2021 Factor Investing Mid-Year Review Part III: Five Key Takeaways for Investors

Featuring:

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Mark Carver:
Jenna, thanks very much. Great to see you. Let me begin by just thanking all of our panelists who participated today. All of our experts. I think the most important thing that I reflect on as I review what I heard is that we had a lot of agreement, but equally a lot of disagreement. I think that probably adds incredible value to all of our listeners, where you're getting a diversity of opinion. You're hearing from firms that represent different roles inside of our ecosystem. I think that's critically important. So I want to emphasize how much I appreciated the differences of opinions and the richness of the discussion. But the five key takeaways that I take from what I heard collectively from our team of experts are the following.

First, it's really important to separate the headlines and the noise from what you're trying to achieve as an investor. Raina and Brynn both emphasized how well equity investments have done despite some of the noise that we've heard, first from COVID, then more recently, we're talking a lot about economies reopening potentially with inflation. But despite that, equities have done really well and investors who stayed the course were very well rewarded. But interestingly, all of the panelists noted how we've seen an incredible rotation across the things that were driving equity markets, and particularly starting with the Pfizer vaccine announcement on November 9th. We saw this big shift from growth and momentum strategies, and instead to value. We saw the best six months of performance for value strategies that we've seen since the financial crisis. The real takeaway there is, separate the fact from the fiction and understand what's happening behind the headlines, and understand that factors in markets in general will be cyclical and there will be some rotation.

The second big thing that I think I heard today, and I thought was a very important insight, was this idea of knowing your exposure. But it's very important to understand the things that are driving the risk and the return inside your portfolio. Many of our experts today use this expression, and they seem to have a strong agreement in the importance of knowing the exposures of your portfolio. Of course, a lot of investors think about this only their asset allocation mix, stocks, bonds, cash, maybe some of the things that they have within their stock or bond mix. But rather instead, go a level deeper, and this is where factors come in. What factors do you have that make up your equity mix? Where did those factors come from?

Are those consistent with your investment beliefs and with your overall objections? Because at the end of the day, it's these style dimensions, the factors, as we call them at MSEI that will ultimately influence the risk and return behavior of your portfolio.

The third thing, and maybe complimentary to knowing your exposure, is understanding the way those exposures and particularly the style dimensions will interact with one another. There again seem to be fairly wide agreement on understanding the correlation of factors. How does value interact with quality, or momentum, or size, or volatility? All of the panelists use this as a dimension of the way they think about building their asset allocation. In fact, I think we heard some really interesting and diverging views as we go a level beneath understanding the interaction, but what you do with that interaction. Dana talked a lot about the use of value and momentum together, and how they can be complimentary and bring in benefits to your portfolio. While Andrew talked about the correlation between value and quality. In fact, that they've been negatively correlated and how that could be beneficial to overall portfolios. Interestingly, there was also this notion by a range of panelists around the importance of managing the risk of portfolios, and how strategies that are more defensive in nature. Minimum volatility was the factor that was mentioned here, could be a very important utility inside of a portfolio.

The fourth thing that I heard from everybody was the importance of doing due diligence. There was a lot of consideration, particularly now as there's more choice around the way investors take exposures between index strategies and active strategies. But it's really important to do the due diligence both on the index or on that active portfolio. Don, he mentioned very emphatically the importance of understanding the definitions of a factor index, for instance. Are those definitions understandable? Are they grounded in economic and academic logic? Compare those definitions across providers, but equally he mentioned how important it is to be able to understand the exposures of active managers. Where do those exposures come from? Are those active managers giving you the factor exposures and the styles that are consistent with your objectives? The reasons you hired those active managers. I thought that was a really important takeaway under the guise of a due diligence.

The final thing that I heard and I thought was a really important takeaway, was this idea, and these are potentially my words, is the idea of staying the course. This goes back to what I said at the beginning, the importance of separating the noise, in this case, it's about staying the course. The panel seem to believe that while there is clear evidence of factors being cyclical, that doesn't necessarily mean that there was agreement that people should be rotating their factor exposures on a very dynamic basis. In fact, I think it was Dana who used the term that the noise will often trump the signal, the signal being whatever dimension, whatever idea you might use to rotate those factors. So that was an important reminder to stay the course.

However, in this notion of staying the course, what I think most of our experts really meant was stay true to your asset allocation in your portfolio objectives. There was an underlying theme that I think is quite interesting in that today, the way we stay the course, the way we stay true to our asset allocation is very different than what it has been in the years past. We've talked about this notion of asset allocation 3.0 in other Asset TV sessions. This idea is that once upon a time we did stocks, bonds, cash. Then, investors often did asset allocation by looking at geographic over and underweights. But today there's a notion of being even more precise in how you take the exposure if you're underweight or overweight a region, you can still have the decision of how you take that exposure. Bob brought up a really interesting idea when he reflected on the fact that, while the vaccine announcement back in November 9th provided a catalyst for value strategies. The truth is the reason for that was this belief that economies would start to open up as more of the population got vaccinated.

What we know today is that the rollout of the vaccines is very uneven. The US has done a very good job of vaccinating most of the adult population, other countries, other regions have been slower. Why does this matter? What this could do is provide you a level of insight that Bob noted, in terms of the way you play your domestic versus your international exposure. Can you use some of these macro considerations around what's happening in the real world economy to influence your investment decisions in the way you take your asset allocation? So the five key takeaways for me were separate the noise and the headlines from the realities of markets, to know your exposure, to understand the interaction of those exposures, to do your due diligence across your index and your active strategies, and then finally, to think deeply about your portfolio and stay the course, stay true to your ultimate objective.

These are good lessons for all investors. I want to again say thank you very much to the panelists. It was a really great discussion. Thank you so much to Raina and Andrew for setting us up so well with the research dialogue, and appreciate all of you. Of course, thank you to all of you as well for listening. So with that, Jenna, let me turn it back to you.

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