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# Factor Views

Themes from across the factor investing landscape

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## In brief

- Factors in 1Q 2024 enjoyed their best quarter in more than 10 years and one of their strongest quarters since our records began in 1990, continuing a very strong run over the past three years.
- Equity factors performed very well in Q1: The value, quality and momentum factors were all positive and momentum experienced its second-best quarter since 1990.
- The merger arbitrage factor was flat in Q1 as a few deal terminations and other deal-specific concerns weighed on performance.
- Macro factors had a strong first quarter, posting gains across the carry and momentum factors, and seeing strong performance across all asset classes.
- We maintain our positive outlook for factors overall. Equity factors look well supported: The value factor looks inexpensive globally and the quality factor is attractive in the U.S. Other factors, including macro carry, also appear attractive.

## Overview

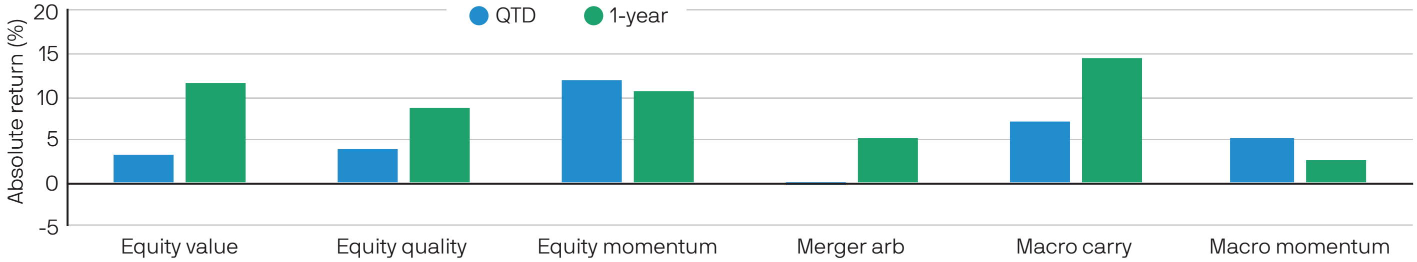
Risk assets powered higher for a second consecutive quarter and factors joined in, rallying significantly in 1Q 2024. While markets in 4Q 2023 were responding to expectations the Federal Reserve (the Fed) would ease policy, in Q1 the story became the macroeconomic data itself—evidence of surprising U.S. economic strength. Market sentiment picked up on the Fed's dovish pivot in December 2023, and in 1Q 2024 investors increasingly positioned for momentum built on the potential for a "no landing" scenario: stable sustained inflation and continuing growth.

Equities, credit and commodity markets all performed well, as did the U.S. dollar. As of March 31, the S&P 500 Index had climbed for five consecutive months (without a day of pullback of even 2%), while volatility has stayed muted. Government bonds, on the other hand, were challenged by hotter than expected inflation data—however, even those declines were modest. We observed interest rate volatility declining to levels we have not seen since the lows of early 2022.

Momentum factors performed particularly well against this backdrop, cross-sectionally within equity markets and directionally (e.g., trend momentum factors) across asset classes. The value and quality factors also rose, as did macro factors. Overall, the factor landscape enjoyed one of its best quarters on record (**Exhibit 1**).

**Factors in aggregate started 2024 with a strong Q1**

EXHIBIT 1: QUANTITATIVE SOLUTIONS LONG/SHORT FACTOR RETURNS




Source: J.P. Morgan Asset Management; data as of March 31, 2024. Note: Factors presented are long/short. Equity factors are global in nature and represented as 100% long notional exposure and shown on a beta-neutral basis; macro factors are an aggregation of 5% volatility subcomponents.

Looking ahead, we continue to believe a soft landing is the most likely macroeconomic outcome; that is, a gradually slowing but still growing economy and inflation falling to around 2%. As such we favor equities and high yield credit among risk assets, expecting duration to play a role later in the year as inflation subsides. We also see unusually strong opportunities in relative value, or factor, vs. directional positioning, with strong valuation support for the equity value and equity quality factors in particular.

One caution, however, aside from market concentration in general: The momentum factor's strong recent performance and increased investor flows make it potentially more susceptible to a pullback or reversal.

## Factors in focus

**Equity factors: A historic quarter for equity momentum; value and quality also joined in.**

The equity momentum factor enjoyed the second strongest quarter in our records dating back to 1990,[1] as economic growth continued at a surprisingly strong pace and markets rewarded names that were already performing well. Equity momentum delivered strong performance in the U.S. and in every region our factor database covers spanning developed and emerging markets.

Factors' strong 1Q 2024 gains were coordinated and included the value, quality and size factors. This was a contrast with the previous quarter, 4Q 2023, when factor performance diverged across regions, by market cap and by month. The value factor was up in Q1 for nearly every region that we track, with gains strongest in Japan, where value stocks have been on a tear thanks to corporate governance reform and an increased focus on company valuations.[2] The quality factor also rose nearly everywhere we track. However, in this metric, Japan proved the exception: Japan's Q1 equity rally lifted low quality stocks more than high quality stocks. As for size factors, large cap stocks dominated small cap stocks in every region we track, with the largest gap within U.S. markets, following the trend of recent quarters.

Can such a run of strong, coordinated performance continue? We studied the momentum factor, where factor valuations are less predictive of future performance, evaluating the momentum of momentum quarter-over-quarter. We found that a positive quarter for momentum tends to be followed by another positive quarter directionally, but the relationship is not statistically significant.

On the other hand, we can see from the equity momentum factor's quarterly performance since 1990 that some of the factor's worst quarters have followed strong runs (**Exhibit 2**). Pullbacks came amid the dot-com bubble in 2Q 1999, in 1Q 2001 as the bubble began to burst and in 2009 following the end of the global financial crisis.

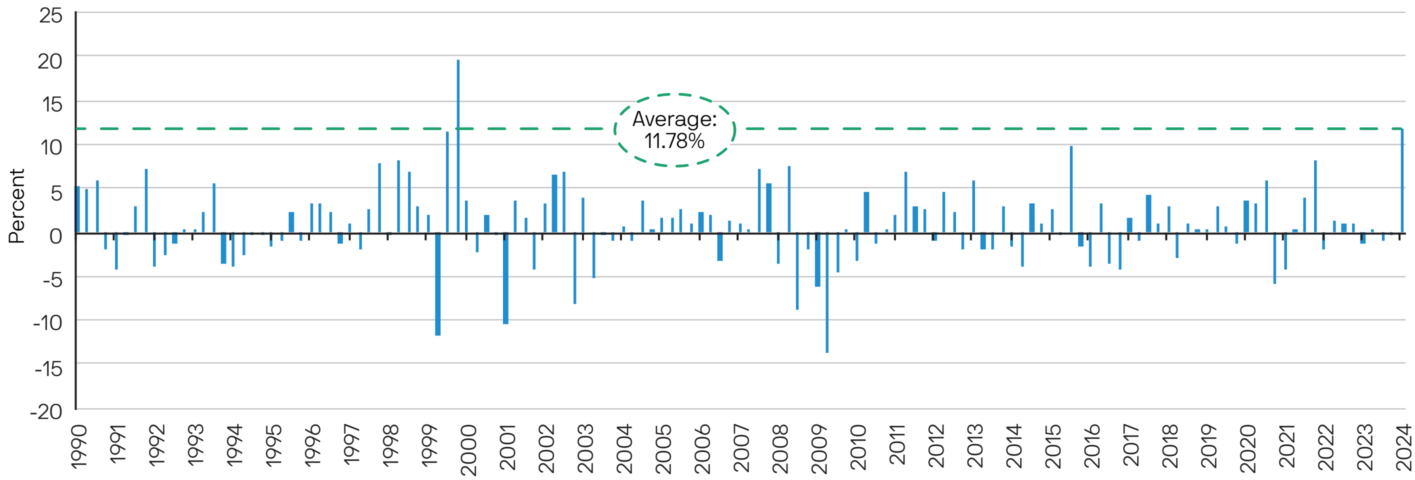
Given our outlook for a soft landing, we do not foresee any specific force that would impede the momentum factor; however, these historical examples do signal potential volatility ahead in the factor. We, therefore, recommend that investors access the momentum factor in a manner that seeks to control for unintended or uncompensated risks (e.g., sector or stock-specific biases), to limit potential downside.

[1] Bested only by 4Q 1999, near the peak of dot-com euphoria.

[2] The Tokyo Stock Exchange has targeted companies whose shares rade below a price-to-book ratio of one.

### Equity momentum saw its best quarter since Q4 1999

EXHIBIT 2: GLOBAL EQUITY MOMENTUM FACTOR QUARTERLY RETURNS




Source: J.P. Morgan Asset Management; data as of March 31, 2024.

Turning to the value and quality factors, we remain quite optimistic on the basis of their attractive valuations. The value factor remains inexpensive across the globe, and particularly within U.S. markets where it is more than one standard deviation less expensive than its historical average. We have seen lower valuations only during the dot-com bubble—which preceded one of the value factor's best runs in history (**Exhibit 3**). The quality factor also remains inexpensive on a global basis, driven by U.S. market valuations.

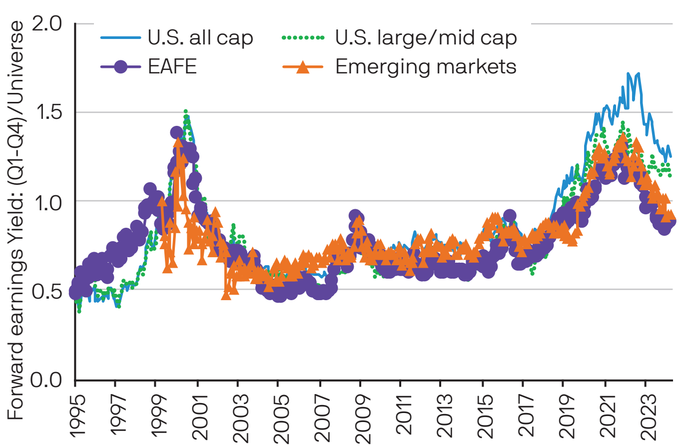
Exhibit 3 shows that, like value, the quality factor is more than one standard deviation less expensive than its historical average, at levels eclipsed only during the dot-com bubble.

Quality is inexpensive in the U.S. primarily because small cap stocks are attractively priced vs. large caps—even as high-quality large cap stocks are much less expensive than they would typically be in a mid- to late-cycle environment.

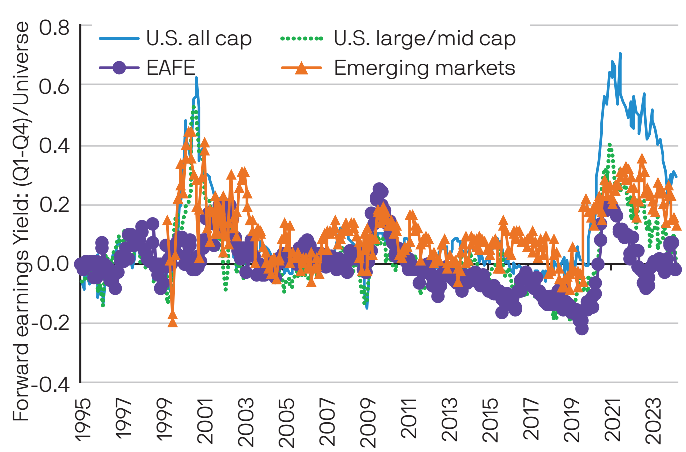
### Value and quality generally remain inexpensive across regions

EXHIBIT 3: EQUITY VALUE AND EQUITY QUALITY VALUATION SPREADS

3A: VALUE




3B: QUALITY




Source: J.P. Morgan Asset Management; data as of March 31, 2024. EAFE: Europe, Australia and the Far East.

One more important consideration: factor correlations. Would a pullback in the momentum factor present a headwind for other factors? The momentum and value factors have exhibited a correlation of 0.01 over the past three years—essentially no correlation between their performance. That is a notable change: Normally, strong performance for one frequently correlates with weak performance from the other, as seen in their historical correlation of –0.54 since 1990. The momentum and quality factors, on the other hand, have exhibited a correlation of 0.52 over the past three years vs. an average of 0.33 over rolling three-year windows dating back to 1990. (All these pairwise alignments across value, quality and momentum are moderately, but not exceedingly, high.)

In sum, this study does not leave us concerned that a momentum drawdown could impact other factors adversely, although we do acknowledge it as a potential risk.

## Merger arbitrage: A flat first quarter as deal failures presented head winds

The merger arbitrage factor experienced a flat first quarter in 2024. Performance earned from healthy merger arbitrage spread levels was negated by losses across a few deal failures, some realized and some presumed. In the quarter's largest deal that wasn't, Amazon abandoned plans to acquire iRobot, the consumer robotic vacuum maker, due to opposition from European Union (EU) and U.S. antitrust regulators. JetBlue and Spirit Airlines ended their merger plans after a federal judge blocked the deal and President Joe Biden released a statement opposing Nippon Steel Corporation's proposed acquisition of U.S. Steel, causing merger arbitrage spreads to widen. Outside of the U.S. market and across smaller deals, the merger arbitrage factor was positive.

Merger arbitrage spreads tightened over the quarter, ending Q1 slightly wider than their long-term average as several of the deals noted and others with high spreads were terminated—thereby taking spread out of the market—and market risk appetite picked up. The merger arbitrage market still appears to be pricing in regulatory concerns, preventing spreads from tightening further in an otherwise "risk-on" market.

Deal activity picked up during Q1, moving from about one standard deviation below its long-term average to its historically average level. The proportion of friendly deals, which are more likely to close, to all deals rebounded after falling in 4Q 2023, returning to its long-term average as well. In all, these developments leave us neutral on the merger arbitrage factor. We see the potential for steady returns, but no strong, compelling opportunities are apparent.

## Macro factors: A strong first quarter across carry and momentum

Macro factors started 2024 on strong footing across carry and momentum as well as across equity, fixed income, currency and commodity markets.

Commodity factors were the top performers from an asset class perspective; the commodity carry and momentum factors both fared well. Cocoa futures posted the strongest gains. Carry and momentum both pointed long, benefitting from a historic (and near parabolic) rise in cocoa prices amid significant supply issues in Ghana and Ivory Coast, typically the dominant cocoa producers. Elsewhere, commodity carry and momentum benefitted from a rise in crude oil prices and declines in wheat and corn prices—highlighting that commodity factor performance was broad-based across the asset class over the quarter.

FX factors also performed well over the first quarter. FX carry had risen for much of 2023 before giving back a portion of gains in the fourth quarter. The first quarter of 2024 looked like the good times of 2023, as long positioning in the U.S. dollar benefitted from upside surprises to U.S. economic growth, the Japanese yen's continuing fall and the Mexican peso's ongoing outperformance vs. lower carry EM currencies. FX momentum also gained in Q1, recovering from a generally challenging 2023 and supported by the yen's decline.

Cross-asset time-series momentum factors also rebounded in Q1, supported by commodity market trends and gains from long positioning across a range of equity markets (positioning in 4Q 2023 had shifted from short to long).

The opportunity for the carry factor remains attractive. Commodity carry spreads have widened and are now above their long-term average, signaling better-than-average return prospects. However, real yield and yield curve differentials tightened over Q1 and are now in neutral territory, slightly dampening the outlook. FX carry spreads remain as wide as they have been since the 2008–09 global financial crisis, a favorable signal in the near term; however, they are neutral on a longer-term basis.

As U.S. economic growth momentum has seemingly gained steam, impacting other markets globally, so has the strength of a range of macro momentum factors (e.g., equity time-series momentum and FX momentum). Positioning in equities, fixed income and currencies is set up for the "no landing" scenario increasingly being priced into markets, with commodity momentum finding opportunities on a relative-value basis. We note, however, that as with equity momentum, the risk of a reversal has potentially risen after this strong run.

## Concluding remarks

We continue to see generally attractive prospects for a range of factors including equity value, equity quality in the U.S. market and macro carry. Our outlook is for some challenges for traditional asset classes if markets continue to seesaw between a "soft landing" (our call) and the "no landing" scenario that market participants are increasingly pricing in. GIven this environment, we see factors as an attractive alternative for investors looking for diversification and those who may harbor concerns that risk asset valuations have risen too far too fast.

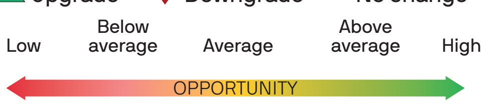
### Factor opportunity set

The table below summarizes our outlook for each of the factors accessed across J.P. Morgan Asset Management. It does not constitute a recommendation, but rather indicates our estimate of the attractiveness of factors in the current market environment.

Our framework for evaluating factor outlooks is centered on the concepts of dispersion, valuation and the opportunity for diversification. For equity factors, we measure dispersion and valuation spreads between top-quartile and bottom-quartile stocks on a market, region and sector-neutral basis. For event-driven factors, we measure implied carry and the level of corporate activity as indicative of the ability to minimize idiosyncratic stock risk. For macro factors, we measure the dispersion or spread between top-ranked and bottom-ranked markets, as well as the number of significantly trending markets.

**FACTOR VIEWS VS. LAST QUARTER:**

▲ Upgrade ▼ Downgrade — No change




| | | | | Rationale |
|---|---|---|---|---|
| Equity | Valuation | | — | Attractive on valuation, neutral on dispersion |
| | Quality | | — | Attractive on valuation (driven by US markets), neutral on dispersion |
| | Momentum | | — | Neutral on valuation, neutral on dispersion |
| | Size | | — | Neutral on valuations |
| Event-driven | Merger arb | | ▼ | Neutral on deal premia (decrease from last quarter), neutral on % of friendly deals, neutral on activity level (increase from last quarter) |
| Macro | Carry | | — | Neutral on FX spreads, neutral on fixed income spread (decrease from last quarter), attractive on commodity spread (increase from last quarter) |
| | Momentum | | — | Negative on FX price dispersion, positive on commodity price dispersion, positive on significant price trends (increase from last quarter) |

Source: J.P. Morgan Asset Management; data as of March 31, 2024. For illustrative purposes only.

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Glossary

- **Equity momentum:** Long/short global developed stocks based on price change and earnings revisions; sector and region neutral
- **Equity value:** Long/short global developed stocks based on book-to-price, earnings yield, dividend yield, cash flow yield; sector and region neutral
- **Equity quality:** Long/short global developed stocks based on financial risk, profitability and earnings quality; sector and region neutral
- **Equity size:** Long/short global developed stocks based on market capitalization; sector and region neutral
- **Merger arb:** Long target company and short acquirer (when offer involves stock component) in announced merger deals across global developed markets
- **Event-driven (other):** Conglomerate discount arbitrage, share repurchases, equity index arbitrage, post-reorganization equities and shareholder activism
- **Macro carry:** FX G10 carry, FX emerging market carry, fixed income term premium, fixed income real yield, commodity carry
- **Macro momentum:** FX cross-sectional momentum, commodity cross-sectional momentum and time-series momentum across equity, fixed income and commodity markets

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