

Market Navigation Insights

Do traditional factor and style indexes create a false market narrative?

May 24th, 2023

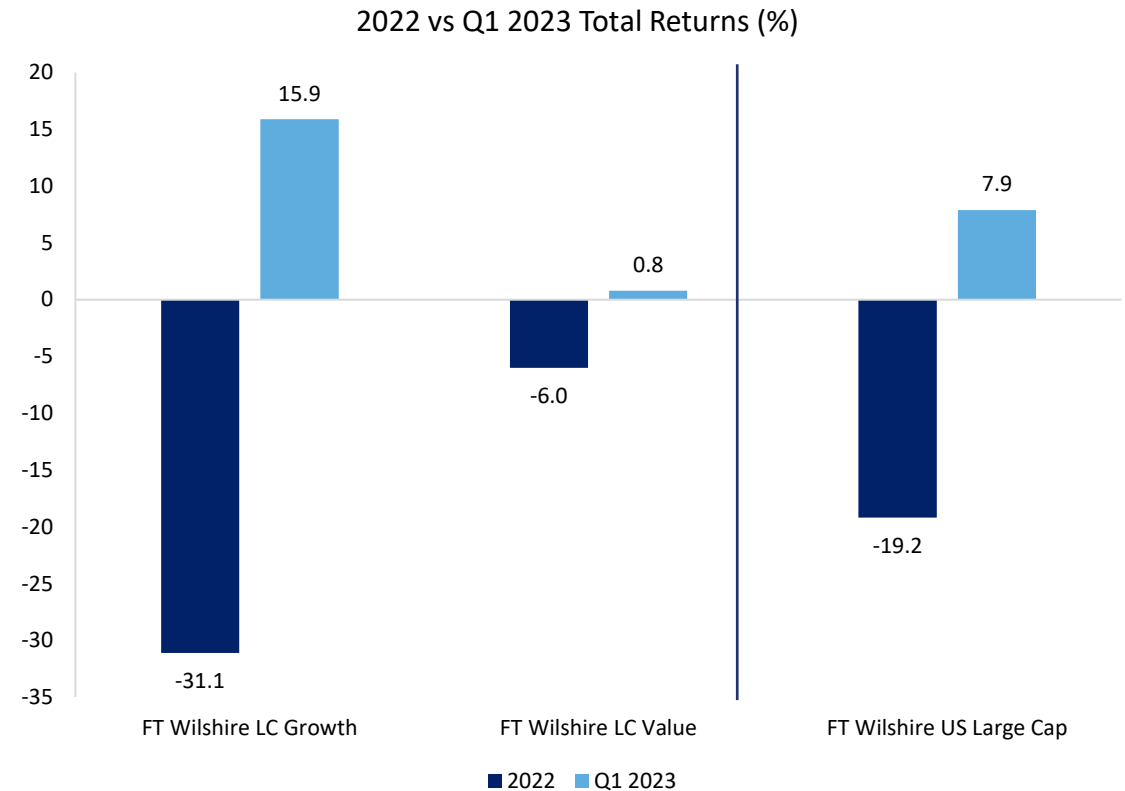
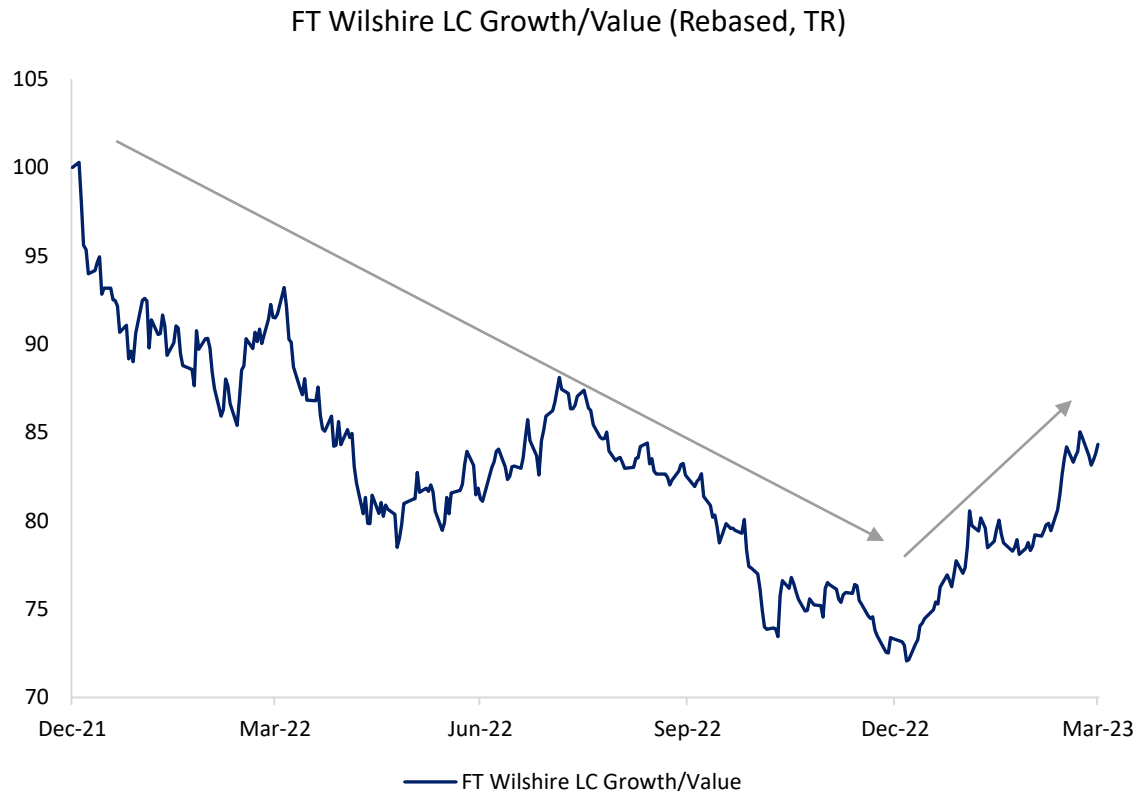


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(Wilshire Indexes)



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(Wilshire Indexes)

Significant Growth v Value rotation – what does this reflect?



Source: Wilshire, Data as at 31 March 2023

How are Style indices constructed?

Value:

(Equal Weight)

- Forecast Earnings Yield
- Book to Price
- Cash flow yield

Growth:

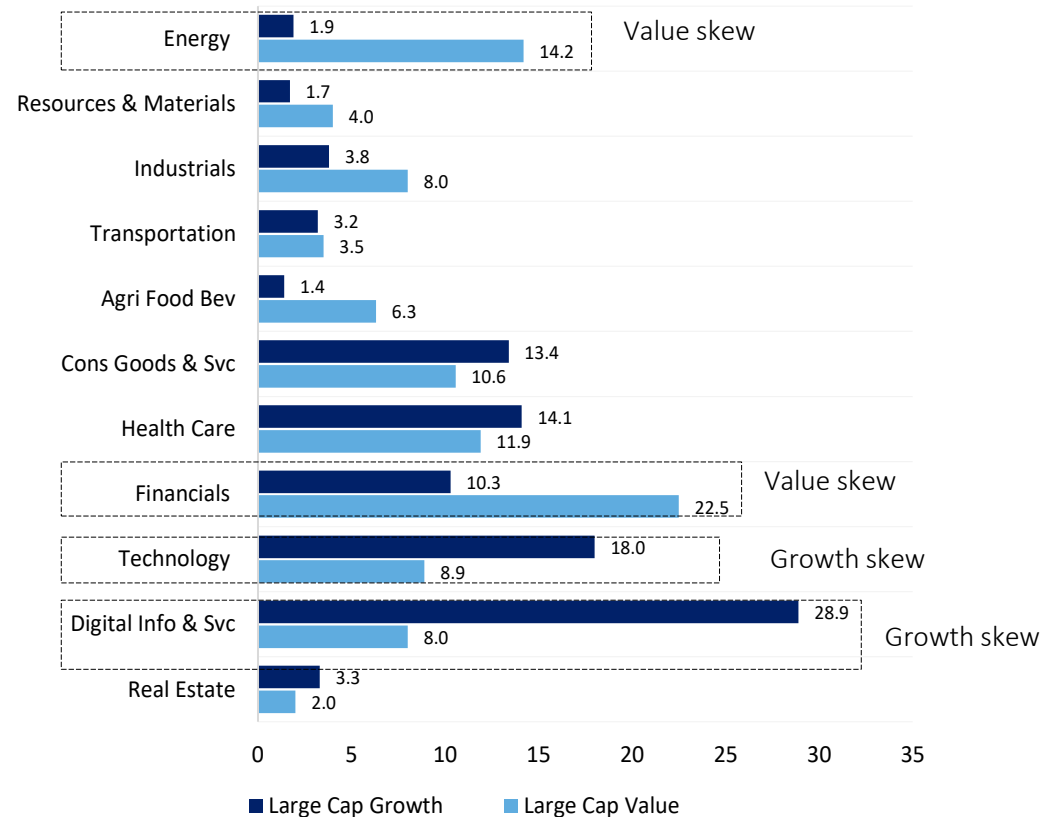
(Equal Weight)

- Long Term EBITDA growth
- Long Term revenue growth
- Forecast EPS growth

How much genuine 'Factor Premia' do they capture?

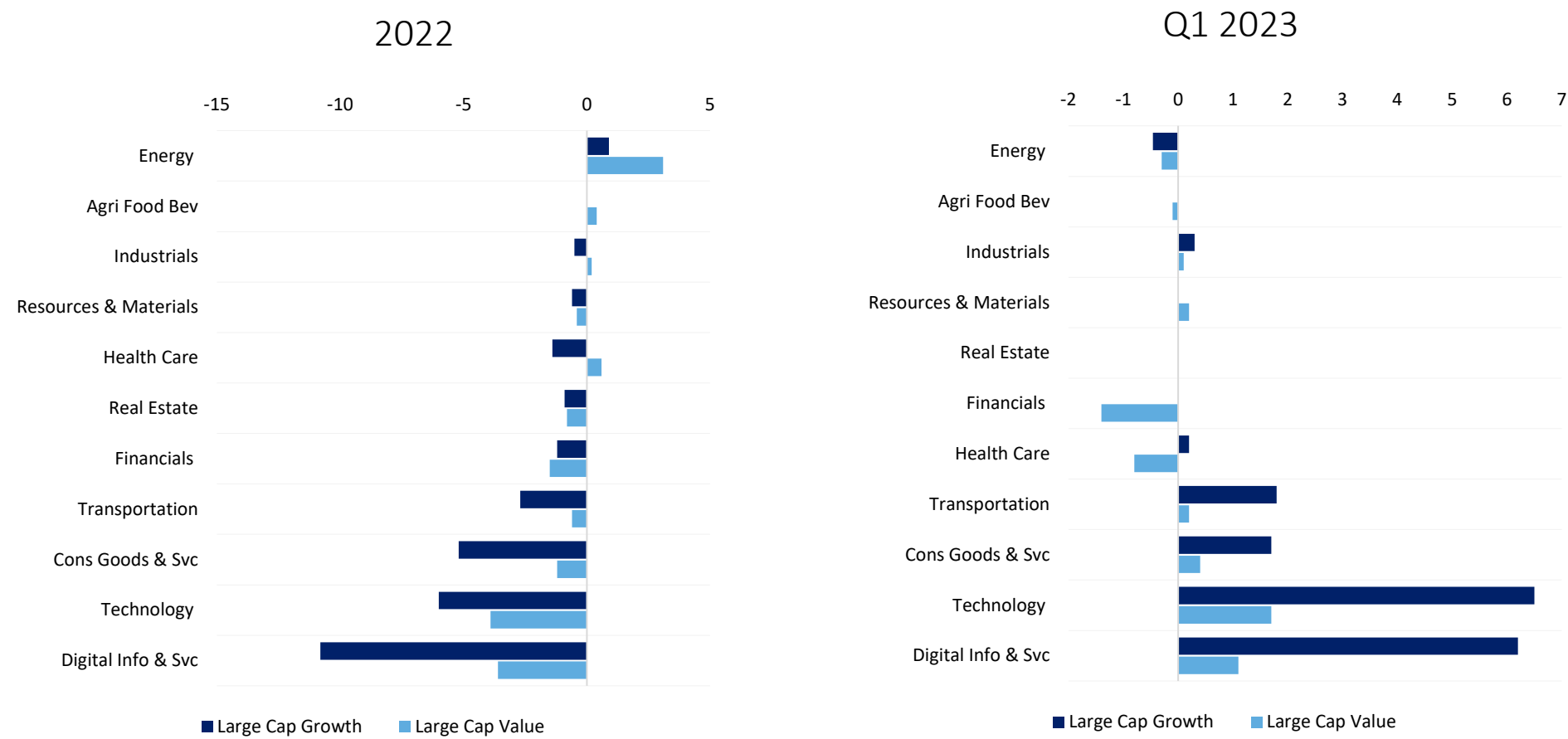
A key problem is the capture of significant unintentional exposures ...

Large sector exposure skews (as at year end 2022)



Source: Wilshire, Data as at 31 December 2022

...resulting in distorted sector weighted performance distributions



Source: Wilshire, Data as at 31 December 2022

Stock concentration exposure ...

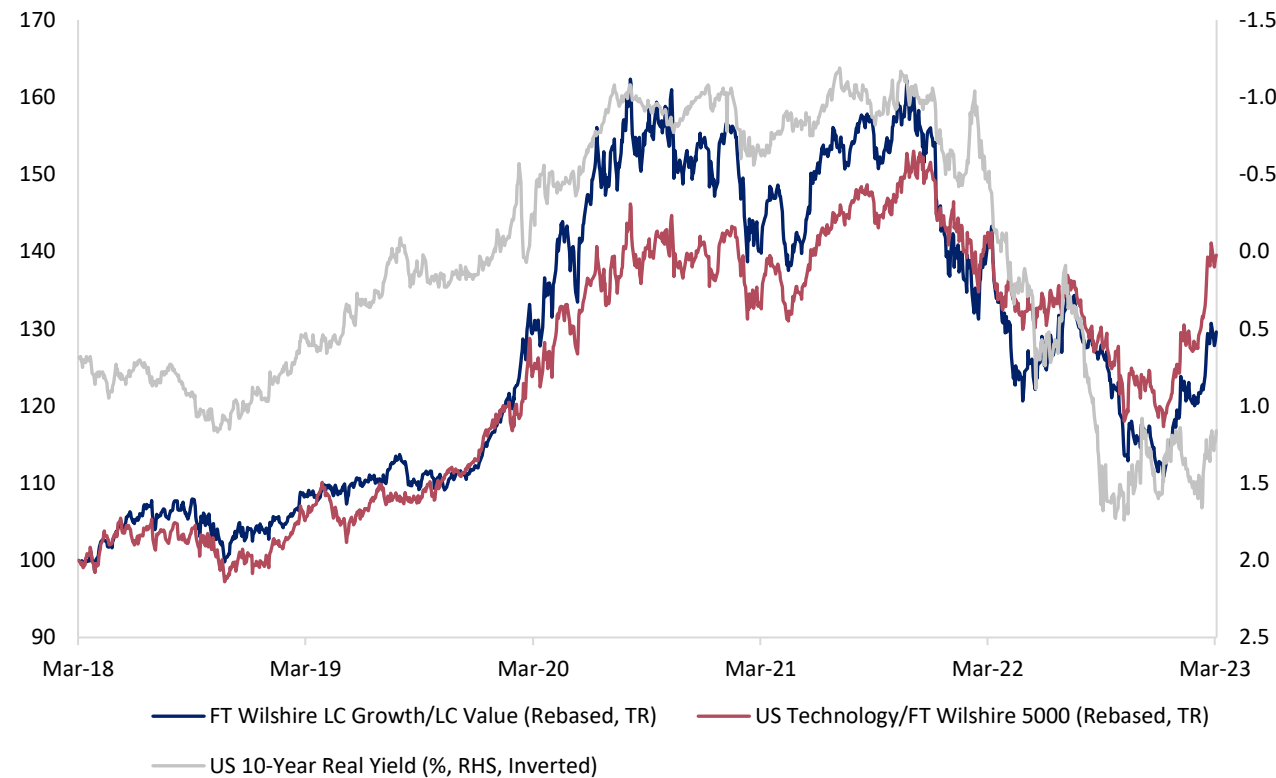
Weight and Contribution to 2022 Return of Top 10 Largest Stocks by Market Cap

Growth	Weight	Cont
Microsoft Corp.	10.1	-2.8
Apple Inc.	9.3	-2.5
Amazon.com Inc.	4.9	-2.4
Alphabet Inc Cl-C	3.1	-1.2
Alphabet Inc Cl-C	3.0	-1.1
NVIDIA Corp.	2.3	-1.2
Tesla Mtrs Inc	2.1	-1.4
MasterCard Inc.	2.0	-0.1
UnitedHealth Group Inc.	1.6	0.1
Eli Lilly & Co.	1.6	0.6
Total	40.1	-12.0

Value	Weight	Cont
Apple Inc.	4.0	-1.0
Exxon Mobil Corp.	2.7	2.4
Johnson & Johnson	2.5	0.1
Berkshire Hathaway Inc	2.4	0.1
JPMorgan Chase & Co.	2.3	-0.3
Procter & Gamble Co.	2.1	-0.1
Chevron Corp.	2.1	1.2
Pfizer Inc.	1.7	-0.2
Merck & Co. Inc.	1.7	0.8
Coca-Cola Co.	1.6	0.2
Total	22.9	3.2

Source: Wilshire, Data as at 31 December 2022

... and macro indicator & long duration equity sensitivity



These 'off target exposures' dilute intended factor premia exposure

Source: Wilshire, Refinitiv and FactSet, Data as at 31 March 2023

‘Pure factors’ paint a different picture – via minimization of ‘off target’ exposures

- Methodology designed to focus on factor premia and the minimization of off target exposures
- Via sector neutral and ‘multiple tilt’ approach:

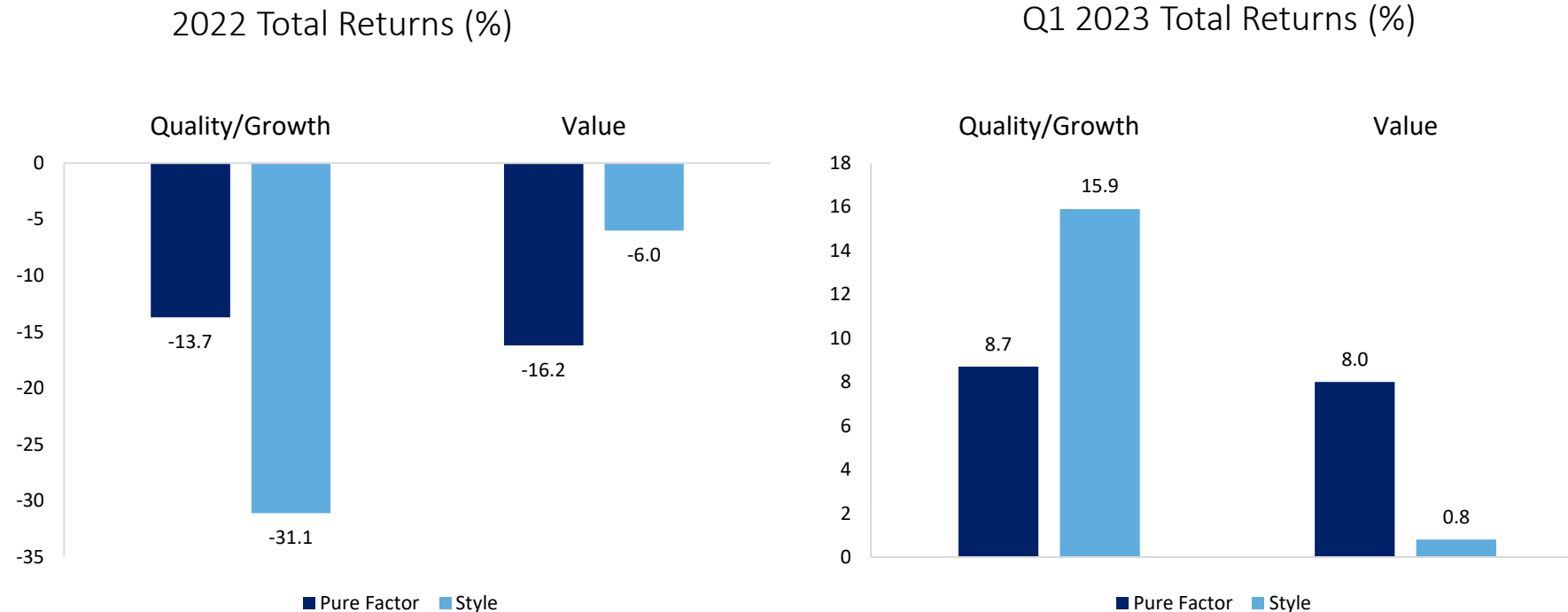
Quality is defined as an equally weighted composite of:

- ROE
- Accruals Ratio (Net income –FCF)/Total assets
- Debt to Equity Ratio

Value is defined as an equally weighted composite of:

- Earnings Yield,
- Sales to Price Ratio,
- Cash Flow Yield
- Book to Price Ratio

Pure factors have delivered very different return profiles to Style indices



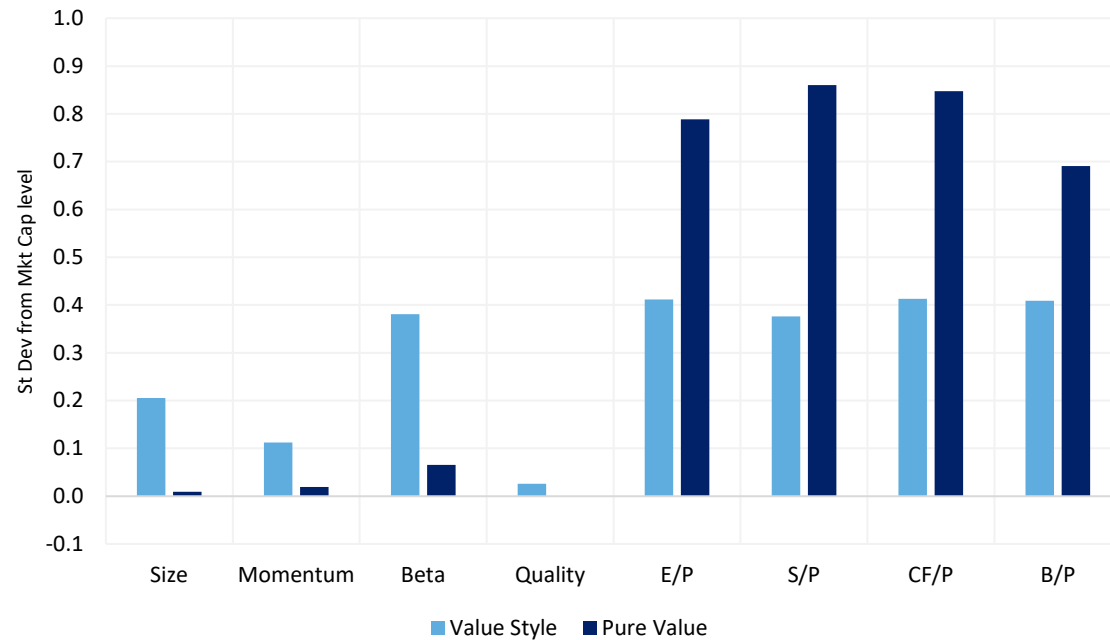
Not as much Growth/Value rotation via the prism of 'Pure Factors'

Source: Wilshire, Data as at 31 March 2023

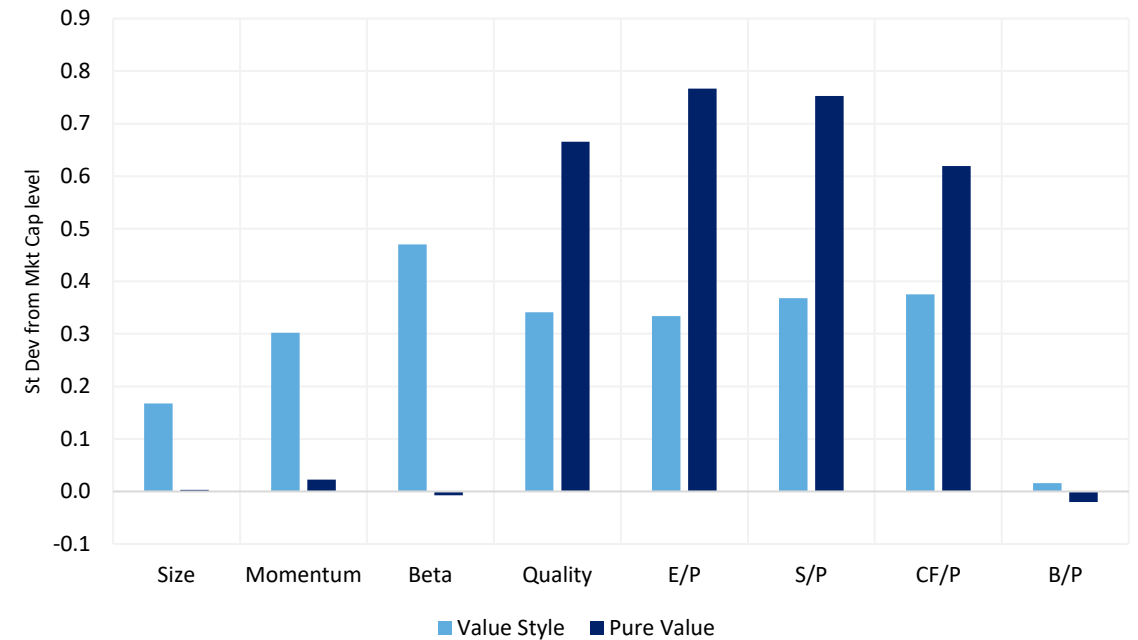
Why the difference? Minimizing 'off target' active exposures

Value:

Value Style vs Pure Value-2022 Average Active Exposure



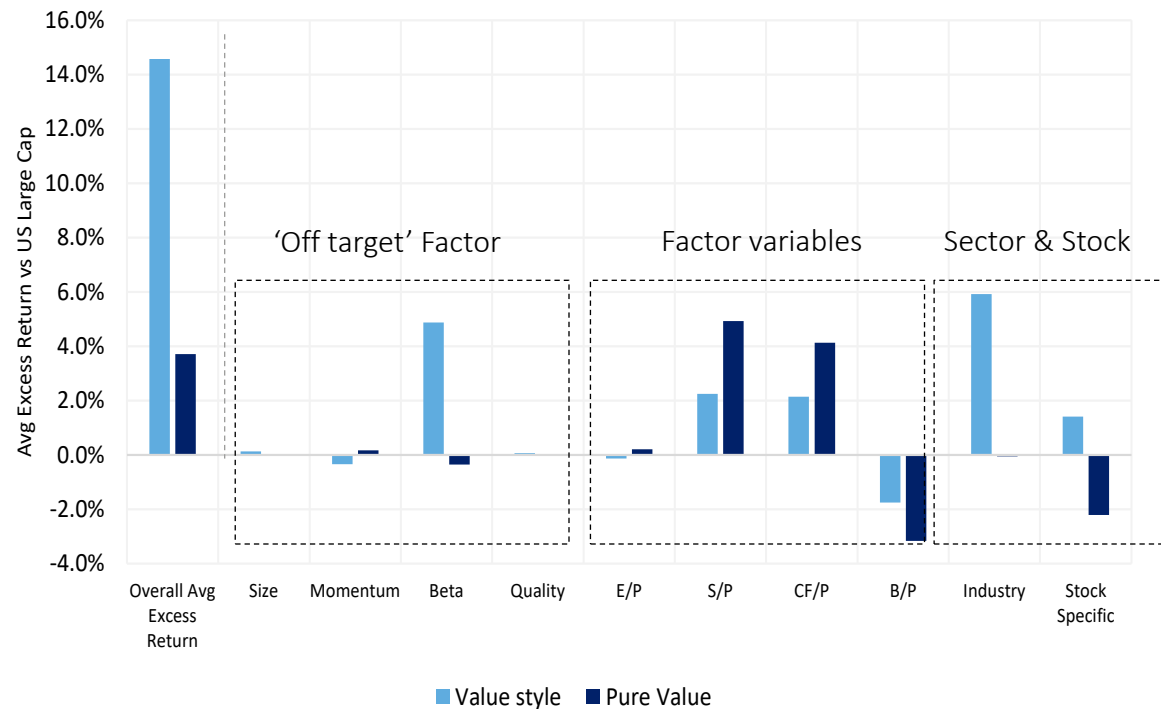
Value Style vs Pure Value-Q1 2023 Average Active Exposure



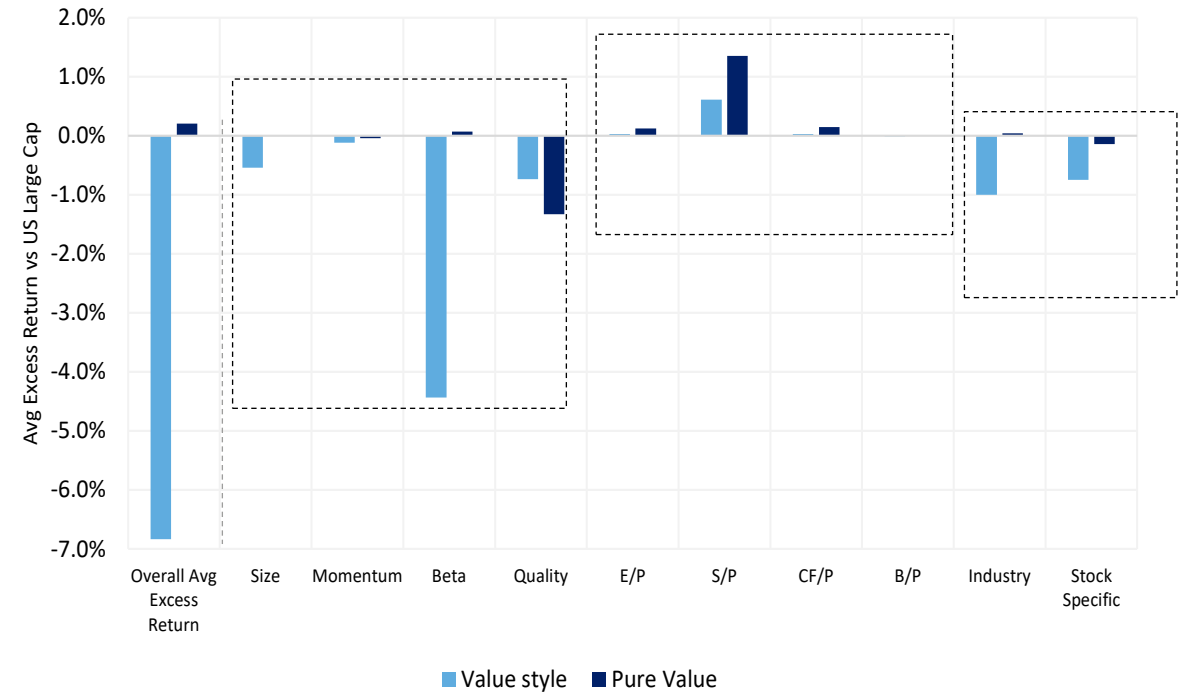
Source: Wilshire, Data as at 31 March 2023

Resulting in very different return drivers and characteristics

Value Style vs Pure Value-2022 Performance Attribution



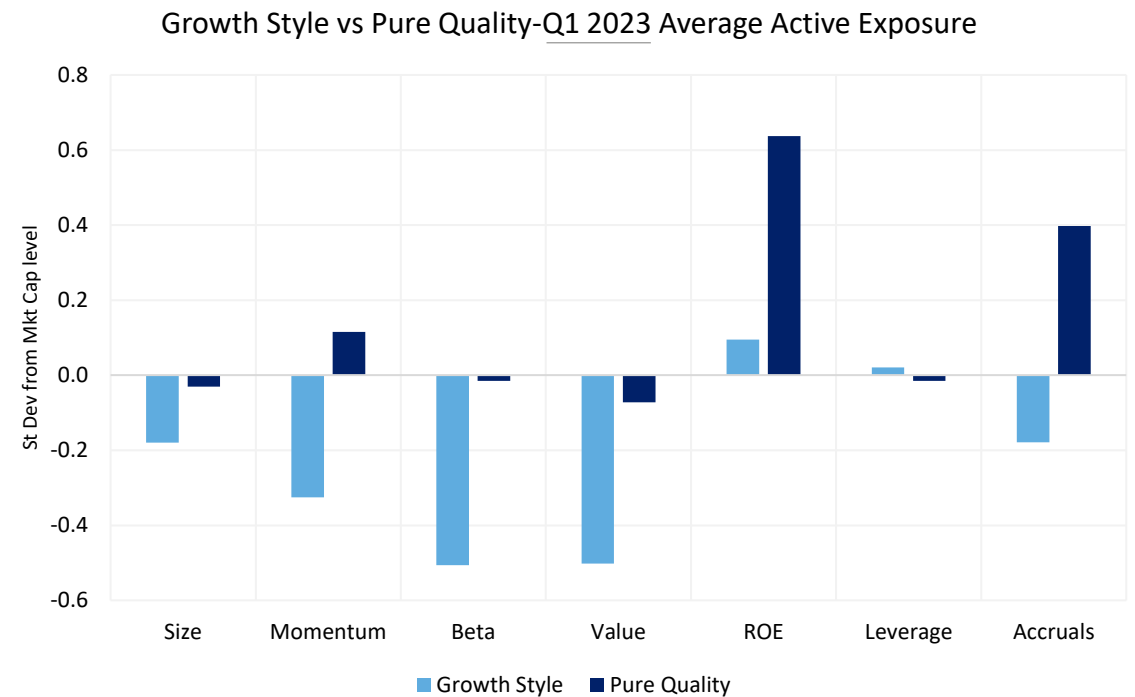
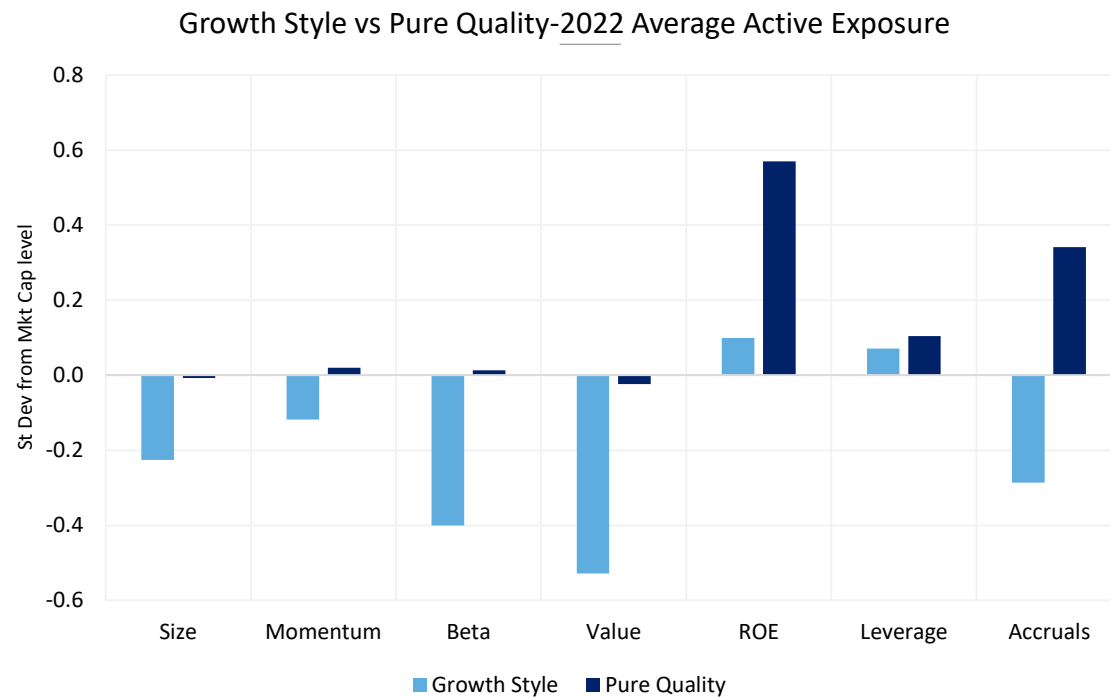
Value Style vs Pure Value-Q1 2023 Performance Attribution



Source: Wilshire, Data as at 31 March 2023

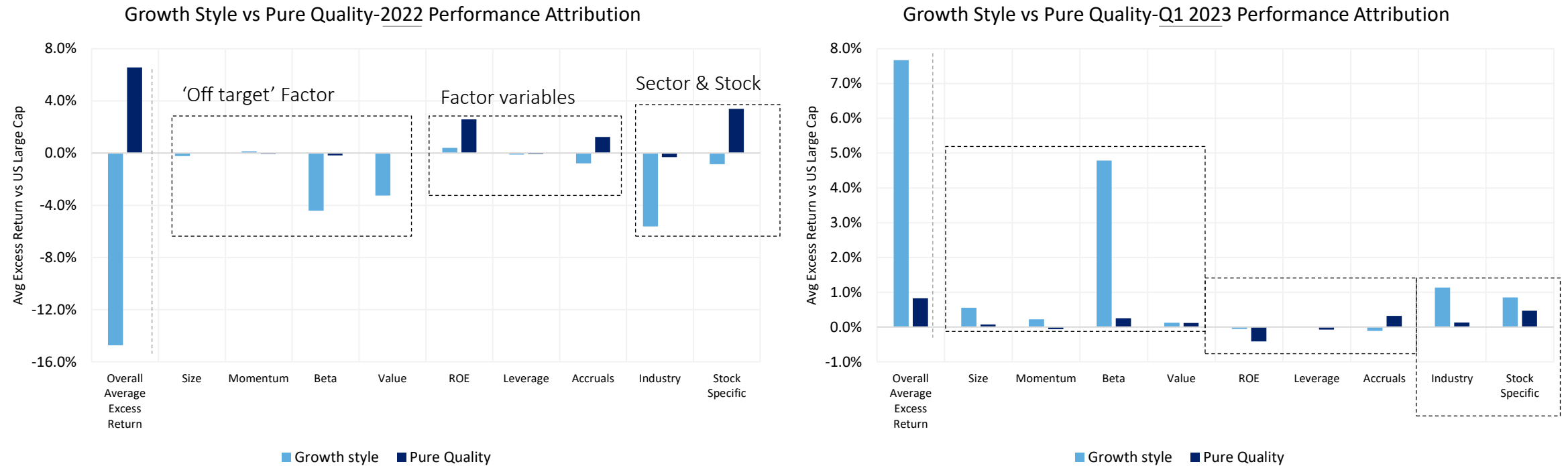
The same story comparing Growth v Pure Quality active exposures

Growth v Pure Quality:



Source: Wilshire, Data as at 31 March 2023

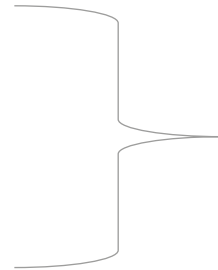
Growth vs Quality factor performance attribution



Source: Wilshire, Data as at 31 March 2023

Traditional factors & style indices capture numerous off target exposures

- Sector
- Stock concentration
- Macro – long duration
- Other factors



These minimize factor premia signalling and create a false narrative of exaggerated rotation

Pure Factors are designed to apply precision to Factor Premia capture enhancing multi-factor application

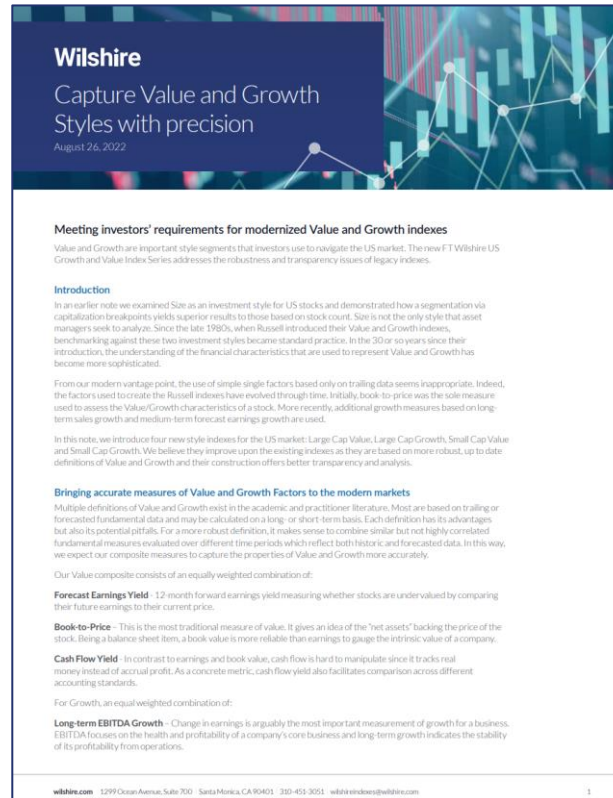
More information

Subscribe and download here: <http://www.wilshire.com/>

Pure Factors Methodology



Research Papers



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