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TRANSCRIPT

“Global market trends and the Magnificent 7”

Transcript

Jenna Dagenhart (00:07):
Global equity markets bounce back strongly this year, however, the market returns have largely been driven by the Magnificent 7 and the rise of artificial intelligence. Today we'll look at the broader market overview, key trends in performance across factors which are pretty surprising, and thematic and regional indexes. Joining us now from MSCI with some great insights on investors thinking regarding equity factors and their evolving role in asset allocation, we have Mark Carver, Managing Director, Global Head of Equity Factor Products and Equity Portfolio Management, and Hitendra Varsani, Managing Director at Global Solutions Research. Well, Mark and Hitendra, it's great to have both of you back with us. Starting with you, Mark, could you share some global and regional trends in the market and help explain the so-called Magnificent 7?
Mark Carver (00:58):
Yeah, of course. I mean, I think it's been a very interesting year for the market. Markets have been relatively resilient and actually fairly strong, but when we're talking to investors, you don't necessarily feel that from what we're hearing from clients. But let's put a fine point on this, equity markets posted a positive return in the second quarter. MSCI ACWI, our flagship global index, was up 6%. Developed markets did a bit better, MSCI World 7%, and obviously MSCI USA even stronger. The emerging markets struggled a bit with MSCI EM only up about 1% for the quarter. It's been a good first half of the year, but you said it very well in the opening, this so-called Magnificent 7, which is a collection of mega-cap, mostly US technology companies have been the story this year.
(01:49):
Let me put some specifics around that. So far through June, these groups of stocks, the Magnificent 7, have accounted for 50% of the return of the MSCI ACWI Index. Now remember, that index is made up of almost 3,000 names. If we look at the US market, it's even more pronounced where those seven stocks have accounted for over 70% of the return. Interestingly, we did see some broadening of the market toward the end of the quarter in fact, market breadth improved in June, and we can see this both in actually measuring the breadth of the market, but even looking at things like the performance of an equal weighted index versus the broad market cap index, where equal weighted indexes in the month of June did better. But let's stay on this idea of market breadth for a minute. What we have seen through the end of June is that 70% of global equities have underperformed the MSCI ACWI through June. More US equities have underperformed the MSCI USA.
(02:53):
The reason I say this is it's a very tough operating environment for active managers, for any investment that's betting against the market cap portfolio, which maybe, Jenna, is the reason why we're hearing a little bit of concern or anxiety among those investors we're talking to.
Jenna Dagenhart (03:11):
Yeah, to your point, it seems like there's a bit of a disconnect between the total returns that we've seen and then investor sentiment. Now, Hitendra, how can investors gain exposure to artificial intelligence outside of the Magnificent 7?
Hitendra Varsani (03:28):
Yeah, so clearly there's been a lot of excitement about artificial intelligence and the outsize impact that's actually had on the Magnificent 7 as well. But not many active managers have diversification constraints and that may limit their ability to get exposure to those names. MSCI thematic indexes provide diversified exposure to various structural mega-trends based on the MSCI ACWI IMI universe. So that's a universe that spans large caps, mid-caps, as well as small caps as well. The MSCI Robotics & AI Index is composed of companies associated with increased adoption and utilization of artificial intelligence, robots and automation. Now you can think of many of the new winners in the new economy may not even exist today, and so it does make sense to look at the entire cap spectrum.

(04:28):
This particular index has over 600 names and outperformed the MSCI ACWI IMI Index over the first half, 42% versus 12% for the MSCI ACWI IMI. Now, we've witnessed this narrow group of stocks leading the ACWI index, as we've highlighted, as Mark highlighted. But within the AI index, we've actually seen a very broad base rally. So the AI has actually been a factor in itself driving markets over the first half of this year.
Jenna Dagenhart (05:00):
And sticking with you, Hitendra, you recently looked at patterns and equity performance once US interest rates peaked. Could you share some of the key findings with us?
Hitendra Varsani (05:10):
It's very topical, given the disinflation that we've seen and the implications that may have on the rate hike cycle. We look back over the last 40 years to see how US equity markets have reacted over a six-month window around Fed pauses and Fed pivots. Now pause is effectively keeping rates unchanged for six months, whereas a pivot is a rate cut within a six-month period. So what are our findings? Well, during rate pauses, we've seen strong equity market performance, but we've also seen MSCI USA factor indexes deliver positive active returns across the board, alongside sectors such as financials and technology. During pivot phases where the Fed reverses rate hikes effectively cutting rates within a six-month period, we've seen more moderate performance inequities and we've seen defensive factors like quality, like high dividend yield, outperform alongside sectors such as consumer staples, healthcare, utilities. The details [inaudible 00:06:13] looking beyond the rate hikes for those that are interested in seeing the details.
Jenna Dagenhart (06:20):
Mark, circling back to you, you recently did a survey on factors with global institutional investors and wealth managers. Could you share some of the top insights from that?
Mark Carver (06:31):
Yeah, of course. In fact, that survey, we call it Equity Factors: Investor Views and Research Insights. What we did, Jenna, was we went out and we surveyed in a very systematic way, a group of institutional, i.e. asset owners, endowments, as well as what I might refer to as institutional wealth clients who we know have strong familiarity with factors. Now, I said strong familiarity. I didn't necessarily say that they're factor investors or people who allocate a lot of money to factors. We wanted to see what was on their minds, how they were thinking about the markets. What we heard was five really key things, and some of these are complimentary, but I want to make them distinct. The first is that generally the faith in factor investing has increased. We have heard over the last couple of years that investors maybe didn't think so much in terms of a factor lens, but instead were maybe allocating to ESG or climate strategies, maybe just buying traditional either active strategies or indexes. But instead we heard that there's more faith in equity factors, and that's coming off obviously strong performance for factors in 2022.
(07:45):
But complimenting this was the way investors are allocating. What we heard is that generally investors recognize that there is cyclicality to the factor story and that in some markets, and it's similar to what Hitendra was just saying, certain factors will do better than in others. And because of that, clients are much more tactical in their factor allocations than maybe people previously thought. Now, I want to distinguish tactical versus timing. We don't hear a lot from clients about timing factors, but rather tilting, i.e. over-weighting and under-weighting factors, based on their views of the market. In today's market, what we heard was a preference for quality. In fact, nearly 50% of the respondents said that they thought in this market environment quality was the factor to overweight.
(08:38):
We've seen that play out in returns. Quality has been the strongest performing factor index so far this year across most of our regions. Interestingly, they also said an overweight to value. Now value hasn't performed as well. Clients said they would underweight growth. Growth has performed quite well this year. So it's some sort of interesting things to unpack there. But for sure, clients told us that they were looking for ways to try to generate active returns. In that regard, they said that factors or styles would likely provide the best source of active returns ahead of things like country or industry allocations and even stock specific allocations. Two other

things that I think are notable is that investors don't think of factors the same way maybe academics do in that they believe that it's time to refresh the way we identify factors, the way we actually build signals to capture factors.
(09:38):
Some of the things we heard called out we're using techniques of machine learning and natural language processing. We heard a lot about crowding. Not surprisingly to our listeners, we heard a lot about ESG and climate. These should be brought into the broader factor lens. Then finally we heard something that compliments what I just said in this notion that there's a convergence of things that sometimes organizations like MSCI and maybe even some of our clients like to separate, this notion of themes and factors in climate. Investors converge these things and they look at them as ways to express investment views. And because of that, they're converging the notion of these various characteristics that sometimes we isolate, but instead they're trying to bring together to try to capture those out sized returns or investment opportunities, maybe ways to manage risk. That's very, very interesting and it's quite different than maybe the conversation we would've had with these clients five or ten years ago.
Jenna Dagenhart (10:43):
Tying together both of the findings that you shared, Mark and Hitendra, it's a little bit surprising that there would be an underweight to growth in the face of a potential pause or pivot. You might think it might be the opposite.
Mark Carver (11:01):
Yeah. Well first I think some of this is reflected in the timing of when we did the survey, where we did it very early in the year and we were coming off historic out-performance of value versus growth. There was a view that rates maybe would stay high for longer, inflation would be persistent, and in those environments, maybe they favored value. Now, fast-forward to where we are today, the macro regime looks a little bit different. So perhaps if we surveyed them today, we might hear some different views on growth versus value. But I would say, generally there's this view that value had underperformed for a long time and we may be in a secular shift longer term of growth and value. Hitendra, I know you have some thoughts on this question as well.
Hitendra Varsani (11:56):
Yeah, so I think the growth value debate has been there. Another emerging debate has been index concentration. The parent indexes are the most concentrated, some of them since 1999. So now investors are now asking, well, how do I capture more breadth? How do I capture more diversification? What themes can I capture that help me create more resilient portfolios? Now, in the past, you could say, well, in Kuwait, I mean, that's one way of diversifying. But another way of diversifying across is many of the themes that we've talked about, factor investing builds more diversified portfolios, integration of thematic exposures provides diversification opportunities, and at the same time integrating ESG and sustainability characteristics. So I think Mark did highlight earlier, but just to reiterate this, investors are looking at holistic solutions to create more diversified portfolios, to build more resilience for for the long term.
Jenna Dagenhart (12:56):
Well, we better leave it there. Mark and Hitendra, thank you both for joining us today and we look forward to more insightful sessions with both of you soon.
Hitendra Varsani (13:03):
Thank you very much.
Mark Carver (13:07):
Thank you.
Jenna Dagenhart (13:07):
And thank you for watching. Once again, I was joined by MSCI's, Mark Carver and Hitendra Varsani. I'm Jenna Dagenhart with Asset TV.

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