BLOG POST

Review of Factor Performance

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The returns across equity factors year-to-date look quite different than the returns we experienced in 2020. As we have mentioned in previous reports, the momentum trade has lost a bit of steam as investors bid on value and dividend-paying stocks. Nevertheless, we are still sitting at record-high valuations across most of the equity market.

We examined the returns across the following six indexes – S&P 500 Momentum, S&P 500 Value, S&P 600 Small Cap, S&P 500 High Quality, S&P 500 Low Volatility, and the S&P Dividend Aristocrats. We compared the returns for each index against the benchmark S&P 500 and illustrated relative performance over the past year.

Momentum Factor

Momentum has been in favor since the onset of the pandemic. In particular, the S&P 500 Momentum Index gained roughly 23% in the second half of 2020, which more-or-less matched the return of the S&P 500 Index (which is dominated by large-cap growth stocks).

However, for the year, the momentum trade has slowed somewhat. The S&P 500 Momentum Index is higher by only 4% compared to a gain of roughly 12% for the broader S&P 500 Index. However, valuations for high momentum growth stocks remain quite elevated. The price-to-earnings ratio for the S&P 500 Momentum Index is currently 44 times, which is well above the historical long-run price-to-earnings ratio of 16 for the broader market.

Value Factor

In general, value stocks broadly underperformed the S&P 500 Index coming out of the pandemic lows of 2020. The S&P 500 Index was dominated by momentum stocks, which caused value stocks to lag. In the second half of 2020, the S&P 500 Index advanced roughly 23% with dividends, compared to a gain of approximately 18% for the S&P 500 Value Index.

However, year-to-date, value stocks have caught up to the broader market. The S&P 500 Value Index has advanced roughly 17% compared to a gain of 12% for the S&P 500 Index. Despite the outperformance for the year, the price-to-earnings ratio for value stocks is approximately 25 versus 44 for the S&P 500 Index.

Size Factor

Small cap stocks have weathered the pandemic fairly well. In the back half of 2020, the S&P 600 Index soared 35%, well ahead of the broader S&P 500 Index. Likewise, for the year, the S&P 600 Index has advanced a further 21% compared to a gain of 12% for the large-cap S&P 500 Index.

Perhaps part of the reason for small cap outperformance is that these companies are not as capital intensive as large-cap equities. Still, from a valuation standpoint, the price-to-earnings ratio on the S&P 600 Index sits at 22 times, which is well below the same measure for the S&P 500 Index.

Quality Factor

In the second half of 2020, the S&P 500 Quality Index advanced roughly 20%, which was slightly below the broader S&P 500. With strong underlying fundamentals, high quality stocks performed relatively well coming out of the March 2020 lows. Likewise, so far this year, the S&P 500 Quality Index is higher by 11%, outpacing the broader market.

From a valuation standpoint, the price-to-earnings ratio for high quality stocks is roughly 30 times, which is below the broader S&P 500 Index but above the long-term historical average.

Low Volatility Factor

The low volatility factor has underperformed the broader market over the past year. Given its weighting methodology and defensive positioning, the S&P 500 Low Volatility Index avoided many of the high-flying momentum names that led the markets higher in 2020. For the second half of 2020, the S&P 500 Low Volatility Index advanced 14%, which was about 9% below the return of the S&P 500 Index over the same period.

Likewise, for the year, the S&P 500 Low Volatility Index has advanced roughly 10%, which is lower than the overall S&P 500 Index return. However, from a valuation standpoint, low volatility stocks are generally trading at a price-to-earnings multiple of 22, or about half that of the S&P 500.

Dividend Factor

In general, dividend stocks underperformed the broader market in 2020. The S&P Dividend Aristocrats Index, which is more heavily weighted to financials and energy than the broader S&P 500 Index, advanced 20% in the second half of 2020. However, year-to-date the Index is higher by approximately 16%, which has outpaced the S&P 500 Index.

With an above average price-to-earnings multiple of approximately 18, the yield on the S&P Dividend Aristocrats Index is a mere 2.8%.

In summary, returns across factors have been quite varied over the past twelve months as the economy reopens and investors reposition their portfolios. Indeed, from a valuation standpoint, some areas of the market remain quite expensive.