



Precision insights: Factors

Updated July 2024











Highlights

- **As we look to dial up cyclical allocations, set against an improving macro backdrop**, we lean into momentum and value as naturally diversifying complements.
- **We keep a preference for the size factor within Europe**, where rate cuts have materialised.
- **We increase conviction on value** as an opportunity to add cyclicity into portfolios and given its longer-term, inflation-sensitive properties. The factor could also act as a hedge against market concentration, given its negative correlation to the Magnificent 7.

Factor selectivity: identifying differentiated sources of return

We outline our current views on equity style factors, updated to reflect the latest macro and microeconomic developments.

Click through to explore our precision factor views in detail.

Factor	View	Outlook
 <u>Minimum volatility</u>		We lower our conviction on minimum volatility as we look to dial up equity market risk through other factor exposures.
 <u>Momentum</u>		We turn more positive on momentum post-rebalance, especially with broad trends in markets year-to-date.
 <u>Quality</u>		We lower our conviction on the quality factor, but continue to look to build a quality core in equity portfolios.
 <u>Size</u>		Size valuations look compelling, but we keep a mixed view, with a preference for European size as a rate cut trade.
 <u>Value</u>		We increase our conviction on value, with a continued focus on the US but also a more positive view on European value.

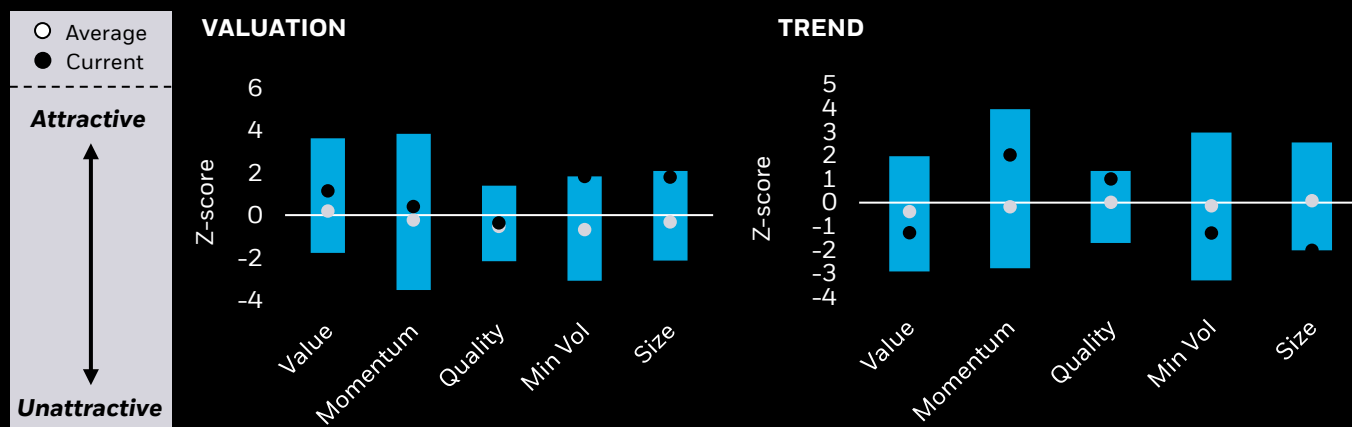
The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.

A systematic framework underpinning our views on factors across regions

Style factors are defined by their unique tilts or biases, which should be taken into consideration when assessing their attractiveness in a given environment. Factor maps help identify favourable entry points for single factors based on 'valuation' and 'trend' scores: this puts current valuations into historical context, using an expanding time window on a z-score basis to compare each factor with its own history. Valuation scores offer an equal-weighted average of z-scores based on an index's historical book/price (B/P), cash earnings/price (CE/P), and forward earnings/price (E/P), relative to the benchmark. Trend scores are based on equal-weighted z-scores for 6- and 12-month excess returns.

Factor maps may provide insights into whether factors in different regions are cheap or expensive, and whether they have a strong or weak price trend. This approach forms the basis of our factor views.

Figure 1: Global factor valuation and trend scores, June 2024



Source: BlackRock, MSCI, as of 28 June 2024. For illustrative purposes only. Historical data for the period 30/06/1994 – 28/06/2024. The valuation score is an equal-weighted average of z-scores for an index's historical B/P, CE/P, and forward E/P, relative to its parent index. The trend score is an equal weighted z-score of 6m and 12m excess returns. The z-score is calculated on an expanding time window.

Figure 2: Five-year annualised performance of factor indices, June 2024

	28/6/19 30/6/20	30/6/20 30/6/21	30/6/21 30/6/22	30/6/22 30/6/23	30/6/23 28/6/24	2024 YTD
MSCI World Minimum Volatility Index	-1.39%	18.50%	-6.49%	6.74%	8.42%	4.68%
MSCI USA Minimum Volatility Index	-0.17%	22.97%	-3.67%	7.37%	13.93%	8.24%
MSCI Europe Minimum Volatility Index	-3.32%	23.75%	-15.80%	12.81%	7.67%	3.95%
MSCI World Momentum Index	11.32%	31.95%	-17.54%	9.48%	37.09%	26.12%
MSCI USA Momentum Index	11.86%	31.83%	-20.31%	7.98%	37.39%	25.60%
MSCI Europe Momentum Index	7.52%	30.62%	-19.47%	16.26%	19.29%	13.24%
MSCI World Sector Neutral Quality Index	4.26%	38.08%	-15.68%	19.59%	24.86%	14.23%
MSCI USA Sector Neutral Quality Index	6.25%	40.20%	-15.07%	22.15%	27.66%	16.26%
MSCI Europe Sector Neutral Quality Index	-0.70%	36.21%	-19.11%	19.98%	12.00%	5.13%
MSCI World Mid Cap Equal Weighted Index	-6.35%	41.02%	-19.70%	11.50%	8.19%	0.68%
MSCI USA Mid-Cap Equal Weighted Index	-4.24%	54.18%	-15.94%	11.35%	11.14%	2.87%
MSCI Europe Mid Cap Equal Weighted Index	-7.05%	42.67%	-25.33%	13.02%	8.48%	-0.34%
MSCI World Enhanced Value Index	-11.05%	37.55%	-10.63%	15.07%	11.85%	3.80%
MSCI USA Enhanced Value Index	-8.92%	47.69%	-12.05%	6.18%	12.37%	3.09%
MSCI Europe Enhanced Value Index	-11.53%	39.47%	-13.21%	19.68%	8.73%	3.14%
BENCH MARK MSCI World Index	2.84%	39.04%	-14.34%	18.51%	20.19%	11.75%
BENCH MARK MSCI USA Index	7.79%	41.87%	-13.17%	18.98%	24.10%	14.64%
BENCH MARK MSCI Europe Index	-6.45%	34.84%	-17.31%	21.56%	11.58%	5.62%

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.

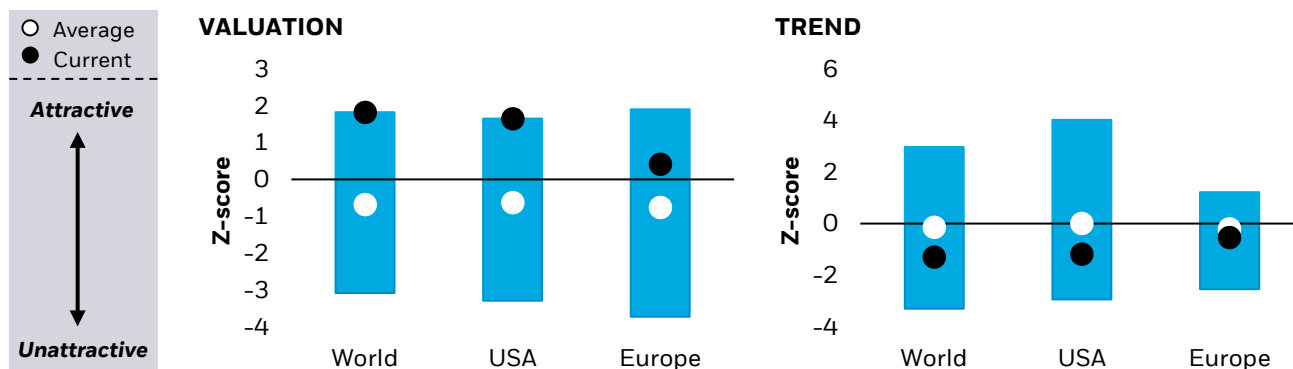
Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock and Bloomberg, as of 30 June 2024.



Minimum volatility

We further moderate our conviction on minimum volatility (min vol) as a reflection of the mixed signals from the valuation and trend charts below. While min vol valuations appear cheap, we see this as justified when taking into account trend analysis. Volatility in equity markets has been low this year; while it could pick up, we are comfortable taking more cyclical exposure with an improving macro backdrop and rate cuts starting to materialise in Europe. We still prefer to build core equity allocations through quality. As a defensive exposure, min vol has underperformed at global and regional levels, with the MSCI World Min Vol Index gaining 4.7% versus 11.8% for MSCI World, as investors have favoured higher beta exposures.¹ Investor sentiment towards min vol has been lacklustre: min vol ETPs have only recorded one month of net inflows globally since the start of 2023, with a cumulative \$26.7B of selling over this period.² We stop short of taking a negative view on the factor. We see central banks learning to live with higher inflation, leading to a higher-for-longer rate backdrop; min vol has historically fared well in high inflation and rate environments.

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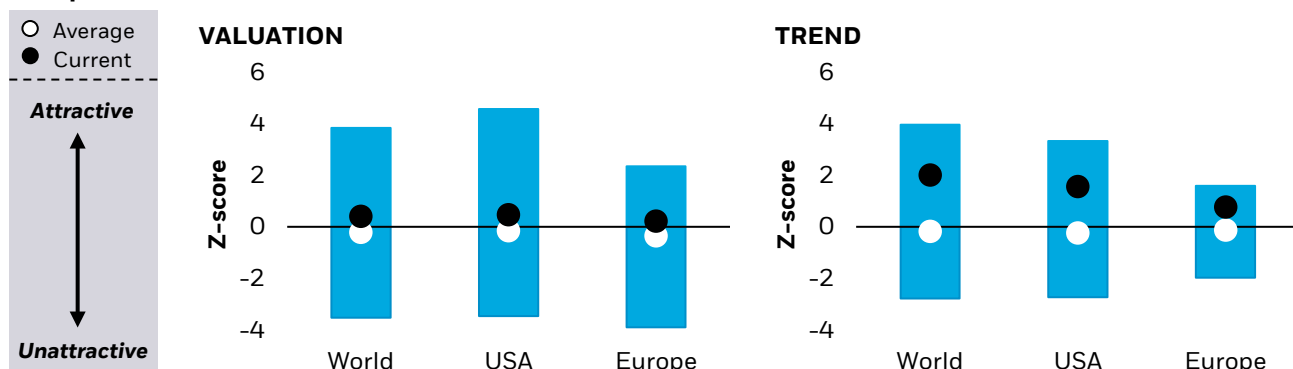
Source: BlackRock, MSCI, as of 28 June 2024. For illustrative purposes only. Historical data for the period 30/06/1994 – 28/06/2024. The valuation score is an equal-weighted average of z-scores for an index’s historical B/P, CE/P, and forward E/P, relative to its parent index. The trend score is an equal weighted z-score of 6m and 12m excess returns. The z-score is calculated on an expanding time window.



Momentum

In contrast to 2023, momentum has led factor performance in 2024, due to its favourable index construction – the MSCI World Momentum Index has returned 26.1% YTD versus 11.8% for MSCI World.³ We increase our conviction on the factor after a second favourable rebalance, which has added cyclical into the sector makeup through industrials, as well as financials. While valuations are in line with their historical average, the macro backdrop is more supportive, in our view, with monetary conditions easing or set to ease across developed markets (DM). Momentum is a chameleon-like theme that adapts to market leadership: as such, it may face challenges in an environment where market trends are less clear or persistent, but has so far benefited this year from clear trends in the market. Risks remain, though: market leadership could be subject to further whipsaws amid market uncertainty in 2024. Investors have increasingly been allocating to momentum this year – with inflows in five out of six months YTD, totalling \$4.1B.⁴

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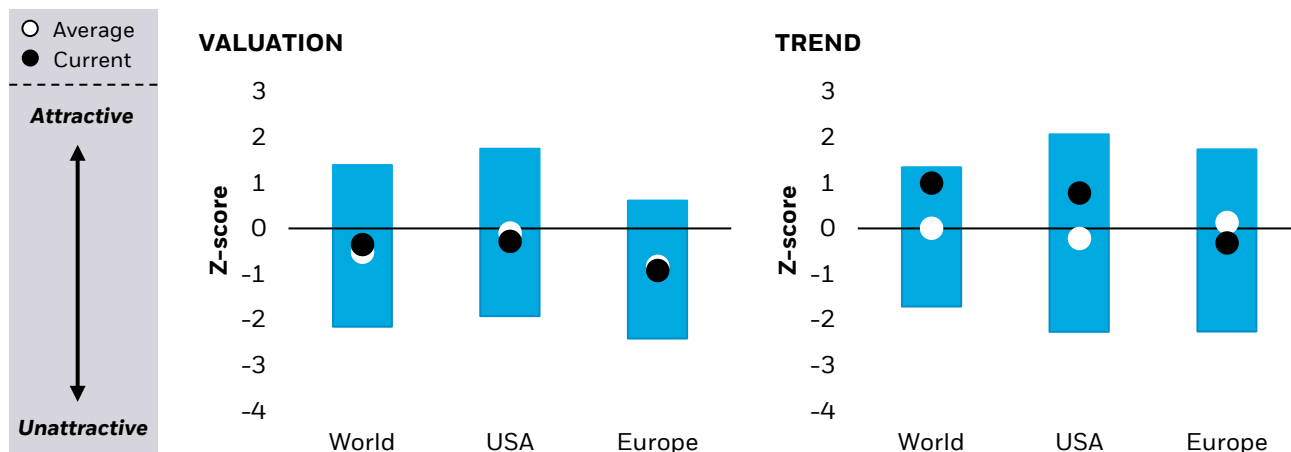


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1,3 Source: BlackRock and Bloomberg, as of 30 June 2024. **2,4** Source: BlackRock and Markit, as of 27 June 2024.

Quality

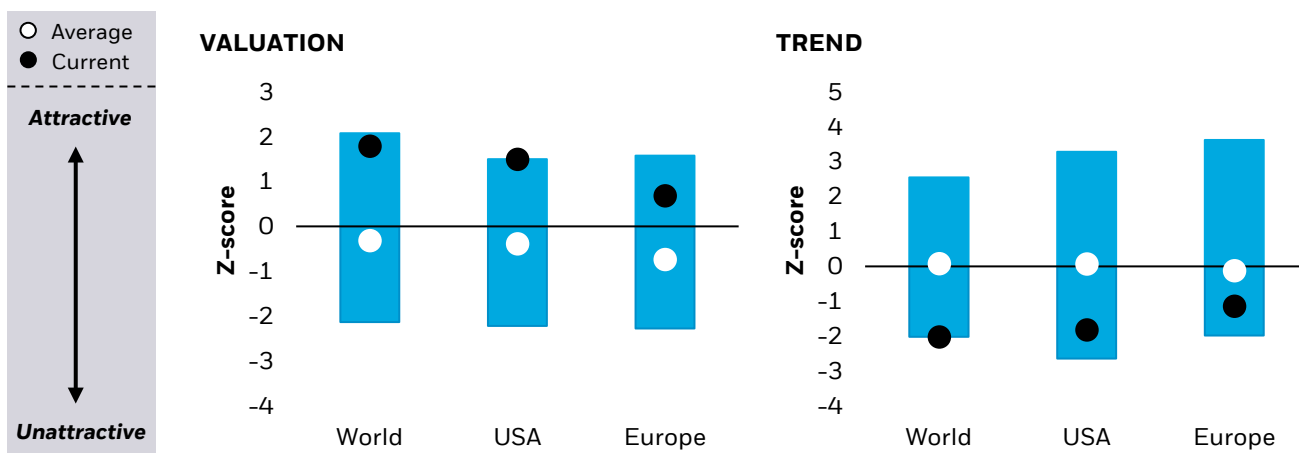
We turn less positive on quality as we look to build up cyclical exposure and with our conviction in broader equities rising – although we keep quality at the core of portfolios, especially at the global and European exposure levels. While we think the macro backdrop is improving in Europe, we prefer to dip our toes back into European equities with a quality profile – earnings are yet to turn positive at the headline level and market concentration has been a key driver of sentiment. The highest-quality European companies have been streaks ahead in terms of both earnings and valuations this year. We are comfortable taking the valuation premium in European quality given our overarching macro views. Our conviction on global quality remains high as well, while we are a little more comfortable taking a more diverse factor view in the US. Quality has been far and away the most popular ETP factor allocation this year (\$20.6B), following on from the same trend in 2023 (\$36.0B).⁵



Source: BlackRock, MSCI, as of 28 June 2024. For illustrative purposes only. Historical data for the period 30/06/1994 – 28/06/2024. The valuation score is an equal-weighted average of z-scores for an index’s historical B/P, CE/P, and forward E/P, relative to its parent index. The trend score is an equal weighted z-score of 6m and 12m excess returns. The z-score is calculated on an expanding time window.

Size

We remain mixed on the size factor, but hold a clear preference for Europe as a rate cut trade. The valuations element is still relatively attractive: while risks remain, there is room for the gap in cap-size performance to snap back on technical bases, in our view. European small caps also have lower leverage and floating-rate debt than their US peers, meaning they could be better positioned for a higher-for-longer rate regime, and the US small cap market appears structurally less attractive due to the composition of smaller companies that have gone public in recent years.⁶ While the growth backdrop isn’t showing a clear acceleration – which has historically been a tailwind for size – an easier monetary policy backdrop is supportive, we think. Should there be a worse-than-expected shift in the growth environment, size could be exposed: downturns have historically been more challenging for domestically-focused, smaller-cap companies.



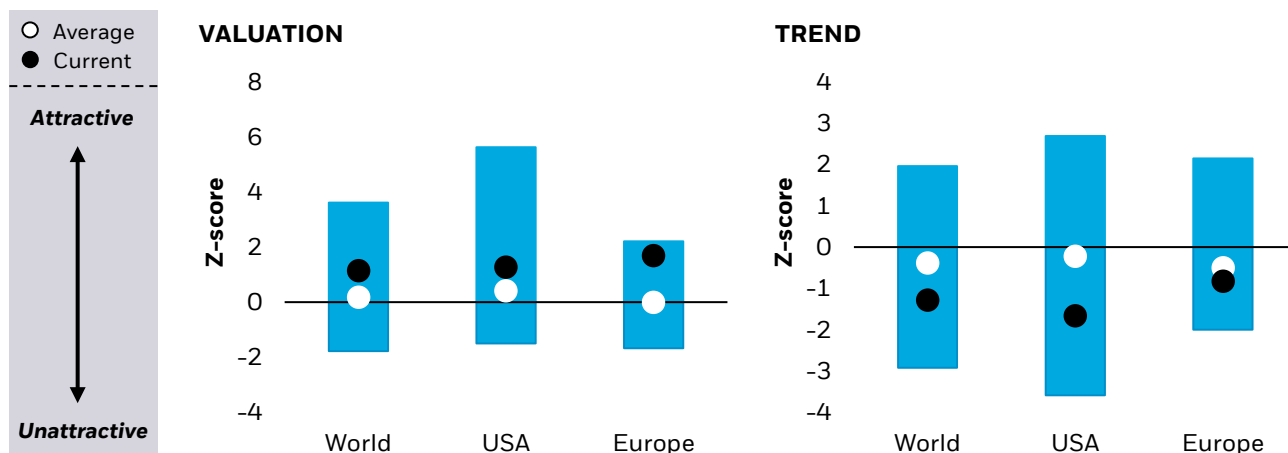
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⁵ Source: BlackRock and Markit, as of 27 June 2024. ⁶ Source: ‘A turning point for US small caps’, Wellington Management, April 2024.



Value

We further increase our conviction on the value factor, which offers a way to add some cyclicality in equity allocations. In addition, valuations have turned more attractive as shown in the chart below. We have a clear preference for value in the US, where the growth backdrop is less challenged and we are actively looking to add cyclicality into our equity exposure. In general, US value exposures also offer a way to diversify US equity allocations, given the inherent tech-bias in large market-cap indices. The rate cut backdrop in Europe has increased our conviction in European value, and hence underpins our increased conviction in the factor globally. We also maintain a base level of allocation to the value factor for its longer-term, inflation-sensitive properties. Policy rates look set to remain higher for longer, and while inflation has been declining, we see it rising again later this year. This, coupled with a steeper yield curve, favours value over growth, in our view, as elevated interest rates drive up discount rates, making future cash flows of growth stocks less attractive. Amid uncertainty, value stocks may benefit structurally from near-term cash flows, and we think the factor looks cheap versus its history.



Source: BlackRock, MSCI, as of 28 June 2024. For illustrative purposes only. Historical data for the period 30/06/1994 – 28/06/2024. The valuation score is an equal-weighted average of z-scores for an index’s historical B/P, CE/P, and forward E/P, relative to its parent index. The trend score is an equal weighted z-score of 6m and 12m excess returns. The z-score is calculated on an expanding time window.

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