

MARKETS IN FOCUS – LOOKING BEYOND THE RATE HIKES

Presenters:

Mark Carver, Global Head of Equity Factor Products and Equity Portfolio Management, MSCI

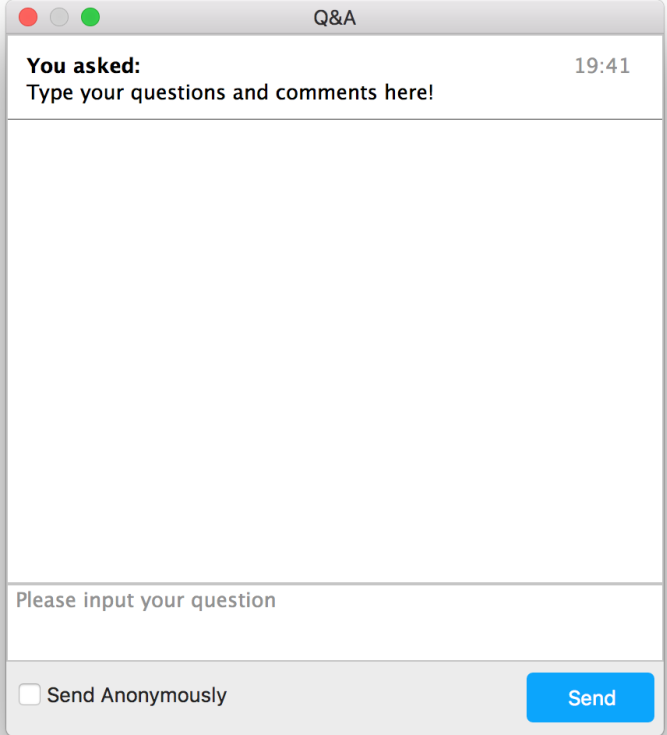
Oleg Ruban, Head of APAC Equity Solutions, MSCI

Sivananth Ramachandran, CFA, Director of Capital Markets Policy, India, CFA Institute



HOUSEKEEPING

- Today's webinar is scheduled for 60 minutes including Q&A
- All participants are muted throughout the webinar
- We welcome comments via the Chat button and questions via the Q&A button on your screen.
- This webinar will be recorded and be made available to view soon after the presentation concludes today
- The main presentation will be uploaded onto [CFA Institute Asia-Pacific Research Exchange \(ARX, www.arx.cfa\)](http://www.arx.cfa)



The image shows a screenshot of a Q&A window interface. The window has a title bar with the text "Q&A" and three colored window control buttons (red, yellow, green). The main content area is titled "You asked:" and contains the text "Type your questions and comments here!". The time "19:41" is displayed in the top right corner. Below the main content area, there is a text input field with the placeholder text "Please input your question". At the bottom left, there is a checkbox labeled "Send Anonymously". At the bottom right, there is a blue button labeled "Send".

Markets in Focus: Looking Beyond the Rate Hikes



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Oleg Ruban
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Ramachandran, CFA**
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Markets in Focus

LOOKING BEYOND THE RATE HIKES

SPECIAL TOPIC: INVESTOR VIEWS ON FACTORS

July 2023

Agenda

- 1. Market Overview and Trends**
- 2. Factor, sector and thematic performances**
- 3. Investor Views on Factors**

Market overview and trends

H1 and Q2 have been difficult for investors to navigate

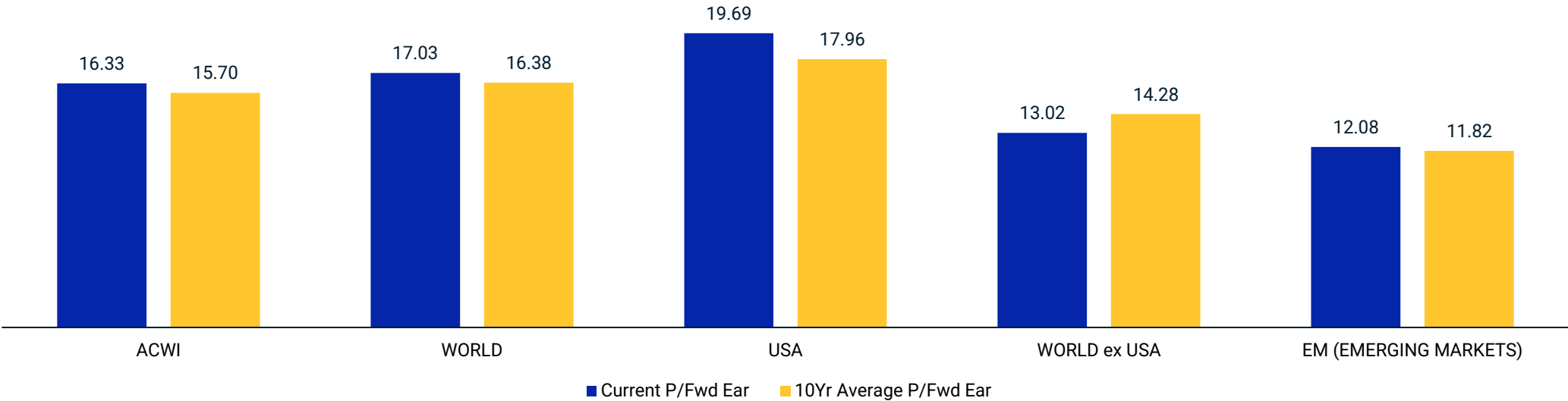
- Equity Markets posted positive returns in Q2 with MSCI ACWI +6% - with developed markets outperforming emerging as MSCI World returned 7% versus 1% return of MSCI EM
- Market returns have been driven by a narrow number of securities with the so called “Magnificent 7” accounting for 50% of the return of MSCI ACWI through June 30th
- Market breadth improved in June but it's a difficult environment for active investors, evidenced by the notion that more than 70% of global equities are underperforming MSCI ACWI through June 30th

Global and regional factor index performance in Q2 2023

	Absolute Returns				Relative Returns			
	Parent	Low size	Low volatility	Yield	Quality	Momentum	Value	Growth
ACWI	6.3	-6.0	-4.0	-4.2	3.1	-2.2	-1.4	-1.9
World	7.0	-3.9	-5.2	-4.6	2.8	-2.7	-1.8	-1.5
World ex USA	3.3	-1.3	-1.2	-1.0	-1.2	0.9	1.9	1.9
EM	1.0	-3.6	0.8	1.2	-1.8	3.0	4.2	-0.8
USA	8.7	-4.2	-6.1	-7.3	3.0	-4.4	-6.8	-3.7
Europe	3.1	-1.7	-0.9	-1.1	-0.9	0.9	-0.1	1.4
AC Asia ex Japan	-1.1	-3.7	1.0	2.1	0.7	6.3	4.6	-0.2
Japan	6.4	-2.4	-2.0	2.7	-1.0	1.5	2.8	-1.3

Equity market valuation on Price to Forward Earnings

PFE for Market Cap Indexes

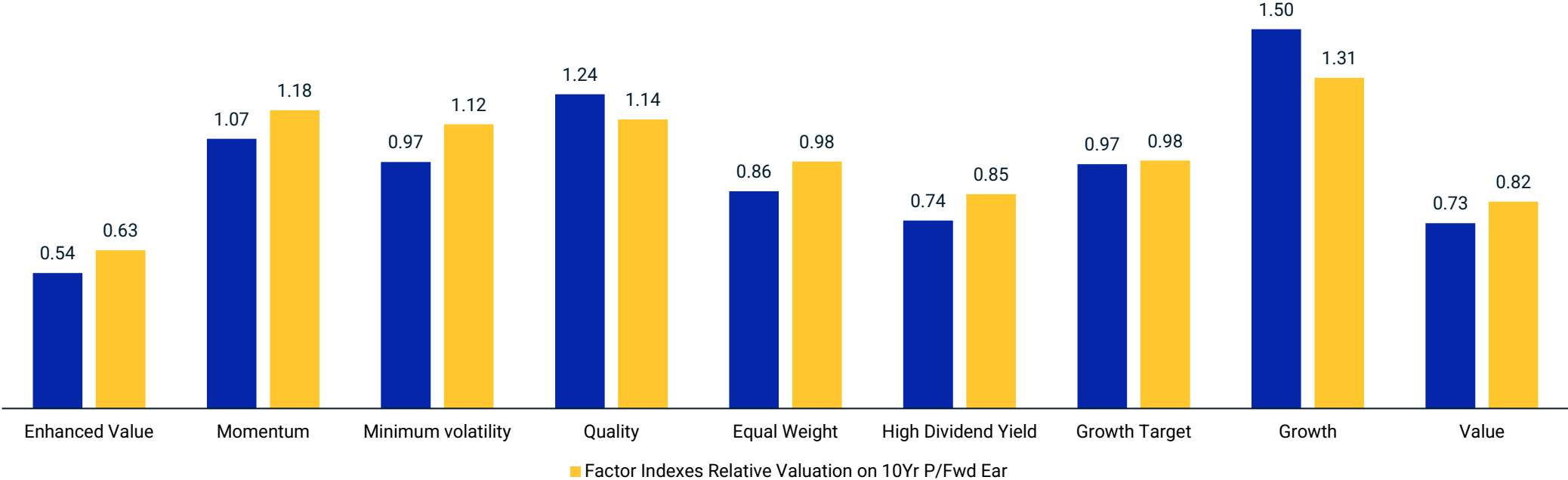


Price to Forward Earnings for MSCI Indexes as of June 30, 2023

Information Classification: GENERAL

World factor index Relative Valuation

World Factor Relative Valuation



Relative Valuation is a Ratio of the Price to Forward Earnings of the Factor Index divided by the Price to Forward Earnings of the MSCI World Index as of June 30, 2023

Information Classification: GENERAL

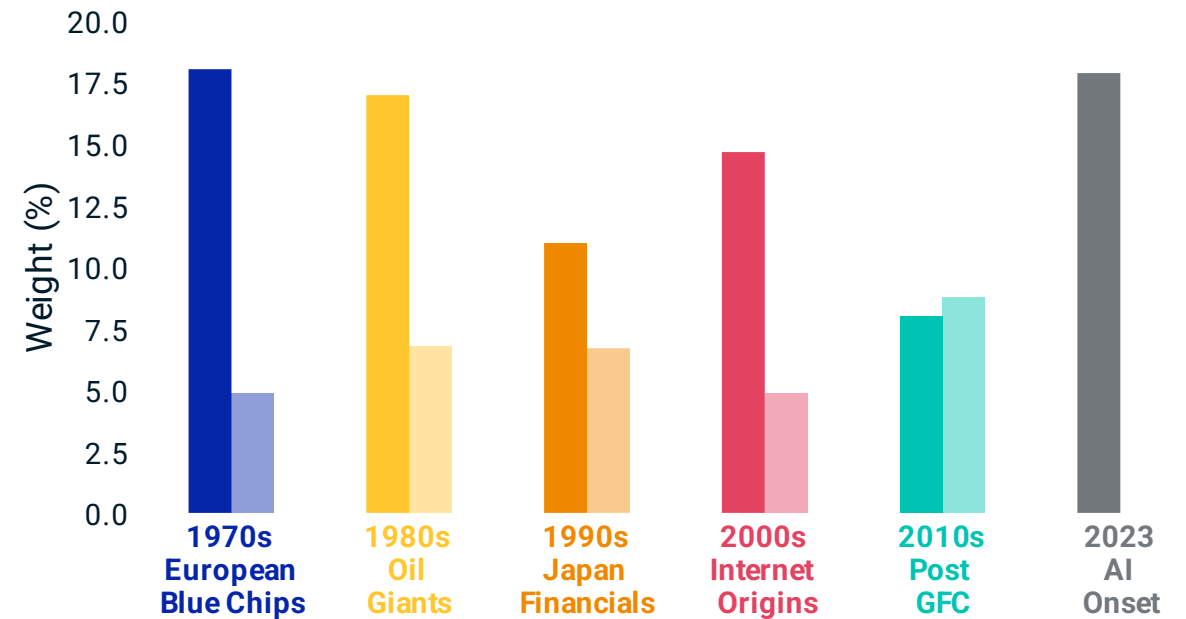
Looking beyond the rate hikes

MSCI ACWI index - past and present market leaders

The ten largest firms at the beginning of each era...

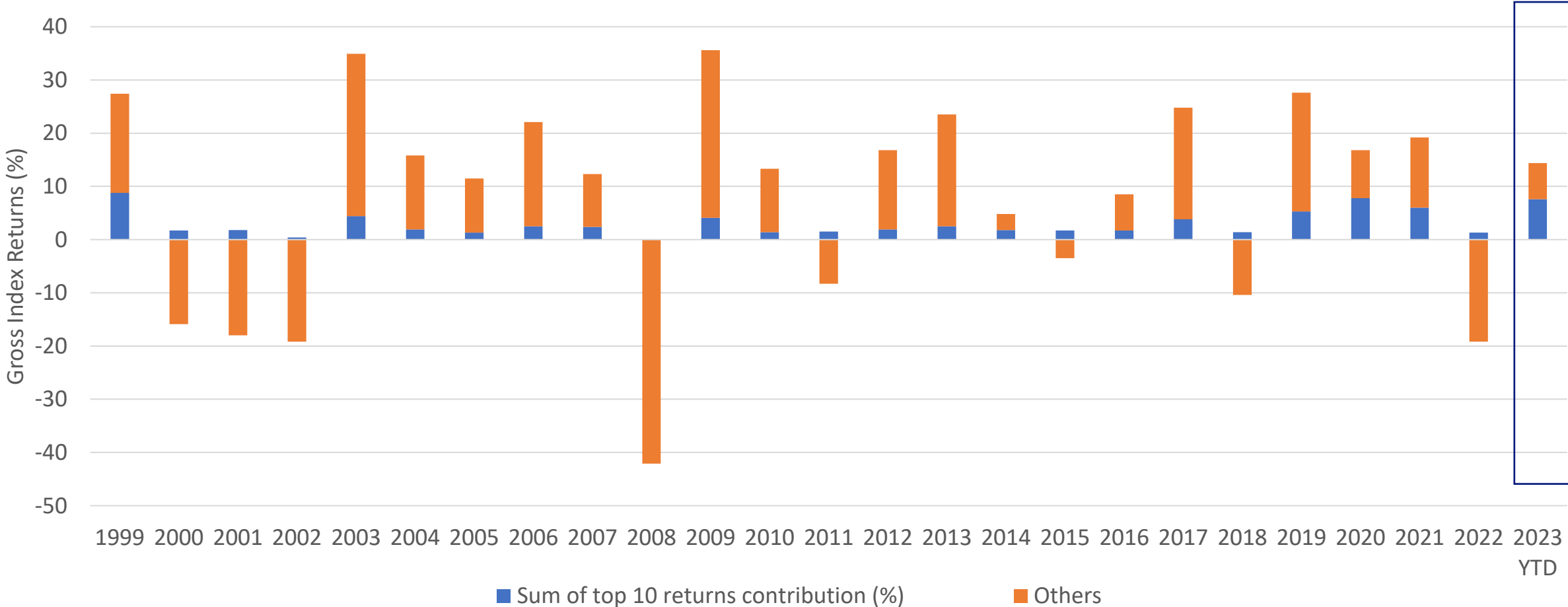
1970s European Blue Chips	1980s Oil Giants	1990s Japan Financials	2000s Internet Origins	2010s Post GFC	2023 AI Onset
Royal Dutch Petrol.	IBM	Industrial Bank Japan	Microsoft Corp	Exxon Mobil Corp	Apple
Shell T & T	AT&T	Sumitomo Bank	General Electric Co	Microsoft Corp	Microsoft Corp
British Petroleum	Exxon Corp	Fuji Bank	Cisco Systems	HSBC Holdings	Amazon.Com
Imperial Chemic	General Motors	Daiichi Kangyo Bank	Wal-Mart Stores	Apple	Nvidia
Broken Hill Prop	British Petroleum	Exxon Corp	Exxon Mobil Corp	BP	Tesla
Philips	General Electric USA	General Electric USA	Intel Corp	Johnson & Johnson	Alphabet A
Hamersley Hldgs	Standard Oil Indiana	Tokyo Electric Power	Lucent Technologies	Procter & Gamble Co	Alphabet C
Rio Tinto-Zinc	Royal Dutch Petrol.	IBM	Nokia Corp	IBM Corp	Meta Platforms A
Telefonica Nacional	Standard Oil California	Toyota Motor	Ntt Corp	Nestle	TSMC Corp
Daimler-Benz	Atlantic Richfield	AT&T	Deutsche Telekom	AT&T	Unitedhealth Group

...had a smaller market weight a decade later



1H 2023 : 53% of the ACWI Index return came from 10 stocks

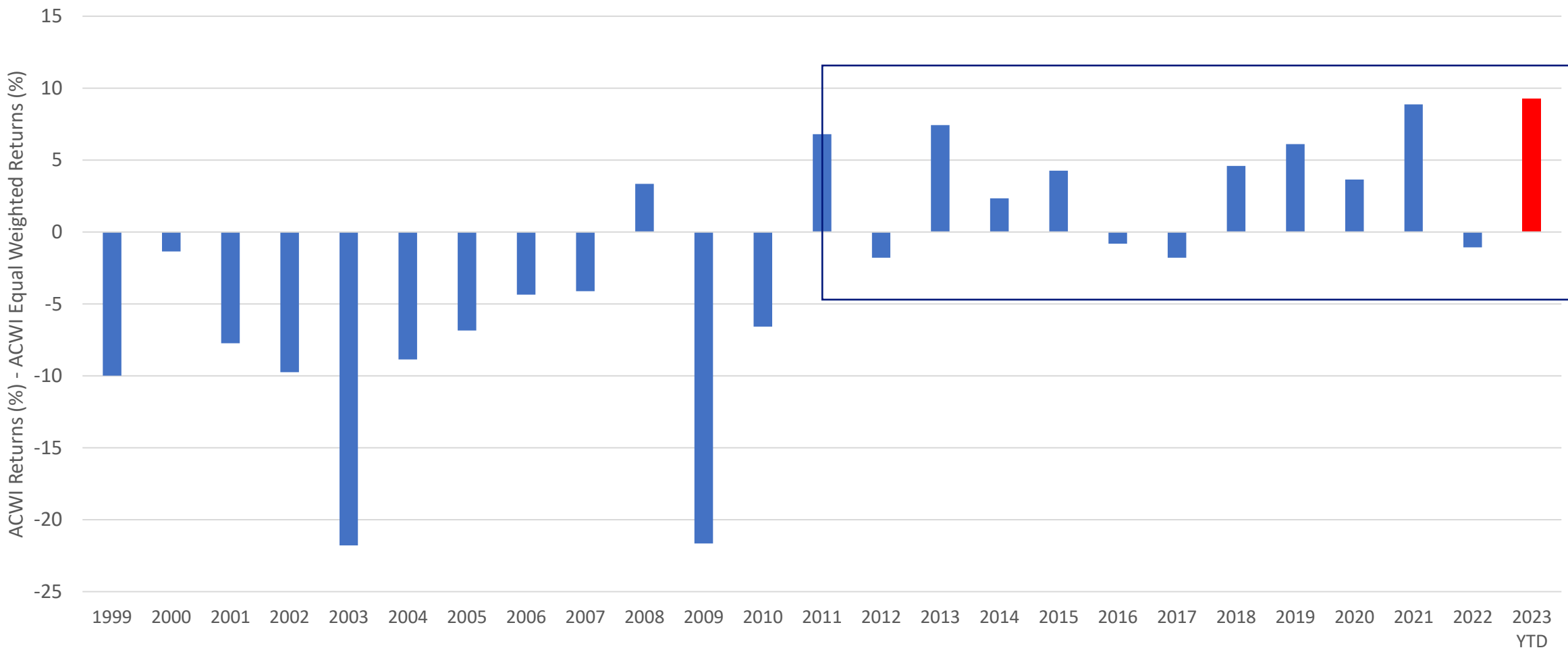
MSCI ACWI Top 10 Return Contributions



Time period : Dec. 31, 1998, to June 30, 2023.

Information Classification: GENERAL

MSCI ACWI – Market Cap vs Equal-Weight

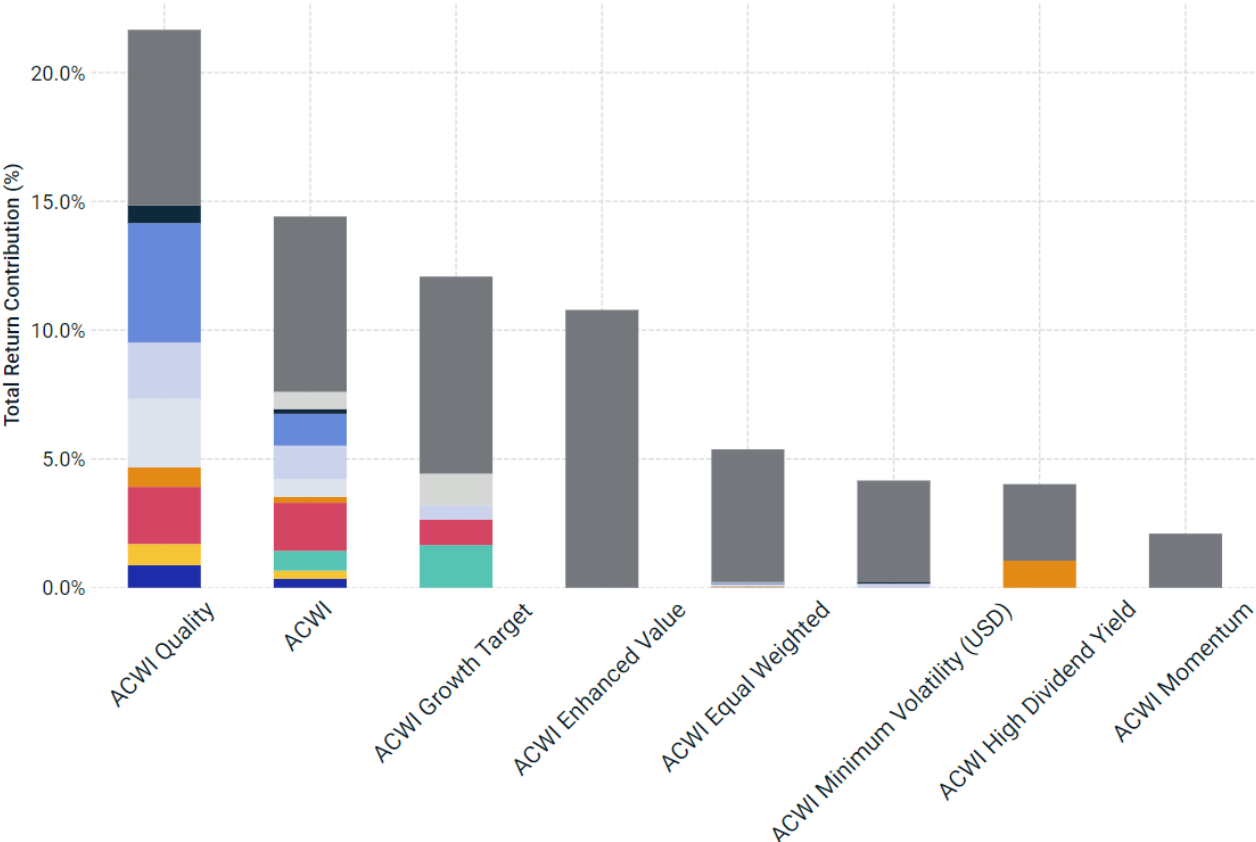


Time period : Dec. 31, 1998, to June 30, 2023.

Information Classification: GENERAL

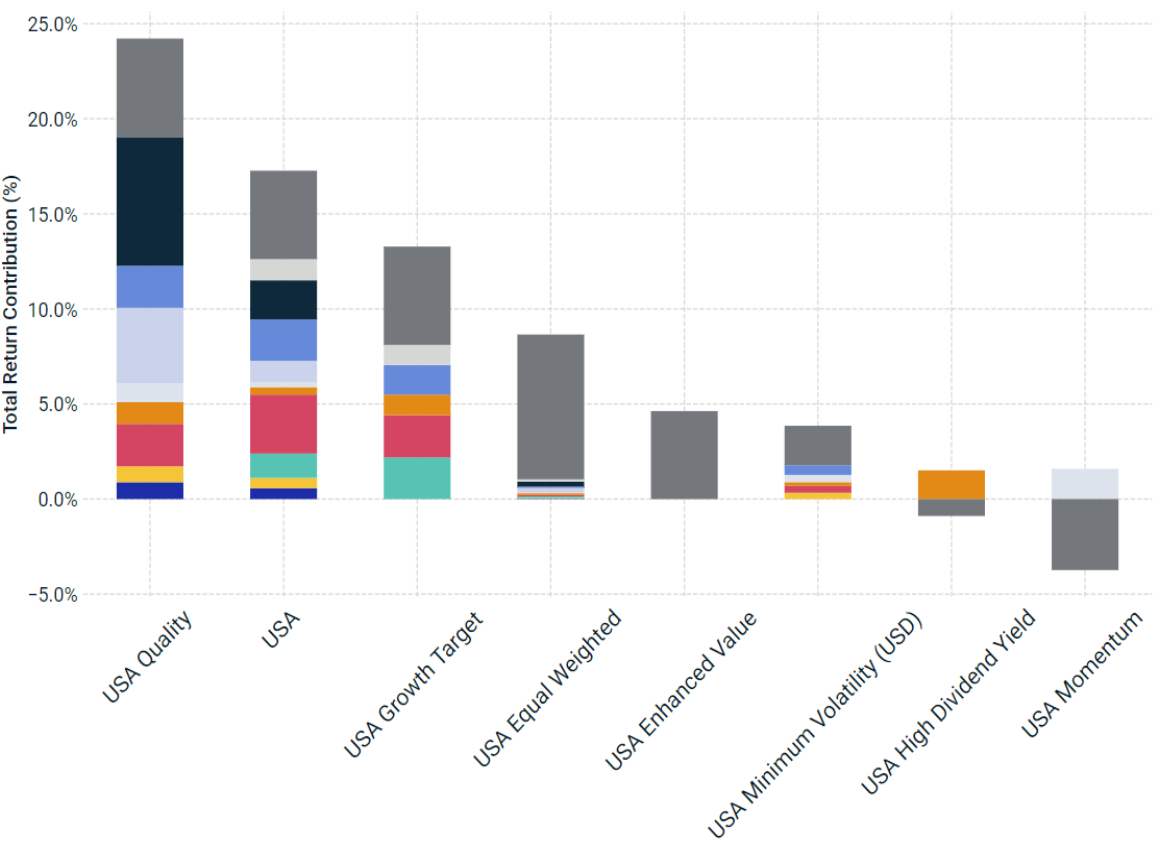
1H 2023: How did top 10 contributors to ACWI index impact factor indexes?

MSCI ACWI Indexes



- ALPHABET A
- ALPHABET C
- AMAZON.COM
- APPLE
- BROADCOM
- META PLATFORMS A
- MICROSOFT CORP
- NVIDIA
- TAIWAN SEMICONDUCTOR MFG
- TESLA
- OTHERS

MSCI USA Indexes

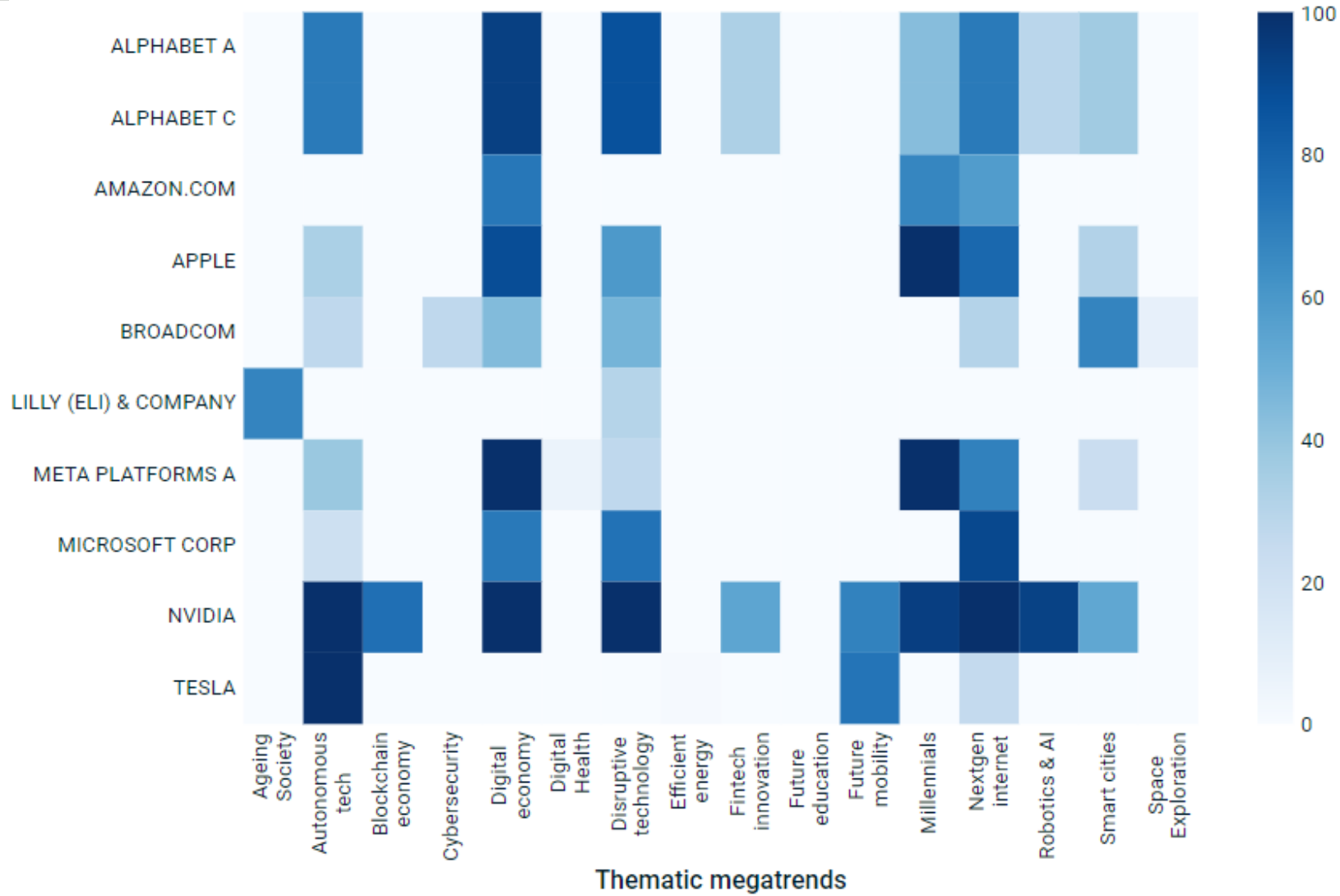


- ALPHABET A
- ALPHABET C
- AMAZON.COM
- APPLE
- BROADCOM
- LILLY (ELI) & COMPANY
- META PLATFORMS A
- MICROSOFT CORP
- NVIDIA
- TESLA
- OTHERS



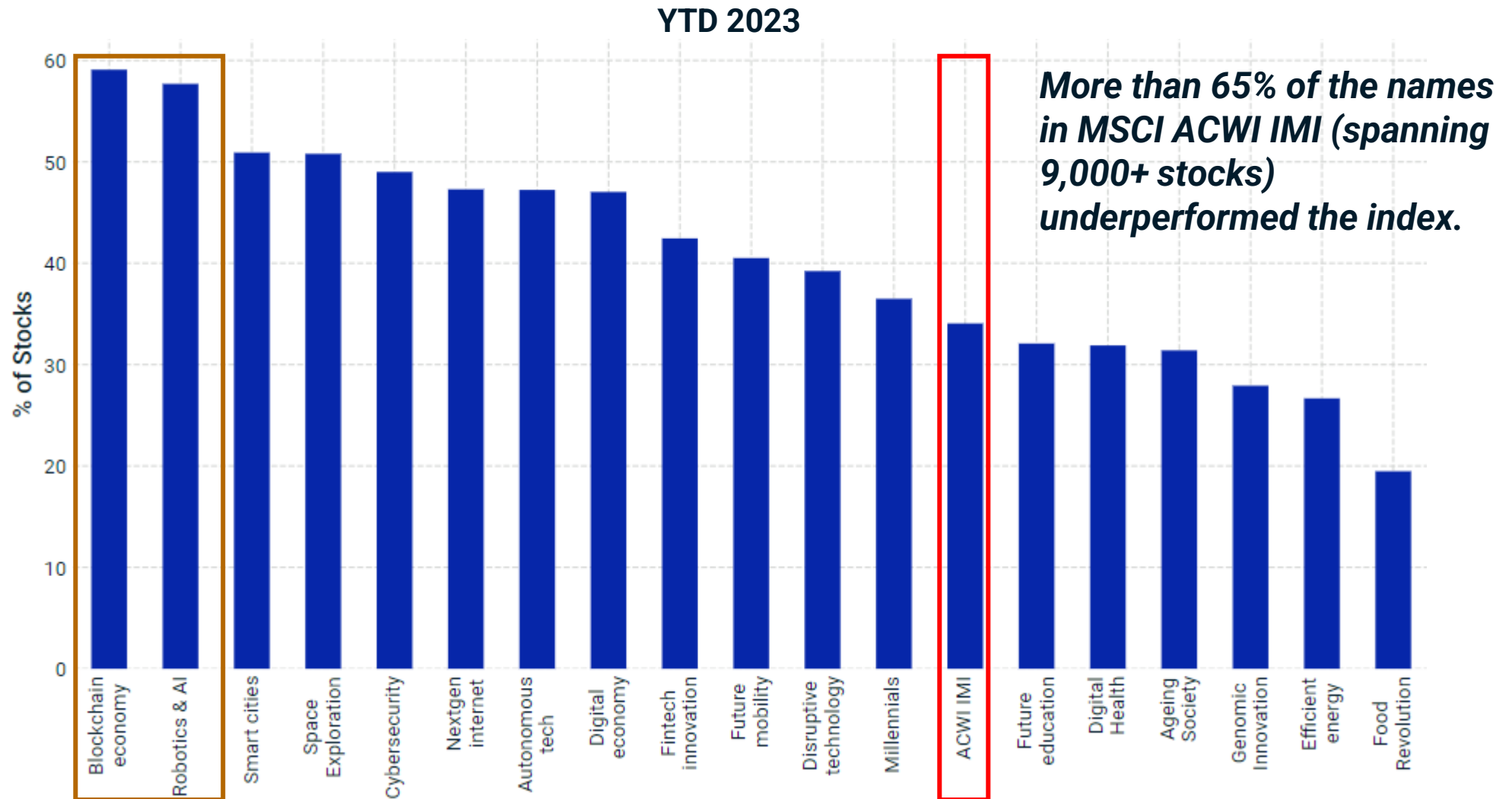
YTD performance as of June 30, 2023.

Top 10 contributors and thematic relevance scores



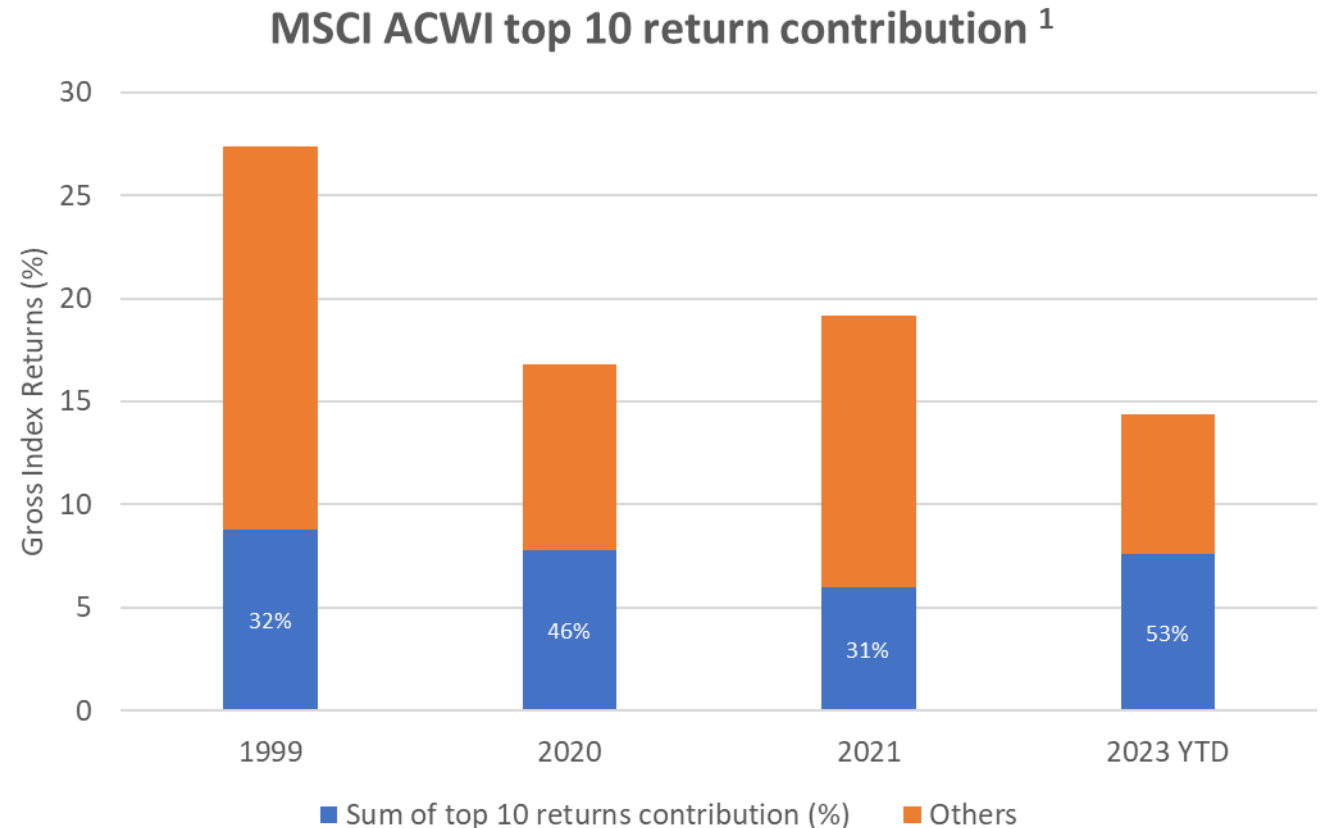
1H 2023: Large majority of names underperformed

MSCI ACWI IMI Index



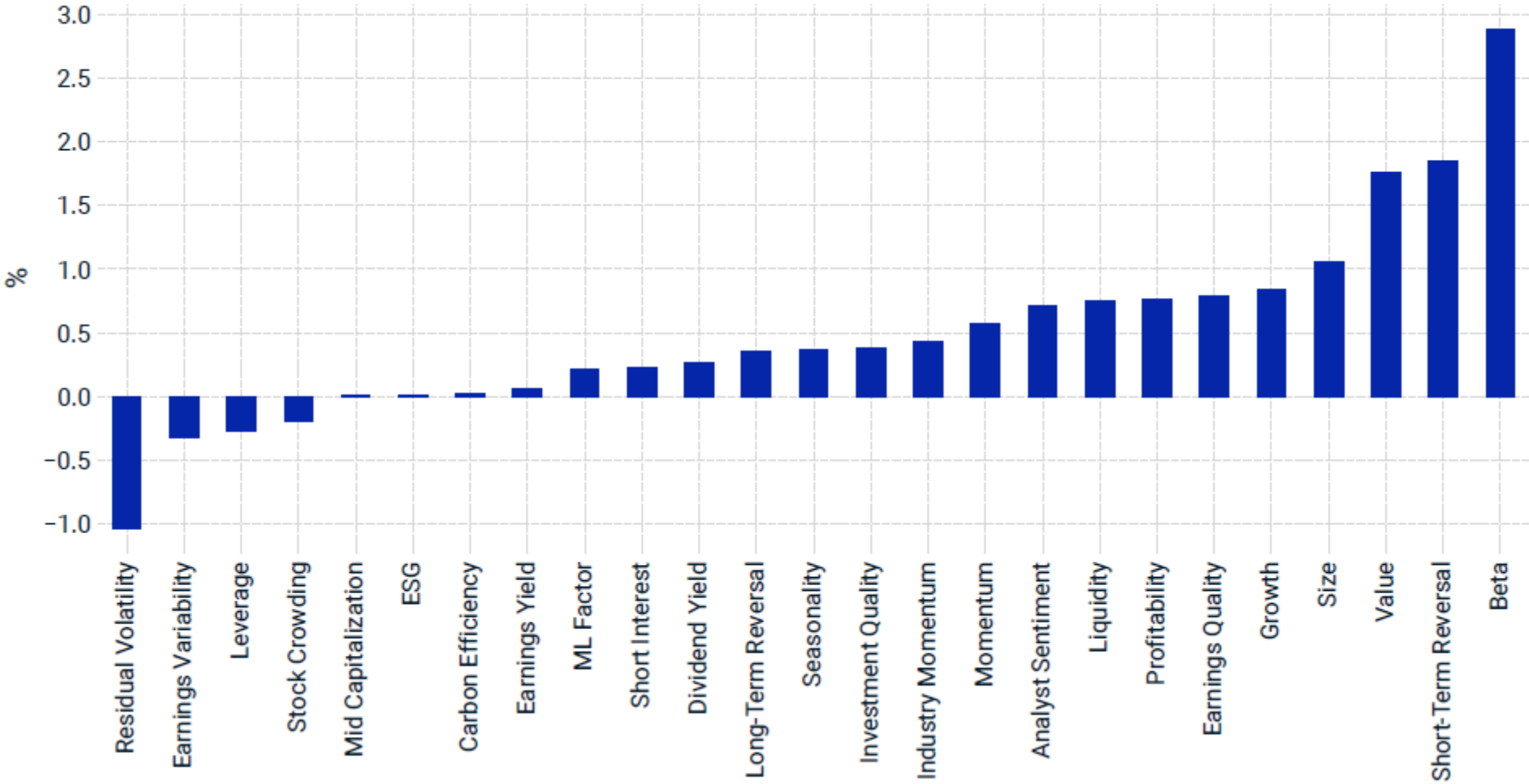
Looking back at outsized performance from 10 stocks

- We analysed years of outsized performance **contributions by top 10 stocks** during:
 - Tech bubble - 1999
 - COVID pandemic - 2020 & 2021
 - Artificial Intelligence – 1H 2023.
- Why this time was *different*
 - Beyond large cap, factor exposures reveal key differences
 - Change in analyst sentiment was more pronounced in 2023



1H 2023 – Global equity market model pure factor performance

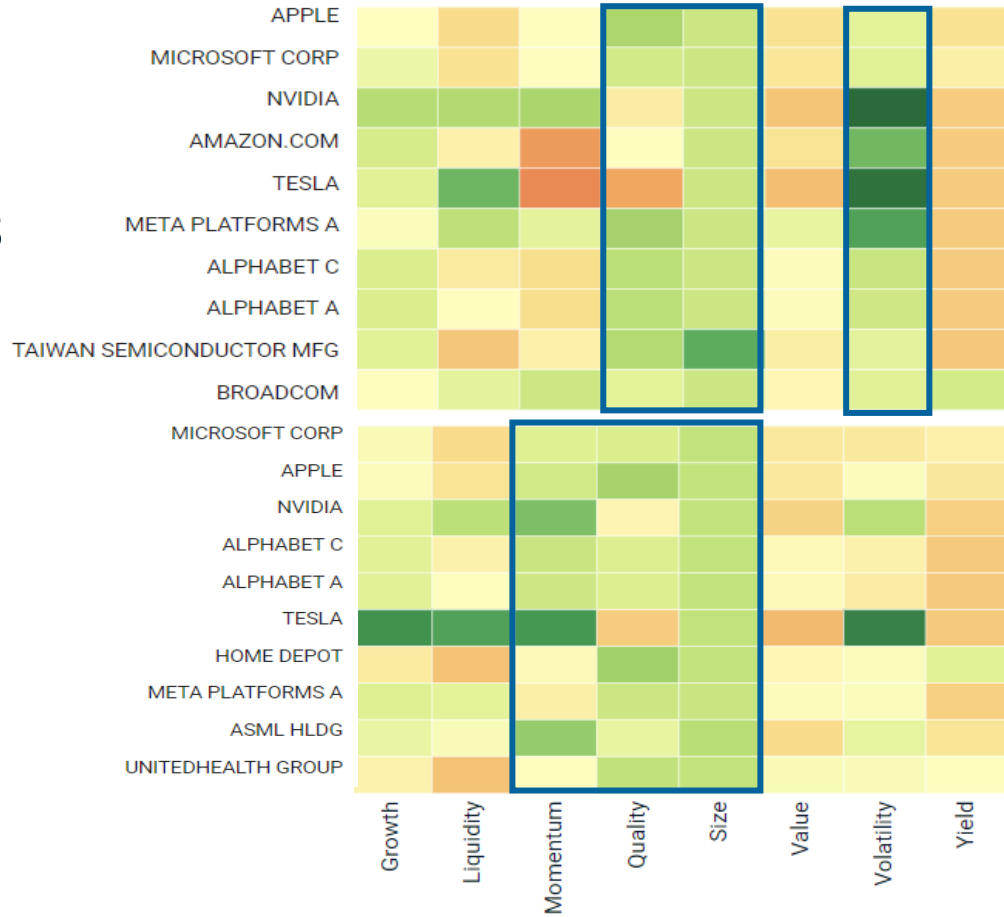
EFMGEMTR Style Factors YTD Return as of 30 Jun, 2023



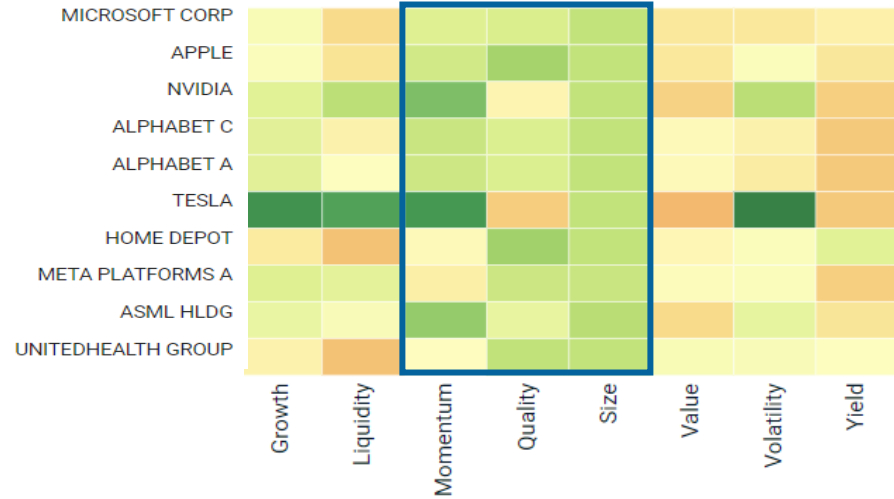
YTD 2023 vs pandemic and tech bubble

Top 10 Contributors - Average Factor Exposures

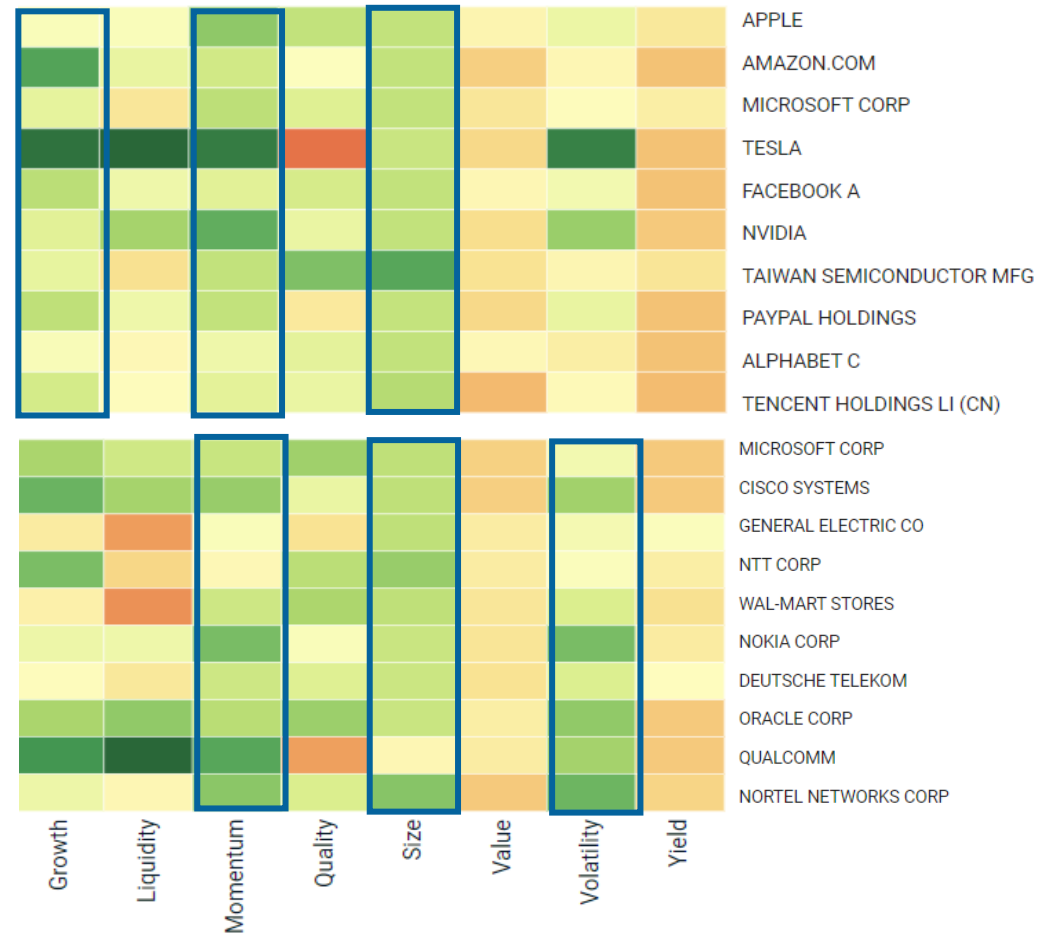
YTD
2023



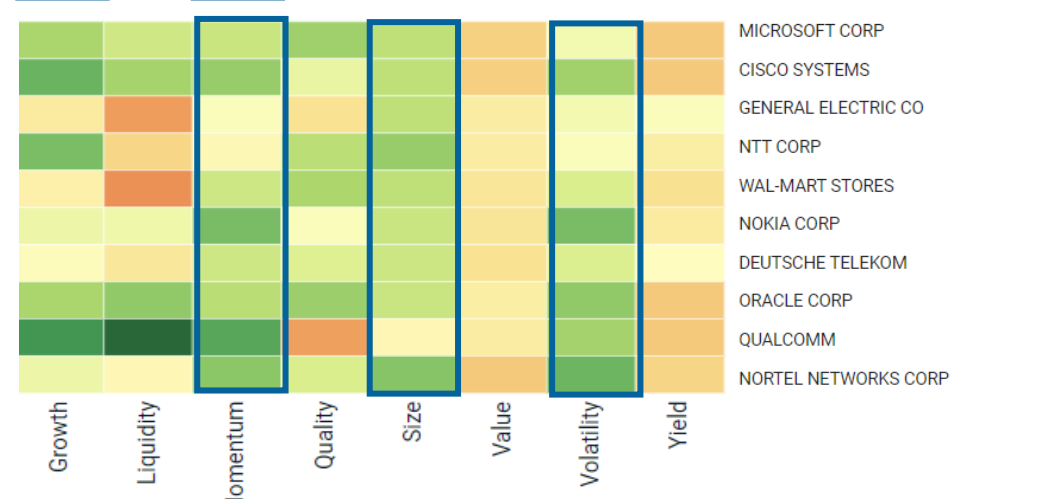
2021



2020



1999

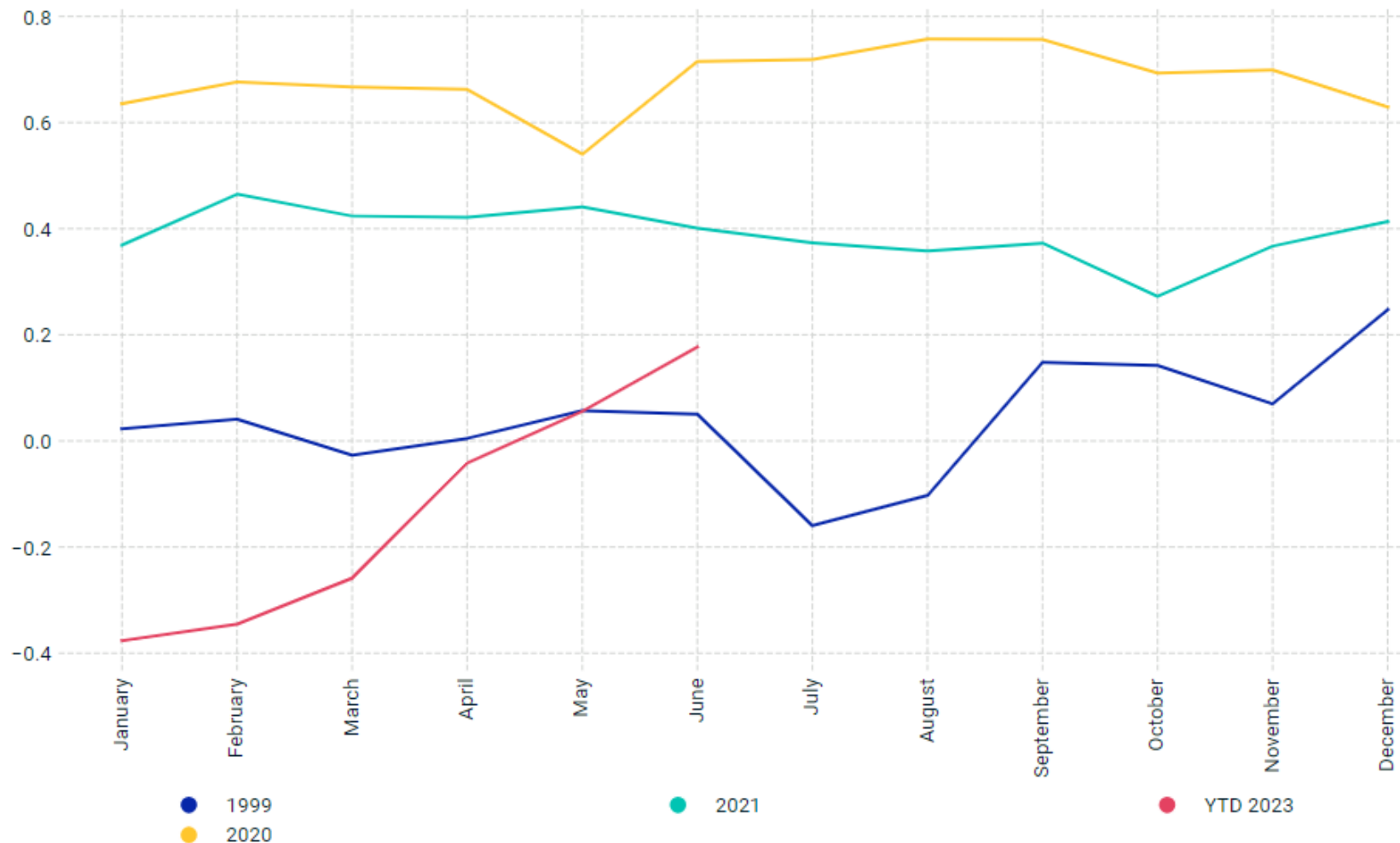


The plot shows average factor exposures of the top 10 contributors to MSCI ACWI Index during the highlighted time period.

Information Classification: GENERAL

2023: Change in analyst sentiment from negative to positive

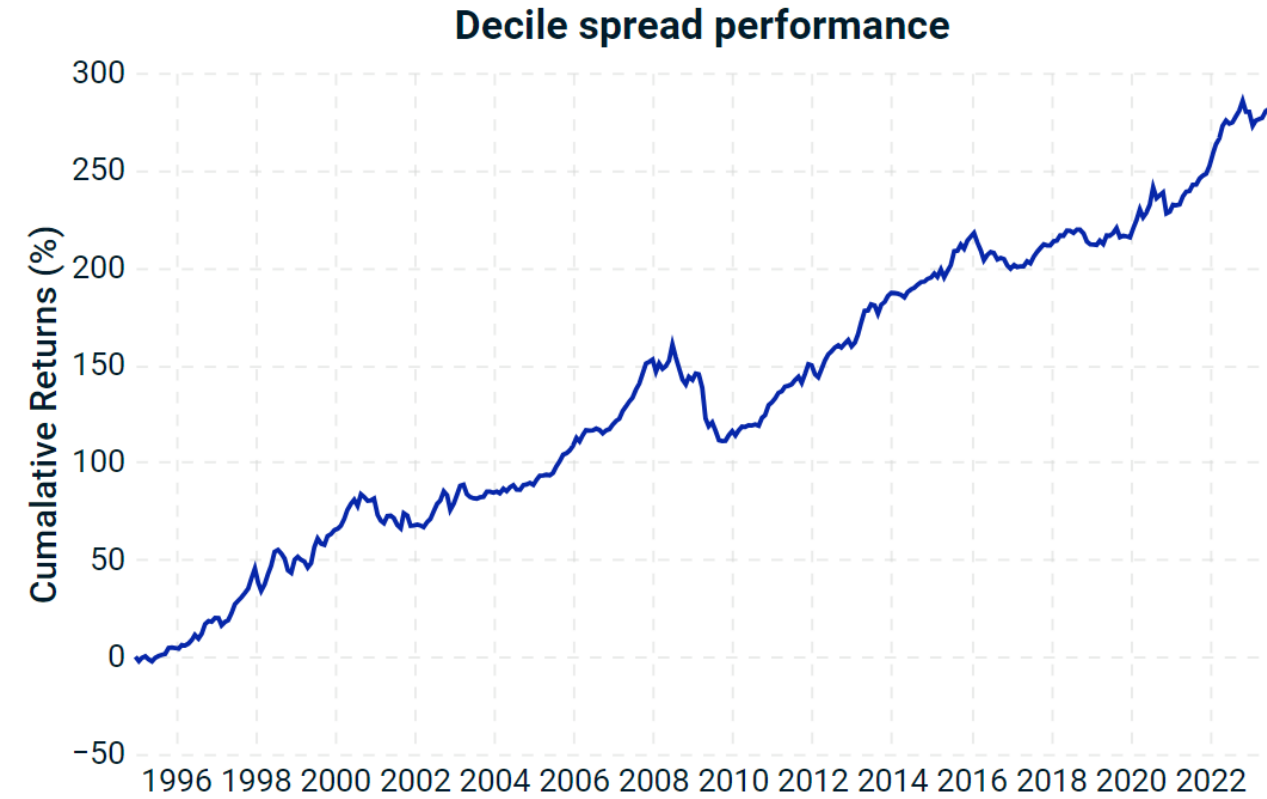
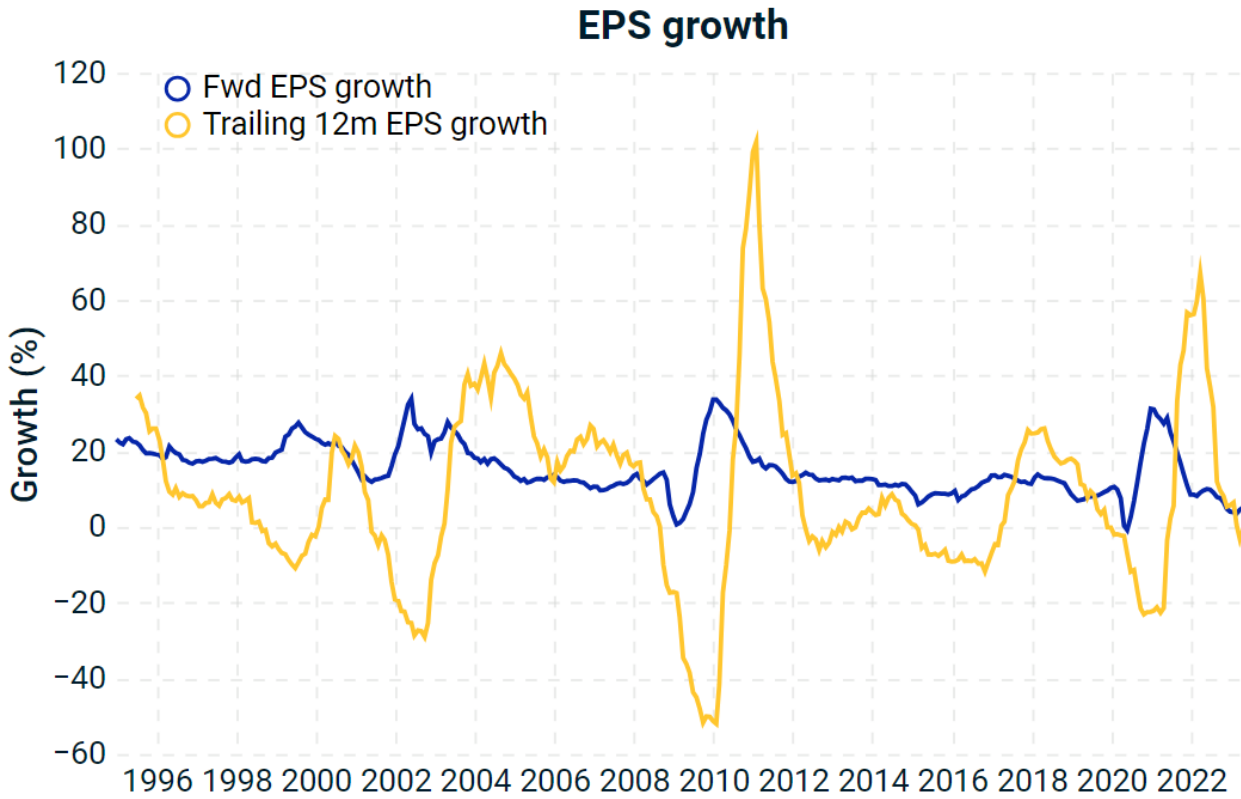
Average Exposure Analyst Sentiment



Source: MSCI. Analyst Sentiment for each month end is the average of Change in Analyst-Predicted EPS across mega caps.

Information Classification: GENERAL

Analysts' EPS expectations and performance of hypothetical portfolio following their revisions

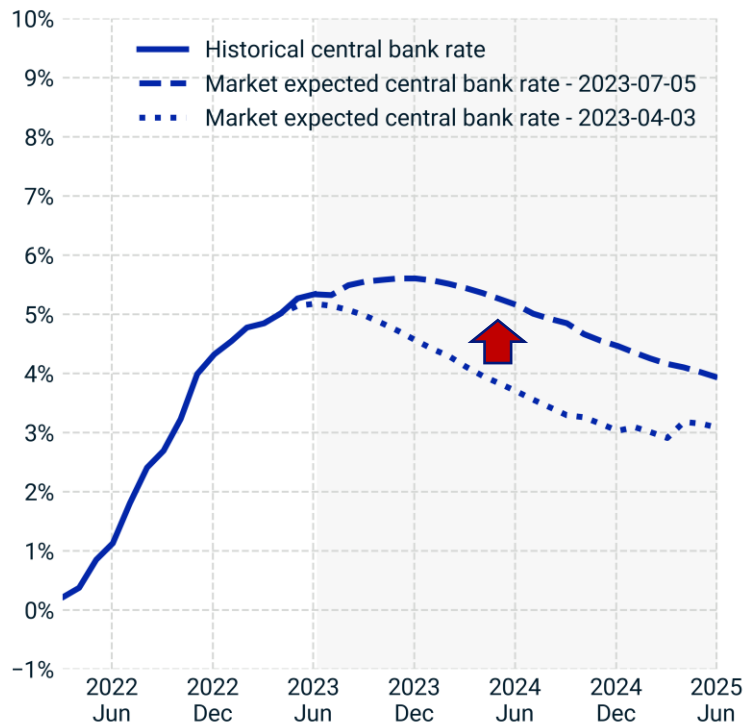


The plot shows the comparison of trailing 12-month EPS growth rate and one-year forward expected EPS growth rate for MSCI ACWI index, along with the performance of a hypothetical decile-spread portfolio (long top decile, short bottom decile) of the change in analyst-predicted EPS descriptor. Data from December 1994 to June 2023.

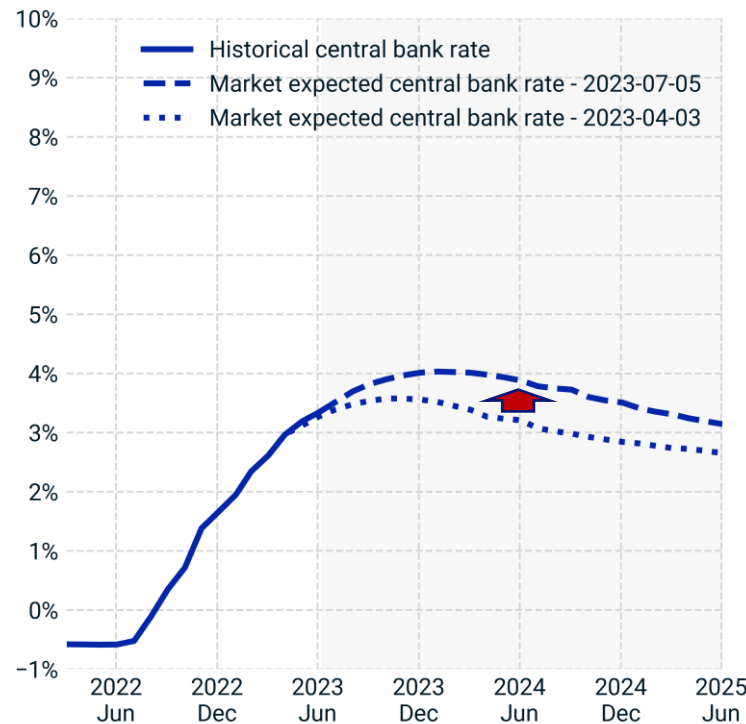
Investors anticipate higher policy rates compared to April

Market-implied expectations for policy rates signal that rates will stay high for longer*. UK rates are expected to be higher amidst more entrenched inflation.

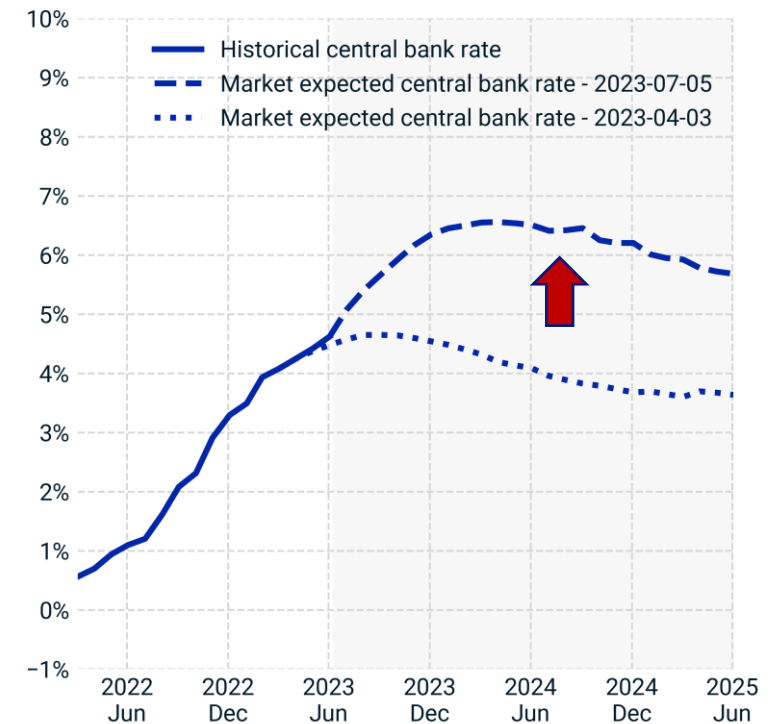
United States



Eurozone



United Kingdom









Historical factor and sector performance during rate pauses and pivots

Average 6m Forward Returns	After Cut		After Hike	
	Pause	Pivot	Pause	Pivot
USA	4.6%	6.8%	11.5%	4.9%
Active Returns for USA Factors				
Enhanced Value	0.1%	0.9%	0.0%	0.8%
Equal Weighted	1.3%	0.6%	1.0%	0.1%
High Dividend Yield	-1.9%	4.4%	2.0%	5.0%
Minimum Volatility	-1.0%	-0.4%	1.3%	0.3%
Momentum	2.4%	-0.7%	1.9%	-0.3%
Quality	0.2%	-0.5%	1.4%	0.8%
Active Return for USA Sectors				
Communication Services	-5.1%	2.3%	2.2%	2.2%
Consumer Discretionary	3.0%	-0.3%	-2.5%	-1.1%
Consumer Staples	0.7%	0.3%	1.5%	4.9%
Energy	-0.3%	-0.4%	-0.1%	1.8%
Financials	-1.4%	5.6%	4.1%	1.0%
Health Care	-1.5%	0.5%	0.3%	3.1%
Industrials	0.5%	-1.6%	1.7%	-0.7%
Information Technology	2.7%	-4.8%	4.1%	-9.9%
Materials	1.9%	-1.9%	-1.4%	-0.1%
Utilities	-3.5%	4.3%	1.7%	6.4%

Data from September 1982 to June 2023. Source: Federal Reserve Bank of St. Louis's FRED database

Information Classification: GENERAL

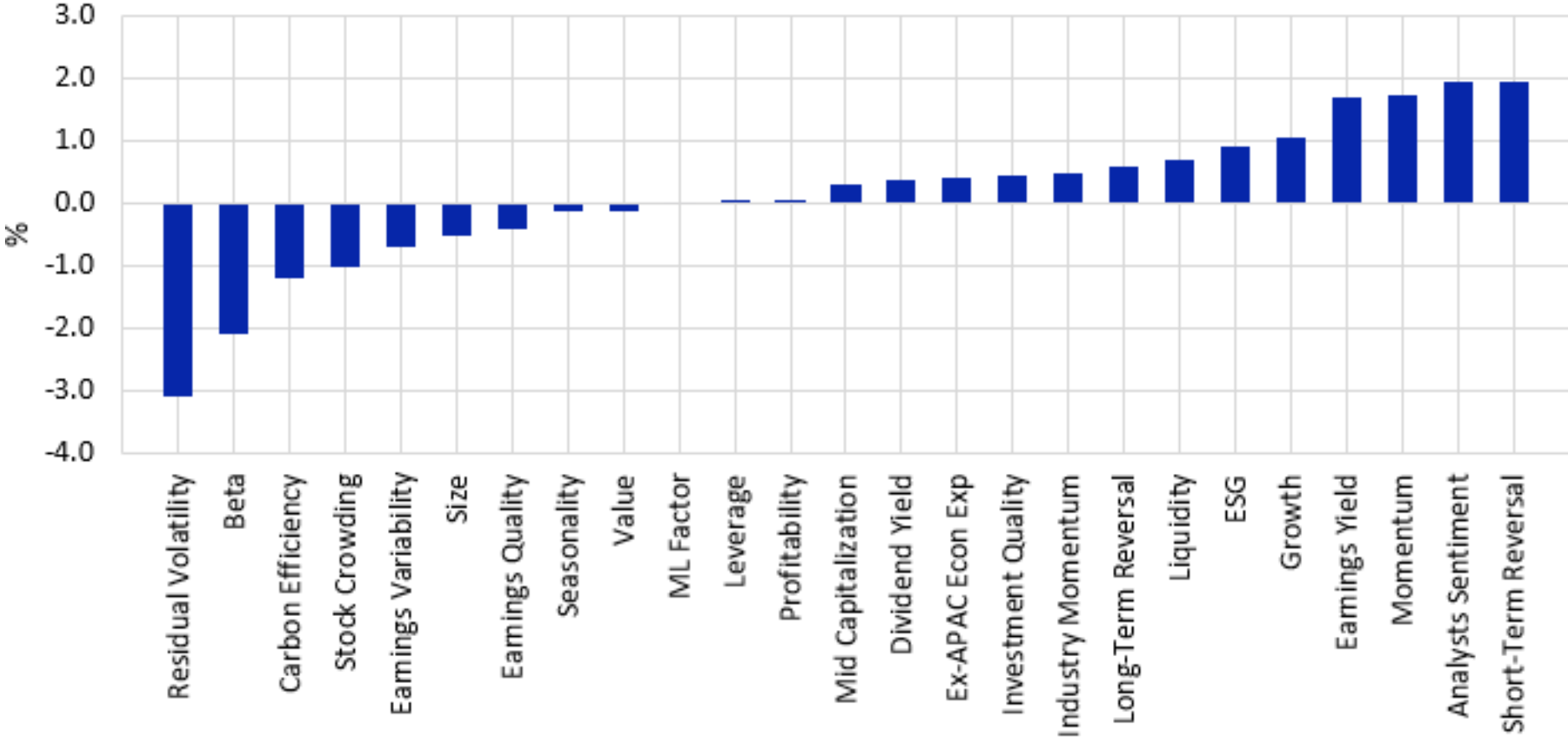
MSCI Adaptive multi-factor allocation model

	Macro Cycle	Valuation	Momentum	Market Sentiment	Composite
 LOW VOLATILITY	+	+	--	-	-
 YIELD	--	-	--	-	--
 QUALITY	+	--	++	-	N
 MOMENTUM	-	--	++	+	N
 VALUE	++	++	++	+	++
 LOW SIZE	-	++	--	+	N

Factor update for Asia Pacific

1H 2023 – Asia-Pacific equity market model pure factor performance

APACEFMTR Style Factors YTD Return as of 30 Jun, 2023



Japan style factors (JPN) are excluded for clarity

Investor views on factors

Investors believe Factors will likely be the dominant driver of active returns going forward

In Q1 2023, MSCI launched a survey to gain insights on investors' current thinking regarding equity factors and to learn how investors believe traditional factor strategies should evolve to better serve the increasingly complex investment landscape

Key Insights from Client Survey



Investor faith in equity factors increased

Investors consider factors important components of equity portfolios and remain optimistic about performance in the medium- to long-term



Factor rotation remains important

Some investors are looking to manage their factor exposures more actively by opportunistically rotating to Value and Quality



Factors are seen as key elements of active performance

Investors are increasingly reliant on factor performance attribution to decompose the risk and return of portfolios



Investors don't view factors and factor strategies as static

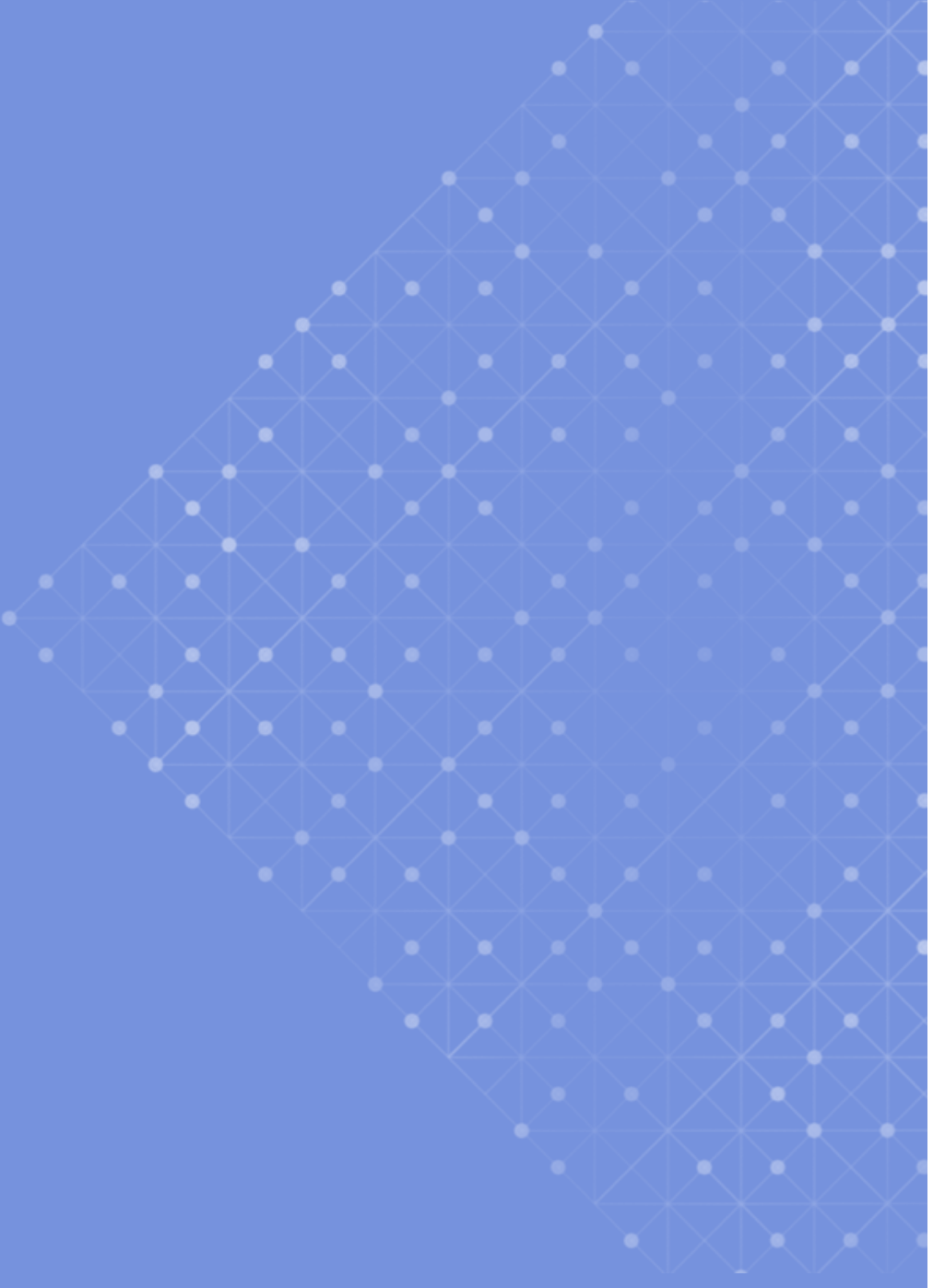
Investors believe that factor definitions should evolve through time and new factors may be discovered from alternative datasets



Different investment characteristics have converged

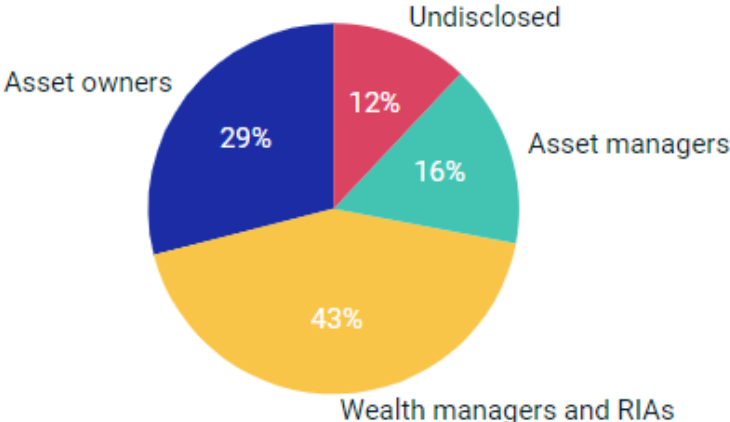
Investors are increasingly drawn to integrate ESG, Climate, thematics within their factor allocations

Appendix

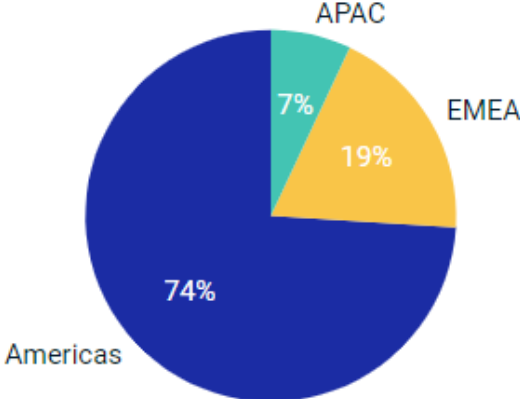


Investor profile

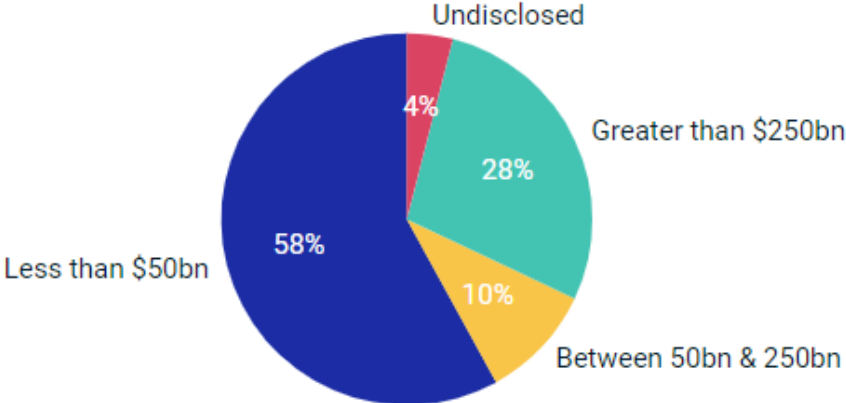
Investor type



Regional representation

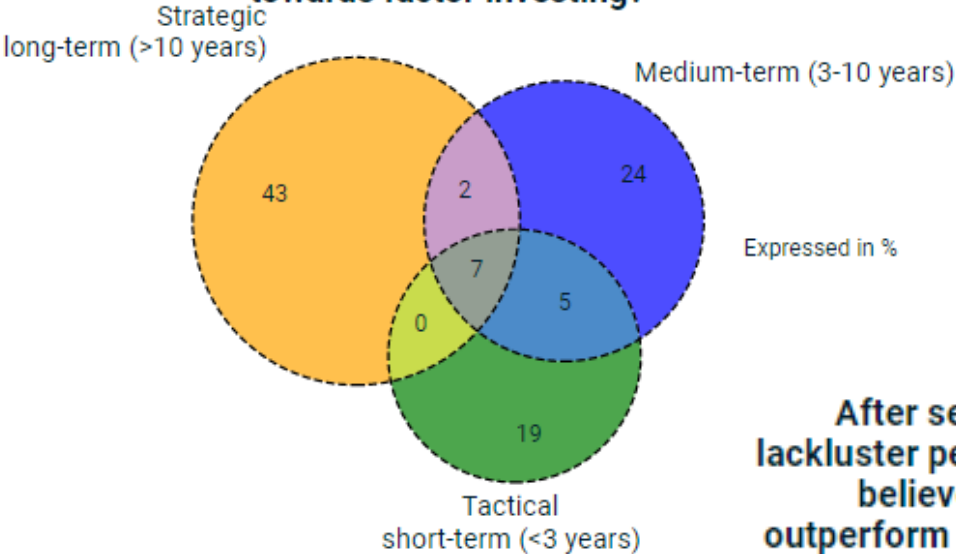


AUM breakdown

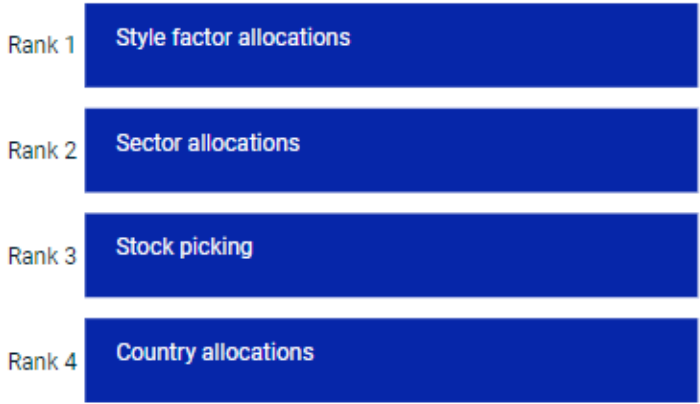


Investor faith in equity factors increased

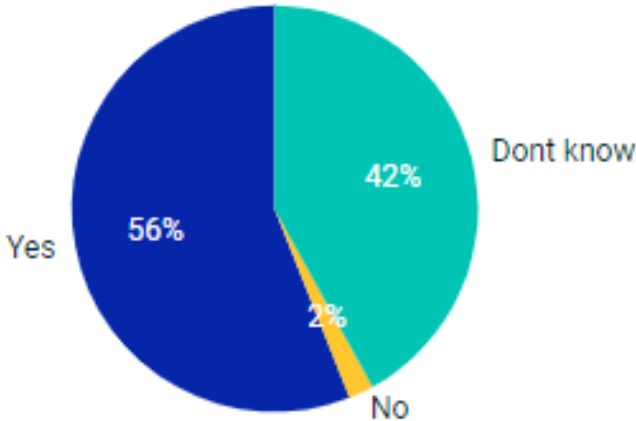
How would you characterize your approach towards factor investing?



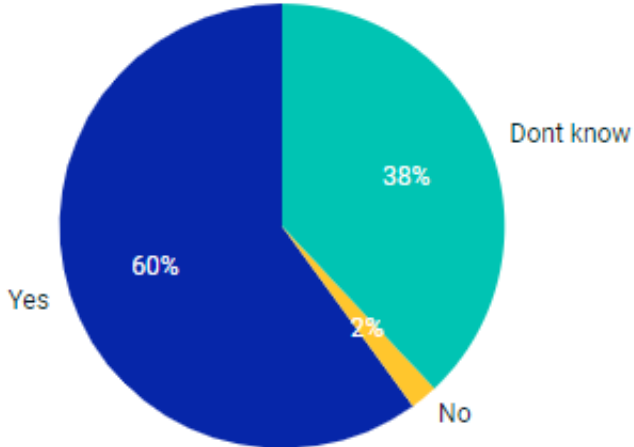
How would you rank the following in terms of their ability to generate alpha?



After several years of lackluster performance, do you believe factors will outperform over the next 5-10 years?

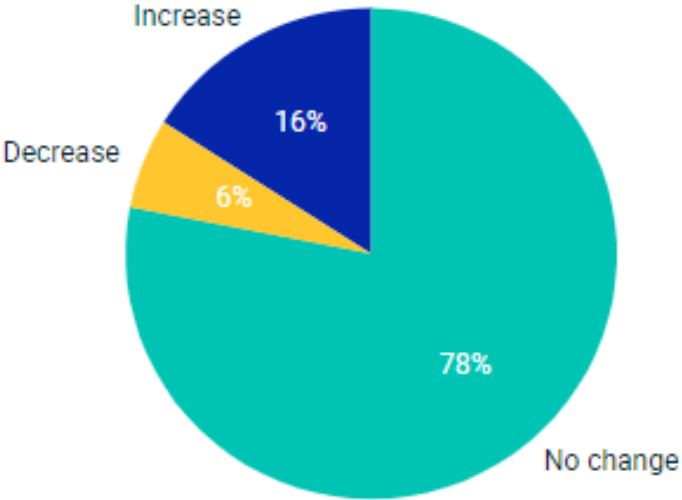


Can factors be harvested in EMs just the same way as DMs?

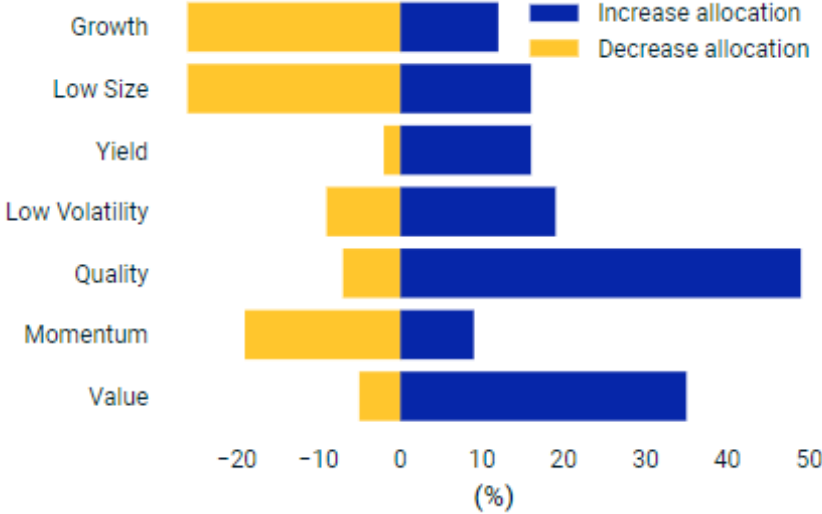


Factor rotation remains important

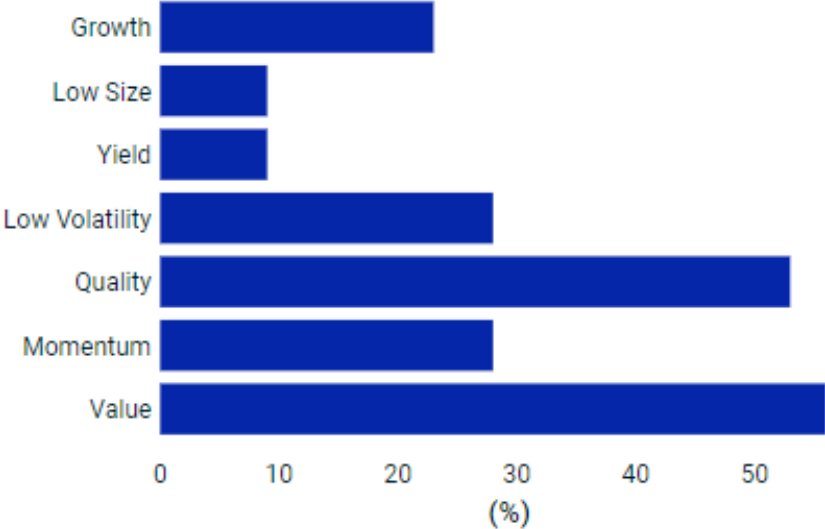
Would you increase, decrease or maintain your pool of assets allocated to factors in the next 12 months?



Within DMs, which factors are you likely to change your allocation towards in the next 12 months?

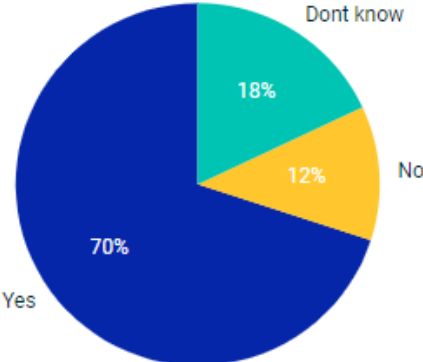


Within EMs, which factors are you likely to INCREASE your allocation towards in the next 12 months?

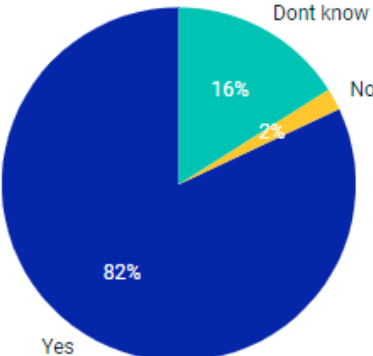


Investors don't view factors and factor strategies as static

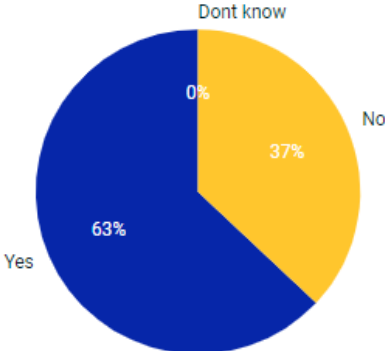
Should valuation ratios, used for value-factor definitions account for intangible assets?



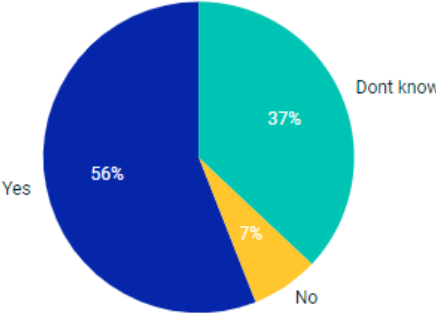
Should lower accruals and lower asset/issuance growth be integrated into quality-factor definitions?



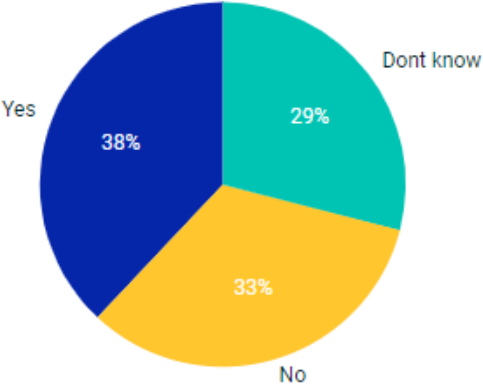
Are there factor signals beyond the traditional value, momentum, quality type of factors, that can be harvested for premia?



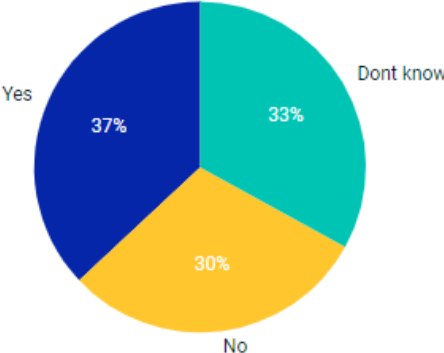
Would factors extracted from alternative datasets or with application of advanced techniques such as machine learning, have a role to play in your factor allocations?



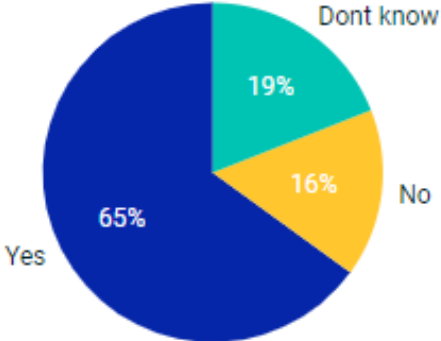
Do you believe analyst sentiment is predictive of future performance of companies?



Do you believe analyst sentiment when integrated with other factors such as value or quality can improve investment outcome of those portfolios?

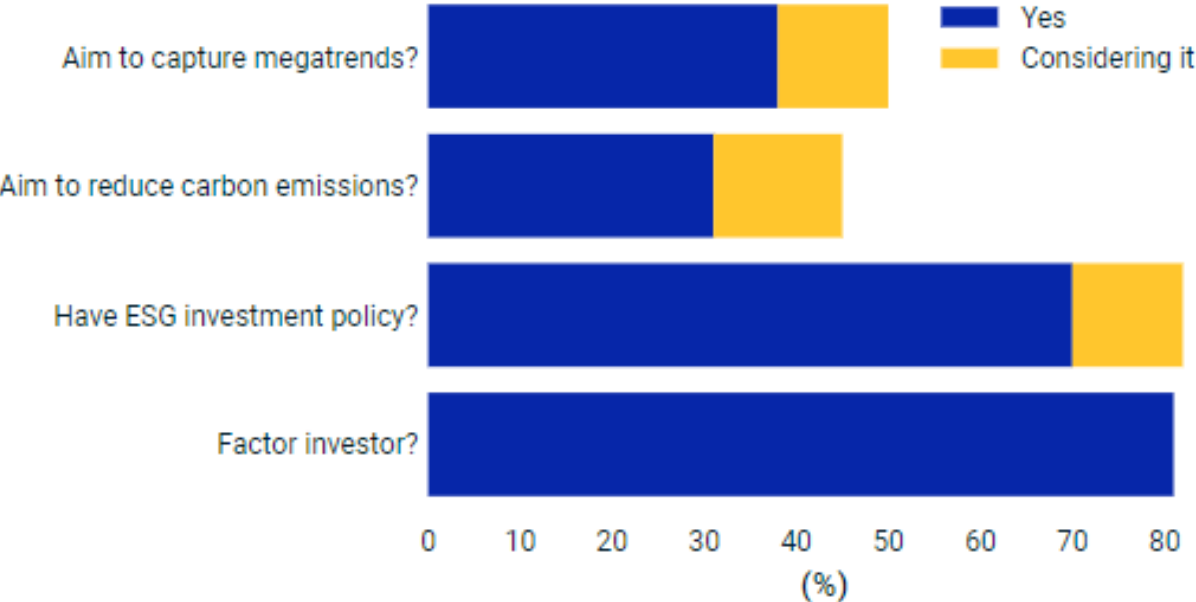


Should crowding risk in securities or factors be addressed in factor portfolio construction?

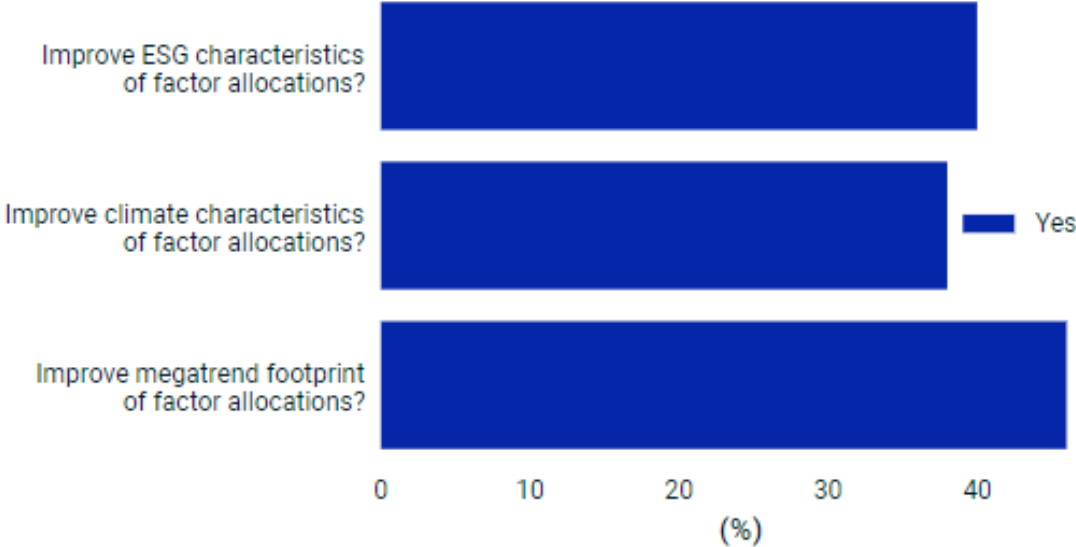


Different investment characteristics have converged

Investors have multiple investment objectives...



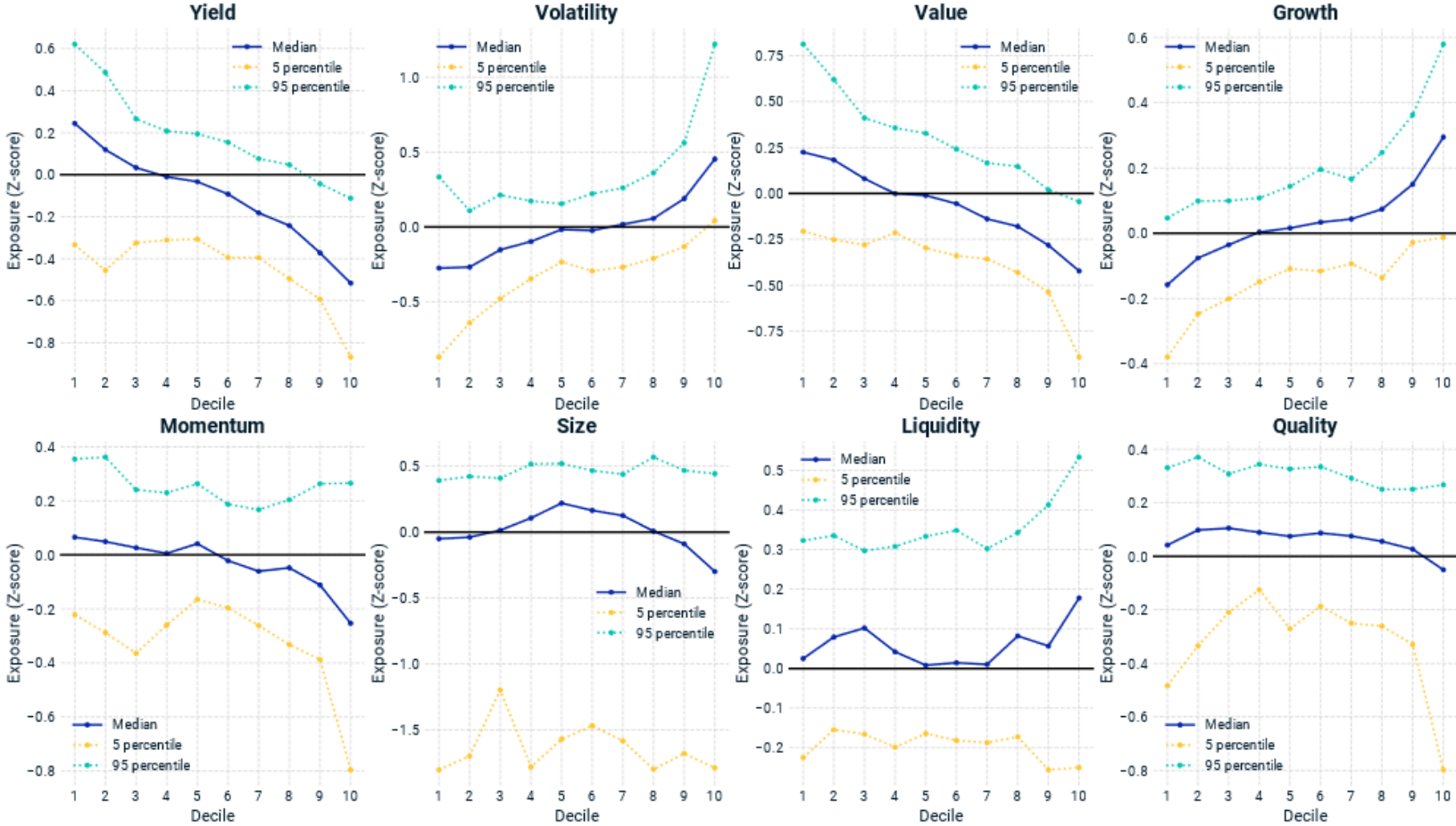
...some investors aim to integrate them



Style factors – Key elements of performance in active funds



Strong relationship between fund performance and style factor bets



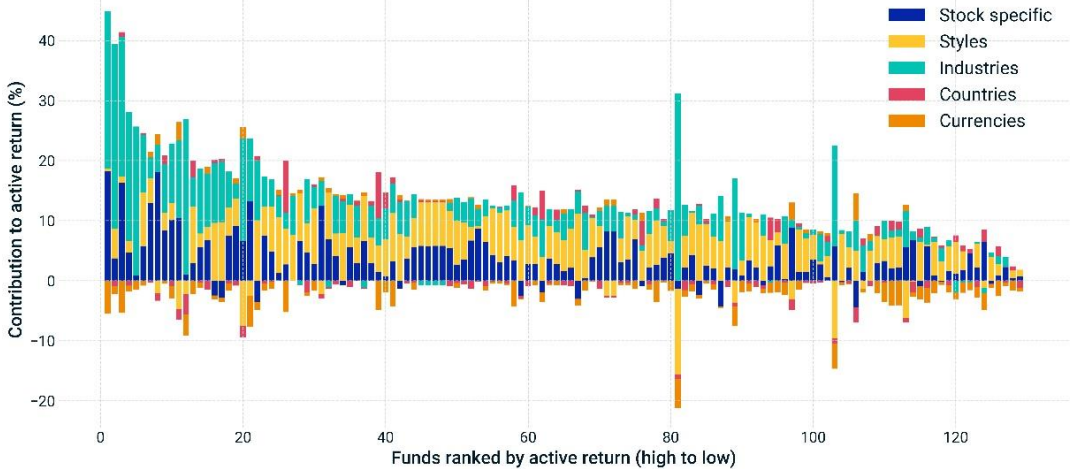
Funds are ranked and grouped into deciles based on their 2022 performance. Decile 1 corresponds to the best-performing funds and decile 10 to the worst-performing funds in our sample. The exhibits show the MSCI FaCS™ exposures of the 5th, 50th (median) and 95th percentile managers in each decile based on fund holdings information.



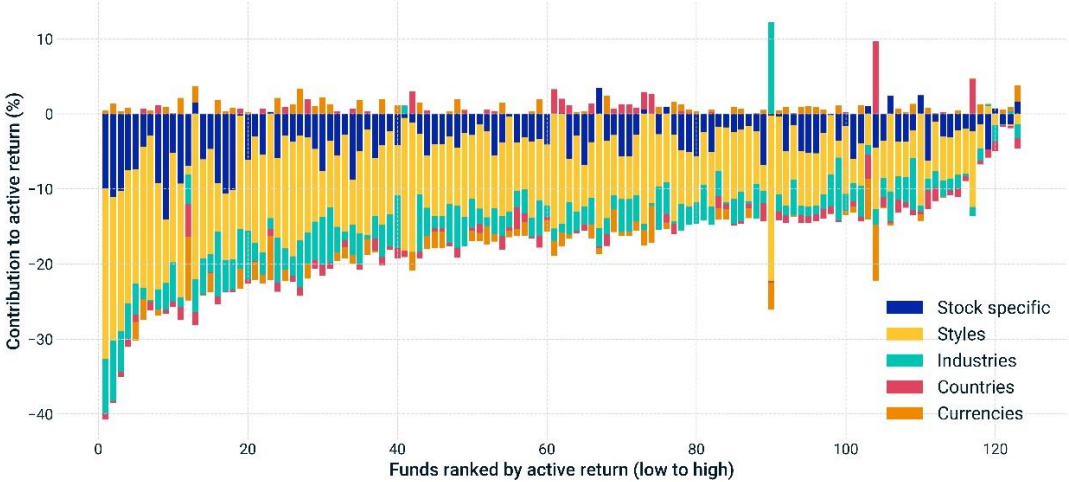
Style factors largest alpha driver in global funds

Style factors explained about a third of active outperformance in top decile funds and half of the underperformance in bottom decile funds

Top decile funds

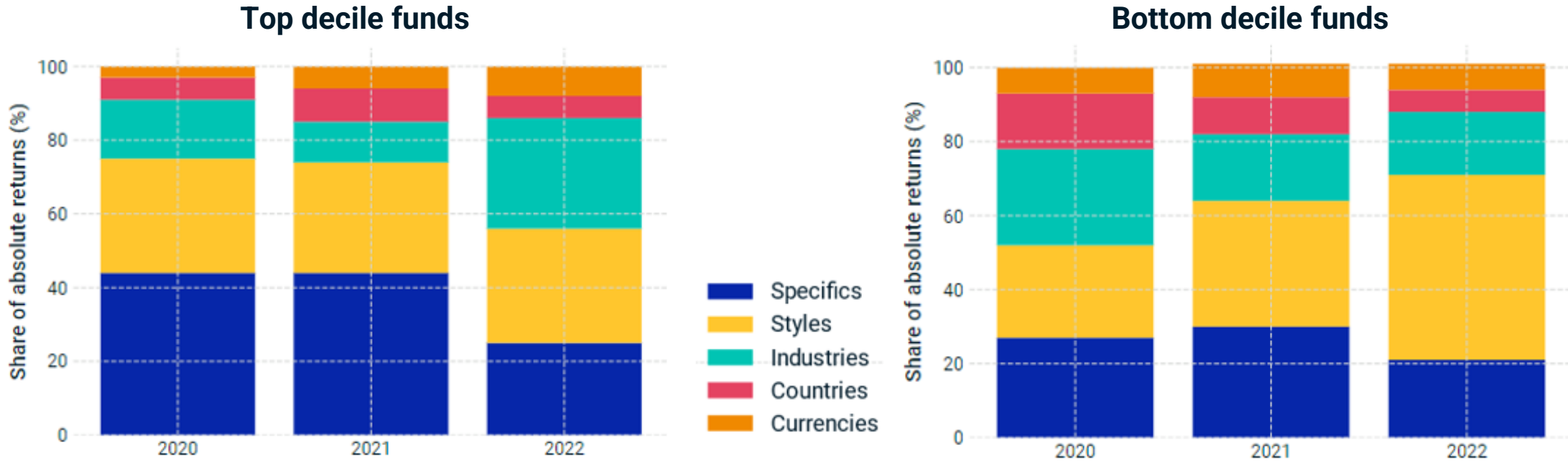


Bottom decile funds



Factors explained greater share of performance in 2022

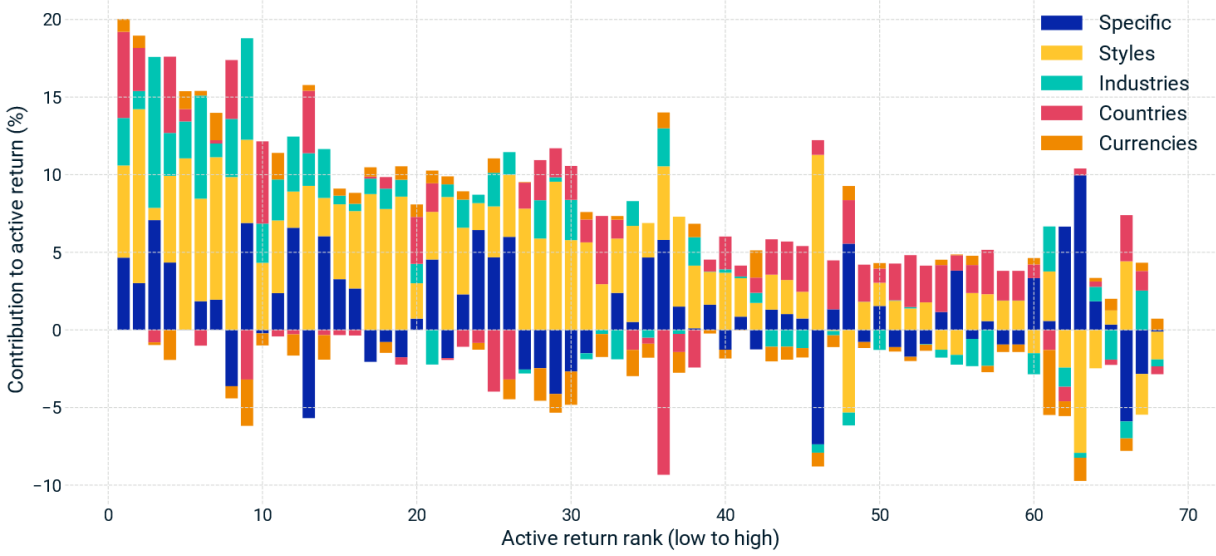
Compared to recent past, last year, common factors (country, industry, currency and style factors) became more dominant in explaining active returns, led by industries in the top decile and style bets in the bottom decile.



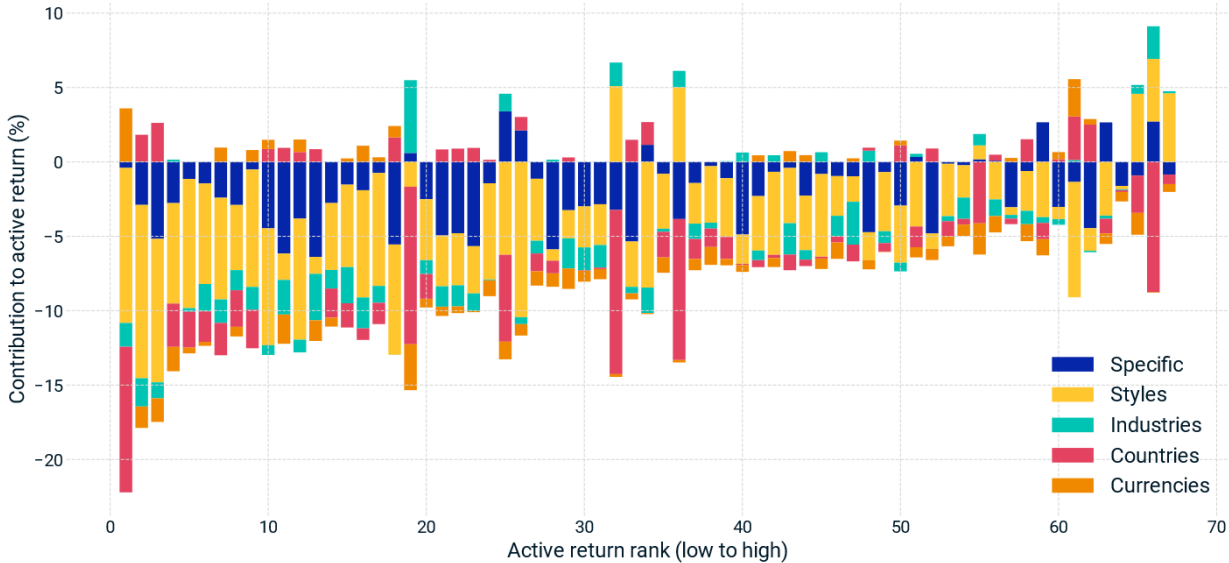
Style factors important performance drivers in EM funds

Style factors on average explained 40% of active performance in the top and bottom quintiles

Top quintile funds



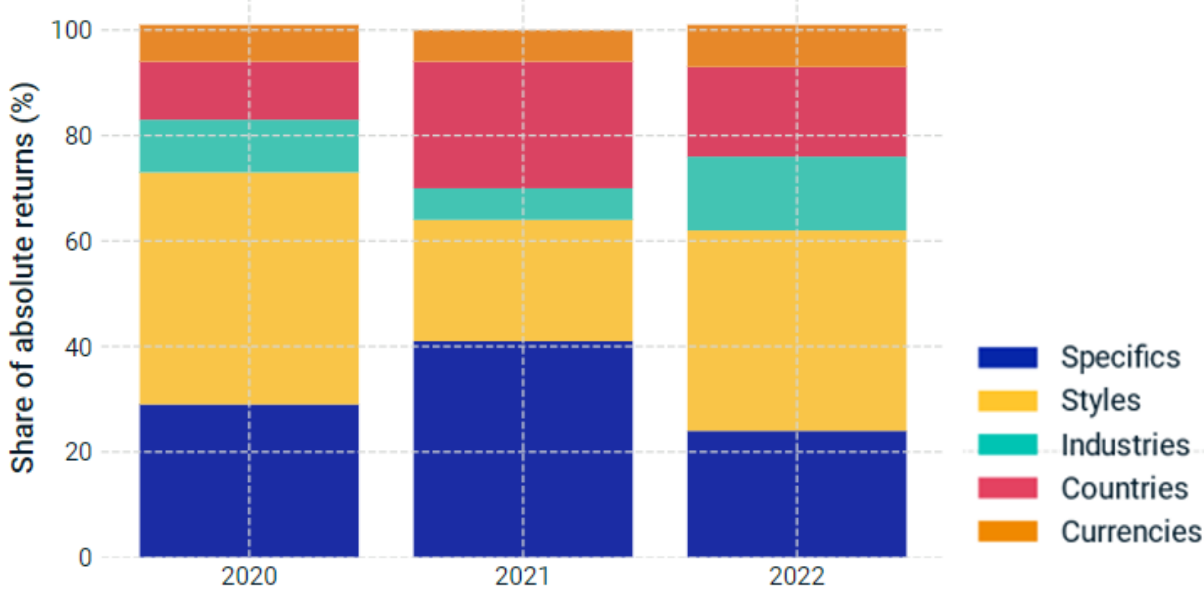
Bottom quintile funds



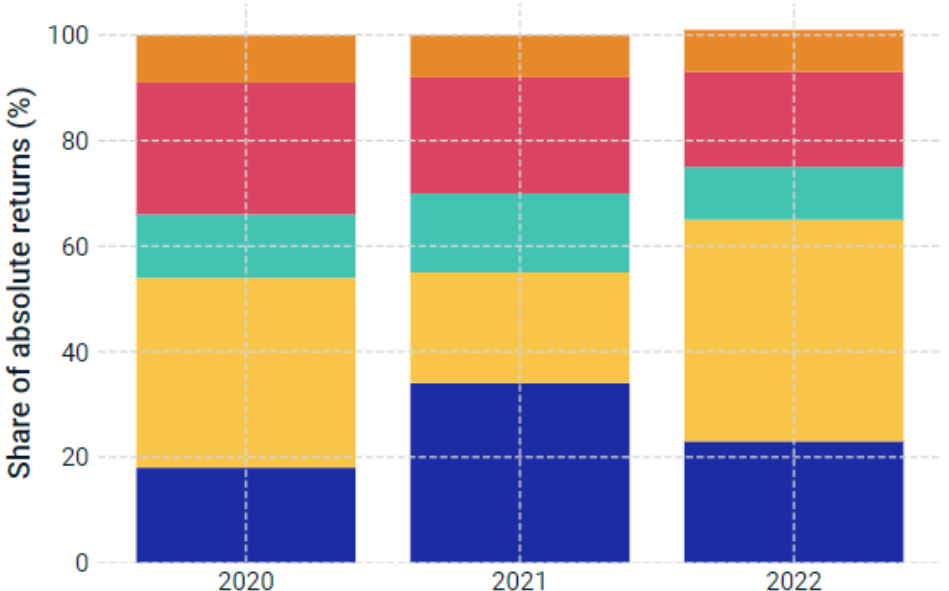
EM fund analysis – style factors remain most important

Compared to DM funds, in EMs, industry factors were less important and countries were more important. Style factors continued to create the largest impact

Top quintile funds



Bottom quintile funds



Conclusions

- Active managers may have **different underlying investment processes, but their portfolios share the same set of risk and performance drivers** – common factors (country, industry, currency, and style factors) and stock specific exposures
- Some managers tilt towards factors intentionally, while others may not be aware of these exposures and the sources of their excess returns
- An active manager's investment process and stock selection approach defines their stripe but **recognizing and managing their exposures to common factors** can supplement their approach
- Understanding the return drivers of active portfolios **can help asset owners in allocating capital** among managers and in combining factor and active mandates

MSCI current research resources

Thank you for attending the webinar! Please refer to below resources for more information. You can also visit [MSCI Factor Investing Research page](#) to access our research and leadership library on Factor Investing.

- **Blog** - [Markets in Focus: Looking Beyond the Rate Hikes](#)
- **Research paper** - [Equity Factors: Investor Views and Research Insights](#)
- **Quick take** - [Macro Scenarios: Resilient US Economy but Downside Risks Loom](#)
- **Quick take** - ['Magnificent Seven' Drove the Equity-Market Rally](#)
- **Quick take** - [Tech and AI-Driven Firms Spearheaded Thematic Resurgence](#)
- **Blog** - [Style Bets, Not Stock Picks, Drove Returns in 2022](#)
- **Podcast** - [The Market's Bad-Breadth Problem](#)

Markets in Focus: Looking Beyond the Rate Hikes

Jul 4, 2023



- Historically, a U.S. rate hike pause or pivot saw all factors but momentum outperform in the six months following the last rate hike, while communication services, consumer staples, financials, health care and utilities did well.
- The MSCI ACWI Index was up 6.3% in the second quarter of 2023, as developed markets outperformed while China weighed on emerging markets.
- The MSCI Adaptive Multi-Factor Allocation Model p

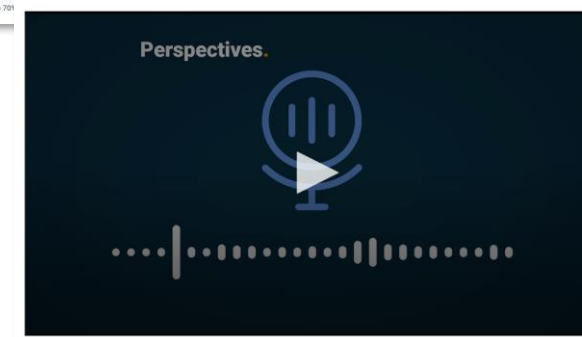
In the second quarter of 2023, the MSCI ACWI Index gain strong earnings from the technology sector. Among a un the index in the year to date, making it a challenging emi (Apple Inc., Microsoft Corp., NVIDIA Corp., Amazon.com contributed more than 50% of index returns (close to 70) outsized returns in mega caps.

Style Bets, Not Stock Picks, Drove Returns in 2022

May 25, 2023



- Stock selection is a key element of an active manager's investment process, demonstrating manager skill, but the impact of common factor exposures can dominate those decisions.



Q&A



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