

Looking back at Equity Factors in Q4 with WisdomTree

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The fourth quarter can be split into 2 very distinct periods from an equity performance's perspective. Before the US election, the equity markets took a breather in anticipation of the US elections. Then, following the Biden victory, equities entered a period of cyclical recovery during which value stocks and small caps led the market to new highs. This does not mean that technology stocks' fortune turned but that instead of leading they followed for a while with Energy and Financials being the two sectors that benefitted the most.

In the fourth instalment of the WisdomTree Quarterly Equity Factor Review(Definitions of each factor are available at the end), we aim to shed some light on how equity factors behaved over the last 3 months and how this has impacted investors' portfolios.

- In Q4, Size led the way in developed equities while Value won out in emerging markets
- Both Size and Value benefitted from the cyclical recovery in late November and December
- Momentum and Quality delivered slight underperformance for the quarter, suffering from underweights in Financials and Energy in particular
- Min Volatility continued to suffer across regions delivering deep underperformance for the 3rd quarter in a row.

Looking forward to 2021, it is possible to see the value-driven recovery continuing on the back of a successful rollout of Covid-19 vaccinations. Such recovery would most likely support undervalued stocks and sectors, and therefore Value and High Dividend while hurting Momentum, which is currently strongly overweight in technology and communication, leading to a rebalancing of the scales. However, if 2020 has taught us anything, it is that investors and their portfolios need to be ready for everything and anything. 2021 is starting with widespread lockdowns in Europe and Tech companies could continue to benefit from the new working and living habits that we all picked up during 2020. Such an uncertain and Tech-driven environment could benefit Momentum and Quality once again.

Performance in focus: Size won Q4

Despite a small correction in October, in part due to the upcoming US election and the expected volatility surrounding it, the fourth quarter of the year followed on the tracks of the second and third quarters with a strong rally. MSCI World closed up 14% for the period and MSCI Emerging Markets was up 19.7%. Having said that, this is where the similarities ended since the drivers of the performance in Q4 ended up being

very different. Technology stocks took a back seat for the first time this year in favour of Financial and Energy stocks and cyclical investments in general.

In the fourth quarter, the drivers of equity factor performance changed quite dramatically:

- Size dominated across developed markets by a mile with US small caps returning 16.7% more than US large caps.
- Value closely followed, winning the crown in emerging markets on the back of a strong November.
- Momentum and Quality suffered for the first time in 2020 with continued underperformance versus the market.
- Min Volatility struggled over the full quarter closing a very lacklustre year.

Figure 1: Equity factor outperformance in Q4 2020 across regions

	World Q4 2020: 14.0%	USA Q4 2020: 12.0%	Europe Q4 2020: 10.8%	Emerging Markets Q4 2020: 19.7%
High Dividend	-2.3%	-2.7%	1.0%	-0.3%
Minimum Volatility	-8.3%	-5.2%	-6.4%	-6.0%
Momentum	-3.4%	-2.7%	-3.9%	2.6%
Quality	-3.5%	-2.1%	-2.9%	-1.7%
Size	9.9%	16.7%	5.8%	2.5%
Value	4.1%	6.3%	5.7%	4.8%

The performance of equities in Q4 is perfectly encapsulated in the few days following the US election. Equity markets woke up in the week after the election and in just 2 business days, market participants observed one of the strongest value rotations in recent history with Value outperforming the market by 4.3% between the 6th and the 10th of November. Over those two same days, Momentum trailed by an astonishing 5.5%. Starting from there, markets continued on this trend for the rest of the quarter delivering the results we just discussed.

Figure 2: Equity factor outperformance in global developed equities from 6th to 10th November 2020

Source: WisdomTree, Bloomberg. 6th November 2020 to 10th November 2020.

Historical performance is not an indication of future performance and any investments may go down in value.

A strong sector rotation in Q4 can explain part of the factor rotation as well

Similarly, to equity factors, sectors also exhibited a strong rotation in Q4. Some of the sectors that suffered the most in the first 9 months of the year rebounded the strongest in Q4 with Energy and Financials posting double-digit returns. At the same time, consumer discretionary and information & technology which had benefitted the most up to October posted more contained performances.

However, some sectors continued to suffer even in Q4. Real estate and consumer staples for example continued to lose over the quarter. The performance of these historically high dividend paying sectors also

explains in part why high dividend has been lagging Value this quarter.

It is also worth noting that despite the incredible amount of news and focus on the vaccines and the different companies producing them, the performance of healthcare as a sector remained lacklustre at best. Coming back to factors, this sector rotation contributed to the muted performance of Momentum and Quality which both suffered from their underweight in financials and energy.

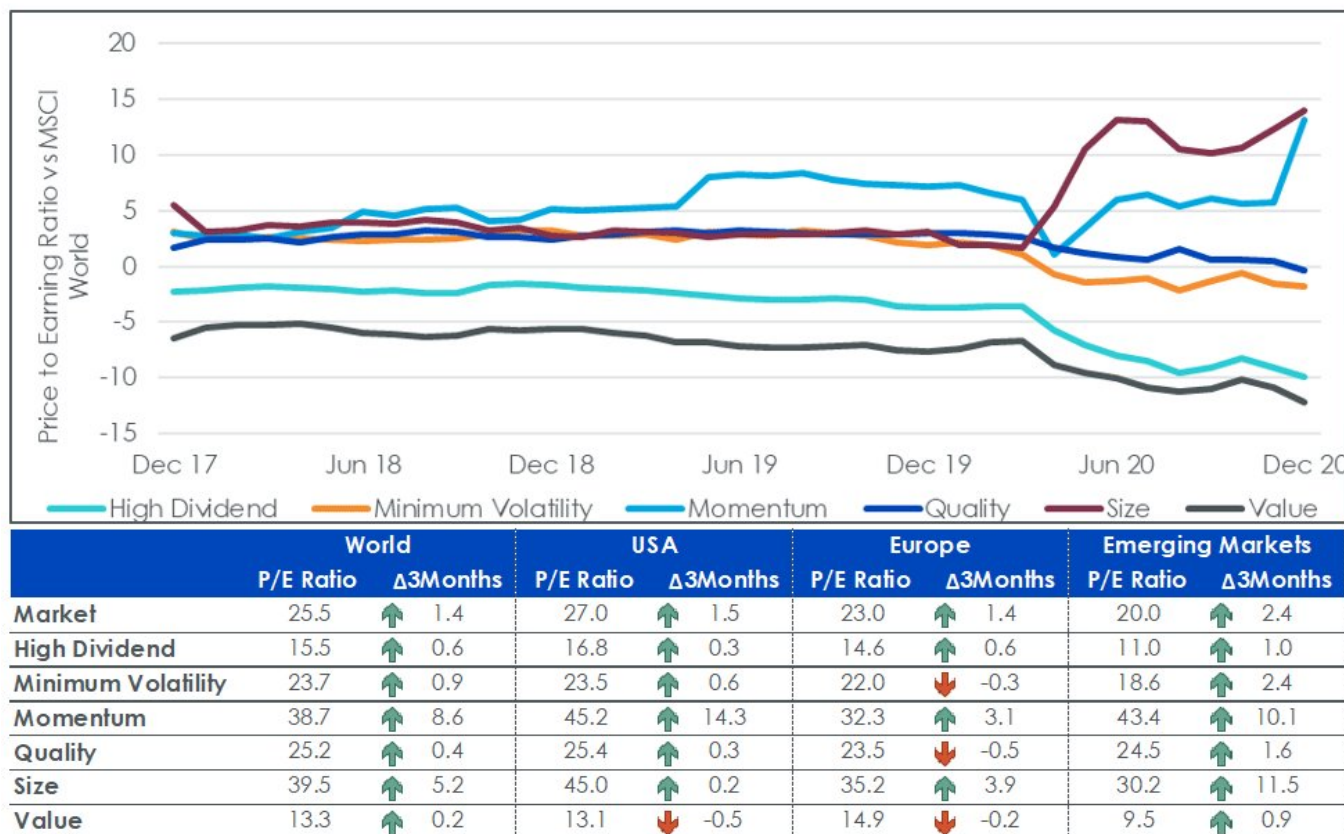
1GICS stands for The Global Industry Classification StandardSource: WisdomTree, Bloomberg. 31st December 2019 to 31st December 2020.

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Valuations have continued to increase in Q4. Following recent trends, factors got more expensive this quarter:

- In particular, Size continued to get more expensive across regions, following its very strong performance in the quarter, with its price to earning ratio closing in on 40.
- Momentum's valuation increased further following its latest rebalancing which concentrated even further on expensive technology stocks.
- Quality continued to exhibit very stable multiples with current multiples at a slight discount to the market
- Finally, Value and High Dividend remained very cheap compared to the markets.

Figure 4: Historical Evolution of Price to Earnings ratios of equity factors

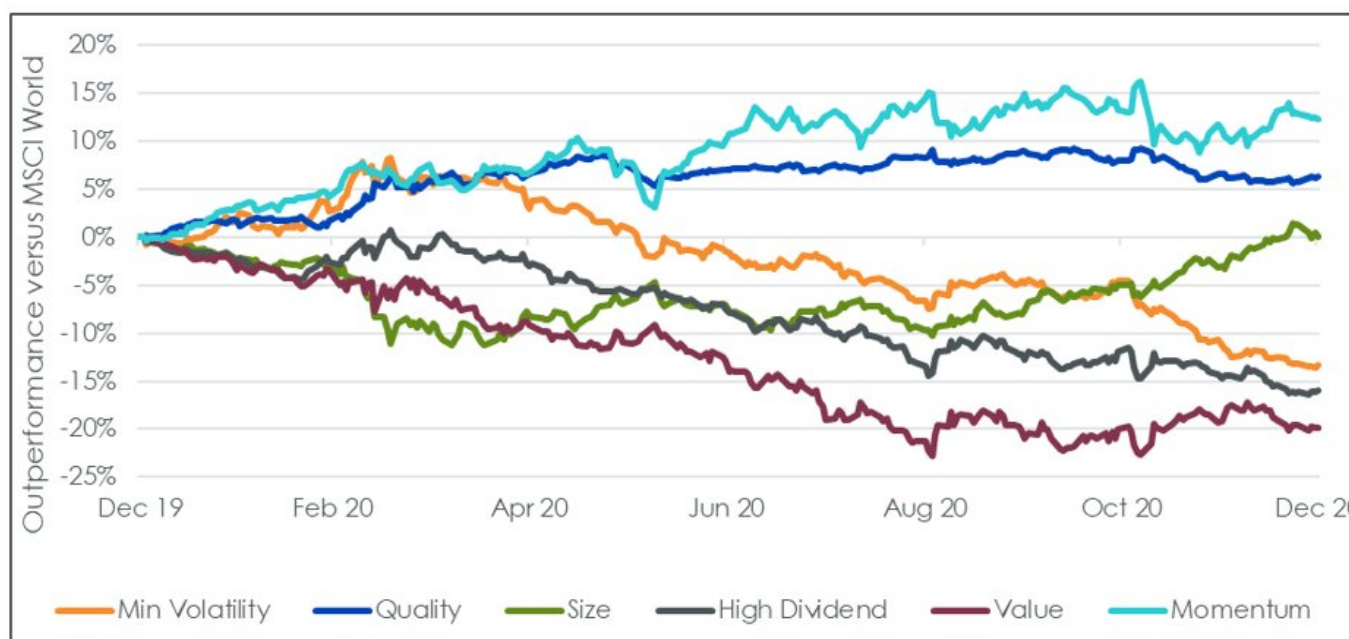


Q4 did not change the overall equity factor picture for the year

Looking back at 2020 in its globality, the recent change of fortune in Factorland did not fully turn the table. Overall, Momentum won the year across all regions and in particular in global developed equities with a 12.4% outperformance versus the market. It is followed closely by Quality which also delivered a solid yearly outperformance. On the other side of this ranking, despite a good fourth quarter, Value remains at the bottom closely followed by High Dividend but also Min Volatility which suffered for 3 quarters following a strong first quarter.

Size closed the year pretty much flat after a very contrasted year that started with a terrifying first quarter followed by 9 strong months.

Figure 5: Global developed equities factors outperformance (vs MSCI World)



In an unpredictable 2020 year, it is particularly noteworthy that the success of equity factors could have been predicted by two very simple criteria: exposure to technology stocks and exposure to non-dividend paying stocks. On one hand, Momentum, benefitted from strong overweights in both categories to deliver double-digit outperformance, reminiscent of the 2000 Tech Bubble. Min Volatility, Value, and High Dividend, on the other hand, suffered from being largely underweight in Tech and in non-dividend paying stocks (Facebook or Amazon leap to mind) to deliver double-digit underperformance. Between them, Quality, acting, as usual, the role of the wise old man, delivered measured outperformance in 2020 to the market with balanced exposures to both criteria.

Looking forward to 2021, some predict a Value-driven recovery following the successful rollout of Covid-19 vaccinations, similar to what we have seen in Q4 this year. Such recovery would most likely support Value and High Dividend while hurting Momentum, which is currently strongly invested in technology stocks and non-dividend payers, leading to a rebalancing of the scales. However, if 2020 has taught us anything, it is that investors and their portfolios need to be ready for everything and anything. 2021 is starting with widespread lockdowns in Europe and Tech companies could continue to benefit from the new working and living habits that we all picked up this year. Quality has shown the advantages of balancing upside capture while reducing downside risk in 2020. 2021 could be the same - in other words, it may be worth listening to the wise old man one more year.

World is proxied by MSCI World net TR Index. **US** is proxied by MSCI USA net TR Index. **Europe** is proxied by MSCI Europe net TR Index. **Emerging Markets** is proxied by MSCI Emerging Markets net TR Index. **Minimum Volatility** is proxied by the relevant MSCI Min Volatility net total return index. **Quality** is proxied by the relevant MSCI Quality net total return index. **Momentum** is proxied by the relevant MSCI Momentum net total return index. **High Dividend** is proxied by the relevant MSCI High Dividend net total return index. **Size** is proxied by the relevant MSCI Small Cap net total return index. **Value** is proxied by the relevant MSCI Enhanced Value net total return index.

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