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Assessing Stocks Through a Multi-Dimensional Lens

Stocks that meet criterion across all themes — Value, Quality, and Sentiment — can help insulate portfolios from market gyrations. Assessing stocks through a robust, multi-dimensional approach is pivotal to building resilient portfolios for the long term.

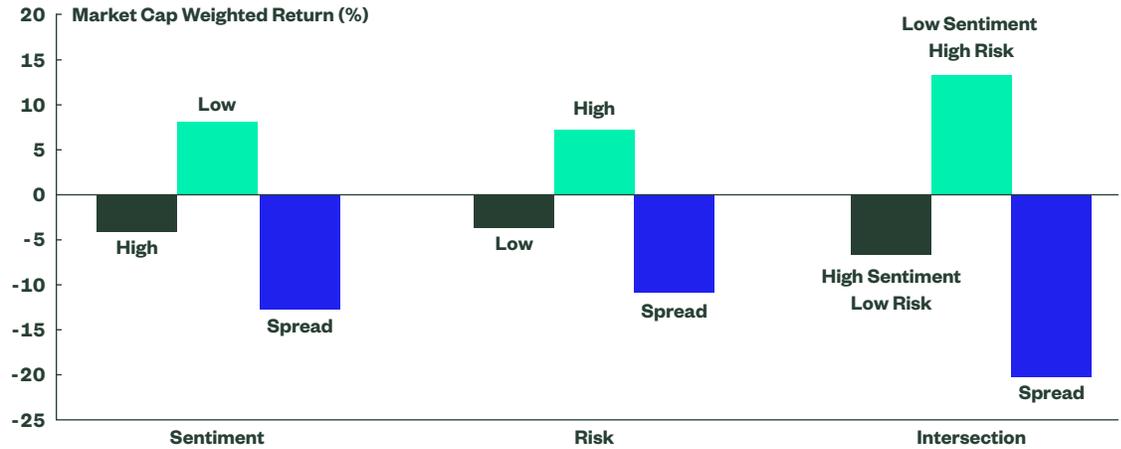
The Active Quantitative Equity (AQE) team evaluates a broad range of metrics to forge a multi-dimensional view of stocks, based on key themes of Value, Quality, and Sentiment. We believe that it is important to assess stocks across all three dimensions, preferring names with attractive valuations, high quality fundamentals, and positive sentiment. Stocks that meet all these three criterion give us greater confidence over the long term and help insulate portfolios from sudden and unexpected market pivots.

Sentiment Reversals: What Do They Tell Us?

As highlighted over the past few months, Sentiment has been a key topic that the team has closely analyzed over the course of 2022. Our proprietary measures of Sentiment incorporate many elements including price and volume data, supply chain linkages, hedge fund positioning, and analyst earnings estimate trends. By assessing many aspects of investor sentiment, the team acquires many angles of information which helps us to project potential stronger performers.

As noted in our November commentary, there was a sharp but abbreviated Sentiment reversal in the month. However, due to a relatively swift recovery that followed, most of the losses were recouped by the end of the month — and a true price momentum crash was avoided. This was a cautionary tale for investors. The continued volatility and macroeconomic uncertainty increased the likelihood that a true price momentum reversal, a persistent reversal inflicting greater realized losses, was potentially on the horizon. Fast forward two months, and this is exactly what unfolded in January 2023. The AQE team observed a continuous reversal throughout the month, where we saw basic momentum underperform in 15 out of 22 trading days. The more persistent momentum reversal in January led to the second worst decline in momentum factor performance since the Global Financial Crisis (GFC). It was a similar story for our proprietary sentiment signal which captures more than price momentum. January was one of the worst months since the GFC, as high sentiment underperformed low sentiment by over -12% (see Figure 1). Similarly, high risk names outperformed low risk by more than 10%. Expanding on this point further, the spread of the extreme intersection of these dimensions — high risk low sentiment versus low risk high sentiment — was nearly twice as large in magnitude, down over -20%.

Figure 1
**Sentiment, Risk,
 and Intersection
 Quintile Returns**



Source: State Street Global Advisors, MSCI. Data as of January 31, 2023. Universe is MSCI World. Sentiment and risk reflect proprietary State Street Global Advisors Active Quantitative Equity Team signals.

Digging deeper into the composition of these intersection cohorts within the highest risk low sentiment group, we observed that the strongest performers had relative weak Quality metrics and those names with adequate scores tended to have expensive valuations. Importantly, we believe it is critical to assess stocks across all dimensions when building a portfolio to be successful over full market cycles. Securities that exhibit attractive valuations, high quality fundamentals, and positive sentiment give us greater confidence of stock performance over the long term.

Switching gears to the high sentiment, low risk cohort, we detected some interesting trends. We found that many of the top detractors had extremely strong Quality profiles and compelling valuations — or in other words, names that met all the criterion. These stocks were primarily consumer and health care names that in our team’s view appear to be better positioned to weather a market storm and to produce positive earnings over several market cycles.

The Bottom Line

It is no secret that Sentiment reversals occur and will continue to persist over the course of future market cycles. This pattern underscores the importance of why the AQE team feels it is so critical to also consider other attributes such as Quality and Value when constructing a portfolio. Broadly, by assessing all factors — Value, Quality, and Sentiment — the team is able to build a more robust and resilient portfolio in order to more effectively navigate sharp capitulations in market sentiment.

Contributor

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* Pensions & Investments Research Center, as of December 31, 2021.

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