STYLE ANALYTICS
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Report

July 2023

Factor Performance Analysis

High-Beta and Value stocks outperformed globally, Growth not far behind

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Market Background

In July, global equity markets continued their momentum from Q1 and Q2 as the MSCI ACWI index returned an additional 3%, amounting to over 15% YTD. Emerging Markets led the way this month and many of those returns can be attributed to Chinese equities. The MSCI Emerging Markets ex-China index returned 14% as of July month-end after a 4% increase in July.

Developed Markets were not too far behind, returning approximately 3.5% in July and the MSCI World, covering Developed Markets, is also up 16% YTD. Amidst rising geopolitical tensions and global inflation rates still above central bankers' targets, equity markets may appear somewhat disconnected from reality.

Latest CPI figures indicate inflation has picked up slightly in July, breaking a 12-month run of slowing consumer price increases which leaves the door open for potential interest rates hikes at the Federal Reserve's September meeting. The commodities market also observed a divergence in energy prices as crude oil increased by 15% to $80/barrel in July, although natural gas decreased by 4% to $2.63/MMBtu after a 30% increase in June.

The Eurozone has also observed smaller rates of inflation, although the decrease (20bps from 5.3% to 5.5%) is marginal and doesn't show the same momentum as seen in the US. The European economy remained afloat in July, as GDP in the region increased by 30bps.

From a factor standpoint, the clear winner in July was Volatility as investors around the globe benefitted from exposures to high beta and short-term volatility as markets navigate an increasingly complex geopolitical climate with increased pressures from China.

Although Value equities delivered a premium this month across the world, this was not at the expense of all Growth subfactors. In the US, companies with increased sales growth over five years continued to offer returns higher than that of its Value counterparts and Canadian companies with high earnings and sales growth delivered approximately 90 bps of outperformance in its respective market. The Eurozone and the UK diverged from this trend, where Growth equities offered negative or neutral returns this month and heavily favored stocks with strong cash flow and earnings yields.

Commented [EL1]: Should this read "returns higher than"?

Factor Summary

- **US Equities:** Value, Volatility, and sales growth outperformed.
- **Europe:** Value and Volatility also outperformed to similar magnitude as in the US.
- **UK:** Value subfactors outperformed more than Europe and US, while Volatility mirrored them.
- **Emerging Markets:** Volatility and forecasted growth beat the market, Value largely underperformed.
- **Canada**: Value and Volatility beat the market by a large margin, nearly 200bps in one month.

US Equities

The factor performance trend in the U.S. shifted slightly in favor of Value equity in July. Although Growth subfactors offered smaller premiums than the first half of 2023, stocks with high sales growth over five years still outperformed the market by 70 bps. This was greater than any of the core Value subfactors, which on average offered 40bps of outperformance.

July's CPI data rose a mild 0.2% from June breaking a disinflationary trend that's taken shape over the past year. Annual core inflation went down to 4.7% in July from June's 4.8%.

The Bureau of Labor Statistics confirmed unemployment fell 10bps in July to 3.5% and Non-Farm Payrolls stayed consistent, leading to consumer confidence in the US that reached its highest point since October 2021 at 71.6 compared with May's low of 59.2, according to the University of Michigan Consumer Sentiment Index.

Stocks with high five-year sales growth that outperformed the US market include NVIDIA, Alphabet, Meta, and Adobe, which all realized returns above 10% in July. Qualcomm, Abbvie, and Bank of America led the pack from a Value standpoint (specifically, sales to price), returning 11.03%, 12.25%, and 11.54% respectively.

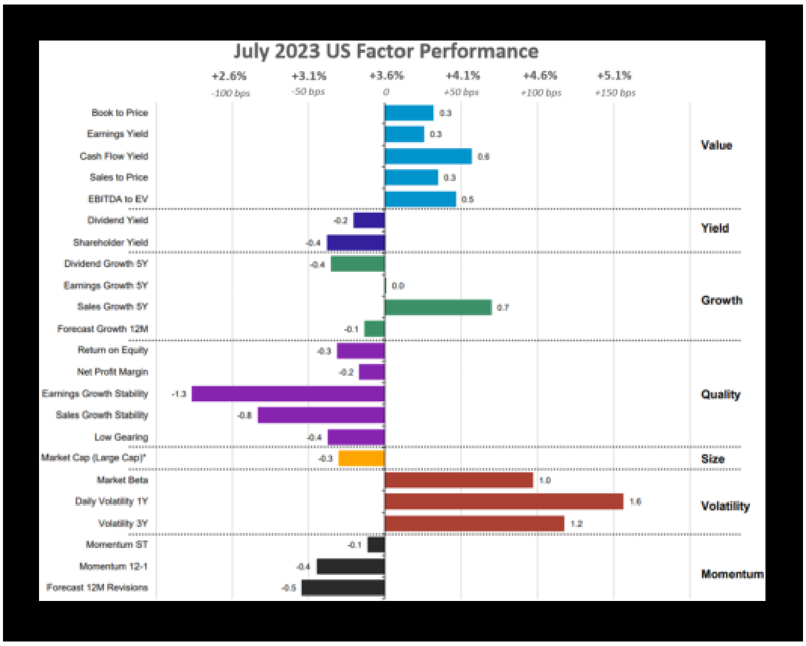

***Figure 1:** July 2023 US Factor Performance (sector adjusted)*
Source: Investment Metrics, a Confluence company

Report

European Equities

European equities slightly outperformed the UK, realizing a 3.5% return in July. The factor performance trend observed in June became much more pronounced as high Value and Volatility stocks outperformed by about 50 and 80 bps, respectively.

The focus on forecasted growth seen throughout the first two quarters of the year has receded, as Growth stocks performed neutrally to the European market. Stocks with high forecasted growth over the next 12 months underperformed the market by 40 bps.

The disinflation trend has continued in the Eurozone, although not at the same pace as seen in the U.S. July inflation data showed consumer prices grew by 5.3% opposed to June's 5.5% increase, registering a marginal change.

GDP also remained neutral at +0.3% growth in the Eurozone, largely led by tourism in France and Spain and dragged down by Italy while the German economy has remained flat since June. This is in line with economist expectations of +0.2% growth, showing that the region's economic output is hovering just above negative growth this month.

German manufacturing, as proxied by the HCOB German Manufacturing PMI index, fell to its lowest level since May 2020, the peak of the COVID lockdowns, and has declined every month in 2023 so far. On the bright side, the latest new factory orders data in Germany shows an increase of 7% in June, mainly for the aerospace industry.

Notable outperformers in this market environment include Value stocks like Dutch automotive manufacturing company Stellantis (+17%); Italian banking group Intesa Sanpaolo (+10%); and German shipping firm Hapag-Lloyd (+12%).

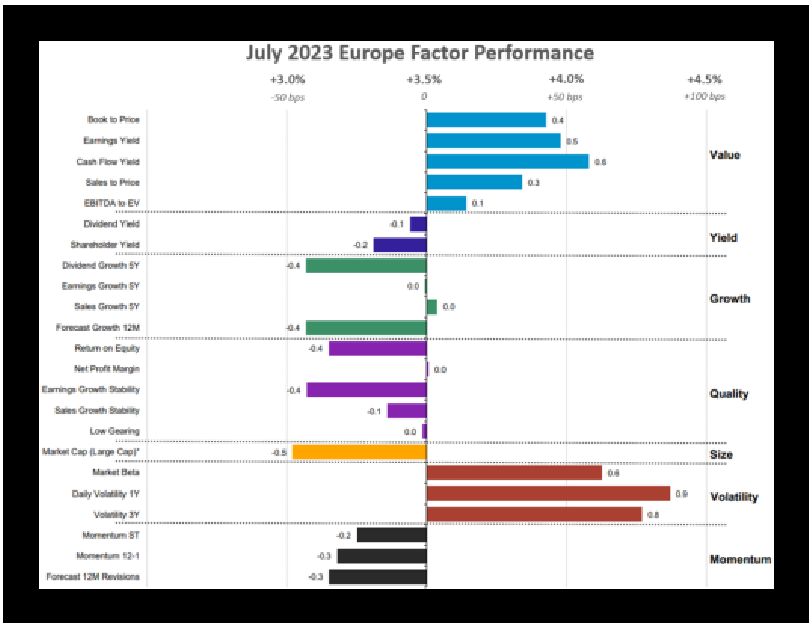

Figure 2: July 2023 Europe Factor Performance (country and sector adjusted)
Source: Investment Metrics, a Confluence company

UK Equities

Although the public equity market in the UK is still underperforming its European counterpart, it did realize a positive return in July with a clear investor preference on high-beta and Value equities.

However, as observed in Europe, manufacturing has been steadily declining in the UK as the S&P Purchasing Managers' index fell to its lowest point since 2020. Consumer confidence, which had been improving each month in Q1 and Q2, dipped in July as inflation and interest rates continue to dampen sentiment.

High Volatility and mid-small cap companies at cheap prices led the region this month, beating the market by 100bps. Investors in companies with these metrics would have realized returns similar to passive exposures to European and American markets.

UK companies with a strong earnings yield that delivered excess returns in July include financial services firm Standard Chartered PLC (+10%); Energy firm Centrica (+12%); and small cap manufacturing company Mondi (+15%).

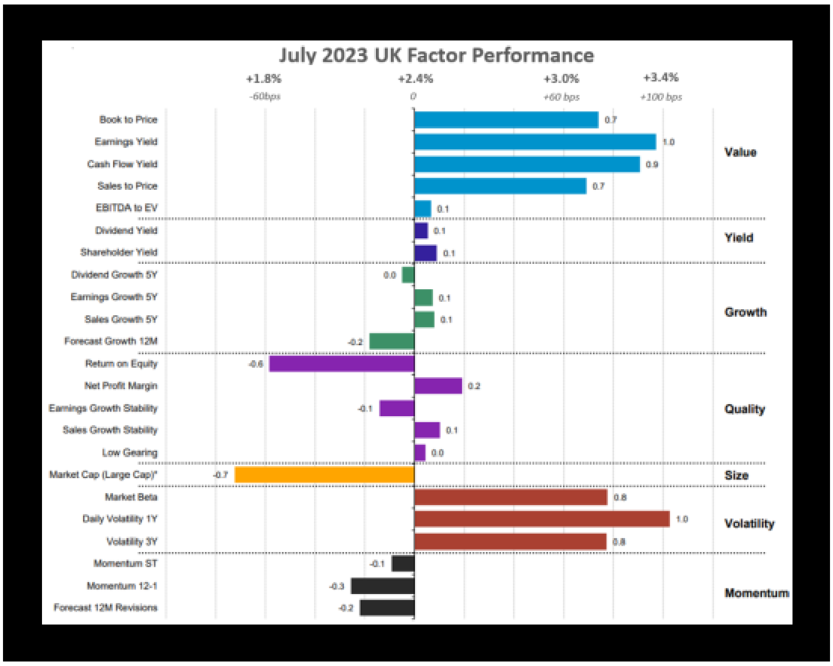

Figure 3: July 2023 UK Factor Performance (sector adjusted)
Source: Investment Metrics, a Confluence company

Emerging Markets Equities

Emerging Markets equity performance continues to differ from Developed Markets, although all regions observed increased premiums from exposure to Volatility subfactors. Although outperformance was largely dominated by Chinese equities, several other countries also realized favorable returns as equities returned 6% overall in the region.

The trend in July favored companies with increased forecasted earnings growth over the next twelve months, and investors benefitted from being exposed to short term volatility.

Notable outperformers in this market environment include Chinese e-commerce firm PDD (+29%), Taiwanese tech firm Quanta Computer Inc (+55%), and Dubai's government owned bank Emirates NBD (+14%).

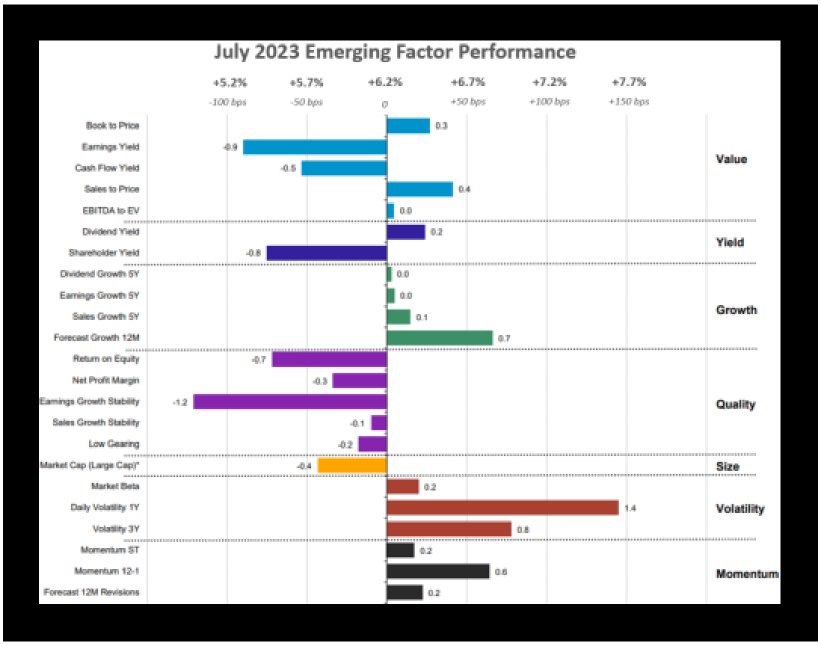

Figure 4: *July 2023 Emerging Factor Performance (country and sector adjusted)*
Source: Investment Metrics, a Confluence company

Canadian Equities

In Canada, the factor performance trend in July mirrored what was observed in June with smaller overall equity returns, but more defined factor premiums. Value stock's outperformance was over 2.5 times more pronounced than last month, scaling from 30 bps on average in June to 80 bps in July. Likewise, the premiums observed in Volatility also doubled as high beta stocks now rewarded investors with 170 bps of outperformance compared to 90 bps observed last month.

Other outperforming subfactors from June continued to offer outsized returns in July, including return on equity, shareholder yield, and sales growth over five years. Just because Value stocks outperformed the Canadian market, didn't mean Growth underperformed. Mid-small cap companies with elevated earnings growth over five years offered 120 bps of outperformance, although stocks with a high forecasted growth over twelve months underperformed the market by 70 bps. This broke up the favorable forecasted growth trend seen in the first two quarters of 2023.

However, subfactors like low gearing and dividend growth over five years which outperformed in June, no longer offered premiums and were market neutral this month.

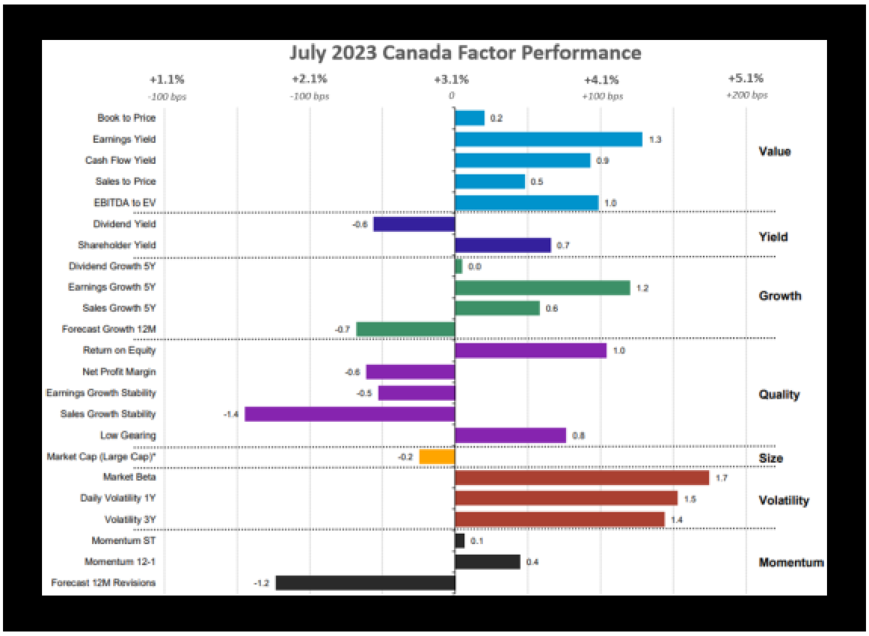

***Figure 5:** July 2023 Canada Factor Performance (sector adjusted)*
Source: Investment Metrics, a Confluence company

Appendix: How to read the charts

Each factor's performance is based on the relative performance of its top 50% of stocks by market cap, compared to the overall market. The Size factor uses the top 70% of stocks, as the only exception.

For example, for the book-to-price factor, we determine the period's performance of the basket of stocks with the highest book-to-price values, relative to the total market. Each factor is analyzed independently, market and fundamental data are adjusted to enable sector-average (within each country) relative data to be used, and the performance measurement isolates the factor's contribution to return.

Disclaimer

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