

Tariff threats weigh on sentiment

June 2018

Research Signals

Relative to most global equity markets, US investors maintained a more positive outlook as earnings have held up amid trade tensions. However, US stocks have not been able to support sentiment globally, confirmed by the key role of low risk strategies across markets (Table 1). Volatile markets in the second quarter reflected investors' concerns of whether trade wars will weigh on growth, at the same time as global manufacturing slipped to an 11-month low in June according to the J.P. Morgan Global Manufacturing PMI™.

- **US:** Price Momentum measures such as Industry-adjusted 12-month Relative Price Strength suffered, along with Demand Supply Ratio particularly among large caps, as the most shorted names outperformed for a third consecutive month
- **Developed Europe:** While investors punished high risk names for a second month, they did not turn to the safe haven of undervalued names as the most attractively valued name ranked by TTM EBITDA-to-Enterprise Value underperformed by an increasing margin over the period
- **Developed Pacific:** High risk names captured by 24-Month Value at Risk were a weak performing group, as were the most expensive to borrow names in the securities lending market as gauged by Implied Loan Rate, especially in markets outside of Japan
- **Emerging markets:** Low beta names outperformed high beta across the full spectrum of 60-Month Beta quintile groups, suggesting a systematic trade across this factor

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Table 1

Global factor quantile return spread performance snapshot, Jun 2018

Factor	Factor Group	US Large Cap	US Small Cap	Developed Europe	Developed Pacific ex Japan	Japan Standard Cap	Emerging Markets
Book-to-Market		0.16	2.24	-0.78	-1.92	0.03	0.70
Forward 12-M EPS-to-Enterprise Value	Deep Value	-4.21	1.65	-3.13	0.91	-1.30	0.35
TTM EBITDA-to-Enterprise Value		-0.82	3.61	-3.45	4.13	0.14	-0.19
TTM Free Cash Flow-to-Enterprise Value		-1.88	1.55	-1.08	4.15	-0.49	1.17
Industry Relative Leading 4-QTRs EPS to Price	Relative Value	-1.57	-0.58	-1.31	-1.51	-2.14	-0.42
Industry Relative TTM Dividend Yield		0.43	0.31	0.60	6.52	0.11	2.52
Fixed Assets Turnover Ratio		-2.77	0.22	-2.09	-1.84	-2.05	0.04
Inventory Turnover Ratio	Management Quality	0.82	2.42	0.64	2.11	0.51	-1.26
Net Operating Asset Turnover		-0.63	4.97	-2.13	-0.78	-0.56	1.08
Change in Accruals to Assets		2.52	1.61	-0.29	-0.24	2.36	-0.09
Change in TTM COGS vs. Inventory Level	Earnings Quality	0.93	0.24	-0.41	-0.43	-0.07	1.42
Change in TTM Sales vs. Accounts Receivable		0.28	-1.27	-0.74	1.55	-0.17	-0.69
Working Capital Accruals		-1.21	-1.61	0.20	-0.66	-1.01	-0.98
1-yr Growth in TTM Free Cash Flow		-0.69	-0.26	-0.50	1.22	-1.31	0.85
Reinvestment Rate	Historical Growth	-2.39	-0.17	0.16	-1.03	-4.07	-0.69
Average Monthly Trading Volume-to-Market Cap	Liquidity, Risk & Size	2.22	-1.53	0.34	-1.92	-2.57	-0.78
60-Month Beta		4.87	3.15	3.10	4.47	2.58	6.14
Asset Quality Index		-1.18	1.36	-1.06	-1.92	0.20	0.13
Operating Leverage		-1.19	1.45	1.28	3.33	0.64	-0.93
Natural Logarithm of Market Capitalization		3.54	0.86	0.16	3.65	-1.67	0.74
2-Year Ahead EPS Growth	Earnings Momentum	-3.18	0.33	-0.12	-1.79	-1.12	-3.00
3-M Revision in FY2 EPS Forecasts		-2.41	-3.30	1.50	3.25	-0.20	-0.61
Real Earnings Surprise		1.95	1.37	0.86	1.97	0.97	-0.73
24-Month Value at Risk		-2.58	0.35	2.85	6.75	2.65	2.68
5-day Industry Relative Return	Price Momentum	-0.48	-0.81	-0.82	1.52	-2.00	0.49
Industry-adjusted 12-month Relative Price Strength		-5.52	-1.01	-0.09	-0.41	-2.45	-0.40
Rational Decay Alpha		-4.24	-1.37	-1.60	-1.03	-3.19	0.05
Demand Supply Ratio	Short Sentiment	-3.12	1.34	1.05	4.29	-0.32	0.82
Implied Loan Rate		-1.25	2.63	1.88	7.47	1.26	-1.69

Source: IHS Markit

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United States

US Large Cap

June data signalled a slightly softer rate of growth across the US manufacturing sector, with the PMI dipping to a four-month low of 55.4, down from 56.4 in May, as output and new orders expanded at the slowest rates since November 2017. The effects of tariffs were widely cited as contributing to another sharp rise in input prices, and also contributed to increased market volatility in the second half of the month, though stocks eked out a positive gain for the month and remained in positive territory for the quarter and first half of the year.

Relative Value measures topped the list of top performing factors in the US Large Cap universe in June (Table 2). 5-yr Relative TTM Dividend Yield (5.98%) was the top performer, posting its strongest spread since April 2016. Low beta names were also preferred by investors with the top five 60-Month Beta deciles outperforming with an average return of 2.20% compared with -0.17% for the bottom five (Figure 1). Low momentum names also outperformed, resulting in Price Momentum's run of the list of bottom performing factors (Table 3). 24-Month Active Return with 1-Month Lag (-6.71%) was the weakest performer, also demonstrating a clear dichotomy between the top and bottom five deciles, with average returns of -0.45% and 2.58%, respectively (Figure 1).

Table 2

US Large Cap top decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
5-yr Relative TTM Dividend Yield	5.98	Relative Value
5-yr Relative Book-to-Market	4.93	Relative Value
60-Month Beta	4.87	Liquidity, Risk & Size
5-yr Relative TTM Sales-to-Price	4.85	Relative Value
36-Month Sharpe Ratio	4.63	Price Momentum
Product of Beta and Sigma	4.63	Liquidity, Risk & Size
5-yr Relative TTM Oper Cash Flow-to-Price	4.52	Relative Value
60-Month Active Return with 1-Month Lag	4.19	Price Momentum
Sortino Ratio	4.15	Price Momentum
Assets Turnover Ratio	3.93	Management Quality
36-Month Active Return with 1-Month Lag	3.91	Price Momentum
Natural Logarithm of Market Capitalization	3.54	Liquidity, Risk & Size
Capital Gearing Ratio	3.28	Liquidity, Risk & Size
Housing Starts Sensitivity	3.24	Macro
Net Cash to Equity	3.16	Liquidity, Risk & Size

Source: IHS Markit

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Figure 1

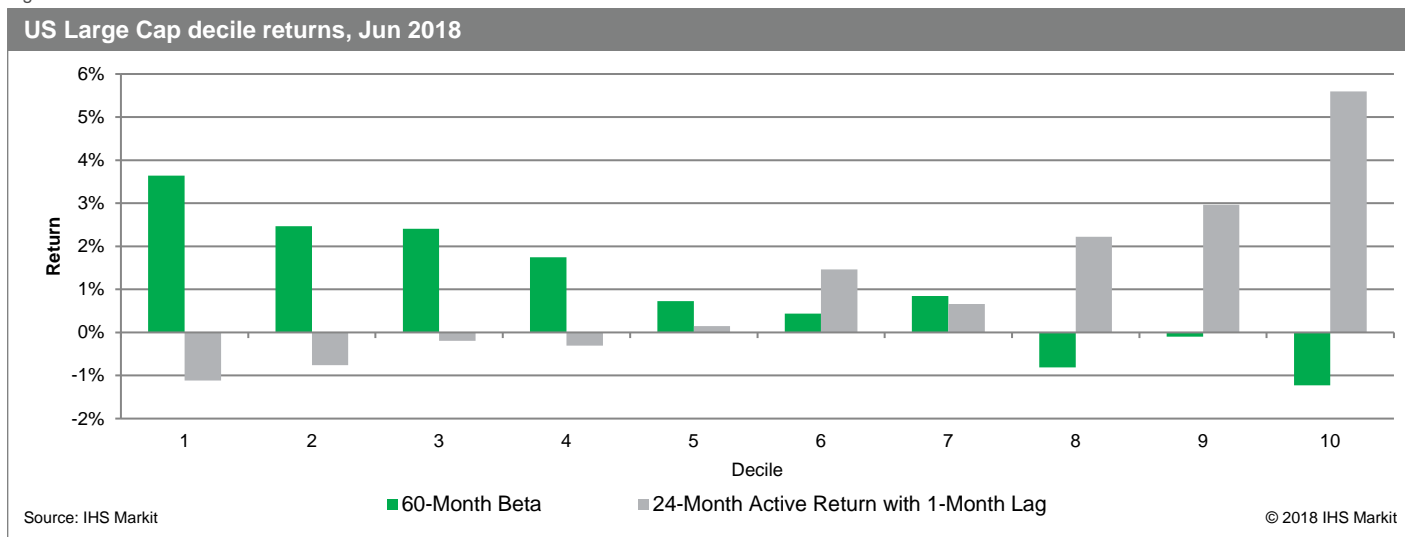


Table 3

Factor	Decile spread (%)	Factor group
24-Month Active Return with 1-Month Lag	-6.71	Price Momentum
18-Month Active Return with 1-Month Lag	-6.37	Price Momentum
9-Month Active Return with 1-Month Lag	-6.34	Price Momentum
4-52 Week Price Oscillator	-6.16	Price Momentum
39-Week Return with 4-week Lag	-6.04	Price Momentum
Net Asset Value to Price	-5.96	Deep Value
30-75 Week Stock Price Ratio	-5.80	Price Momentum
Fama-French Momentum	-5.77	Price Momentum
1-Year Price Momentum Indicator	-5.60	Price Momentum
Industry-adjusted 12-month Relative Price Strength	-5.52	Price Momentum

Source: IHS Markit © 2018 IHS Markit

US Small Cap

Negative return effects from healthcare sector exposures affected factor performance for small caps in June, thus we review sector-neutral top (Table 4) and bottom (Table 5) performers. However, under this alternative ranking method, several Management Quality signals which have large Healthcare exposures remained at the top of the list. For example, Cash-to-Sales (Figure 2), which sported a -68% active (D1-D10) Healthcare exposure, posted a cross-sectional spread of 8.41% driven by Healthcare’s underperformance in the bottom decile. Yet, on a sector-neutral basis, a positive quality trade was still detected based on an average spread of 2.28% to the top five deciles compared with 0.18% at the bottom. The weakest performing signals on a sector-neutral basis gave a less clear picture of a specific common theme and include factors such as Industrial Production Sensitivity (-4.31%) along with Price Momentum measures capturing positive trends (Slope of 52 Week Price Trend Line: -3.41%) as well as short-term reversals (4-week Industry Relative Return: -3.38%).

Table 4

US Small Cap top sector-neutral decile return spread factor performance, Jun 2018		
Factor	Decile spread (%)	Factor group
1-Year Trough Operating Margin	3.48	Management Quality
Cash-to-Sales	3.48	Management Quality
5-yr Relative Book-to-Market	3.36	Relative Value
2-Year Trough Operating Margin	3.34	Management Quality
Working Capital-to-Total Assets	3.34	Management Quality
3-Year Trough Operating Margin	3.25	Management Quality
3-Year Trough Gross Margin	3.10	Management Quality
Current Cash Flow Debt Coverage Ratio	3.05	Liquidity, Risk & Size
Working Capital-to-Trailing 12-Month Sales	3.03	Management Quality
DomainKeys Identified Mail (DKIM) Risk	3.00	Cybersecurity
Equity Turnover Ratio	2.98	Management Quality
Retained Earnings-to-Total Assets	2.90	Management Quality
5-yr Relative TTM Oper Cash Flow-to-Price	2.85	Relative Value
Cash Burn Rate	2.69	Management Quality
Asset Composition	2.68	Liquidity, Risk & Size

Source: IHS Markit

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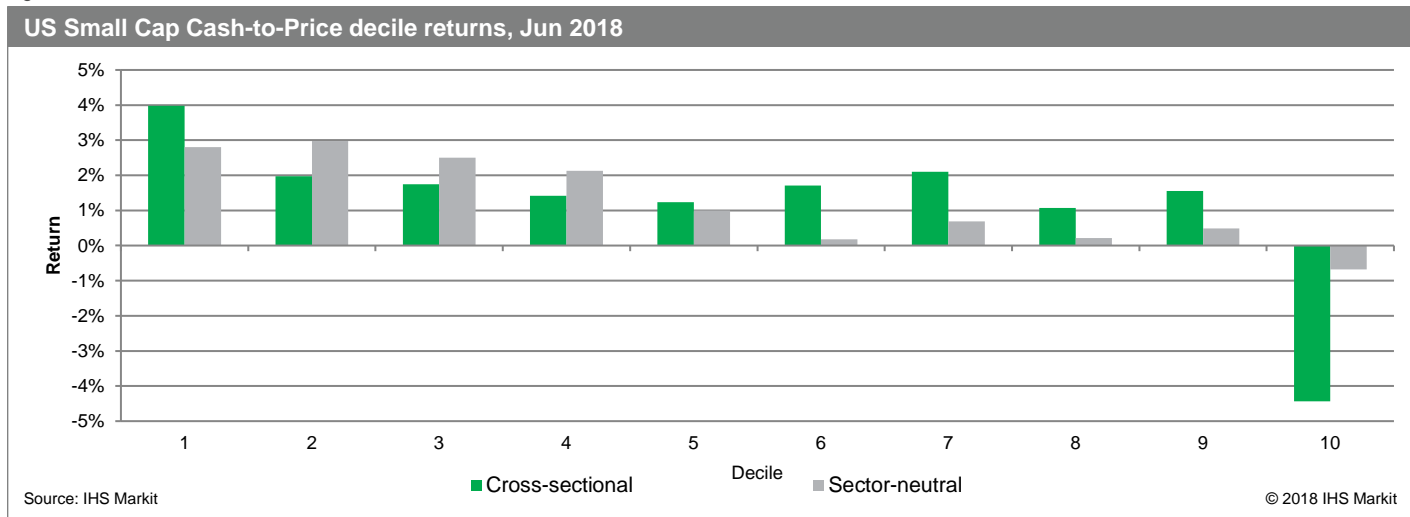
Table 5

US Small Cap bottom sector-neutral decile return spread factor performance, Jun 2018		
Factor	Decile spread (%)	Factor group
Cash-to-Price	-4.37	Deep Value
Industrial Production Sensitivity	-4.31	Macro
Latin America Sales Exposure	-4.05	Macro
Attention Span Ratio	-3.77	Management Quality
Reciprocal of Dividend Yield-adjusted PEG	-3.76	Earnings Momentum
Slope of 52 Week Price Trend Line	-3.41	Price Momentum
4-week Industry Relative Return	-3.38	Price Momentum
Cash to Enterprise Value	-3.28	Deep Value
Inverse of PEG Ratio	-3.26	Earnings Momentum
Averaged Last 6-M EPS Revisions for FY2	-3.25	Earnings Momentum

Source: IHS Markit

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Figure 2



Source: IHS Markit

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Europe

The eurozone manufacturing PMI fell to an 18-month low in June, registering at 54.9, down from 55.5 in May. Weaker expansions were seen in the two best performers (Netherlands and Austria), along with Germany, France and Greece. European stocks declined for the month as trade tensions and questions about the European Central Banks' interest rate policy also weighed on markets.

European markets were characterized by a risk-off trade, as demonstrated by several Liquidity, Risk & Size and Price Momentum measures on the list of top performing factors in June (Table 6). Product of Beta and Sigma (3.97%) and 52-Week High (3.30%) captured this theme, with clear negative biases to the bottom five deciles of both factors, which house stocks with the highest risk and those trading closest to their annual highs (Figure 3). However, investors did not turn to undervalued names as a safe haven, as Deep Value, including TTM EBITDA-to-Enterprise Value (-3.45%) and Time Weighted Sales Yield (-2.52%), occupied nearly the totality of the factor performance laggard board (Table 7).

Table 6

Developed Europe top decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
Std Dev of FY2 EPS Estimates-to-Price	4.02	Earnings Momentum
Product of Beta and Sigma	3.97	Liquidity, Risk & Size
52-Week High	3.30	Price Momentum
Stock Return Volatility	3.14	Liquidity, Risk & Size
60-Month Beta	3.10	Liquidity, Risk & Size
Working Capital-to-Total Assets	3.05	Management Quality
Working Capital-to-Trailing 12-Month Sales	3.03	Management Quality
60-Day Residual Risk	3.02	Liquidity, Risk & Size
Net Current Assets-to-Price	2.97	Deep Value
24-Month Value at Risk	2.85	Price Momentum
Current Ratio	2.82	Liquidity, Risk & Size
Regression Error of 60-Month CAPM	2.77	Liquidity, Risk & Size
24-Month Residual Return Variance	2.70	Price Momentum
Std Dev of FY1 EPS Estimates-to-Price	2.67	Earnings Momentum
Net # of Revisions for Fiscal Year 2	2.53	Earnings Momentum

Source: IHS Markit

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Figure 3

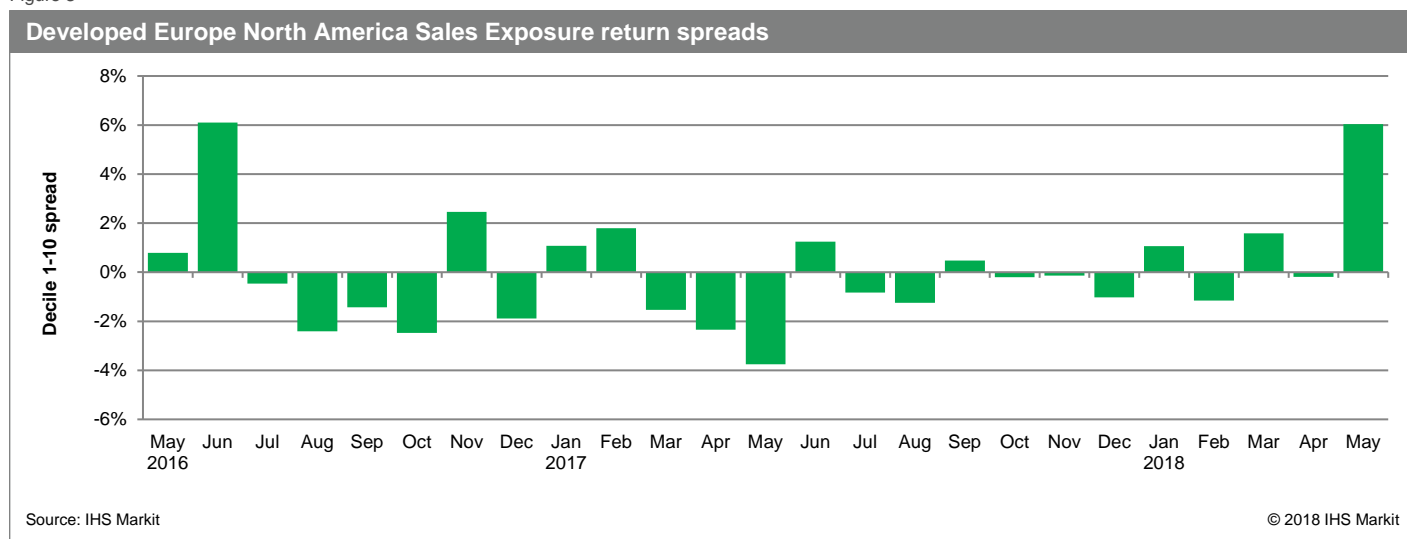


Table 7

Developed Europe bottom decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
Asia-Pacific Sales Exposure	-3.72	Macro
TTM EBITDA-to-Enterprise Value	-3.45	Deep Value
Time Weighted EBITDA/ EV	-3.15	Deep Value
Forward 12-M EPS-to-Enterprise Value	-3.13	Deep Value
Leading 12 Month EBITDA/ EV	-3.03	Deep Value
4-week Industry Relative Return	-2.97	Price Momentum
Cash to Enterprise Value	-2.66	Deep Value
Time Weighted Sales Yield	-2.52	Deep Value
TTM Sales-to-Price	-2.47	Deep Value
TTM Sales-to-Enterprise Value	-2.34	Deep Value

Source: IHS Markit © 2018 IHS Markit

Asia-Pacific

Manufacturers in the two largest Asian economies continued to point to improved operating conditions in June. Japan remained the stronger of the two, with the PMI rising to 53.0 in June from 52.8 in May. In China, manufacturing survey data remained modest in June, with the PMI falling fractionally to 51.0 from 51.1 in May. Stocks diverged in the two countries with Chinese stocks especially hit by rising trade tensions.

Developed Asia-Pacific markets were also characterized by a risk-off trade. Top performing factors in the Developed Pacific exJapan universe in June (Table 8) were led by 1-Month Realized Stock Return Volatility with a solid double digit spread (11.03%). In fact, while this factor has been a mostly negative indicator over the past year with an average spread of -0.28% (Figure 4), this latest reading marked the highest spread since August 2015 when the rout in Chinese equities sent shockwaves through global equity markets. Conversely, the weakest performing factors for the month (Table 9) include Street Consensus Rating (-6.45%) and Cash-to-Price (-6.24%).

Investors in Japan also had a penchant for low risk names as confirmed by the list of top performing factors in June (Table 10). Product of Beta and Sigma (5.12%) and Stock Return Volatility (4.20%) were the top two measures capturing this theme. At the opposite extreme, Price Momentum measures were among the weakest performers (Table 11). 24-Month Active Return with 1-Month Lag trailed by the largest margin and has been a negative indicator in all but two months thus far this year (Figure 5).

Table 8

Developed Pacific exJapan top decile return spread factor performance, Jun 2018

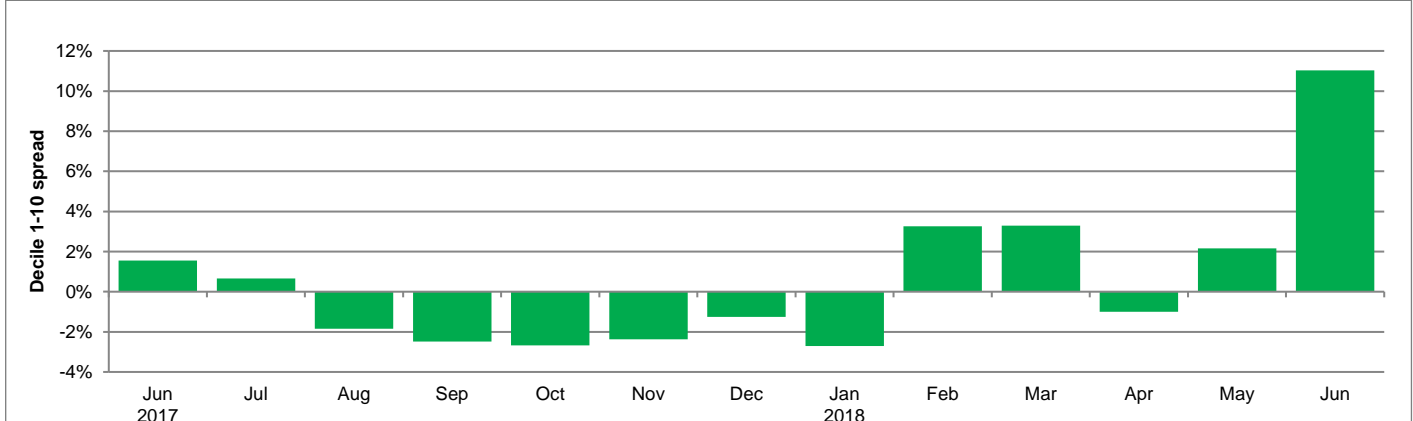
Factor	Decile spread (%)	Factor group
1-Month Realized Stock Return Volatility	11.03	Liquidity, Risk & Size
60-Day Residual Risk	10.68	Liquidity, Risk & Size
1-Month Stock Return Interquartile Range	10.15	Liquidity, Risk & Size
Trading Turnover Ratio	10.02	Liquidity, Risk & Size
Regression Error of 60-Month CAPM	9.86	Liquidity, Risk & Size
Stock Return Volatility	9.80	Liquidity, Risk & Size
CV of Prior 90-Day Closing Prices	9.66	Price Momentum
Distress Measure	9.02	Liquidity, Risk & Size
Long-term Debt-to-Equity	8.33	Liquidity, Risk & Size
Std Dev of FY1 EPS Estimates-to-Price	8.03	Earnings Momentum
Product of Beta and Sigma	7.73	Liquidity, Risk & Size
FY2 EPS Forecast Dispersion	7.60	Earnings Momentum
Implied Loan Rate	7.47	Short Sentiment
Std Dev of FY2 EPS Estimates-to-Price	7.41	Earnings Momentum
24-Month Residual Return Variance	7.07	Price Momentum

Source: IHS Markit

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Figure 4

Developed Pacific exJapan 1-Month Realized Stock Return Volatility decile return spreads



Source: IHS Markit

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Table 9

Developed Pacific exJapan bottom decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
Market Cap per Analyst	-7.03	Liquidity, Risk & Size
Street Consensus Rating	-6.45	Earnings Momentum
Cash-to-Price	-6.24	Deep Value
Cash to Enterprise Value	-5.43	Deep Value
Attention Span Ratio	-5.00	Management Quality
Natural Logarithm of Total Assets	-4.66	Liquidity, Risk & Size
Demand Value Concentration	-4.50	Short Sentiment
Operating Liability Leverage	-4.35	Management Quality
Supply Volatility	-4.18	Short Sentiment
2-Year Projected EPS Growth	-3.56	Earnings Momentum

Source: IHS Markit

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Table 10

Japan Standard Cap top decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
Product of Beta and Sigma	5.12	Liquidity, Risk & Size
Average Trading Volume in Preceding 6-month	4.26	Price Momentum
Stock Return Volatility	4.20	Liquidity, Risk & Size
1-Month Realized Stock Return Volatility	3.73	Liquidity, Risk & Size
52-Week High	3.72	Price Momentum
Trading Turnover Ratio	3.71	Liquidity, Risk & Size
Inventory-to-Total Assets	3.48	Management Quality
24-Month Residual Return Variance	3.31	Price Momentum
Regression Error of 60-Month CAPM	3.30	Liquidity, Risk & Size
Short Loan Concentration	3.19	Short Sentiment
1-yr Change in Total Assets	3.18	Historical Growth
36-Month Active Return with 1-Month Lag	3.17	Price Momentum
1-Month Stock Return Interquartile Range	2.91	Liquidity, Risk & Size
Distress Measure	2.89	Liquidity, Risk & Size
Std Dev of FY2 EPS Estimates-to-Price	2.81	Earnings Momentum

Source: IHS Markit

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Table 11

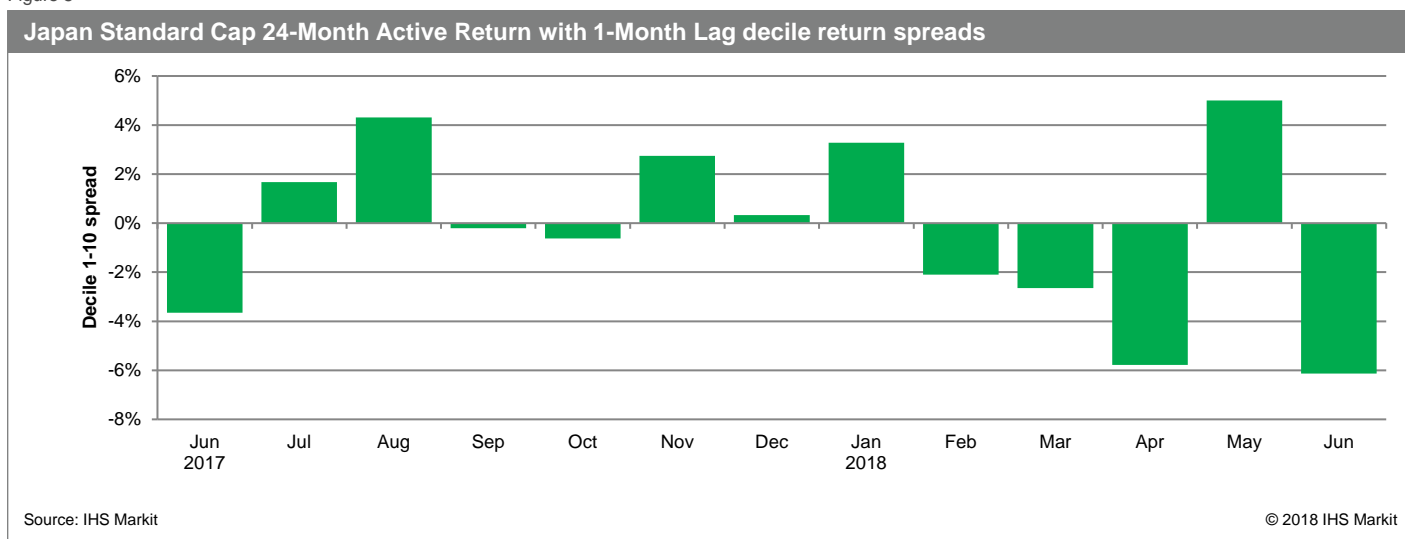
Japan Standard Cap bottom decile return spread factor performance, Jun 2018

Factor	Decile spread (%)	Factor group
24-Month Active Return with 1-Month Lag	-6.13	Price Momentum
Second Preceding 6-month Return	-5.10	Price Momentum
3-Month Active Return	-4.53	Price Momentum
18-Month Active Return with 1-Month Lag	-4.42	Price Momentum
Reinvestment Rate	-4.07	Historical Growth
Sustainable Growth Rate	-4.07	Historical Growth
Averaged Last 6-M EPS Revisions for FY2	-3.82	Earnings Momentum
Dividend Coverage Ratio	-3.77	Liquidity, Risk & Size
12-Month Active Return with 1-month Lag	-3.69	Price Momentum
Averaged Last 6-M EPS Revisions for FY1	-3.52	Earnings Momentum

Source: IHS Markit

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Figure 5



Emerging Markets

Lastly, we review top (Table 12) and bottom (Table 13) performing factors in emerging markets in June. Yet again, low risk was a common theme among the top performers with a familiar set of factors including Product of Beta and Sigma (6.20%), 60-Month Beta (6.14%) and Stock Return Volatility (4.06%). We also draw attention to the dichotomy between North America Sales Exposure (4.82%) and Asia-Pacific Sales Exposure (-2.65%), where the former has been an increasingly positive signal since February this year, while the latter has tended to be a negative indicator over the past year (Figure 6).

Table 12

Emerging Markets top quintile return spread factor performance, Jun 2018		
Factor	Decile spread (%)	Factor group
Product of Beta and Sigma	6.20	Liquidity, Risk & Size
60-Month Beta	6.14	Liquidity, Risk & Size
North America Sales Exposure	4.82	Macro
Stock Return Volatility	4.06	Liquidity, Risk & Size
Regression Error of 60-Month CAPM	3.83	Liquidity, Risk & Size
24-Month Residual Return Variance	3.51	Price Momentum
60-Day Residual Risk	2.96	Liquidity, Risk & Size
Credit Risk Premium Sensitivity	2.90	Macro
1-Month Realized Stock Return Volatility	2.88	Liquidity, Risk & Size
24-Month Value at Risk	2.68	Price Momentum
CV of Prior 90-Day Closing Prices	2.67	Price Momentum
52-Week High	2.60	Price Momentum
Industry Relative TTM Dividend Yield	2.52	Relative Value
1-Month Stock Return Interquartile Range	2.51	Liquidity, Risk & Size
Market Volatility Sensitivity	2.42	Macro

Source: IHS Markit

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Table 13

Emerging Markets bottom quintile return spread factor performance, Jun 2018

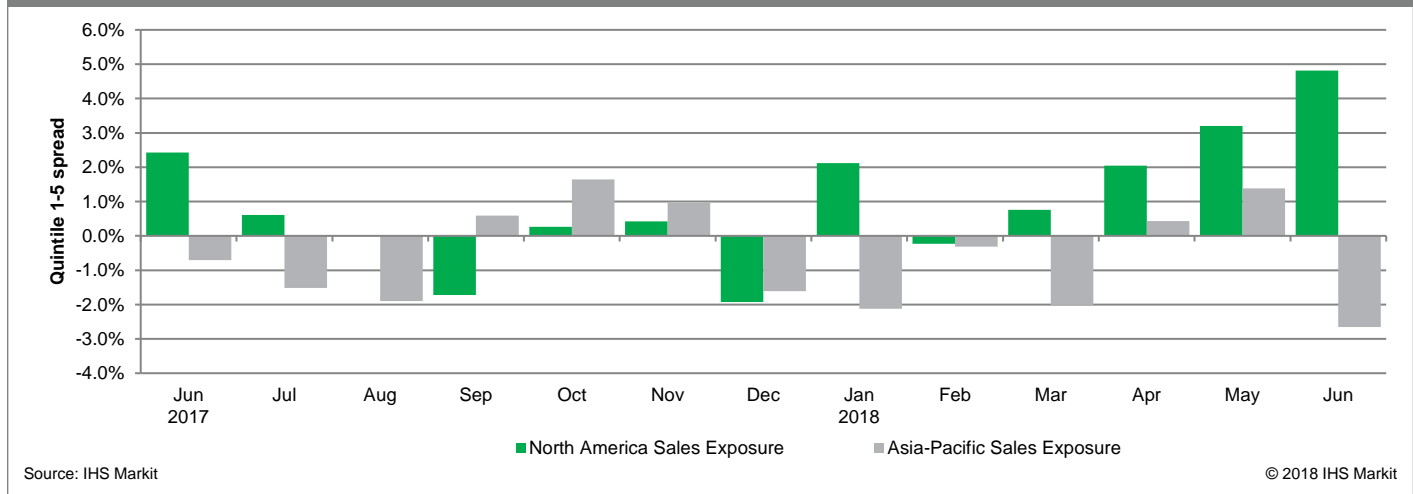
Factor	Decile spread (%)	Factor group
Cash & Equivalents-to-Current Liabilities	-3.51	Liquidity, Risk & Size
Ohlson Bankruptcy Score	-3.04	Liquidity, Risk & Size
2-Year Ahead EPS Growth	-3.00	Earnings Momentum
2-Year Ahead EPS Growth Percentage Change	-2.95	Earnings Momentum
Quick Ratio	-2.92	Liquidity, Risk & Size
Dividend Coverage Ratio	-2.88	Liquidity, Risk & Size
Long-term Debt-to-Equity	-2.83	Liquidity, Risk & Size
Asia-Pacific Sales Exposure	-2.65	Macro
Cash Earnings Return On Equity	-2.58	Management Quality
Net Current Assets-to-Price	-2.55	Deep Value

Source: IHS Markit

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Figure 6

Emerging Markets quintile return spreads



Source: IHS Markit

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