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Momentum Sails On, For Now

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One of the best performing equity investment themes in recent years has been Momentum — winning stocks have kept on winning while losers have struggled to turn things around. But could there be a Momentum ‘crash’? We analyze recent and historic performance and assess the risk.

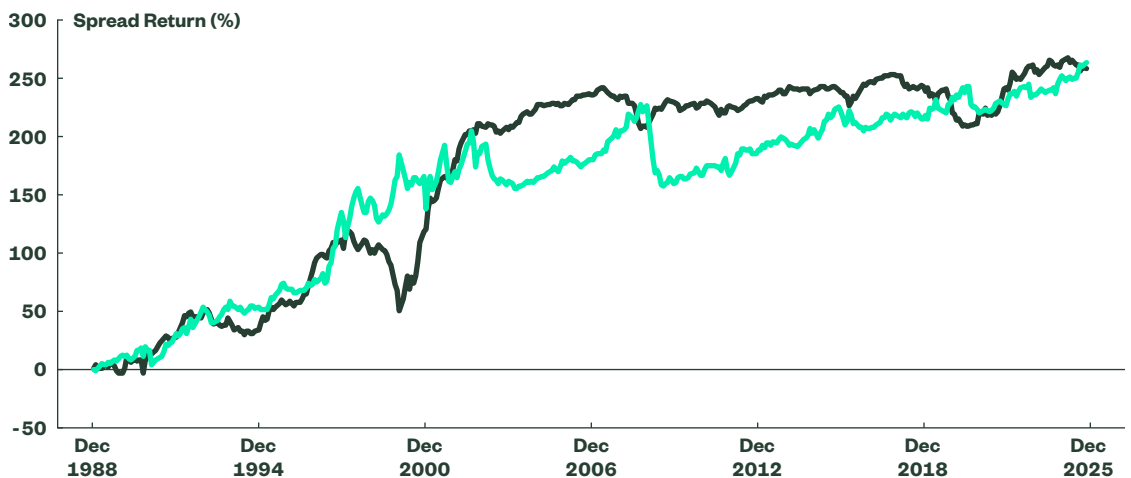
Long-term Performance

At its simplest, the price momentum strategy involves buying the stocks that have performed best in the recent period and selling the worst performers. A typical method, that we will use as the basis for this analysis, assesses the performance of stocks using the past 10 months as the formation period, but excluding the most recent month as markets often experience reversals in the short term. Within the Systematic Equity team’s Alpha model, we have a theme called Sentiment — this is made up from a combination of signals to create a more sophisticated, nuanced yet broadly diversified momentum-like set of exposures.

Momentum and Value have been at the heart of many systematic equity strategies over the past few decades. As we recently discussed in our examination of Value signals ([Waiting for Value: Time to Reassess ‘Cheap’ Equities?](#)), a momentum strategy has performed very successfully over the long term and has been outperforming Value in recent years, albeit with a wobble at the end of February and into March.

Figure 1
**Cumulative Spread
Return of Price
Momentum and Value
(Earnings Yield)**

■ Earnings Yield
■ 10mx1 Momentum

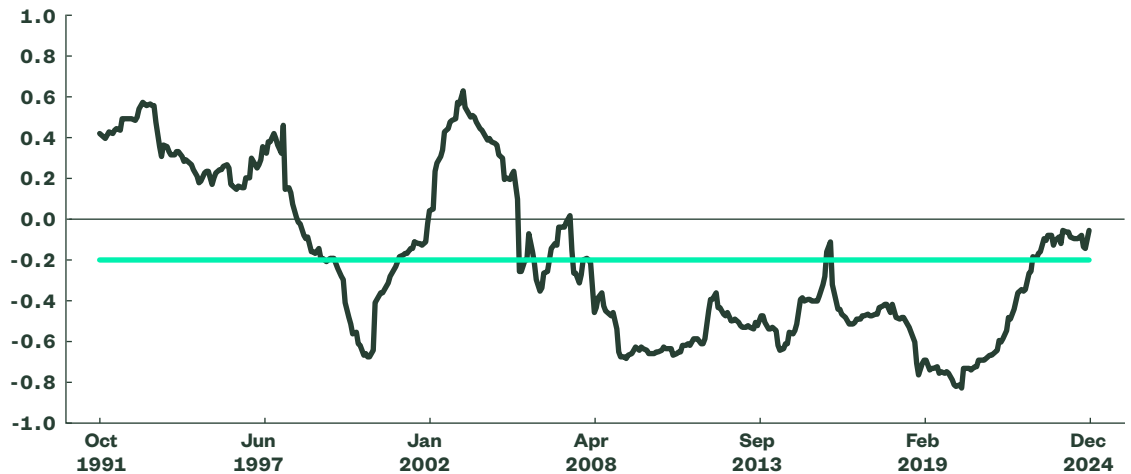


Source: FactSet, State Street Global Advisors as at January 31, 2025. Calculated as the quintile spread return is calculated based on the difference of cap-weighted return of Quintile 1 vs Quintile 5 as ranked by Blended Earnings Yield and 10-month Momentum ex- 1 month, in the Systematic Equity Developed Market Large Cap Universe. Past performance is not a reliable indicator of future performance.

Adding to the appeal of combining Value and Momentum has been the low, but negative, correlation in returns. Although time-varying the low correlation offers diversification; when Value does poorly, Momentum often does well with the result of smoothing the overall return profile of the combination. In the most recent period, the return correlation has been around the long-term average.

Figure 2
Rolling 36-month Return Correlation for Value vs Momentum and Long-Term Average

■ Correlation
 ■ Long-Term Average



Source: FactSet, State Street Global Advisors as at January 31, 2025. Calculated as the rolling 36-month correlation of Value and Price Momentum quintile spread, in the Systematic Equity Developed Market Large Cap Universe. Past performance is not a reliable indicator of future performance.

Although the long-term returns of Momentum are extremely attractive on both an absolute and relative basis, there have been periods of sharp falls, known as “Momentum Crashes”. These typically occur in periods of recovery after a crisis when the old world order is turned on its head and the winners become losers, and the vice-versa. The most significant example of that in the past 35 years was in 2009 at the height of the Global Financial Crisis after the Federal Reserve Bank unveiled its TARP program, and investors realized the financial system was actually going to survive (even if wounded). The cheapest, most distressed securities (many of them financial stocks) rallied strongly, leading to a significant crash in the momentum factor.

To analyze the momentum crash phenomenon further, we divided the 3-month returns for the momentum signal into three: the top 5% of return periods we classified as “Boom”; the worst 5% as “Crash”; and the rest as “The Rest”. In Figure 3, the table shows average characteristics in these periods alongside comparisons with the current environment.

Figure 3

Characteristics of Momentum Booms and Crashes

	Crashes	Booms	The Rest	Current
Average 3m Momentum Return	-10.2	22.9	1.2	8.6
Momentum Returns next 3 months	-0.5	-2.6	1.5	N/A
Momentum Returns next 12 months	6.3	-1.0	7.6	N/A
MSCI World Trailing P/E Ratio	20.2	26.5	20.6	22.4
Value 3m Returns	2.7	0.7	1.9	-3.0
Value 12m Prior Returns	6.0	29.9	6.9	-2.1
Value Returns next 12 months	7.0	15.4	7.1	N/A
MSCI World 12m Volatility	19.0	14.7	13.8	9.5
MSCI World Returns prior 12 months	-1.5	1.4	7.7	19.7
MSCI World Returns next 12 months	11.5	5.2	7.2	N/A

Source: Factset, MSCI, State Street Global Advisors as at December 31, 2024.

Momentum refers to 10-month price momentum excluding most recent month. Value Returns refers to a blended Earnings Yield spread returns. Alpha is Systematic Equity Alpha Model Spread returns. Crashes worst 5% of rolling 3m Momentum returns; booms best 5% of returns. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

The average three-month return in boom periods was 22.9%, in crashes it was -10.2%, and in other periods it was 1.2%. Interestingly, after a Momentum crash, returns to the factor have rebounded over the following 12 months, although on average not fully recouping their losses. In boom periods, however, we have not observed mean-reversion to the same extent.

Analyzing the above table, we can see Momentum crashes have taken place in periods of increased volatility and weak equity markets, which then typically rebound significantly over the subsequent 12 months. The current environment, by contrast, has been one of strong momentum returns, robust market returns, and low volatility.

Demonstrating the diversification benefits of combining Value with Momentum, we note that in the Momentum crash periods Value on average would have helped reduce the drawdown by returning +2.7% and continuing to add return over the next 12 months.

The Bottom Line

The current market environment does not look like that typically seen in past Momentum crashes, but that does not mean that we won't see some rotation out of Momentum at some point this year. Timing factor returns over the short term is notoriously difficult, and particularly so in the current news-driven cycle of tariffs, political U-turns, and geopolitical upheaval.

Within our Alpha model and Active portfolios, we aim to be diversified and maintain positive exposure at all times in the cycle to the four key themes we believe drive returns within markets: Sentiment (Momentum), Value, Quality, and Catalyst.

Careful consideration of the signals we use within the Sentiment theme and thoughtful weighting of Sentiment with the other diversifying factor themes allows us to capture the long-term return power from the theme, whilst reducing the overall impact of potential Momentum drawdowns on active returns.

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* Pensions & Investments Research Center, as of December 31, 2023.

[†]This figure is presented as of December 31, 2024 and includes ETF AUM of \$1,577.74 billion USD of which approximately \$82.19 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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The value style of investing that emphasizes undervalued companies with characteristics for

improved valuations, which may never improve and may actually have lower returns than other styles of investing or the overall stock market.

The strategy employs a momentum style of investing that emphasizes investing in securities that have had higher recent price performance compared to other securities, which is subject to the risk that these securities may be more volatile and can turn quickly and cause significant variation from other types of investments.

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