The quarterly Satrix Style Tracker chronicles the success of a range of factors over the medium to long-term for the South African investor. In this publication, we share with you our most recent analysis for the second quarter of 2018.

What worked and what didn’t in Q2 2018

Factor performance review at a glance

The second quarter of 2018 saw some reversal of the first quarter’s factor performance. **Price to Book** made a complete U-turn over the quarter, topping the list with a return spread of 9.8%, while the worst performing factor was **Price Momentum** (-8.2%). **Earnings Momentum** showed some resilience, posting a +6.0% spread, while **Dividend Yield, Debt to Equity** and **Return on Equity** showed flat to marginal performance during the prior three months.

Key events that impacted performance in Q2

Globally, equities made gains in a volatile second quarter, as resilient economic and earnings data competed with an unsettling geopolitical backdrop to establish the market’s direction. Bond markets struggled, despite risk aversion escalating late in the quarter, as policy tightening set the tone. Developed market equities showed gains as supportive economic data outshone China-US trade posturing, while emerging markets equities recorded sharp falls, with the US Dollar strength a significant headwind. Domestically, SA markets followed their emerging market peers, as the Rand and local equity indices sold-off back to fair value levels, despite the positive political sentiment and benign corporate earnings.

Introducing factor investing

**What are factors?**

Factors are measurable characteristics of listed stocks that may in some way explain future performance. The most well understood factor is likely the price to earnings (PE) ratio. Many studies have shown that stocks that have low PEs tend to outperform stocks with high PEs over the long term. This is often referred to as ‘value investing’ in the active space. We measure many of these ‘factors’ and then test to see whether they have any predictive power.

**Why is factor investing important?**

Factor investing has the ability to empower asset consultants and multi-managers to build client portfolios simply and efficiently. Factor investing is revolutionising both the passive and active investment industry, from

- the transparent way in which factor portfolios are systematically constructed
- to the capability of building tailored investment outcomes with greater diversification and predictability
- to lower fees, and lastly
- to reliably and consistently delivering a specific investment philosophy.

An in-depth look at factor performance

In the charts on the following page we look in-depth at the drivers of the last quarter’s performance for the various styles: **Momentum** (Price Momentum and Earnings Momentum), **Value** (Price to Book and Dividend Yield) and **Quality** (Return on Equity and Debt to Equity).
Momentum

June saw major factor reversals as the cyclical Price Momentum factor underperformed amid concerns of trade wars and slowing global growth. Both Growth and Price Momentum factors have been recent winners, thus naturally exposing themselves to profit taking in what can arguably be termed crowded positions. Price Momentum still shows positive 12-month performance, but will require stabilisation in market conditions to recover.

Earnings Revisions (a sub-component of headline Momentum) suddenly came alive in Quarter 2, as investors gravitated toward companies with positive earnings sentiment. Interestingly, Earnings and Price Momentum continue to exhibit divergent performances.

Value

After two consecutive very poor quarters, Price to Book rekindled its 2016 performance where cyclical value was favoured. To some extent the unwinding of Momentum has benefitted deep value measures (Price to Book) in the short term, however should macro uncertainty continue and deepen, we may see a shift toward more defensive Value or Quality strategies. Price to Book remains the worst performing strategy over 12 months.

Dividend Yield, on the other hand, has experienced mixed fortunes, as the environment tussled between ‘flight-to-safety’ and pro-risk. Over the previous year, however, investors continued to show a preference toward yield as opposed to more deep value.

Quality

After a stellar 2017, the Return on Equity (ROE) factor experienced another strong first half of the year as investors have continued to favour stocks with defensive characteristics. While the strength of this positive performance seems to be waning, global macro concerns continue to weigh on risk appetites, which compelled investors to seek companies that return high profits despite macro headwinds.

Debt to Equity continues to incrementally add positive returns, and has started to establish its more consistent and traditional role of providing protection during market stress. Pre-2018, the factor typically showed only sporadic bursts of defensiveness, but largely disappointed during periods of market corrections.
How we measured this...

The strategies shown in this report are factors we believe to be most significant in our domestic market. The universe we use is the All Share universe excluding property and small cap shares. We rank the stocks from highest to lowest factor score for each factor and divide the universe into quartiles (subsets or groups of 4). We then calculate the quartile spread by taking the top quartile’s return experience less that of the bottom quartile.

Rebalancing and performance calculations are conducted each month. The performance results do not reflect transaction costs, tax withholdings or any investment / advisory fees. The results of these quantitative factor strategies are significantly less diversified, and, as such, their performance is more exposed to specific stock or sector results. Past performance should not and cannot be viewed as an indicator of future performance.

International experience

If one considers the MSCI World as your universe, Growth, Price Momentum and Low Risk have been the clear outperformers for 2018 to date. Growth’s strong performance has made the style expensive across many regions, while Earnings Momentum is currently trading at much more attractive valuations than Growth. The strong recent earnings season, where optimistic earnings growth forecasts were generally beaten, has laid the foundation for continued strong performance going forward. Value’s underperformance can somewhat be explained by a sector effect (long financials and short healthcare and tech).

While many factors outperform over the long-term, all suffer from periods of underperformance. Combining factors reduces the exposure to a single factor’s cyclical risk, and can create more diversified portfolios.

Long-term SA factor performance since July 2002

Source: Satrix 2018

Source: Citi
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Performance is based on NAV to NAV calculations of the portfolio. Individual performance may differ to that of the portfolio as a result of initial fees, actual investment date, dividend withholding tax and income reinvestment date. The reinvestment of income is calculated based on actual distributed amount and factors such as payment date and reinvestment date must be considered.