

# Defensively supporting gains

June 2017

## Research Signals

Global stocks have outperformed other major asset classes, posting attractive gains in the first half of the year, especially driven by technology stocks. However, investors are not consumed with euphoria as they rotate to a more defensive posturing across many regional markets (Table 1). Some high flyers have given up gains as central bankers take on a more hawkish tone, oil entered a bear market and technology shares lost some momentum.

- US: Industry Relative Leading 4QTRs EPS to Price outperformed while Rational Decay Alpha lagged on a more defensive investor posturing
- Developed Europe: Investors favored positive analyst outlook captured by 2-Year Ahead EPS Growth
- Developed Pacific: As the sole exception among our coverage regions, developed Pacific markets outside Japan highly rewarded price momentum, an indication of risk-on trades
- Emerging markets: High quality stocks continued to outperform, gauged by measures such as Fixed Assets Turnover, Industry Relative TTM Dividend Yield and Real Earnings Surprise

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## Contacts

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Table 1

## Global factor quantile return spread performance snapshot, Jun 2017

Factor	Factor Group	US Large Cap	US Small Cap	Developed Europe	Developed Pacific ex Japan	Japan Standard Cap	Emerging Markets
Book-to-Market		0.83	2.56	1.42	1.26	4.13	-0.27
Forward 12-M EPS-to-Enterprise Value	Deep Value	2.30	-6.57	0.40	0.19	-0.18	0.30
TTM EBITDA-to-Enterprise Value		-0.13	-5.68	-1.74	1.00	1.14	0.70
TTM Free Cash Flow-to-Enterprise Value		1.26	-3.26	-1.16	2.05	0.59	0.59
Industry Relative Leading 4-QTRs EPS to Price	Relative Value	3.13	1.49	0.36	0.77	1.62	0.23
Industry Relative TTM Dividend Yield		-0.97	-0.80	-0.09	2.34	1.03	0.89
Fixed Assets Turnover Ratio	Management Quality	2.99	-0.93	-0.14	1.75	2.23	0.58
Inventory Turnover Ratio		-0.97	-5.65	0.86	0.84	-0.52	0.14
Net Operating Asset Turnover		-2.72	-5.24	-0.91	1.19	-1.01	0.47
Change in Accruals to Assets	Earnings Quality	-0.42	2.45	-0.47	-0.58	-0.59	-0.21
Change in TTM COGS vs. Inventory Level		-0.26	-4.55	-1.27	0.12	0.40	0.55
Change in TTM Sales vs. Accounts Receivable		0.39	3.37	-0.42	-1.05	-0.71	0.50
Working Capital Accruals		1.59	1.98	1.90	-1.49	0.47	0.17
1-yr Growth in TTM Free Cash Flow	Historical Growth	-0.84	0.17	-1.98	2.42	-0.74	0.44
Reinvestment Rate		-0.36	-4.01	-0.64	0.54	-1.53	0.01
Average Monthly Trading Volume-to-Market Cap	Liquidity, Risk & Size	-0.35	0.51	-1.43	0.62	4.20	1.38
60-Month Beta		-1.88	-0.99	-1.42	-0.90	-3.46	1.17
Asset Quality Index		-0.48	0.10	1.43	-0.95	-1.87	-0.20
Operating Leverage		0.39	0.04	-0.77	0.99	-0.64	0.18
Natural Logarithm of Market Capitalization		1.79	3.51	1.19	1.45	0.90	0.68
2-Year Ahead EPS Growth	Earnings Momentum	1.74	-0.57	1.91	-0.70	0.40	-0.25
3-M Revision in FY2 EPS Forecasts		-2.19	-4.07	0.79	2.93	-0.83	0.24
Real Earnings Surprise		-0.66	0.36	-0.60	-1.10	-0.99	1.44
24-Month Value at Risk	Price Momentum	-2.27	-2.17	0.82	1.46	-4.27	-0.20
5-day Industry Relative Return		1.24	3.66	0.00	-1.56	2.28	0.55
Industry-adjusted 12-month Relative Price Strength		-3.15	-0.15	-0.70	3.88	0.13	0.75
Rational Decay Alpha		-6.25	-7.12	-0.36	1.07	-6.79	-0.06
Demand Supply Ratio	Short Sentiment	-2.10	-3.11	0.35	1.04	0.68	-1.81
Implied Loan Rate		-2.53	-0.84	-2.02	1.76	-0.25	-1.04

Source: IHS Markit

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## United States

### US Large Cap

US manufacturing growth weakened again in June, a disappointing end to the second quarter with output, new order and employment growth all slowing since May. The PMI registered 52.0, down from 52.7 during May and a nine-month low. In equity markets, stocks finished the month in positive territory despite a tech selloff, capping a strong gain for the first half of the year.

Top performing factors in June (Table 2) include a notable presence of dividend based indicators. The top measure of the group is 2-Year Ahead Regular Dividend Growth (4.59%), derived from IHS Markit's proprietary Dividend Forecast dataset (see Dividend forecasting factor introduction, April 2017), which recorded its largest spread over the past year (Figure 1), perhaps a sign of more defensive posturing. Yield Curve Slope Sensitivity (3.82%) was a beneficiary of banks' outperformance relative to utilities on speculation of higher interest rates following Fed member commentary.

Other signs of a risk-off stance are captured by the list of bottom performing factors for the month (Table 3), where medium-term Price Momentum measures moved from the top performers in May to the weakest in June. Rational Decay Alpha (-6.25%) topped the list with a 7.7 percentage point drop in performance as investors rotated once again away from the market leaders (Figure 2).

Table 2

#### US Large Cap top decile return spread factor performance, Jun 2017

Factor	Decile spread (%)	Factor group
51- Week Volume Price Trend with 4-week Lag	5.40	Price Momentum
14 Day Relative Strength Index	5.26	Price Momentum
Price-to-Total Assets	4.71	Deep Value
2-Year Ahead Regular Dividend growth	4.59	Dividend Forecast
1-Year Ahead Regular Dividend growth	4.57	Dividend Forecast
1-Year Percentage Growth in Regular Dividend	4.51	Dividend Forecast
5-Year Dividend Growth Rate	4.46	Historical Growth
4-week Industry Relative Return	4.44	Price Momentum
2-Year Percentage Growth in Regular Dividend	4.28	Dividend Forecast
5-yr Relative TTM Sales-to-Price	4.20	Relative Value
Industry Relative TTM Sales-to-Price	4.18	Relative Value
Graham Number Fair Value Premium	3.94	Deep Value
Yield Curve Slope Sensitivity	3.82	Macro
3-yr MAD of TTM Net Income	3.81	Liquidity, Risk & Size
5-yr Relative TTM Dividend Yield	3.78	Relative Value

Source: IHS Markit

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Figure 1

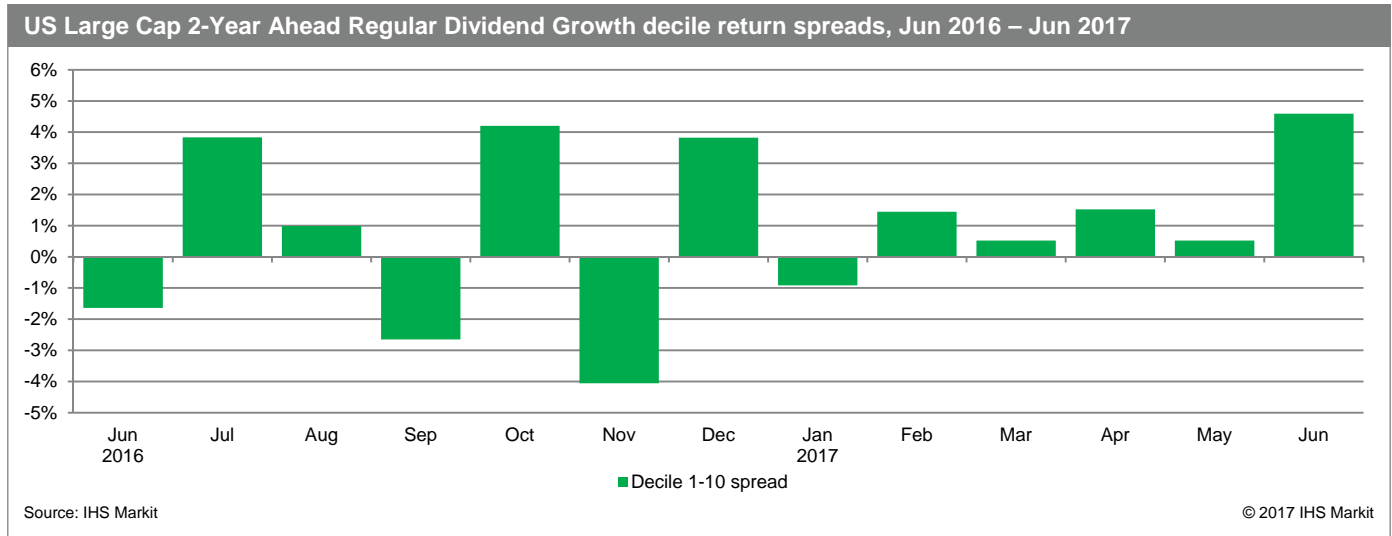
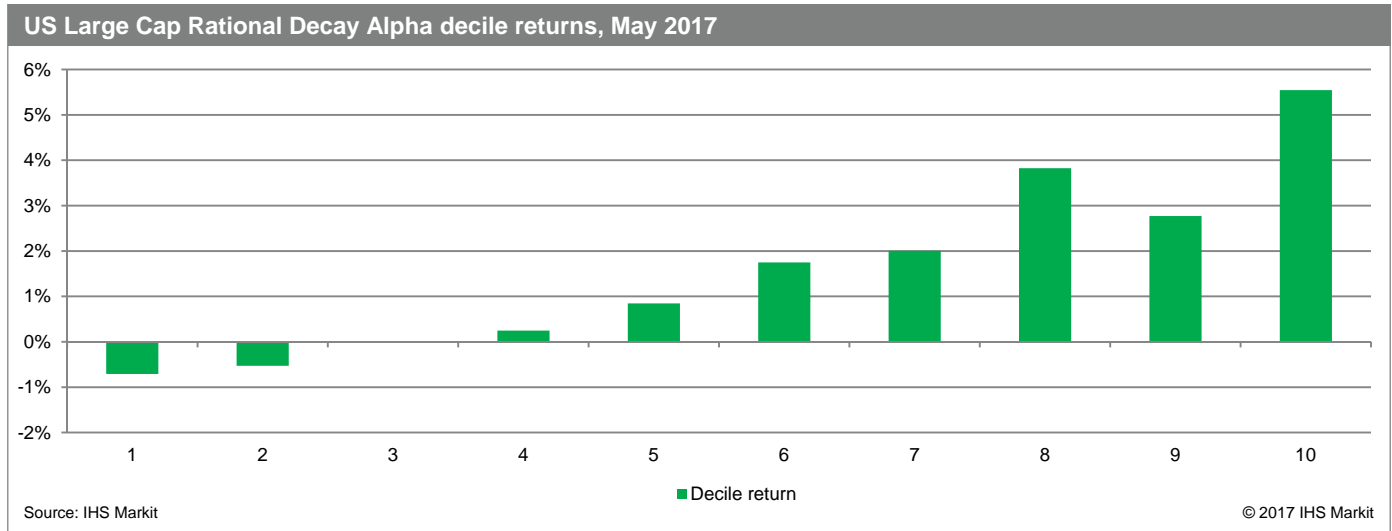


Table 3

Factor	Decile spread (%)	Factor group
Rational Decay Alpha	-6.25	Price Momentum
Operating Cash Flow Ratio	-4.76	Liquidity, Risk & Size
18-Month Active Return with 1-Month Lag	-4.53	Price Momentum
Asia-Pacific Sales Exposure	-4.17	Macro
52-Week High	-4.12	Price Momentum
Operating Cash Flow to Assets	-4.01	Management Quality
Cash Flow Leverage	-3.88	Liquidity, Risk & Size
Slope of 66 Week Price Trend Line	-3.83	Price Momentum
Assets Turnover Ratio	-3.80	Management Quality
12-Month Active Return with 1-month Lag	-3.69	Price Momentum

Source: IHS Markit © 2017 IHS Markit

Figure 2



## US Small Cap

After tracking relatively closely for the prior two months, small cap factor performance at the top and bottom extremes diverged from that of large caps in June. However, exposure to Healthcare, which posted strong returns for the month, was a key driver of factor performance, elevating measures such as Advertising Intensity (6.78%), Ohlson Bankruptcy Score (5.88%) and Working Capital-to-Total Assets (-9.89%) to the top of the leader and laggard boards, thus, we present sector-neutral results (Tables 4 and 5, respectively). In this case, Dividends-to-Cash Flow (4.72%) took over the lead. Short-term price reversal metrics also outperformed, as demonstrated by June performance (Figure 3) which almost perfectly reversed that of May, as investors favored recent underperformers, breaking a four-month string in favor of outperformers. Factors which lagged for the month on a sector-neutral basis did include two measures common to large caps, namely Rational Decay Alpha (-5.95%) and 52-Week High (-4.64%), suggesting a similar defensive stance.

Table 4

### US Small Cap top sector-neutral decile return spread factor performance, Jun 2017

Factor	Decile spread (%)	Factor group
Dividends- to-Cash Flow	4.72	Management Quality
2-Month Active Return	4.68	Price Momentum
1-Month Active Return	4.66	Price Momentum
5-yr Relative Leading 12-Month Earnings Yield	4.17	Relative Value
Long-term Debt-to-Cash Flow	4.02	Liquidity, Risk & Size
Natural Logarithm of Closing Price	4.01	Liquidity, Risk & Size
14 Day Relative Strength Index	3.91	Price Momentum
4-week Industry Relative Return	3.87	Price Momentum
3-Month Active Return	3.86	Price Momentum
5-day Industry Relative Return	3.79	Price Momentum
Implied Volatility	3.53	Liquidity, Risk & Size
Book-to-Market	3.43	Deep Value
Time Weighted Book Yield	3.31	Deep Value
Ohlson Bankruptcy Score	3.24	Liquidity, Risk & Size
Capital Expenditure-to-Total Assets	3.11	Management Quality

Source: IHS Markit

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Table 5

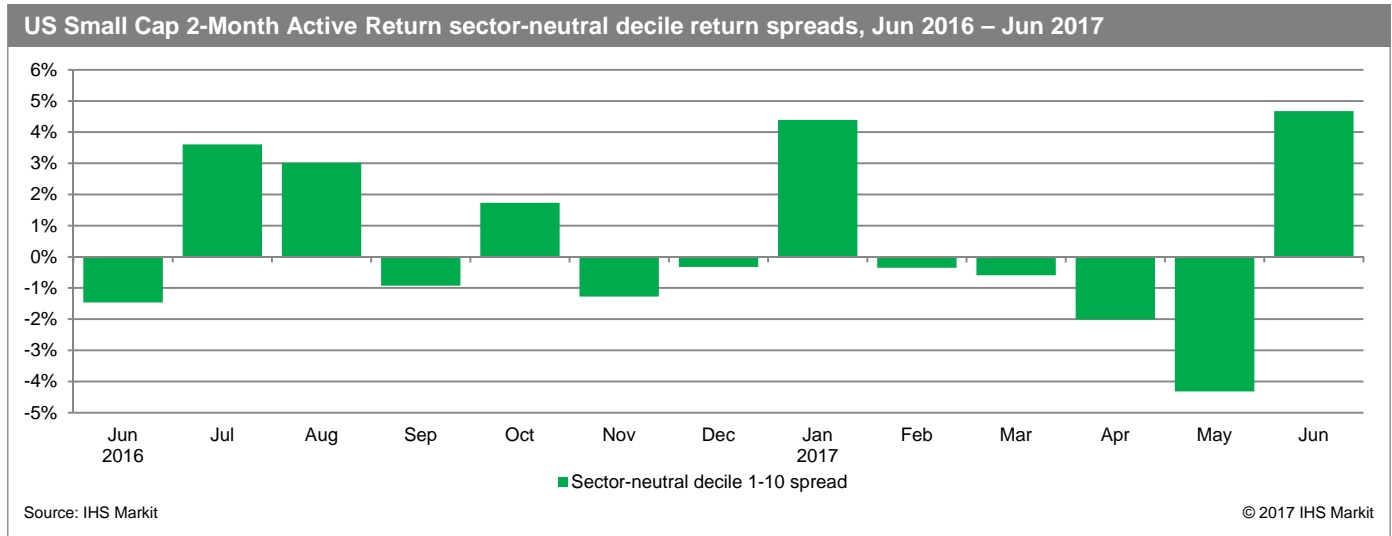
### US Small Cap bottom sector-neutral decile return spread factor performance, Jun 2017

Factor	Decile spread (%)	Factor group
Rational Decay Alpha	-5.95	Price Momentum
Distress Measure	-5.11	Liquidity, Risk & Size
Stock Return Volatility	-4.80	Liquidity, Risk & Size
Short Loan Concentration	-4.65	Short Sentiment
Std Dev of FY2 EPS Estimates-to-Price	-4.65	Earnings Momentum
52-Week High	-4.64	Price Momentum
Regression Error of 60-Month CAPM	-4.52	Liquidity, Risk & Size
At the Money Put Option Implied Volatility	-4.41	Liquidity, Risk & Size
Operating Cash Flow Ratio	-4.03	Liquidity, Risk & Size
Predicted Dividend Yield	-4.02	Deep Value

Source: IHS Markit

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Figure 3



## Europe

The eurozone manufacturing upturn gained further momentum in June, accelerating to its fastest rate in over six years. The PMI rose to 57.4, up from 57.0 in May on improved performances across Germany, France, Italy, the Netherlands, Ireland, Austria and notably Greece which returned to expansion. However, European stocks struggled on hawkish comments from central bankers, though shares remain in positive territory for the year.

Decile return spreads of top (Table 6) and bottom (Table 7) performing factors in the Developed Europe universe in June were relatively subdued in magnitude, suggesting little evidence in the way of high conviction trades. Measures which topped both lists include Acquisition Multiple (3.80%) and Operating Cash Flow Ratio (-3.69%), respectively. Another factor of interest is Short Interest (1.99%), derived from IHS Markit Securities Finance’s comprehensive dataset sourced directly from leading industry participants on a daily frequency, with a 3-month cumulative spread of 6.7% (Figure 4).

Table 6

Developed Europe top decile return spread factor performance, Jun 2017		
Factor	Decile spread (%)	Factor group
Acquisition Multiple	3.80	Deep Value
Inventory-to-Total Assets	2.62	Management Quality
Net Fixed Assets to Long-term Debt	2.18	Liquidity, Risk & Size
Ohlson Bankruptcy Score	2.18	Liquidity, Risk & Size
Capital Expenditure-to-Total Assets	2.09	Management Quality
Short Interest	1.99	Short Sentiment
60-Month Active Return with 12-Month Lag	1.96	Price Momentum
Time Weighted Earnings Yield	1.94	Deep Value
2-Year Projected EPS Growth	1.91	Earnings Momentum
2-Year Ahead EPS Growth	1.91	Earnings Momentum
Stock Illiquidity	1.88	Liquidity, Risk & Size
20-Day Volume Volatility to Price Volatility	1.86	Liquidity, Risk & Size
Price-to-Total Assets	1.83	Deep Value
Yearly TTM Total Sales Growth Rate	1.83	Historical Growth
Net Debt Ratio	1.71	Management Quality

Source: IHS Markit

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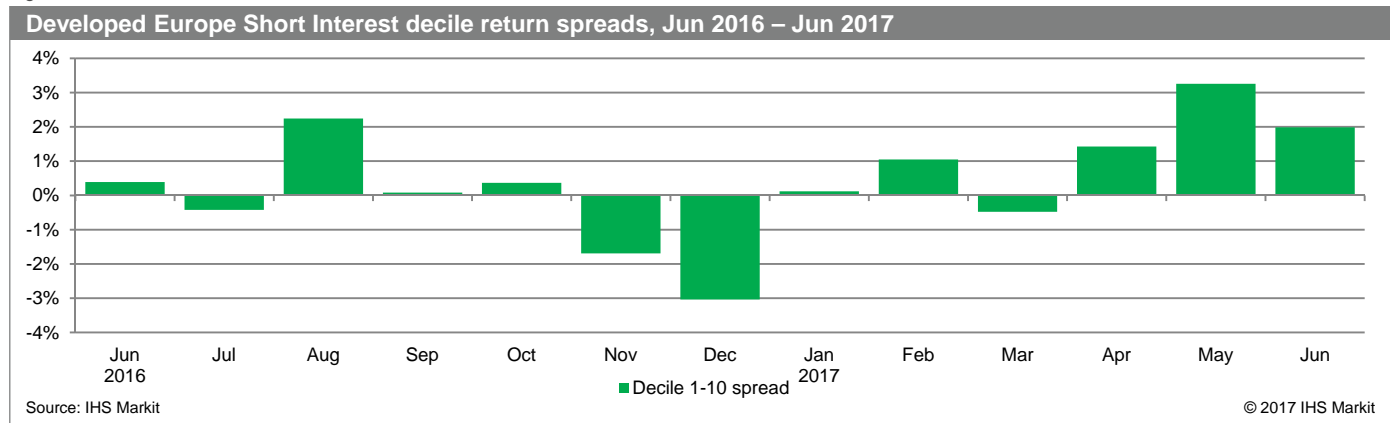
Table 7

Developed Europe bottom decile return spread factor performance, Jun 2017		
Factor	Decile spread (%)	Factor group
Operating Cash Flow Ratio	-3.69	Liquidity, Risk & Size
EBITDA-to-Debt	-3.58	Liquidity, Risk & Size
Cash Flow Return on Invested Capital	-3.00	Management Quality
Basic Defensive Interval	-2.89	Liquidity, Risk & Size
Time Weighted EBITDA/ EV	-2.75	Deep Value
Assets Turnover Ratio	-2.69	Management Quality
Operating Cash Flow to Assets	-2.65	Management Quality
Time Weighted Earnings Revision Dispersion	-2.61	Earnings Momentum
On Loan Value Concentration	-2.47	Short Sentiment
TTM Operating Income to Enterprise Value	-2.45	Deep Value

Source: IHS Markit

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Figure 4



Source: IHS Markit

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## Asia-Pacific

The Chinese manufacturing sector moved back above the 50 no-change mark in June, as operating conditions in the two largest Asian economies both reside again in positive territory. The headline PMI came in at 50.4, up from 49.6 in May, supported by marginal increases in production and new orders. Japan, on the other hand, extended its string of expansion to ten months, with the PMI at 52.4, though down from 53.1 in May. Asia-Pacific stocks gave back some gains, but remained dominant among global shares for the year.

In a sign of optimism, Price Momentum measures took over nearly the totality of top performing factors in Developed Pacific exJapan in June (Table 8). After cycling around a mostly neutral spread over the past year, 12-Month Active Return with 1-month Lag (6.59%) shot to the top of the leaderboard, posting its highest spread since January 2016 (Figure 5). On the other hand, several Macro indicators made their way to laggard board, including Oil Prices Sensitivity (-4.63%) and US Dollar Value Sensitivity (-2.83%) as firms with the highest exposures to the underlying assets underperformed.

Japanese investors departed from the broader regional developed markets with Deep Value measures traversing the full scale of factor performance. In fact, nine factors from the list of June top performers (Table 10) appeared on the list of bottom performers the prior month. At the same time, four risk-on factors experienced the opposite fate, moving from the strongest to the weakest performers (Table 11). Price-to-Total Assets (4.75%) and Rational Decay Alpha (-6.79%) demonstrate this diametrically opposed behavior over the past year (Figure 6), capped with the former posting a 15.2 percentage point improvement in June spread performance while the latter dropped by 14.1 percentage points.

Table 8

### Developed Pacific exJapan top decile return spread factor performance, Jun 2017

Factor	Decile spread (%)	Factor group
12-Month Active Return with 1-month Lag	6.59	Price Momentum
30-75 Week Stock Price Ratio	6.16	Price Momentum
Fama-French Momentum	6.13	Price Momentum
Slope of 66 Week Price Trend Line	5.80	Price Momentum
Slope of 52 Week Price Trend Line	5.70	Price Momentum
15/36 Week Stock Price Ratio	5.43	Price Momentum
6-Month Active Return with 1-Month Lag	5.33	Price Momentum
39-Week Return with 4-week Lag	5.22	Price Momentum
Latin America Sales Exposure	5.20	Macro
50-200 Day Stock Price Ratio	4.96	Price Momentum
18-Month Active Return with 1-Month Lag	4.95	Price Momentum
9-Month Active Return with 1-Month Lag	4.86	Price Momentum
1-Year Price Momentum Indicator	4.70	Price Momentum
Averaged Last 6-M EPS Revisions for FY2	4.63	Earnings Momentum
24-Month Active Return with 1-Month Lag	4.54	Price Momentum

Source: IHS Markit

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Figure 5

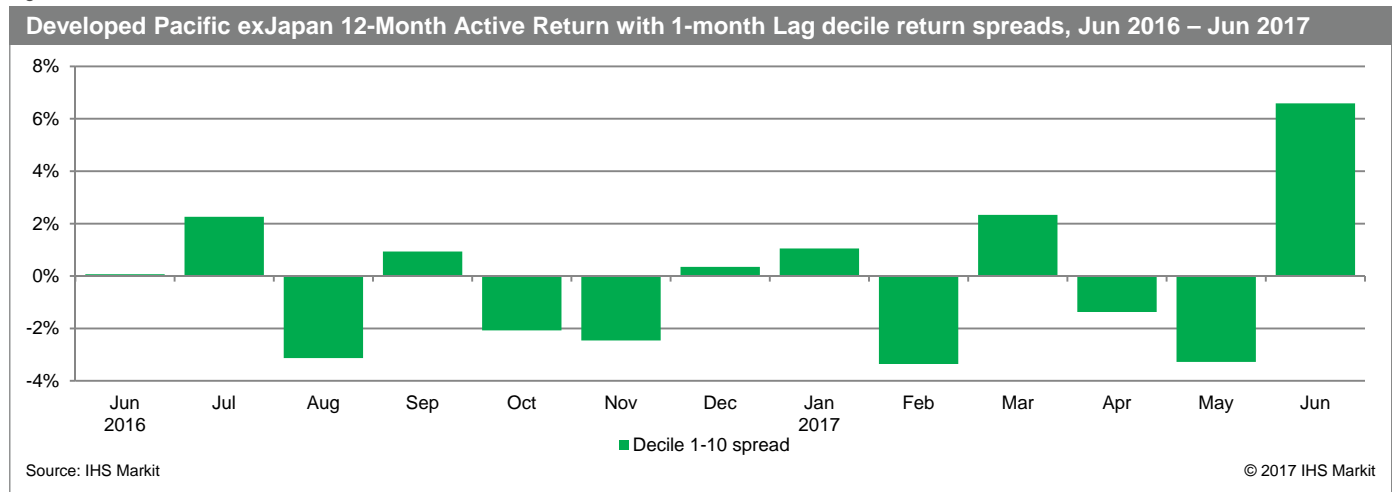


Table 9

**Developed Pacific exJapan bottom decile return spread factor performance, Jun 2017**

Factor	Decile spread (%)	Factor group
Price Above Last 260-day Lowest Trading Price	-5.43	Price Momentum
Oil Prices Sensitivity	-4.63	Macro
Credit Risk Premium Sensitivity	-3.31	Macro
Trading Turnover Ratio	-2.94	Liquidity, Risk & Size
Ohlson Bankruptcy Score	-2.93	Liquidity, Risk & Size
1-Yr Change in Net Profit Margin	-2.93	Historical Growth
Unexpected Change in Depreciation	-2.86	Earnings Quality
US Dollar Value Sensitivity	-2.83	Macro
5-yr Relative TTM Sales-to-Price	-2.80	Relative Value
Shareholder Payout to Gross Profit	-2.78	Management Quality

Source: IHS Markit

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Table 10

**Japan Standard Cap top decile return spread factor performance, Jun 2017**

Factor	Decile spread (%)	Factor group
Natural Logarithm of Closing Price	4.90	Liquidity, Risk & Size
Price-to-Total Assets	4.75	Deep Value
Tobin q	4.68	Liquidity, Risk & Size
60-Month Alpha	4.67	Price Momentum
Yield Curve Slope Sensitivity	4.66	Macro
Time Weighted Book Yield	4.61	Deep Value
Net Asset Value to Price	4.58	Deep Value
Leading 12 Month Book Yield	4.58	Deep Value
3-Month Active Return	4.35	Price Momentum
Average Monthly Trading Volume-to-Market Cap	4.20	Liquidity, Risk & Size
Price-to-Book Return-on-Equity Combination (PB-ROE)	4.20	Deep Value
Book-to-Market	4.13	Deep Value
Slope of 5-yr TTM EPS Trend Line	4.12	Historical Growth
Graham Number Fair Value Premium	4.05	Deep Value
36-Month Active Return with 1-Month Lag	4.05	Price Momentum

Source: IHS Markit

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Table 11

## Japan Standard Cap bottom decile return spread factor performance, Jun 2017

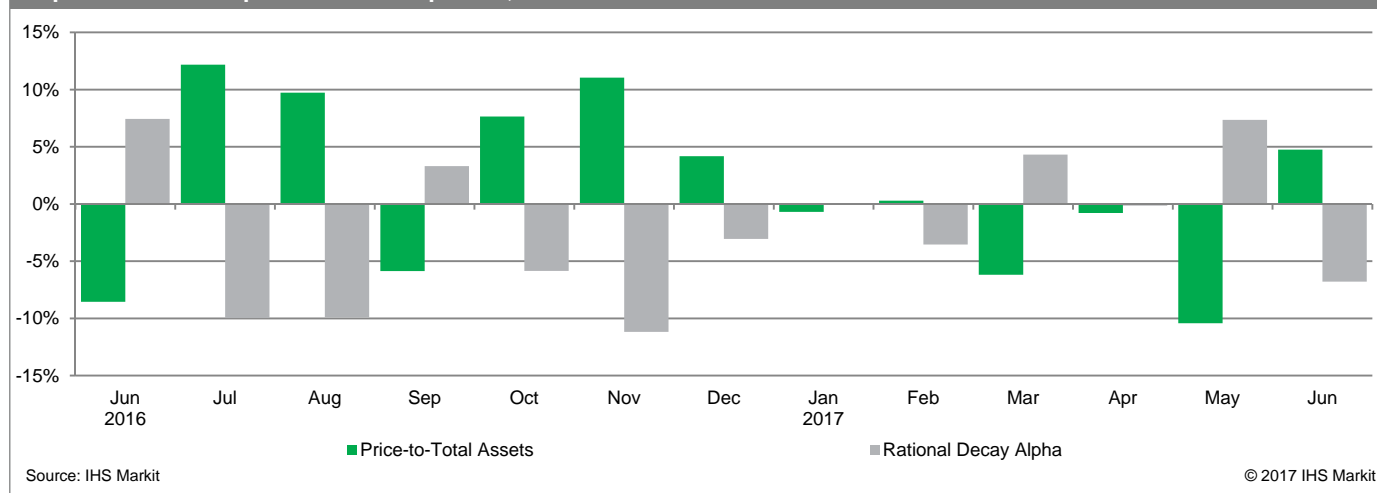
Factor	Decile spread (%)	Factor group
Rational Decay Alpha	-6.79	Price Momentum
24-Month Value at Risk	-4.27	Price Momentum
Std Dev of FY1 EPS Estimates-to-Price	-4.17	Earnings Momentum
Operating Cash Flow to Assets	-3.95	Management Quality
Std Dev of FY2 EPS Estimates-to-Price	-3.89	Earnings Momentum
Distress Measure	-3.69	Liquidity, Risk & Size
Return on Assets	-3.67	Management Quality
24-Month Active Return with 1-Month Lag	-3.65	Price Momentum
Average Collection Period	-3.55	Management Quality
60-Month Beta	-3.46	Liquidity, Risk & Size

Source: IHS Markit

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Figure 6

## Japan Standard Cap decile return spreads, Jun 2016 – Jun 2017



Source: IHS Markit

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## Emerging Markets

Lastly, we review top (Table 12) and bottom (Table 13) performing factors in the Emerging Markets universe in June. High quality and solid fundamentals remained positive themes for stocks, represented by measures such as 5-Year Dividend Growth Rate (1.84%) and Return on Assets (1.20%). However, North America Sales Exposure (2.42%) took top honors, as firms with the greatest proportion of sales to the region outperformed over the past two months, reversing the trend over the prior two months and surpassing results in November 2016 at the time of the US election (Figure 6). At the opposite extreme, measures of long-term underperformers, gauged by 60-Month Active Return with 1-Month Lag (-1.35%) and 5-yr Relative Book-to-Market (-1.26%), were among the list of weakest factor performance.

Table 12

**Emerging Markets top quintile return spread factor performance, Jun 2017**

Factor	Decile spread (%)	Factor group
North America Sales Exposure	2.42	Macro
5-Year Dividend Growth Rate	1.84	Historical Growth
Averaged Last 6-M EPS Revisions for FY2	1.60	Earnings Momentum
Cash to Enterprise Value	1.50	Deep Value
Real Earnings Surprise	1.44	Earnings Momentum
Cash-to-Price	1.41	Deep Value
Average Monthly Trading Volume-to-Market Cap	1.38	Liquidity, Risk & Size
15/36 Week Stock Price Ratio	1.36	Price Momentum
Return on Assets	1.20	Management Quality
Free Cash Flow Return on Invested Capital	1.18	Management Quality
60-Month Beta	1.17	Liquidity, Risk & Size
5-yr Relative Leading 12-Month Earnings Yield	1.10	Relative Value
SG&A Expenses-to-Sales	1.07	Management Quality
Net # of Revisions for Fiscal Year 2	1.07	Earnings Momentum
Unexpected Profitability	1.06	Management Quality

Source: IHS Markit

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Table 13

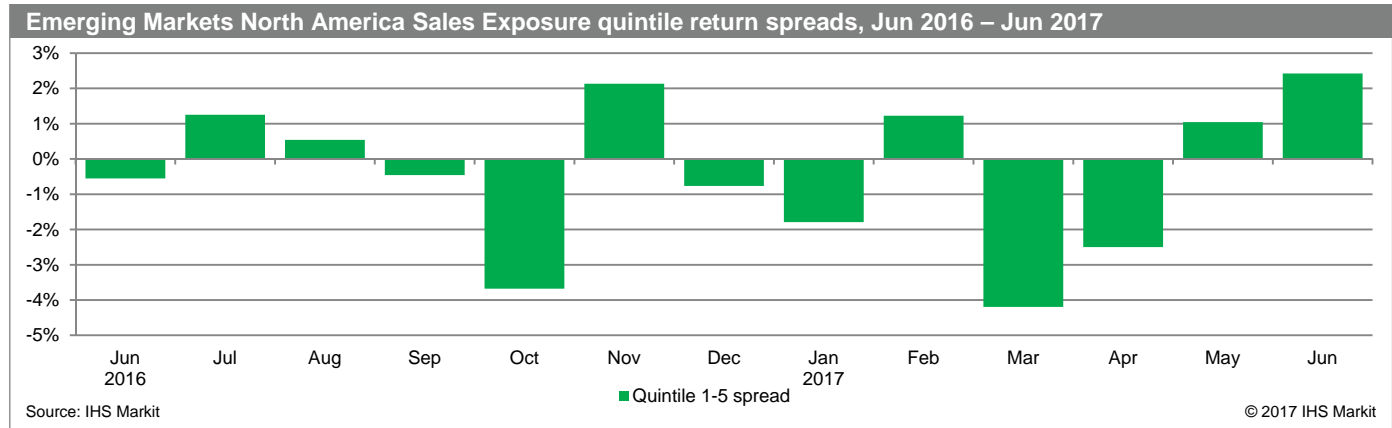
**Emerging Markets bottom quintile return spread factor performance, Jun 2017**

Factor	Decile spread (%)	Factor group
Average Trading Volume in Preceding 6-month	-2.11	Price Momentum
Trading Turnover Ratio	-1.86	Liquidity, Risk & Size
Net Current Assets-to-Price	-1.65	Deep Value
Asset Composition	-1.40	Liquidity, Risk & Size
60-Month Active Return with 1-Month Lag	-1.35	Price Momentum
Cash & Equivalents-to-Current Liabilities	-1.33	Liquidity, Risk & Size
Market Cap per Analyst	-1.26	Liquidity, Risk & Size
5-yr Relative Book-to-Market	-1.26	Relative Value
Working Capital-to-Total Assets	-1.24	Management Quality
5-yr Relative TTM Oper Cash Flow-to-Price	-1.19	Relative Value

Source: IHS Markit

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Figure 7



Source: IHS Markit

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