The Year So Far in Factor Returns

We look at year-to-date factor returns to gain insight into the economy and markets.

Overview

2019 has seen increasing concern over trade policy, political stability, and the overall health of the economy. This, in turn, has led to significant moves in asset prices. There have been significant winners and losers, and one way we can better understand what has happened is by looking at factor returns. A macro fund that correctly predicted these factor moves could be having a fantastic year; whereas, a long/short manager who was on the wrong side of these factors could be experiencing a significant drag on performance.

All Factors

High commodity prices have been negatively impacting both producers and distributors. As of September 13th, of 34 core factors, the best performing factors were related to **Gold** and **Oil**; whereas the worst performing were related to **Metals & Mining** and **Energy** stocks (we've included the year-to-date **Market** return, based on the S&P 500, for comparison).

Absolute Performance	
Return	**Factor**
-12.46%	Metals and Mining Excess
-11.17%	Energy Excess
-10.51%	Health Care Excess
-7.18%	Asia Excess
-7.02%	Emerging Markets Excess
⋮	⋮
13.16%	Real Estate Excess
15.02%	Utilities Excess
16.04%	Gold
21.59%	Market
43.47%	Oil

Risk-Adjusted Performance	
R/Vol	**Name**
-1.73	Health Care Excess
-0.90	Energy Excess
-0.66	Asia Excess
-0.65	Momentum Excess
-0.60	Emerging Markets Excess
⋮	⋮
1.24	Utilities Excess
1.51	Market
1.65	Oil
1.94	Gold
2.97	Bonds vs Equities

Metals & Mining is one of the most volatile factors. If, rather than looking at absolute returns, we look at risk-adjusted returns, then **Health Care** was the worst performing factor overall. **Bonds vs Equities** was the best performing factor on a risk-adjusted basis, reflecting the recent inversion of the yield curve.[1]

[1] Risk-adjusted performance, R/Vol, was calculated by dividing the year-to-date factor return by the annualized realized standard deviation of returns in 2018. In other words, the 2.97 value for **Bonds vs Equities** implies a 2.97-standard deviation move in **Bonds vs Equities**.

Style Factors

On September 9th, our **Momentum** style factor had a −8.35-standard deviation return. This, on a day when the overall market was essentially flat. Year-to-date, **Momentum** is now the worst performing style factor on a relative basis.

Michael Burry, who featured prominently in *The Big Short*, has recently suggested that index funds and ETFs are the next big bubble. One sign of this bubble might be too many investors piling into the most popular, liquid large cap funds, while neglecting small cap names. And we do see evidence for this in factor returns. On an absolute basis, **Small Cap – Large Cap** has been the worst performing style factor in 2019.

Return	Name
-3.61%	Small Cap − Large Cap
-3.20%	Momentum Excess
1.64%	Dividend Excess
2.06%	Hedge Fund Excess
3.03%	Value − Growth

R/Vol	Name
-0.65	Momentum Excess
-0.56	Small Cap − Large Cap
0.34	Dividend Excess
0.55	Value − Growth
0.92	Hedge Fund Excess

On the plus side, the best performing style factor in absolute terms was **Value – Growth**, while our **Hedge Fund** style factor was the best performing on a relative basis.

Country Factors

The trade war has been particularly hard on China and emerging markets. On both an absolute and risk-adjusted basis, the worst performing country factors were **Asia (ex-Japan)** and **Emerging Markets**. The best performing were **Europe** and **Japan**.

Return	Name
-7.18%	Asia (ex-Japan) Excess
-7.02%	Emerging Markets Excess
-4.31%	Mexico Excess
⋮	⋮
6.62%	United Kingdom Excess
7.54%	Europe Excess
11.31%	Japan Excess

R/Vol	Name
-0.66	Asia (ex-Japan) Excess
-0.60	Emerging Markets Excess
-0.25	India Excess
⋮	⋮
0.57	United Kingdom Excess
0.61	Europe Excess
0.72	Japan Excess

Sector Factors

In the overall analysis, we saw that **Metals & Mining**, **Energy**, and **Healthcare** were the worst performing sectors. At the same time, defensive sectors, have been having a great year so far. **Consumer Staples**, and **Utilities** have both outperformed significantly. **Homebuilders** and **Real Estate** are also benefitting from policies promoted by the current administration.

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Return	Name
-12.46%	Metals and Mining Excess
-11.17%	Energy Excess
-10.51%	Health Care Excess
-3.23%	Transportation Excess
⋮	⋮
6.91%	Homebuilders Excess
9.33%	Consumer Staples Excess
13.16%	Real Estate Excess
15.02%	Utilities Excess

R/Vol	Name
-1.73	Health Care Excess
-0.90	Energy Excess
-0.32	Metals and Mining Excess
-0.22	Transportation Excess
⋮	⋮
0.60	Homebuilders Excess
1.04	Consumer Staples Excess
1.20	Real Estate Excess
1.24	Utilities Excess

Further Reading

For an overview of Northstar's approach to factor analysis, see our white paper *Next Generation Factor Models*.

For an introduction on how Northstar uses factors in profit attribution, see *Risk-Based Performance Attribution*.

You might also enjoy our article from June, *The Six-Standard Deviation Move that Wasn't*, about the extremely large moves in three factors on June 3rd.

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