Insight
Active Quantitative Equity

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Assessing the Recent Rally in High-Value, High-Quality, Lower-Risk Stocks

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- The market continued to reward value stocks in March — but shifted to favor high-quality, lower-risk value names.
- This move was in line with our expectations and reinforced our longstanding preferences among equity-market segments.
- Based on our multi-dimensional assessment of potential risk and return — which includes value, quality, and sentiment — our most preferred segments remain tech hardware, autos, and health care equipment.

In the first quarter of 2021, the equities market has returned to rewarding cheap stocks. For some time, we've been expecting the extreme multiple expansion that has characterized many parts of the equities market to peter out. March's market action, which favored lower-risk value names, is in line with that expectation. In this commentary, we'll explore this recent market move and discuss how it has reinforced our longstanding preferences among equity-market segments.

Among Value Stocks, High Risk Gives Way to High Quality

March returns for the S&P 500 were a massive 4.4%. Based on returns alone, one could be forgiven for thinking that the risk-on tone of January and February had continued into March. In fact, the riskiest companies in the US experienced sharply negative returns, while low- to medium-risk companies surged ahead. This shift coincided with a continued focus on value.

The market kicked off its rotation to value in early November, when it shifted from rewarding high-growth, high-risk stocks to rewarding cheap — but high-risk — stocks. In March, the market continued to reward cheap stocks — but rather than favoring high-risk value, the emphasis instead has been on high-*quality* value stocks.

The hardest-hit stocks in March were both expensive and high risk — a mixture of recent stay-at-home winners in the software, media, and consumer segments and impaired high-risk segments like tourism and restaurants. Undervalued names in the homebuilding, traditional industrial, auto, and utilities segments were the strongest beneficiaries.

Our Current Preferred Segments

Given our preferences in Active Quantitative Equity for undervalued, high-quality stocks, this environment bodes well for our favored investments. Cheaper and less-risky stocks were rewarded in all developed market regions in March, most strongly in the US market.

Recent market action has mostly reinforced our preferences from the start of the year. In general, the segments we most preferred at the beginning of 2021 became more attractive in March; the segments that we preferred least deteriorated. Our most preferred segments of the market remain tech hardware, autos, and health care equipment.

Renewed market interest in financials has triggered a turnaround in our sentiment assessment. At the start of the year, we saw these companies as great value, but sentiment was still quite negative. This quarter's turnaround has increased their attractiveness for us. Meanwhile, although we had a positive view on food and staples retailing at the start of the year, a shift in sentiment has taken the shine off that segment, which we now see as neutral.

The largest drops in our forecast returns have been in software, commercial and professional services, and all consumer staples segments, including food retailing, food and beverage, and household products. There was little change to our positive view on tech hardware and health care equipment. Our view of real estate, consumer services, retailing, and utilities also remains negative.

The biggest change to our forecasts occurred in the deterioration of sentiment toward commercial and professional services, all consumer staples industry groups, and software. The biggest improvement occurred in energy and bank stocks.

Figure 1
Change in Active Quantitative Equity's Sector Preferences Over Q1 2021

	Change in Preferences over Q1 2021		
	Improvement	**No Change**	**Deterioration**
Most Preferred Segments	Autos	Technology Hardware	
	Banks	Health Care Equipment	
	Diversified Financials		
	Insurance		
Neutral	Consumer Durables	Materials	Capital Goods
	Energy	Pharmaceuticals	Food Retailing
		Telecom Services	
		Media	
		Semiconductors	
Least Preferred Segments		Real Estate	Household and Personal Products
		Retailing	Transportation
		Utilities	Software
		Consumer Services	Food and Beverage
			Commercial and Professional Services

Source: State Street Global Advisors.

The Bottom Line

We continue to take a multi-dimensional view that evaluates stocks from the bottom up, measuring relative valuation as well as market sentiment and quality. We expect high-quality companies of good value and strong sentiment to deliver the highest returns as the developed world recovers from the pandemic, supported by extensive monetary and fiscal interventions.

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