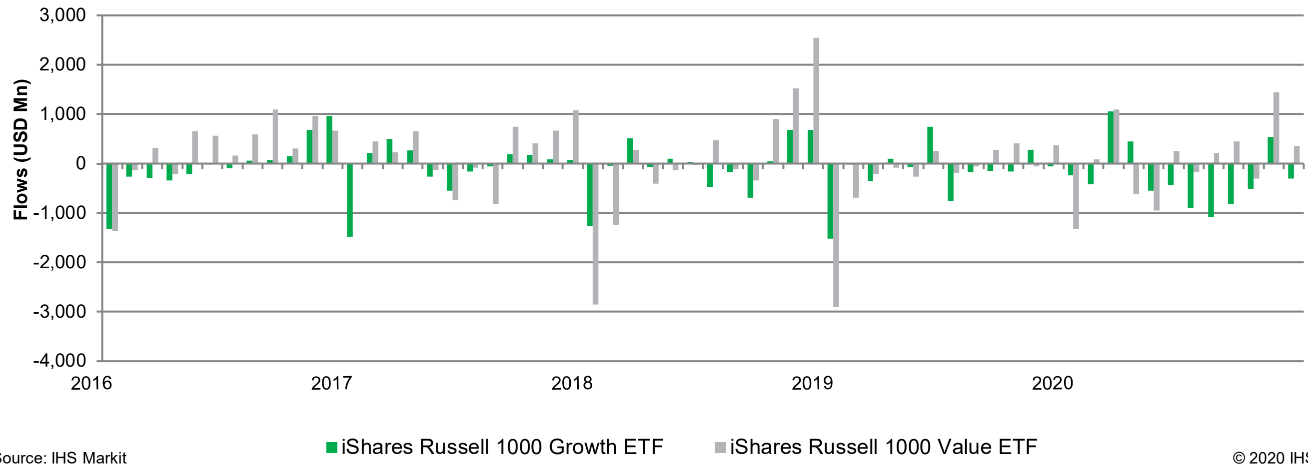


Source: IHS Markit

The developing trend in investor sentiment toward value stocks this year was confirmed by flows into the respective ETFs (Figure 3). Growth began to see monthly outflows beginning in May, with the only exception in November, which was a strongly positive month in general for equity ETFs. In fact, investors poured near record amounts into value for the month, the third highest inflow over the fund's history, only outdone in the final months of 2018.

Figure 3

ETF monthly flows



Source: IHS Markit © 2020 IHS Markit

Key industries in the evolution of markets this year were centered on the Technology and Energy sectors, which we examine next. The ETFs we use to proxy these themes are the Technology Select Sector SPDR Fund (XLK) and Energy Select Sector SPDR Fund (XLE), respectively.

Over the past five years (Figure 4), Technology has trounced Energy, with a 217% cumulative return, compared with Energy's loss of 19%. However, taking a closer look again at recent performance (Figure 5), we see a clear rotation out of Technology and into Energy, with an 11.4% return in November for the former compared with 22.2% for the latter. Energy's outperformance was supported by an ETF inflow in October and November at a rate two-and-a-half times that of Technology. What is more, the spread in monthly returns of the two funds was the second highest drawdown on record (Figure 6), only outmatched in April of this year as markets rebounded from the COVID-19-induced volatility.

Figure 4

ETF NAV performance

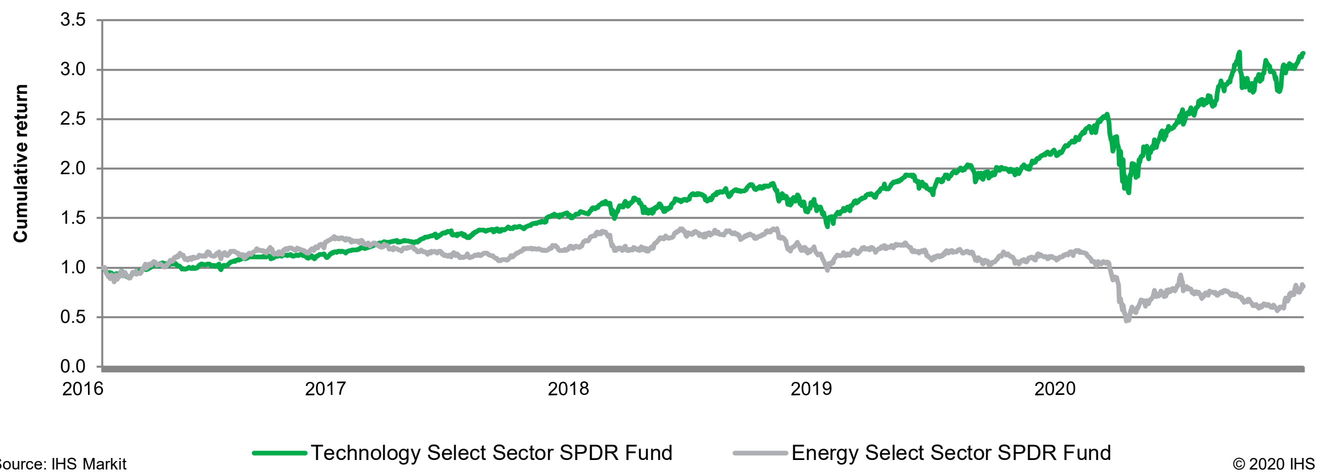


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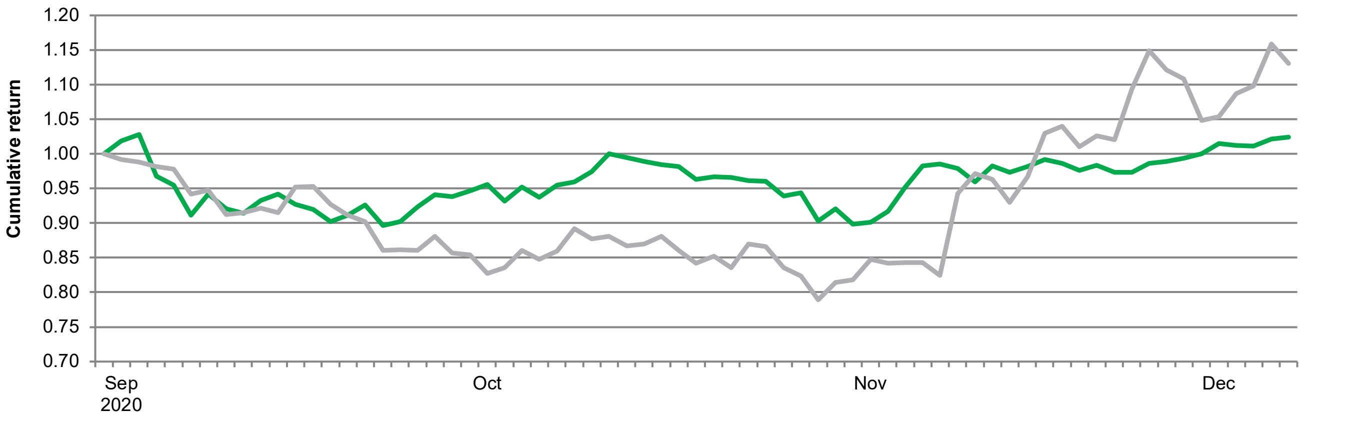
Figure 5

ETF NAV performance



Source: IHS Markit

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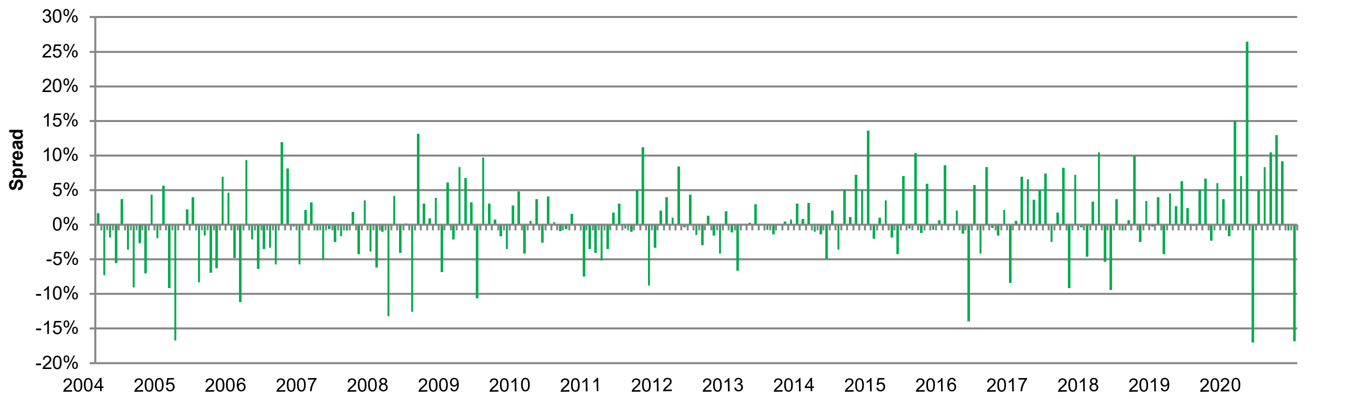
Figure 6

Monthly NAV return spread between Technology Select Sector SPDR and Energy Select Sector SPRD ETFs



Source: IHS Markit

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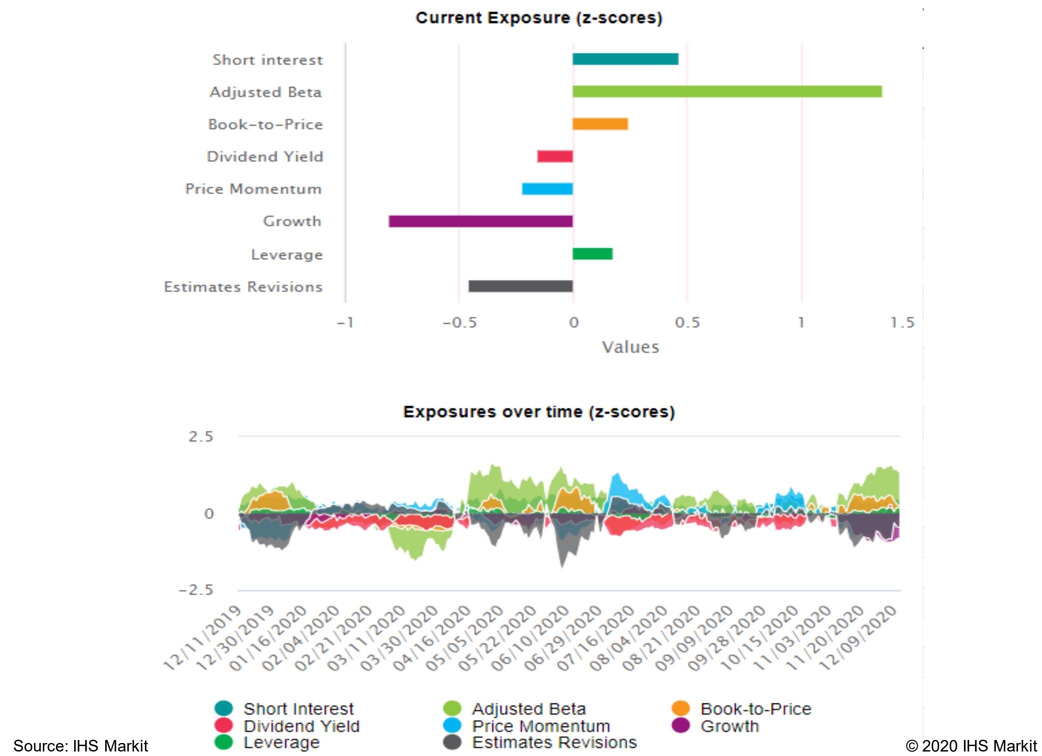
Bottom-up view of recent market trends

Turning from top-down to bottom-up analysis, we use the Research Signals Stock Screener to provide more granular factor level insights, underpinning the recent market and sector developments discussed above. We begin by viewing factor (Figure 7) and sector (Figure 8) exposures to those stocks in the top 10% of 1-month active returns across the US Large Cap universe (representing approximately the top 1,000 names by market capitalization).

This group of top performing stocks was characterized by a prominent exposure to beta, a trend that began developing in early November. We also confirm higher exposures to value stocks over high-flying growth and momentum stocks last month. A rotation to Energy over Information Technology was also prevalent in November, as investors looked beyond the virus on hopes of life returning to normal in the coming year, shifting their preferences to high risk and beaten-down value stocks and cyclical sectors that would benefit from economic growth.

Figure 7

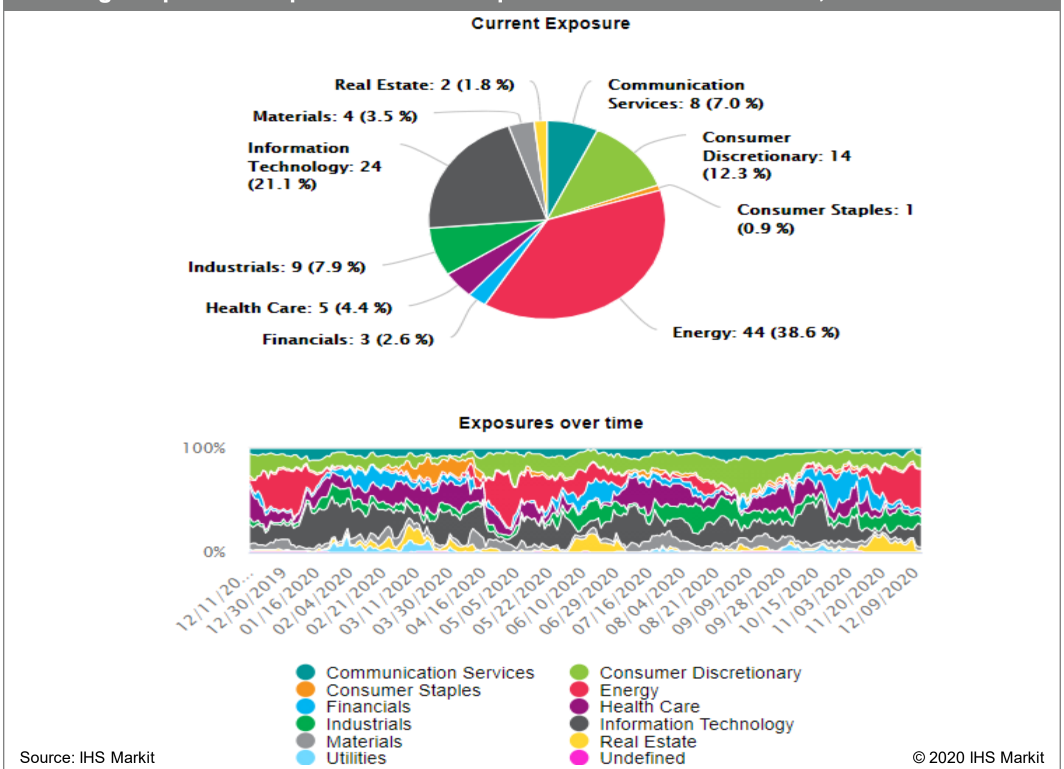
US Large Cap factor exposures across top 10% 1-month active return, 14 Dec 2020



Source: IHS Markit

Figure 8

US Large Cap sector exposures across top 10% 1-month active return, 14 Dec 2020



Source: IHS Markit

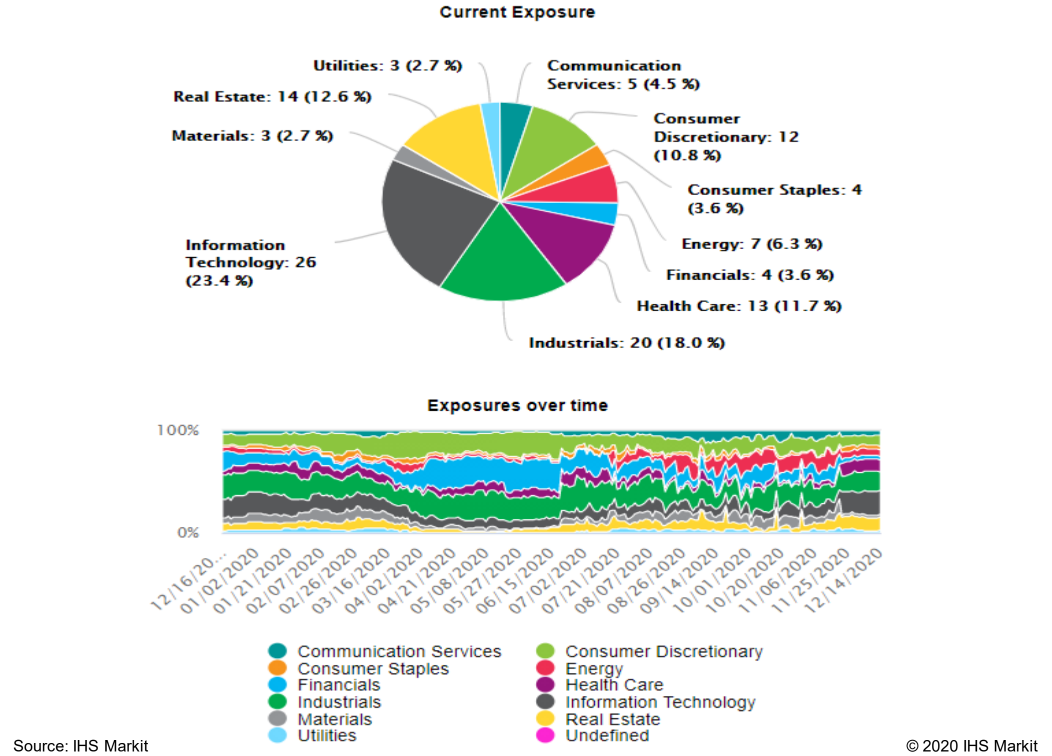
Next, we move from equity investor sentiment to recent developments in stock analyst and credit market outlook across sectors. In this case, we screen for the bottom decile of stocks with the most negative 3-M Revision in FY2 EPS Revisions for FY2 (Figure 9), while we use the broader bottom quintile for Credit Revisions - 3 Month (Figure 10) given the more limited coverage of this metric.

From an earnings perspective, we find that Energy's representation in the bottom decile of revisions in the second half of the year began to wane in November. At the same time, the reverse was seen for Information Technology, indicating an increased negative outlook in the analyst community.

On the other hand, the credit market tended to have a more unfavorable outlook on Energy firms relative to other sectors for a good portion of the year. However, we are seeing some early signs of a turn in sentiment, while, for Information Technology, we do not see much movement in this sector's representation in the bottom quintile of credit revisions.

Figure 9

US Large Cap bottom 10% estimate revisions sector exposures, 14 Dec 2020



Source: IHS Markit

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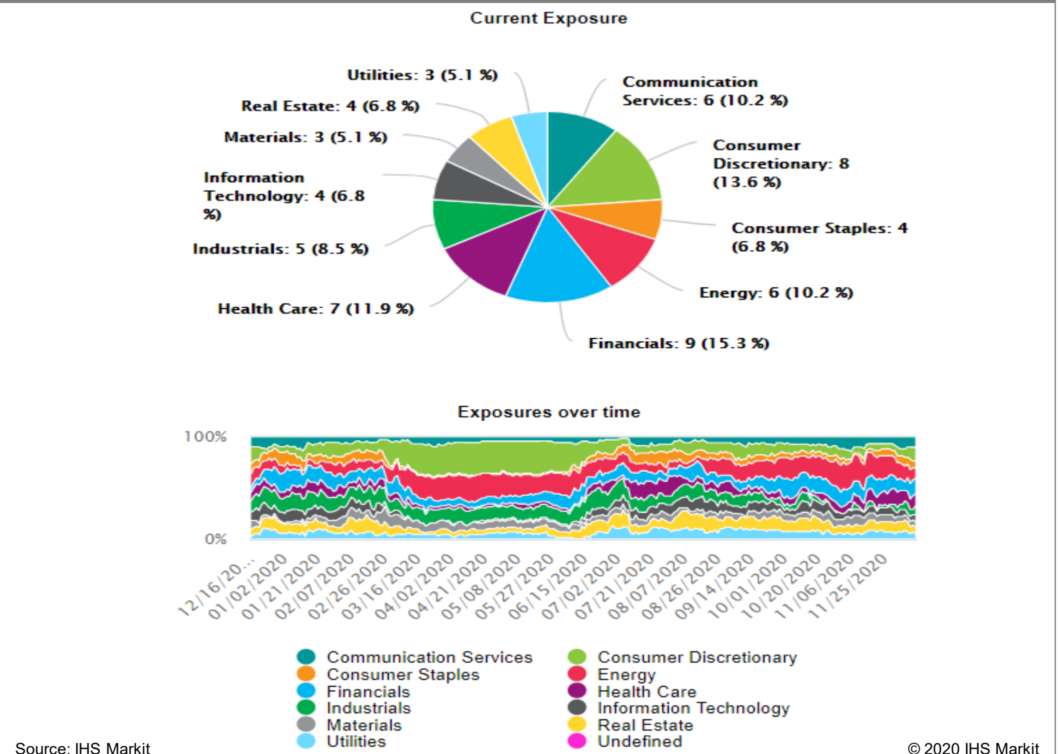
Figure 10

US Large Cap bottom 20% credit revisions sector exposures, 14 Dec 2020



Source: IHS Markit

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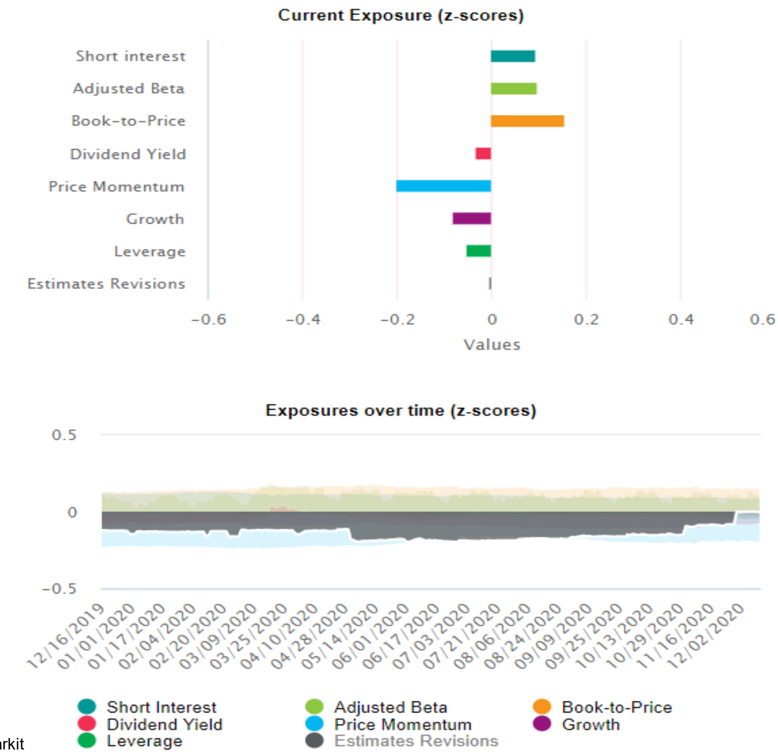
Lastly, we highlight factor exposures to small cap (Figure 11), Energy (Figure 12) and Information Technology (Figure 13) segments of the market. To assess small cap exposures, we begin with the US Total Cap universe (approximately 3,000 names) and filter for the smallest two-thirds of stocks according to the Natural Logarithm of Market Capitalization factor, thus the reported z-scores are relative to the full universe of large and small caps.

Overall, small caps have tended to be undervalued with lower momentum relative to large caps. We also draw attention to the Estimate Revisions exposure which was has been negative relative to large caps for most of the year; however, a noticeable reversal has developed in November.

Figure 11

US Small Cap factor exposures, 14 Dec 2020



Source: IHS Markit

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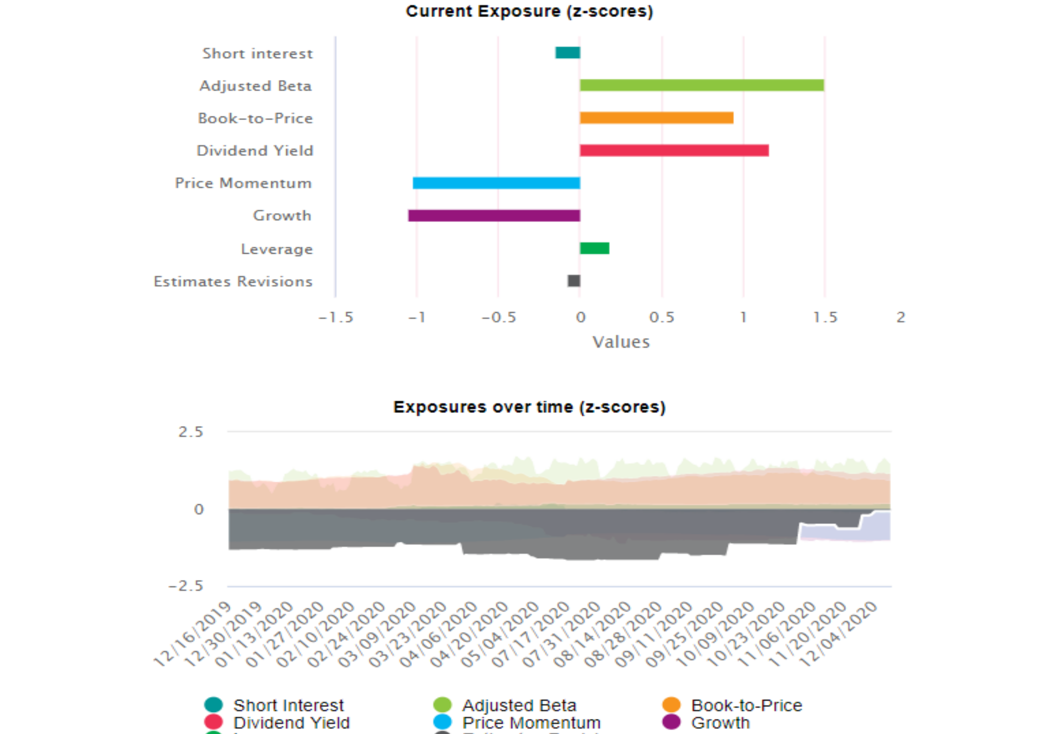
As mentioned above, the reduction in negative earnings revisions for Energy companies alongside the increase for Information Technology firms stands out in the factor exposure time series. Meanwhile, the undervalued, high risk and low momentum characteristics of Energy names has mostly remained intact for the year. Finally, Information Technology names continue to be overvalued, high momentum trades, though at lower risk.

In summary, our analysis confirms a significant shift in leadership to value and small cap stocks in November at a record setting level, alongside a rotation out of Technology stocks and into Energy, again at a record spread. The analyst community likewise moved to a more optimistic outlook on small caps and Energy, as the negative sentiment in earnings forecasts, which has been in place for most of the year, has also demonstrated some signs of reversal.

Figure 12

US Large Cap Energy sector factor exposures, 14 Dec 2020



Source: IHS Markit

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Figure 13

US Large Cap Technology sector factor exposures, 14 Dec 2020

Source: IHS Markit

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