Factor Views

Themes from across the factor investing landscape

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In brief

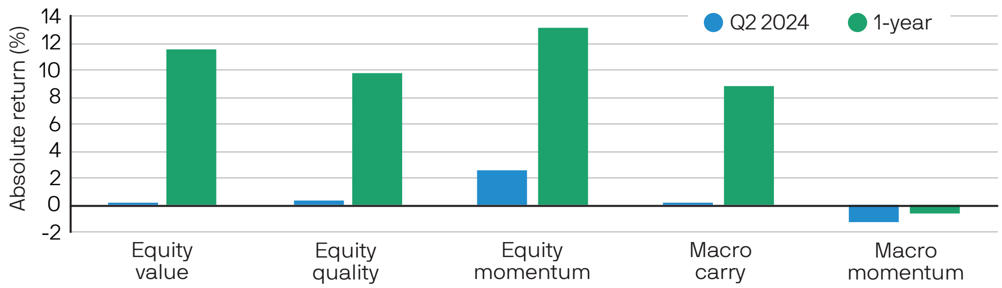
- Factors generally chalked up another strong quarter, continuing what has been a very robust run over the past three years.
- Equity factors performed well in aggregate, driven by gains across international markets.
- Macro factors were slightly negative in aggregate. Headwinds pushed macro momentum lower, offsetting gains from macro carry factors.
- We maintain our positive outlook for factors overall. Equity factors look well supported: The value factor appears inexpensive globally and the quality factor is attractive in the U.S.

Overview

While risk assets charged higher for a third consecutive quarter, powered by sentiment around the Magnificent 6 in particular,[1] factors moved to their own beat and generally performed well, though less so than in Q1. The equity momentum factor captured some of that sentiment and continued to perform extremely well. Other factors' performance diverged across regions, sectors and factors as markets reacted to evolving macroeconomic conditions—offering opportunities beyond the fate of a handful of mega-cap stocks (**Exhibit 1**).

Factors were positive in Q2, although less so than last quarter

EXHIBIT 1: QUANTITATIVE SOLUTIONS LONG/SHORT FACTOR RETURNS (AGGREGATE)



Source: J.P. Morgan Asset Management; data as of June 30, 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.

[1] The S&P 500 gained 4.3% in Q2 and by quarter end had gone eight consecutive months without an index-level pullback of 2%. However, these gains have been propelled by strength in, and investors' enthusiasm for, mega-cap tech companies expected to benefit from artificial intelligence (AI).

To that end, single-stock equity value and quality factors struggled a bit within U.S. markets but performed very well in international markets. And while macro momentum was challenged as inflation fears ebbed and flowed,[2] disrupting certain prevailing trends, macro carry factors posted positive, albeit muted, performance in aggregate.

We continue to believe a soft landing is the most likely economic scenario and favor equities and high yield credit now. Duration would play a role in the second half if inflation continued to subside.

We see a disproportionate opportunity in relative value factor opportunities, rather than in directional positioning. The equity value and equity quality factors have particularly strong valuation support and appear less susceptible to the risk of a pullback or reversal than the momentum factor does. (That risk has played out for the momentum factor in July, in the weeks before publication.) Market concentration generally is another risk.

Factors in focus

Equity factors: Another strong quarter for momentum; value and quality show regional dispersion

The coordinated strength of the equity momentum factor continued this quarter, posting a positive return across regions and boosting aggregate equity factor performance. There were, however, significant regional differences for value and quality: They performed well outside the U.S. but struggled within U.S. markets, especially across large cap stocks.

The U.S. value factor experienced one of its worst quarters vs. international developed and emerging market value factors (Q2 was only the fifth quarter since the early 1990s in which it lagged both by 6% or more). The U.S. quality factor also underperformed other regions; relative returns ranked in the worst quartile in our history (**Exhibit 2**).

Two questions arise in observing the geographic dispersion in equity factors: What is driving it and under what circumstances could it change—what could catalyze either performance of U.S. equity factors to improve or international factors to worsen?

We believe the answer relates to the U.S. equity markets' extreme levels of concentration, in terms of the percentage weight of the top names in the S&P 500 and market returns' lack of breadth, a phenomenon driven by investors' enthusiasm for the handful of stocks expected to monetize current developments in artificial intelligence. The outcome in the factors market has been less support for the U.S. value and quality factors.

That said, the U.S. value and quality factors are cheaper than their regional peers (**Exhibit 3**), particularly the U.S. market's smaller cap segment. This may support performance. We also expect earnings growth to broaden out beyond the Magnificent 6 in Q3 and Q4, which may shift investor focus beyond just the mega caps.

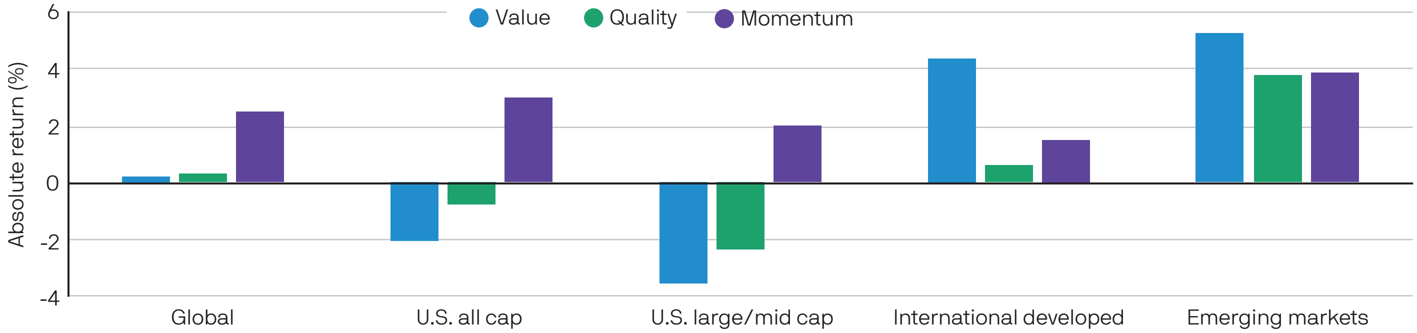
Macro factors: A giveback for momentum

While momentum ruled the road in the single-stock factor space, the story differed in the macro space.

[2] Stronger than expected inflation prints early in the quarter stoked fears in government bond markets that the Federal Reserve would delay loosening monetary policy; however, these fears dissipated as CPI cooled to a three-month low with a May print of 3.3%, lower than expectations.

Value and quality lost ground in the U.S. but had a strong Q2 in other regions

EXHIBIT 2: EQUITY FACTOR RETURNS BY REGION

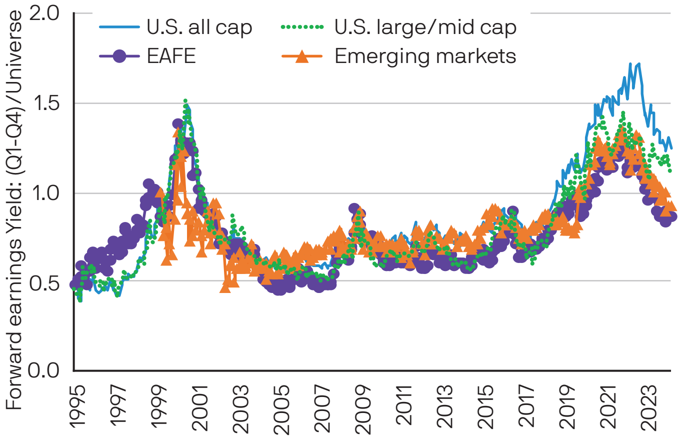


Source: J.P. Morgan Asset Management; data as of June 30, 2024.

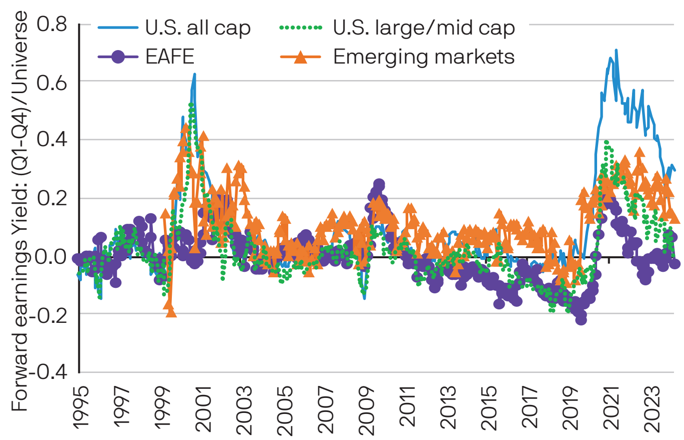
Value and quality generally remain inexpensive across regions

EXHIBIT 3: EQUITY VALUE AND EQUITY QUALITY VALUATION SPREADS

3A: EQUITY VALUE FACTOR



3B: EQUITY QUALITY FACTOR



Source: J.P. Morgan Asset Management; data as of June 30, 2024.

Macro momentum factors detracted from and offset modest gains by macro carry factors.

Headwinds were most notable in commodities, where macro momentum signals suffered, whether measured in relative value or trend-following terms. There was no single explanation as losses prevailed across a range of commodities, impacting both long and short positioning.[3] Losses were most acute across energy and agricultural commodities. Natural gas was the worst performing market as short positioning (from both relative value and time-series signals) was hurt by a rally in natural gas prices. Elsewhere across the macro momentum landscape, a weaker quarter for the U.S. dollar against other developed markets hit FX G10 momentum. A choppy quarter for government bonds hurt fixed income momentum.

Macro carry factors were muted over the quarter. While there were slight gains across FX carry, fixed income carry and commodity carry, they were much more modest than in Q1. Relatively speaking, commodity carry factors fared best as positioning benefitted from a rally in coffee prices (on fears that weather could constrain supply) and a decline in corn prices (on higher than expected supply)

Our view of the opportunity set for macro factors is now neutral across both momentum and carry factors. This step down follows a decline in our assessment of macro carry factors, from positive to neutral, as commodity carry spreads tightened quarter-over-quarter to just slightly above their long-term average.[4]

We remain neutral on the prospects for macro momentum, which ended Q2 with relatively wide dispersion across commodity prices. That dispersion was countered by relatively low dispersion across currency markets and weaker directional trends across government bond markets. As a result, we see time-series momentum factors taking almost no duration position, in aggregate. The clearest macro trend is the climb in equity markets—led by U.S. large caps but joined by counterparts across emerging markets.

Concluding remarks

We continue to see generally attractive prospects for a range of factors. Equity value and equity quality appear best positioned from a valuation perspective. While evolving macro conditions have moved in favor of our call for a soft landing and a generally risk-on posture across traditional asset classes, we continue to see factors as attractive for investors looking for diversifying sources of return.

[3] For example, time-series momentum signals detracted across eight of 10 agricultural commodities; however, drivers were idiosyncratic. These signals began Q2 with a bullish outlook across six markets and bearish outlook across four others.

[4] We note that real yield and yield curve differentials remain in neutral territory—and while FX carry spreads remain as high as they have been since the global financial crisis, they are neutral on a longer-term basis.

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

Low | Below average | Average | Above average | High

OPPORTUNITY

				Rationale
Equity	Valuation		—	Attractive on valuation, neutral on dispersion
	Quality		—	Attractive on valuation (driven by U.S. markets), neutral on dispersion
	Momentum		—	Neutral on valuation, neutral on dispersion
	Size		▲	Attractive on valuations
Macro	Carry		▼	Neutral on FX spreads, neutral on fixed income spread, neutral on commodity spread (decrease from last quarter)
	Momentum		—	Negative on FX price dispersion, positive on commodity price dispersion, neutral on significant price trends (decrease from last quarter)

Source: J.P. Morgan Asset Management; data as of June 30, 2024. For illustrative purposes only.

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Glossary

- **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 momentum:** Long/short global developed stocks based on price change and earnings revisions; sector and region neutral
- **Equity size:** Long/short global developed stocks based on market capitalization; sector and region neutral
- **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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Next steps

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