China, Stress Testing, and Factors: Market impacts during market crisis: Part 2

Featuring:

***Mark Carver**, MSCI Research, MSCI*

***Raina Oberoi**, MSCI Research, MSCI*

Mark Carver

My name is Mark Carver. I'm the head of equity factors at MSCI, and I'm pleased to play host to you today for discussion around the level of uncertainty surrounding the coronavirus. Joining me today is my colleague Raina Oberoi, who leads our solutions research team in the Americas. Raina, thanks for joining me.

Raina Oberoi

Glad to be here.

Mark Carver

The purpose of our discussion is to address the number of questions that we're getting from clients all over the world around how markets are behaving given the heightened uncertainty in the spread of information and the spread of the coronavirus. We're going to break this discussion into three parts. First, we're going to look at this current epidemic and relate it to past epidemics, most particularly the SARS environment. Secondly, we're going to look at how portfolios might behave by talking about stress testing portfolios and the results of those stress tests. And finally, we're going to direct a very common question that we're getting from clients, which is how our equity factor's behaving, particularly model factors and the factor indexes. Are they behaving how we might expect, or do we see some unintuitive or unexpected results from those, both model and index factors? Let's address a question that we're hearing a lot from clients, which is how are factors behaving in this market? And I think it's good for our clients to think about factors in two paths. One is, what are the model factors doing? So when we look at model factors through GMLt, for instance, it's probably giving some information that's very intuitive to clients, and then there might be a few surprises. The things that are intuitive are that low volatility is holding up relatively well. High volatility is actually quite poor. It's one of the worst performing factors, I think, down in a pure sense, 1.9% we're also seeing some of the value factors, earnings yield down 1.6%, booked to price down 60 basis points. Probably not surprising to some clients. What may be surprising is some of the factors that are holding up relatively well. Momentum in the model is the best performing factor this year, up 3.2%, growth is performing very well and also profitability. Something that we've been talking a lot to clients about is the liquidity factor, where the liquidity factor, which for those of you less familiar with it, it effectively looks at the liquidity of that stock relative to the stock size. It's been a weak performing factor and some of the reason for that could be the fact that investors are selling the most liquid names in their portfolio because they know those names are available to trade, and it's a way for them to realize and get cash in their portfolio. And the result of that is you're seeing weakness in the more liquid names. That might be surprising. When we translate to the factor indexes, which is the way a lot of our client s will actually get factor exposures, again, we're seeing some things that are probably very intuitive. On a relative basis, when we look at MSCI World, it's down 15% year to date, but minimum volatility is performing much better, outperforming by about 700 basis points year to date. If we look at the last few weeks where market volatility has been also quite pronounced, minimum volatility, I think it's up over 600 basis points ahead of on a relative basis ahead of the index. Value factors, similar to what we see in the model, are the weakest performing factors where year to date, 400 basis points behind MSCI World and over the period of heightened volatility, trailing by about 0.4%. Again, surprisingly, momentum performing very well on a relative basis. MSCI World momentum year to date is up 7.7% on a relative basis. So it is down, but relative to MSCI World, it's almost 800 basis points ahead and over the last few weeks, almost 400 basis points. Quality may be surprising. You and I were talking a few weeks ago where we were looking at some of this data and quality seemed to be reasonably weak, maybe not what we expected. Recently we've seen that revert where quality is now on a relative basis, performing reasonably strongly. So I think in the index and in the models, we're seeing some things that are very intuitive, but then some things that are surprising. So intuitive, with minimum volatility and quality on the index side, maybe surprising momentum. But let's go back to some things that you were hinting at, where we talk about just this level of heightened volatility rather than looking at longer, it sounds funny to say longer horizons as a little over two months, but rather than looking at the year to date period, what can we learn by looking at much more shorter horizons, even something that may seem silly intraday, what are we seeing in terms of factor behavior in these very short horizons?

Raina Oberoi

Yeah, Mark, that's a really interesting question. And I think something that we all do is we talk abo ut performance over a day, over a few days, over a week, months maybe, but very few of us actually talk about performance intraday. And I think one of the challenges investors have had is to access this real time data to respond to market moves. And I think the importance of this data comes especially in times of these heightened volatility because you want to understand how the dynamics are playing out. You want to understand where are the risks embedded in your portfolio, which factors, which sectors are behaving differently than what you might observe over a few days. And so I think access to this real time index data is becoming more and more crucial. And MSCI obviously has a lot of this data sitting in house. So it's very easy for us to access that. And we actually did some analysis around this over the month of February, and especially if you look at starting probably around February 24, the last couple of weeks, there has been extremely heightened volatility at the open if you just look at the US market, which we measured by MSCI USA. And again, it may be intuitive to some that, yes, at the open, but some might think that even at the close you would see height and volatility. And we actually take this analysis and we compare it to what happened in the quant crisis in August of 2007. And you'll actually see that the analogy plays out quite well in terms of heightened volatility at the open. The other thing that we see, which is very similar to what happened in the quant crisis is which factors are selling off first thing in the morning at the open, and you'll see value in small cap stocks are getting sold off versus other factors, which is again, very much in line with the quant crisis. I think what's different compared to the quant crisis is that this time factors are a lot more active in today than factors. And if you look at the sectors, in particular energy and financials, which are financials mainly lending to these energy companies, they are the ones that are selling off in the early hours compared to the rest of the sectors. So again, intraday data may be very transient for some people, but it can really be used as a very crucial length in times like this.

Mark Carver

Yeah, of course. And I think the overarching message we want our clients to sort of leave with at least this session is that our tools are available to them. We are committed to providing them a level of insight on an ongoing basis. We're talking in very real time here, but also that in many ways our models and our indexes are doing what people might expect. Minval for a lot of those clients who have been more defensive is behaving as you would expect, quality as you would expect, and that we're committed that this conversation is ongoing. It's not ending today or ending with the amount of research that we've put out.

Raina Oberoi

Absolutely. And I think it's again, importance of tools. We are in a day and age where we have so many different dimensions to use for portfolio analysis. In our conversation alone, I think we focused on revenue exposure. We focused on stress testing. We focused on intraday analysis, understanding your portfolio through factors sectors. So I think there is a lot of information out there, a lot of tools and for investors to be better prepared today than they were back in the day, it's just there is a lot of information to digest, and we're there obviously to help with that.

Mark Carver

Raina, thank you for joining me on this three part series and thank you to all of our clients who have listened in on this three part series as well. We are committed to providing you ongoing realtime information to address this level of uncertainty and make sure you have the data that you need to make an informed decision. Visit our website at msci.com/coronavirus or follow us on LinkedIn to see all of our real time information as well as all the blogs that we've produced, research that we've produced year to date. Thank you very much.

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