

# MSCI MONTHLY MARKET VIEW

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OCTOBER 2014

A close-up photograph of a person's hand with pink nail polish pointing at a tablet. The tablet screen displays a complex financial dashboard with multiple charts, including a large bar chart with blue bars and a red line graph, and a pie chart at the bottom. The background is blurred, showing another person in a light blue shirt working at a desk.

MSCI

# MSCI OVERVIEW

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MSCI is a leading provider of investment decision support tools to over 6,000 clients worldwide, ranging from large pension to boutique hedge funds. We offer a range of products and services – including indexes, portfolio risk and performance analytics, and ESG data and research – from a number of internationally recognized brands such as Barra, RiskMetrics and IPD. Located in 23 countries around the world, and with over 2,600 employees, MSCI is dedicated to supporting the increasingly complex needs of the investment community with groundbreaking new products, high quality data, superior distribution and dedicated client support.

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Equity and multi-asset class portfolio analytics products help asset managers and owners measure, manage, and optimize their risk and performance across multiple portfolios. Robust analytics are powered by

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Multi-asset, position-based risk and wealth management products and reporting services enable clients to measure and quantify portfolio risk across security types, geographies and markets. MSCI's offering is well known for its Value at Risk methodologies, as well as being a leading provider of credit liquidity and counterparty risk systems.

95  
of the top  
100  
investment managers  
in the world  
are MSCI clients.<sup>1</sup>

Over \$9 trillion  
in assets is estimated to be  
benchmarked to MSCI Indexes.<sup>2</sup>

75  
of the top  
100  
global asset managers  
are MSCI clients.<sup>3</sup>

40  
of the top  
100  
hedge funds use  
RiskManager.

600 clients with  
\$15 trillion  
in assets under management  
depend on MSCI ESG Research.

10  
of the top  
10  
global asset managers  
are MSCI clients.

IPD delivers over  
170  
indexes each year  
in  
30+ countries.

4,500  
asset owners use  
InvestorForce  
to power their performance  
measurement and reporting.

1 Based on P&I AUM data as of December 2013 and internal MSCI data as of June 2014.

2 As of March 31, 2014, as reported in June 2014, by eVestment, Lipper and Bloomberg

3 Based on aiCIO data as of Dec 2013 and MSCI data as of June 2014.

# US MARKET BRIEF

## ACTIVE MUTUAL FUNDS CONTINUED TO SUFFER WHILE INVESTORS FLED FROM HIGHLY-LEVERED AND SMALL-CAP COMPANIES IN SEPTEMBER

Highly-levered and small-cap companies significantly underperformed in September, reflecting concerns of a possible interest rate hike in 2015.

September proved to be another challenging month for US large-cap and total market active mutual fund managers as they continued to underperform their benchmarks, which

extended their Q3 and YTD performance slumps. Top performing mutual fund managers outperformed the bottom ones by 374 basis points in September **(Table 2)**. Differences in investment style tilts contributed to this performance difference as top managers tilted away from investment styles that experienced significant drawdown in September. These included Value, Beta and Leverage **(Table 3)**. Bottom managers' decisions to overweight smaller cap stocks hurt their performance in September by detracting 53 basis points. **(Table 3)**

### MUTUAL FUND PERFORMANCE HIGHLIGHTS

- Large cap active managers had another difficult month in September underperforming their benchmarks by 74bps. **(Table 1)**
- Investment style and industry tilts continued to play a major role in explaining performance of actively managed funds. The top decile mutual funds outperformed the bottom by 374bps. Tilts in investment styles and industry bets explained 103bps and 113bps of this outperformance, respectively. **(Table 2)**
- While bottom managers took significant bets in small cap stocks with high leverage and high residual volatility, the top managers tilted on large cap stocks with low beta and high profitability. **(Table 2)**

- Size, Profitability, Beta and Leverage explained about 80bps of performance differential. **(Table 2)**

### FACTOR PERFORMANCE HIGHLIGHTS

- A number of investment styles experienced significant performance in September. Most notable underperforming styles were Short-term Reversal and Leverage with -2.9 and -2.1 information ratios. **(Tables 3)**
- Highly-levered firms which significantly benefited from the Fed's low-interest rate policy since the great financial crisis have underperformed low-levered firms in September. This happened in both large- and small-cap segments of the market and across all sectors of the economy. **(Tables 3 and 4)**

- Similarly, Short-term Reversal performed remarkably poorly in both capitalization segments of the market and across all sectors with the exception of Financials. **(Table 4)**
- On the positive side, Size, Asset Turnover and Earnings Quality, all indicators closely associated with quality-investing, posted higher than 1.5 information ratios this month. **(Table 3)**
- While Residual Volatility performed poorly in the overall total market and small-cap segments, the factor performed well in Health Care and Telecommunications. **(Table 4)**

**TABLE 1:** Mutual fund active performance by strategy<sup>1</sup> (in bps)

	Q1	Q2	Q3	July	August	September	YTD
Large cap	-17	-73	-133	-50	-9	-74	-222
Large cap value	-74	-59	-25	-10	-6	-10	-157
Large cap growth	-79	-80	-33	29	-31	-31	-187
Small cap	-36	-5	83	68	-63	78	43
Small cap value	-5	16	143	64	-3	84	164
Small cap growth	-22	-212	39	22	-85	105	-198
Total market	7	-59	-134	-37	-30	-71	-185
Total market value	-56	-41	-145	-53	-15	-76	-242
Total market growth	-66	-65	-83	-27	7	-64	-214

**TABLE 2:** Large cap top vs bottom mutual fund attribution (in bps)      Investment style decomposition

	Top	Bottom	Difference		Contribution (in bps)		Active exposure (% rank)	
					Top	Bottom	Top	Bottom
Active return	<b>78</b>	<b>-296</b>	<b>374</b>					
Investment styles	9	-94	103					
Industries	44	-69	112					
Stock specific	24	-134	159					
				Profitability	-2	8	66%	34%
				Size	-3	-53	65%	16%
				Sentiment	0	1	64%	50%
				Long-term reversal	-2	-1	59%	48%
				Earnings quality	1	0	53%	65%
				Prospect	1	1	52%	38%
				Asset turnover	-1	5	49%	65%
				Value	3	-8	47%	62%
				Momentum	0	8	45%	59%
				Beta	6	-16	38%	53%
				Growth	-7	-5	37%	42%
				Leverage	8	-10	37%	71%
				Residual volatility	4	-11	33%	83%
				Liquidity	6	-10	28%	73%

<sup>1</sup> YTD Performance is calculated as of September 30, 2014.

**TABLE 3:** Risk-adjusted performance of selected investment styles<sup>1</sup>

	Total market			Small cap		
	July	August	September	July	August	September
Size	1.9	(0.2)	2.7	0.5	(1.1)	1.1
Growth	1.9	(0.4)	1.7	0.2	0.3	1.2
Asset turnover	0.5	(0.2)	1.7	0.3	1.0	1.7
Momentum	0.2	0.6	1.7	0.2	0.9	1.8
Earnings quality	1.0	(0.8)	1.6	0.2	1.0	1.4
Industry momentum	(0.0)	1.1	0.8	0.7	(1.6)	0.6
Prospect	0.8	0.6	0.6	(0.3)	0.1	1.8
Residual volatility	(0.9)	(0.1)	(0.4)	(0.2)	(2.5)	(0.6)
Profitability	0.8	(0.6)	(0.4)	1.2	0.5	0.5
Sentiment	(0.4)	1.1	(0.5)	(0.5)	1.5	0.4
Liquidity	1.3	1.9	(0.5)	(0.5)	4.5	(1.9)
Long-term reversal	(1.8)	(2.5)	(0.6)	(0.4)	(1.7)	(1.2)
Seasonality	0.3	1.9	(0.7)	1.2	0.1	0.2
Beta	(0.7)	(0.1)	(1.4)	(0.4)	0.2	(1.3)
Value	3.7	(0.3)	(1.4)	2.2	0.1	(2.7)
Leverage	0.0	(0.1)	(2.1)	0.3	(0.9)	(2.3)
Short-term reversal	0.7	(0.2)	(2.9)	(0.5)	(0.2)	(2.2)

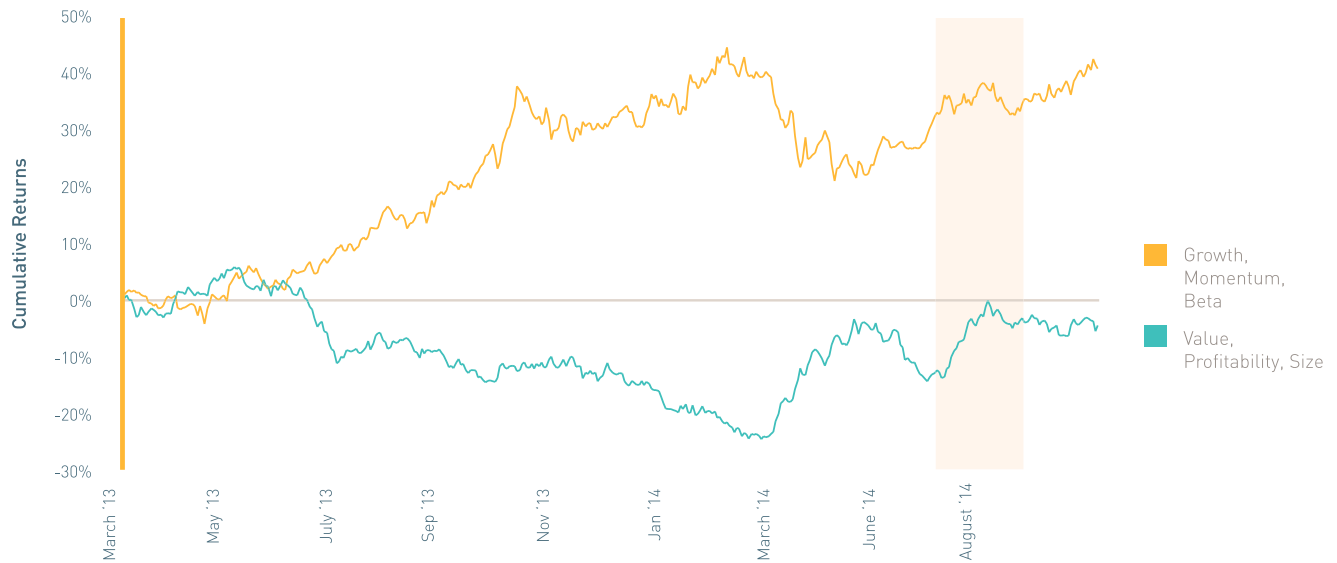
<sup>1</sup> Source: MSCI Barra US Sector Equity Model and MSCI Barra US Small Cap Equity Model

**TABLE 4:** Investment style risk-adjusted performance by sector (September 01 through September 30, 2014.)

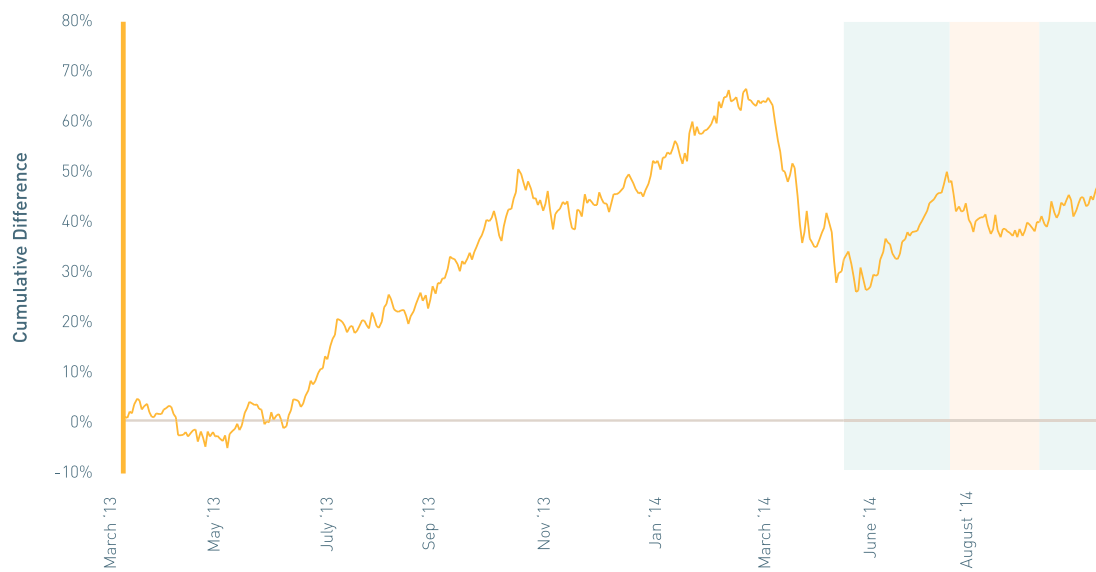
	Consumer discretionary	Consumer staples	Energy	Financials	Healthcare	Industrials	Information technology	Materials	Telecom	Utilities
Momentum	0.5	1.7	2.3	1.4	1.1	2.1	1.2	1.5	1.8	0.2
Size	1.1	(0.0)	(0.1)	2.2	2.0	1.5	1.2	2.1	1.6	2.6
Earnings quality	1.9	(0.7)	1.4	1.4	1.7	(1.2)	0.9	0.9	1.3	(2.1)
Asset turnover	2.1	1.7	(0.0)	(0.1)	2.3	1.7	0.1	1.8	(0.3)	(1.2)
Growth	(0.4)	(0.5)	1.5	0.2	3.0	(2.2)	0.3	2.7	1.3	1.3
Industry momentum	(0.2)	(0.8)	0.9	0.8	0.0	(0.5)	1.0	(0.8)	1.1	0.9
Prospect	1.8	0.5	0.1	0.6	(1.9)	1.3	0.3	(1.7)	0.6	(1.7)
Liquidity	0.1	(0.9)	(1.9)	0.2	(0.9)	(1.1)	0.3	0.1	(0.4)	0.1
Long-term reversal	(1.5)	(0.2)	(3.2)	(0.8)	1.1	(1.8)	(1.4)	1.0	(1.4)	0.9
Residual volatility	(0.9)	0.1	(1.5)	(0.8)	0.8	0.1	(1.0)	(2.0)	0.8	(0.7)
Seasonality	(0.2)	0.8	(0.8)	(0.8)	(0.3)	0.8	0.3	(1.1)	(1.1)	0.7
Sentiment	0.1	0.4	0.4	(1.8)	(0.9)	1.6	(0.3)	(0.8)	(0.5)	(0.7)
Profitability	0.1	0.5	(0.3)	(1.1)	(1.3)	(0.7)	(0.4)	1.3	(0.5)	(0.2)
Beta	(2.8)	(1.6)	(1.7)	0.0	(0.1)	(1.6)	(1.1)	(1.3)	(0.4)	(0.6)
Short-term reversal	(2.8)	(1.1)	(1.2)	1.0	(2.1)	(2.9)	(2.2)	(2.0)	(1.0)	(1.5)
Value	(0.6)	(1.6)	(3.2)	(0.3)	0.1	(0.6)	(0.7)	(0.8)	(0.3)	2.7
Leverage	(1.0)	(1.6)	(2.1)	(0.6)	(0.9)	(2.0)	(2.4)	(2.0)	(1.6)	(0.9)



**FIGURE 1: Investment styles rotation tracking**

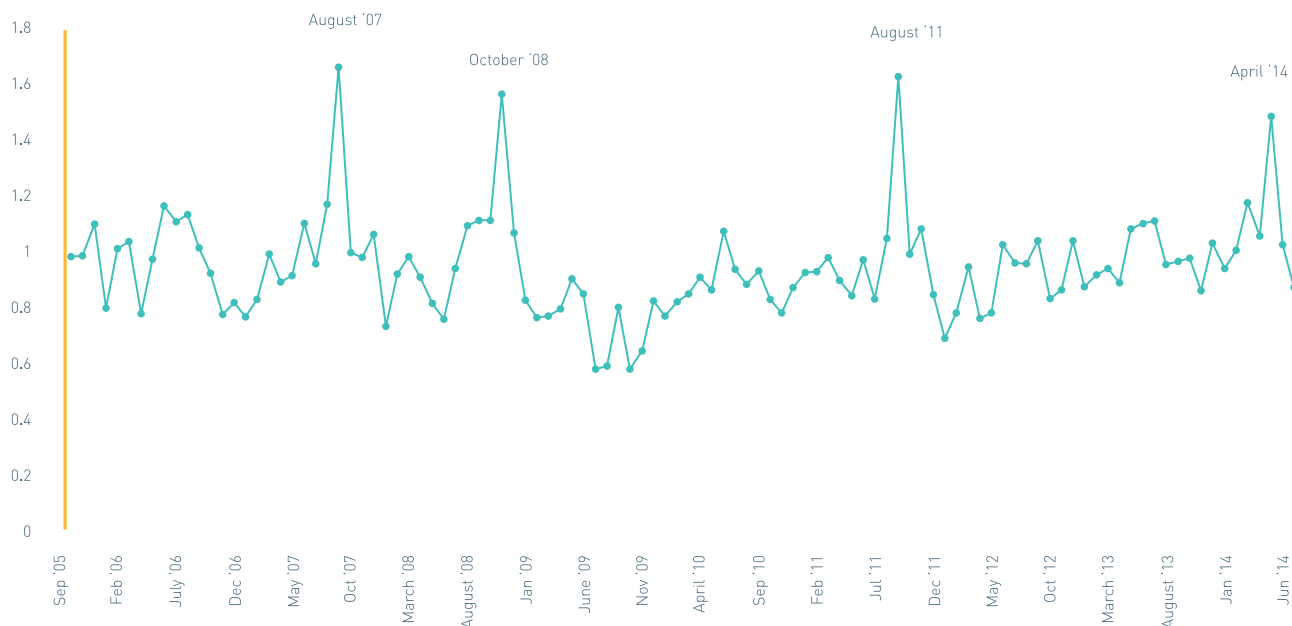


## Difference





**FIGURE 2:** Dispersion of active fund performance



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