The Market's Bad-Breadth Problem

Adam Bass (00:00):

This is MSCI Perspectives, your source for insights for global investors and access to research and expertise from across the investment industry. I'm your host, Adam Bass and today is July 6th, 2023. As we move deeper into the summer, it's not just the air that's getting stickier. Investors are faced with the potential of stickier inflation, as well as equity market concentration and expectations that US interest rates may be higher for longer. I spoke with a panel of MSCI experts to get their views on these issues as well as the questions that are being asked and answered by markets and investors, as well as of course, the potential implications as we head into the second half of 2023.

(00:53):

Today, you'll hear from Thomas Verbraken from MSCI's Risk Management Solutions Team. Hitendra Varsani, Global Head of Factor and Derivative Solutions Research. MSCI's head of Portfolio Management Research, Andy Sparks and Mark Carver, Global Head of Equity Factor Products and Equity Portfolio Management. Enjoy their conversation. I'll see you on the other side. Let's dive in. Thomas, I think I'll turn to you first about your recent research around four potential macro scenarios and how they might affect a multi-asset class portfolio. Why don't we just talk about what those scenarios are?

Thomas Verbraken (01:38):

Sure. So let me start with outlining the four scenarios that we defined actually at the beginning of the year, and I'm sure these scenarios will sound familiar. So, the first one is a soft landing. That's a scenario in which inflation comes down slowly but in line with Fed expectations and the recession is avoided in the US. The banking crisis does not escalate and no further downside risks materialized, so that's the more optimistic one. And then we have the hard landing, which is inflation comes down, but at the cost of a recession. In this scenario, we can also expect a Fed pivot. Then, we the stagflationary scenario, and that's one where monetary policy is not sufficient to tame inflation.

(02:22):

Central banks might lose credibility. Inflation becomes entrenched and the high prices and high rates weigh on growth for a longer period. The final scenario, it's a really optimistic scenario in which inflation is under control and falls more than consensus expectations, and economic growth surprises on the upside. So these are all scenarios which fall within a range of baseline forecasts from economists and strategists. So you can think of these as variations of a baseline expectation. Some more optimistic, some a bit more pessimistic. During the banking crisis, earlier this year commentators were more focusing on the hard landing as being the more plausible scenario.

(03:07):

Now on the back of a continuing strong US labor market and strong consumer confidence, the possibility of a soft landing is again getting more attention.

Adam Bass (03:18):

Thanks a great start. Hitendra, I'll ask you, as you looked back on the quarter for this edition of markets and focus, what did we see in terms of investors thinking for hard landing versus soft landing, et cetera?

Hitendra Varsani (03:34):

Yeah, so the big question on investors' minds is, what's priced in the market? So throughout the year we've been pivoting from a hard landing to a soft landing and as Thomas rightly pointed out, the labor market in the US has been stronger than what many expected. One question is what's priced in the market? We look at analysts' earnings forecasts, they're somewhat the bottom end of their historical range, but if we had a hard landing scenario, earnings historically would be significantly weaker than what these analysts are expecting. So you could say that analysts are not expecting a hard landing, but also, at the same time, they're not expecting a very rosy scenario either, given their low forecast going forward.

(04:17):

So I would say perhaps we're somewhere in between and you could coin that a rocky landing scenario as things stand at the moment.

Adam Bass (04:27):

So Thomas, I guess add that to your list, rocky landing.

Andy Sparks (04:33):

Adam. In terms of the fixed income market, it was an interesting quarter, price wise, most of the audience will recall that we had a little bit of a potential crisis with US regional banks starting in early March, but the market seems to have gotten beyond that and credit spreads have tightened very nicely in both investment grade as well as high yield. At the same time that we've seen this sort of general rally in equities, we've seen government bonds trading off. This is sort of consistent with maybe a greater likelihood of a soft landing, less likelihood of recession, more optimistic growth, maybe a little bit higher inflation than thought, rates from central banks, needing to be higher for longer. So we have seen in government bonds a little bit of a sell off at the same time that we've seen credit spreads tightening and equities rallying.

Hitendra Varsani (05:30):

So Andy, I think from your perspective as a fixed income specialist, you see equity markets painting a rosy picture. Acqui is up 14.3% year to date, but the reality is when you dive deeper into the equity market, there's only a handful of stocks, coined the magnificent seven that's actually lifted the entire acqui universe contributing to almost half of the headline return. If you take those seven stocks out and say equally weigh the rest of the universe, that's significantly weaker and almost flat year to date.

Thomas Verbraken (06:06):

One thing I also want to add to Andy's comments, and it's something that we often look at together with Andy, is what fixed income markets tell us about market implied expectations for the central bank policy rates? There, we've seen consistent with what Andy said, that sovereign bonds have traded off that investors are now expecting more rate rises longer into the year, which is finally consistent with what the Fed is also signaling, and that was actually different earlier in the year around the banking turmoil when investors were pricing in lower rates and even a pivot sooner in the year. So at that time, investors might have been thinking it's a hypothesis that hard landing is more likely and in that scenario the Fed might pivot, but they've now adjusted their expectations and are more aligned with what the Fed has been saying that rates will stay higher for longer.

Adam Bass (07:05):

And that's something we've talked about on the program before, this idea of investors not listening when the Fed is basically telling them what it is that they intend to do. Has that appeared to actually has shifted and if so, any thoughts on what's behind that?

Thomas Verbraken (07:22):

The data shows that indeed investors are now more aligned with what the Fed says.

Andy Sparks (07:28):

This is related to the slope of the yield curve, which I think all investors are very aware it is steeply inverted in the United States and in other countries. It is also inverted and couple of different views about why that is. One view of the world is central bank policies are going to create a much lower level of growth in 2024 and 2025. So one view is that central banks are maybe overly reacting to high inflation and are being too aggressive and are going to engineer a recession. And so just placing it back in the scenarios that Thomas was referring to, that hard landing is generally not a good one for economic growth, of course. Now another view is that the Fed and central banks are not necessarily going to cause a recession, but maybe they're just simply reacting to inflation data.

(08:35):

Inflation may come down more than the central banks expect, and under that view, or I should say one narrative to that view is simply that central banks have been way, way overly optimistic about low inflation going back to 2021 and 2022. So skeptics of central banks might say that they were so wrong, they had such low inflation forecast earlier. They're now going to the other side and they're being too extreme and they're keeping rates higher for a longer period. Fundamentally, I think the big question for investors as well as central banks will be what will realized inflation be going forward? To the extent that short term rates are basically administered by central banks, you can create a steeper, a flatter yield curve just simply through central banks and that does not necessarily imply anything about economic activity.

(09:39):

Longer rates are ultimately going to be driven significantly by views on inflation.

Mark Carver (09:46):

Andy, forgive me, I think I'm a little confused by your answer

Adam Bass (09:50):

And that of course is Mark Carver.

Mark Carver (09:52):

If the question was why are investors seemingly more in line with what the Fed is saying than they've been in the past, the back end of your answer seem to say that they're not actually aligned, that they think the Fed is overestimating what inflation will be and the Fed is going to be wrong.

Andy Sparks (10:12):

Very, very good question. I forgot to say one thing, a crucial thing, inflation has been stubbornly high this year. A month ago, interest rate futures markets thought short rates were going to be coming down by really the second half of this year. That's no longer the case. At the same time we fed over the past few months unexpectedly high realized inflation. So, one way to reconcile these two is that the market is now in line with the fed sort of more pessimistic inflation forecast for 2023. For 2024, the market does see policy rates coming down sort of in line with what the central banks are saying as well, by the way.

Thomas Verbraken (11:03):

I still find the inverted yield curve as an indicator for a recession. I had an interesting data point because if you look back like I think in the past 10 recessions, we saw the yield curve invert prior to the start of the recession and there hasn't been really a false positive. Another piece of information is that between the first time the yield curve inverts and the start of the recession, there could be quite some time. So in the global financial crisis, I think it was ... and it was more than 15 months between those two dates. So I think that's the big question, right? Will it be different this time? And I think Andy indeed pointed out that inflation will be the key here.

Adam Bass (11:53):

And certainly, the question of recession is something certainly on a lot of investors' minds, it's been being discussed for quite a while now and I do want to pursue that, but I don't want to lose track of something Hitendra pointed out, which was the incredible amount of concentration in market performance right now. Mark, I'd love to ask you, can you help us put this in some type of historical perspective?

Mark Carver (12:23):

Well, I think there's two things that are quite interesting about the level of sort of market concentration. First, when we think about it in 2023, we almost have to say what was the impact of the magnificent seven and what was market breadth before June and what did it look like after June? Because the equity markets were quite different in June than what we've seen in the most of the rest of the year. So for example, I think Hitendra was talking about the impact of the magnificent seven or the so-called magnificent seven on acqui performance year to date being roughly 50% of the return of acqui for those seven names. In the US market prior to May, that was more than 90% of the return of the US market was driven by those seven names.

(13:18):

At the end of the quarter right year to date, that was closer to about 70%. The reason for that is that we saw this big shift in market breadth at the end of May for US stocks market breadth was relatively negative, meaning there were more stocks that were negative year to date through the end of May in the US market than were positive by the end of June, market breadth was actually fairly strongly positive. So what we saw is this broadening of the equity markets at the end of June. One way for some investors listening to think about that is you could look at the performance difference between MSCI USA and MSCI USA equal weight in the month of June only, where the equal weighted index outperform the US market by like 80 basis points in the month, where it's underperformed year to date through the end of June by more than 800 basis points.

(14:19):

So we saw this same pattern emerged in the global markets. The relative narrative is quite similar. From a historical perspective, the periods where we saw market concentration driven by a tiny number of names, we could go back to 1998, 1999, where at the time we saw this surge in technology companies. The big thesis at the time, particularly in 1999, was that the internet was going to change society in many, many ways. For sure that is proven to be true, but when you go back and look at some of the names that were the big winners in that period, they weren't necessarily the names that went on to be the winners over the next 10, 20 years. And today, what we have is an AI driven rally that's led to the magnificent seven.

(15:18):

And I think most of the four of us would agree that the impact of AI will be profound on investing, on society and on business. We don't know over the next 10 or 20 years who will be necessarily the winners. So I think Adam, to your question, what's really interesting is in a period in recent memory that was so similar today in terms of market concentration, the overall thesis at the time proved to be spot on. The internet had a profound impact on business, on society. AI will likely have a profound impact on business and society. It's still to be determined who will be the winners. The consideration for many equity investors is how do you play this market? It's a very difficult environment for active investors. Market breadth is only one picture of that, right?

(16:13):

Market breadth looks at the names that are positive versus negative. What's equally important is the names that are outperforming versus underperforming, the acqui or the US market. In the case of acqui, it's something in the order of 70% of names that make up that index are underperforming the index. In the US, it's about 75 or 76% of US stocks are underperforming MSCI USA. What that means, it's profoundly difficult market for equity investors to navigate, particularly active investors or any strategies that vet against the market cap portfolio because of this market concentration. And that means that the way investors are rebalancing portfolios, the way they're allocating to certain strategies needs to be reconsidered, and we're hearing that quite a lot from our clients.

Hitendra Varsani (17:06):

That raises a question of what is the distribution of returns for the full universe? So these seven stocks that outperformed, they had high weights that lifted the entire market, driven by the AI theme and technological revolutions, but questions on investor's mind is where is the treasure and the rest of the universe? What about in the small cap space or the lower cap spectrum where these names may have performed quite well but are going unnoticed because they're not at the top of the index. So we dig a little bit deeper into this and have a look at one of our thematic indexes, namely robotics and AI. And when we look at the distribution of the names outperforming in that particular universe, 70% outperform acqui.

(17:57):

So it goes to show that acqui is a universe that's represented of the broad market and these names had outsized weights and outsized returns, but there are opportunities within the AI space in the rest of the cap spectrum that have also delivered strong performance.

Adam Bass (18:16):

In the face of that, if we look at some other ways of investing, for example, say from a factor's perspective, I guess Hitendra or Mark, how did this play out

Mark Carver (18:31):

From a factor standpoint, when we look at the long only factor indexes, what it meant was there was a flight to quality. Quality indexes across the globe have done very well relative to their parent indexes. Most of these names that are in the Magnificent seven will have some weight in the quality indexes, usually an overweight, and that has been a boost. Generally speaking, investors are highly sensitive to the earnings stability and sustainability of companies and companies that have any risk to their earnings are being punished. Companies that have earning surprises to the positive are being rewarded. That's also generally good for quality investing where you're looking at the profitability and the consistency of that profitability as dimensions of how you select names that are in a quality portfolio.

(19:26):

More broadly, if we say how are factors performing, we are seeing in some ways a bit of a dislocation between pure factors i.e. our model factors and how they're performing to the way you might represent that into a hedge fund portfolio or a long only index. For instance, value has been a relatively strong performing pure factor this year, year to date in our global models, I think value is the second best performing for the quarter. We saw value in long-term reversal be strong performers, but when you look at a long only interpretation of that, you don't see our enhanced value indexes or our value style indexes providing outperformance. That's sort of this interesting dichotomy. We're also noticing, and I was talking to Hitendra about this separately, this gap between some of the value signals, for example, book to price.

(20:36):

Historically, if you look at the performance of deciles, if we did a look at the acqui universe and we sorted companies based on deciles based on their book to price, historically the top decile i.e. cheap names will outperform the expensive names by around 700 basis points. This year, we have not seen that. In fact, in the US market, you're seeing negative performance of roughly 14% in the last 12 months on book to price top versus bottom decile in the US market. That's an extraordinary difference between what you typically see. So in some ways, there's this notion of this dislocation or this loss in translation when you move from a pure factor to a long short implementation to a long only implementation and that becomes a very interesting environment from which investors need to operate.

Hitendra Varsani (21:35):

I love the lost in translation and I have another data point for lost in translation. So when you look at the year to date performance of the style indexes, growth outperformed value by very wide margin. Now, for all the reasons that we've mentioned, the technology exposure, the exposures to these AI themes, et cetera, right? When you look at factor indexes, the enhanced value index has outperformed the growth target index. When you look at pure factor performance, the value factors, the earnings yield factors, they actually outperform both growth and quality metrics as well. So that's why things get lost in translation. There are portfolios constructed for growth that have strong sector industry biases.

(22:21):

And there are certain portfolios that actually neutralizes exposure and try to capture bottom up stock selection through value or growth investing, and those two this year have actually had very different outcomes.

Adam Bass (22:34):

When we look around the world, the issues whether it's inflation, is it stickier in some parts of the world than others, how different central banks are reacting? So, how different investors are reacting in different parts of the world. Can we dig in a little bit to some of those different issues that are facing investors in different parts of the world?

Andy Sparks (23:00):

That's a good one, Adam. I'm sure all of us will have some views on that. Let me just focus a little bit on the government bond market. Central banks are generally following the same playbook. The Fed appears to be a fast reader and has generally been ahead of other banks. So, if you just look at current monetary policies across central banks, you may say it's a little fragmented. So the Fed paused at its most recent meeting and the ECB did not, but if you just look at the overall cycle, they appear to be very similar across central banks. If you look at correlation of government bond returns, so for example, if you look at return correlations of US treasuries versus UK governments or versus Eurozone, sovereign bonds, those correlations are at their highest level since we've been looking at the data, which goes back to about 2006.

(24:03):

So this commonality of monetary policy appears to be reflected in returns as well. So in terms of looking for opportunities and also, one important role for bonds, particularly government bonds historically, has been as diversifiers in multi-asset class portfolios. What we've seen over the past couple of years is A, just within the government bond sectors, there's actually less diversification in mixed portfolios of bonds and equities. We've seen the correlations which had been consistently negative for the prior 20 years between the return correlations between bonds and equities, turn positive roughly speaking when inflation was unexpectedly high. So this idea that bonds offer lots of diversification in portfolios, I don't think that is dead, that's not a dead concept. They still offer diversification, but at least over the past few years and less diversification than before.

Hitendra Varsani (25:10):

We do see equity investors really looking to the bond markets as an indicator of which potential scenario we could be in, hard landing, soft landing recession and so on. So we actually ran a study. To Andy's point, given the US, the Fed is kind of ahead in terms of its rate hiking cycle and maybe at the latest stages of that rate hiking cycle. Clearly, rates are higher for longer, but from an equity perspective, what we are looking for is once we reach the peak, is there going to be a pause? Is there going to be a pivot? In those two scenarios, what are the implications for equity allocation? When we look back at the last 30 years or so, what we've seen is during a pause phase after rate hikes, all factor indexes that we look at have delivered positive active returns.

(26:08):

So whether it'd be value or size or yield or in bulk or momentum or quality, all of these have delivered positive active returns. When we look on a pivot stage, they've also all delivered positive active returns except for momentum. And you could think of that as if there's a change in regime, momentum needs time to adapt, to capture the new trend and so you can intuitively understand why momentum may falter. The factors that have outsized returns in a pivot when rates are declining are the more defensive sectors like minimum volatility, high dividend yield, which is fairly intuitive as well, because investors often look at these as bond proxies to a certain extent.

Adam Bass (26:53):

On that note, Hitendra, what about for sectors? When you looked at sectors, what were the ones that either outperformed or underperformed in these scenarios?

Hitendra Varsani (27:03):

So if we stick with the pivot stage, and I mentioned during declining rate is the more defensive exposures that have outperformed, that's actually consistent with sectors as well. So be it consumer staples, be it healthcare, be it utilities, these have had outsized active returns. On the pause basis, after rate hikes you can think of, for growth stocks, that being somewhat of a relief. Maybe that's what we've seen this year as well. Increasing interest rates have been negative on average for growth stocks, but once we get to the end of the cycle, there's some relief that, okay, so rates are not going to go any higher. That's a relief for growth stocks and they tend to do quite well as well.

(27:43):

From a sector perspective, technology which is often very growthy, has had outsized performance, alongside financials, which you could also think of high rates for longer, and a pause is good for banks, say for net margin exposure.

Andy Sparks (28:00):

I think a big question too for all investors is the level of real interest rates, and if you look across the yield curve, real rates are high certainly by the standards of the past 10 years, but at the shorter end, they're high even by the standards of the past 30 years. To a fixed income investor, that looks like opportunity, and I think an important question is what does that mean for the equity market? Is the equity market really pricing that in, into its valuation, into equity valuations? And one question is why are they so high? So one view is that it's just because central banks have been aggressively raising rates and as ultimately, they loosen their policy and maybe even begin to lower rates are going to go back to where they were before much lower yields, and under that sort of scenario, bonds look like an extremely attractive investment, but just causing a little bit of pause, I think in a lot of investors' minds is that the old playbook may no longer be valid.

Mark Carver (29:06):

I think Andy asks an interesting question about whether or not equity investors are pricing in the level of real yield. So just to put some data around that, the equity markets, if we use our indexes as a proxy, are trading not too dissimilarly on a forward basis from where they've traded on average for the last 10 years. So MSCI World trades now at roughly 17 times forward earnings versus let's call it 16.4 times on average over the last 10 years. MSCI World XUS is actually trading currently at a discount to its 10-year average. The US market trades at a slight premium to its 10-year average, but that premium, you could argue maybe doesn't fully reflect the level of interest rates.

(30:07):

So I think it is an open question of whether or not equity investors are really pricing in the yield curve and pricing in the level of real rates.

Andy Sparks (30:16):

The reality is, is that rates are higher now. I think it is important, as we've look at the impact of the rate cycle, we had the distress in the UK pension sector, going back to October of 2022. The BOE, which had been engaged in quantitative tightening just turned on a dime and said in the name of financial stability, we're going to buy. Then, we had a ... I call it a little bit of a mini version of that in March of this year with SVB and some other US regional banks where the Fed immediately was concerned about contagion to other banks and announced some emergency measures. If we did have some significant financial instability, generally central banks are generally involved in quantitative tightening.

(31:15):

They're lowering their portfolios of government bonds, they're letting them run off and is the Fed put in a serious financial distressed situation? Could central banks really start buying in significant volumes like we saw during the early stages of COVID? That might be a ... it's pretty ugly scenario for capital market investors, but in the bond market that could cause some serious distress as well because the central banks effectively may be a little handcuffed compared to previous crises where they have intervened very significantly.

Thomas Verbraken (31:57):

Turning that around, it's actually also quite interesting given the very fast rate hike cycle that we've seen, especially in the US, that nothing more significant has broken yet, like the economy looks still pretty resilient, like job markets looks resilient, like consumer confidence looks strong. So, I think an interesting question is also how much has the pandemic, how important is the role of the pandemic in the current situation? We've seen this large stimulus which has led to excess household savings, which gives a cushion to what's happening now. Maybe when we burn through, that things will turn worse.

Mark Carver (32:49):

If you think back to the beginning of the year, the themes we were thinking about were this notion of in some ways, continued de-globalization, right? Where we might move towards more regionalization versus globalization. The opportunity was maybe greater in the Eurozone because relatively mild winter where people feared the impact of rising energy costs on the European consumers, the relatively mild winter meant energy costs, didn't rise as much. Obviously the energy situation directly related to the invasion of Ukraine. Then, there was also this notion, maybe I already said it, but of China reopening. All of these have played out in a very interesting way, so we can start with China, where while China is reopening the growth of China and the impact of that reopening on the China employment picture is very different than other parts of the globe where the employment picture in China is not as strong, for instance, maybe as in the US.

(34:01):

So does that lead back to that notion of de-globalization, and does de-globalization mean ... and this is a theme Hitendra and I have talked a lot about in various forums, where investors become a little bit more precise in the way they allocate capital.

Hitendra Varsani (34:17):

Yeah, regional and country investing is on the rise. So when we think about learning from the pandemic, diversifying the supply chain, many corporates are following a China plus one strategy of these countries. We are seeing a high degree of dispersion. So China down almost 10% last quarter, whereas India is up 12.4%. So this trend towards diversification away from China is gaining some momentum. There's also conversations around international exposure versus domestic exposure. So we look at India for example, it's one of the fastest rising countries in the world and is expected to become a top three economy within the next 10 years or so. And that's largely due to the rise of the domestic demand.

(35:13):

So you're seeing this de-globalization from a global allocation perspective, but also you're seeing the rise of domestic demand as well, which is differentiating one country from another and hence country investing as becoming more critical going forward.

Adam Bass (35:28):

I'd like us if we can, to shift and look forward a little more directly. We started with the scenarios, Thomas, that you looked at and their potential effect on multi-asset class portfolios.

Thomas Verbraken (35:46):

Well, let's first focus on the more optimistic one, the soft landing. So we applied that scenario to a diversified portfolio of global equities and US bonds and real estate. The return over the next 12 months would be about 7% for such portfolio. Then, of course, given the potential downside risk that are still looming, like continued tightening, which in uses recession or further escalation in the banking sector, which could lead to a credit crunch because of those downside risks, you have to keep an eye of course on the possibility that the economy could end up in a recession. So under that so-called hard landing, the return of that same portfolio would be minus 3%. Then, the stagflationary scenario would be worst of our range of scenarios with a loss of about 9%.

(36:46):

And the reason that the stagflationary scenario is so bad goes back to what Andy was saying earlier, namely the role of bonds in multi-asset glass portfolios because under the stagflationary scenario, those bonds would lose at the same time when your equities take a hit. So you lose that ... and that hedge or that cushion that the bonds usually provide under a hard landing scenario. And although talked about less, I think the deflationary outcome is something investors should keep thinking about, and perhaps in the UK it might seem a bit more of a realistic outcome because there we see that inflation remains actually pretty stubborn. It doesn't come down as much as in the Eurozone or in the US.

Andy Sparks (37:38):

Just following up on that, I think fixed income markets in general are going to be laser focused on inflation, and I think central banks are ... their policy is predicated on driving it down and it's causing I think some investors to question if there's a whole new playbook that the old way of doing things just doesn't work as much anymore. And I think the market is looking for some certainty that yes, these old rules are still applicable in a new environment, but each month we get new inflation data, there's going to be laser focus on it and there could be some significant market events as that process evolves, and I would also say this too, if you actually look at how price indexes are constructed, it ain't necessarily pretty. If you drill down into different components of the US CPI, for example, you'll see that shelter in the core indexes has about a 40% weight.

(38:45):

And the way that they construct the inflation for shelter is using leases, apartment leases, and there there's literature on the validity of that, but even other components. If you look at the way that health insurance is computed, inflation and health insurance or used vehicle prices, there's some real quirks there. So you don't want to focus too much on one month's inflation read, but particularly, if you see a similar trend over two or three months, it does begin to ... I think if it does change, it will affect prices accordingly.

Adam Bass (39:25):

The other tool we have at our disposal, Hitendra of course, is the adaptive multifactor allocation model. As Q3 began, what did we see there?

Hitendra Varsani (39:35):

So the adaptive multifactor allocation model is based on several pillars. The macrocycle valuation momentum and market sentiment. If we look at the macrocycle, it relies on three indicators, PMI, CFNAI and ADS. The PMI to manufacturing survey is actually showing a contraction. So kind of contrast with some of the other indicators we're seeing from the US economy that are more positive. CFNAI is also in contraction as well, whereas ADS is slightly positive. So from that perspective, the fact that allocation has turned more defensive, low vol is overweight, quality is overweight alongside value. When we look at the valuations of fact indexes themselves relative to the parent or relative to each other, value stands out as having very low valuations.

(40:27):

It's also outperforming the others as well, at least on a relative basis. So overall, across all four pillars, the adaptive multifactor allocation model has an overweight to value and has a neutral weight to quality, neutral to momentum, neutral to size, and are underweight to yield and low vol.

Adam Bass (40:49):

That's all for this week. A big thank you from Joe and me to Thomas, Hitendra, Andy and Mark, and to all of you for listening. As always, you can find more details and research at msci.com. Next up on the program, from extreme heat to wildfires to once in a century, storms that happen multiple times per year, we're all feeling the effects of climate change. We'll look at the question of assessing and managing physical risks for investors, insurers and other companies around the world. Until then, I'm your host Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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