
LOOKING BACK AT EQUITY FACTORS IN Q4 WITH WISDOMTREE

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After three negative quarters, 2022 closed with a bang. Equities around the world delivered very strong returns in both October and November on the back of relatively good news on the [inflation](#) front. Therefore, despite a negative December, developed market equities gained 9.8% in Q4, and emerging market equities gained 9.7%.

This installment of the WisdomTree Quarterly Equity [Factor](#) Review aims to shed some light on how equity factors behaved in this rebound and how this may have impacted investors' portfolios.

- Overall factors performed strongly for global and U.S. investors. Only [growth](#) delivered an underperformance in Q4
- [Value](#), high [dividend](#) and high-quality dividend payers delivered the strongest performance in both regions
- In Europe, [small-cap](#) stocks performed the best, followed by value and high-dividend stocks
- In emerging markets, value and high-quality dividend payers delivered the strongest outperformance

Looking forward to 2023, the same issues that drove markets in 2022 remain. While inflation has shown signs of easing, we expect central banks to remain [hawkish](#) around the globe as inflation is still very meaningfully above target. In an environment where [interest rates](#) and inflation remain high, and the [volatility](#) of both equities and interest rates is increasing, we continue to tilt toward high dividend, value and high-quality dividend payers.

Performance in Focus: High Dividend and Value Finish Strong

In the fourth quarter of 2022, equity markets posted their first positive quarter of the year across regions. In October and November, markets benefited from positive inflation numbers and increased hopes for a [Fed](#) pivot or at least a pause in [rate hikes](#) leading to a sharp rebound. [MSCI world](#) gained 7.2% and 7% in those two months, respectively. However, hopes of such a pivot were dashed quickly, with the Federal Reserve Chair making clear in the December [FOMC](#) meeting that he wanted to see “substantially” more progress on inflation before the hiking would stop. This led MSCI world to lose -4.3% in December.

Overall factors performed strongly for global and U.S. investors:

- Only growth delivered an underperformance in Q4 in U.S. and global equities
- Value, high dividend and high-quality dividend payers delivered the best performance across regions but mostly in the U.S.

- In Europe, factors had a more difficult time. Small-cap stocks performed the best, followed by value and high-dividend stocks, but [quality](#), [momentum](#) and [minimum volatility](#) delivered underperformance.
- In [emerging markets](#), value and high-quality dividend payers delivered the strongest outperformance. In this market, quality, momentum and minimum volatility also delivered underperformance.
- In Q4, the market environment continued to discriminate strongly between quality stocks. The definition of quality and the criteria used have hugely impacted the result. Quality, left unattended, tends to tilt toward growth (investors pay for quality, after all) and would have suffered from that tilt, as illustrated with [MSCI Quality](#) (“Quality” in figures 1 and 2). Highly profitable companies and dividend growers have fared better this quarter, as illustrated by wisdomTree Quality.

Figure 1: Equity Factor Outperformance in Q4 2022 across Regions

| | World Q4 2022: 9.8% | USA Q4 2022: 7.0% | Europe Q4 2022: 9.6% | Emerging Markets Q4 2022: 9.7% |
|--------------------|------------------------|----------------------|-------------------------|-----------------------------------|
| High Dividend | 4.6% | 6.9% | 1.0% | 0.5% |
| Minimum Volatility | 0.2% | 2.7% | -3.3% | -4.0% |
| Momentum | 3.2% | 5.0% | -1.9% | -7.4% |
| Quality | 0.4% | 2.2% | -2.6% | -3.4% |
| WisdomTree Quality | 3.7% | 4.9% | -2.8% | 2.3% |
| Size | 1.0% | 0.9% | 1.4% | -1.5% |
| Value | 6.4% | 5.2% | 1.2% | 4.8% |
| Growth | -5.0% | -6.4% | | |

Sources: WisdomTree, Bloomberg, 9/30/22-12/31/22. Calculated in U.S. dollars for all regions except Europe, where calculations are in EUR. Past performance is not indicative of future results.

2022, the Year of the Dividends

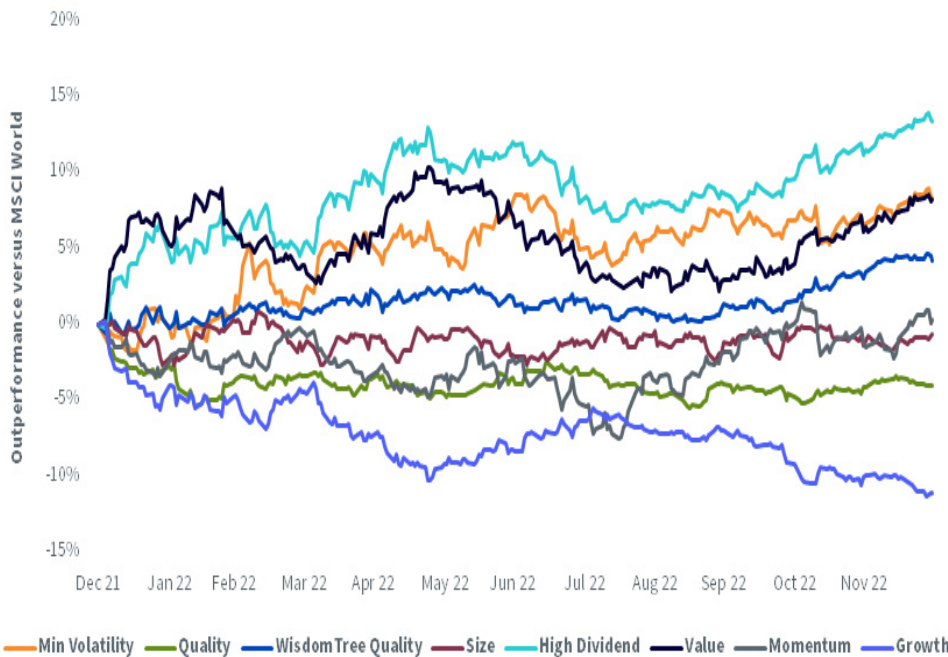
Looking back at the whole year, High Dividend has dominated the factor space consistently across the year. It delivered a 13.4% outperformance to MSCI world and a 15.2% outperformance versus [MSCI USA](#).

In global equities, Value and Min volatility completed the podium with 8.3% of outperformance. In the U.S., the podium is a bit different, with [wisdomTree Quality](#) (i.e., high-quality dividend payers) finishing second (+11.4%) and Minimum Volatility and Value coming third and fourth.

In both regions, Growth and Quality (with its growth tilt) were the only factors to deliver underperformance.

In Europe, High Dividend and Value also dominated the field.

Figure 2: Year-to-Date Outperformance of Equity Factors in Developed Markets



Sources: WisdomTree, Bloomberg, 12/31/21-12/31/22. Past performance is not indicative of future results.

Valuations Rebounded in Q4

In Q4 2022, [valuations](#) rebounded across the board on the back of markets’ positive performances. Small caps saw the largest increases, with +1.7 in global and European equities and +2.2 in U.S. equities. European and emerging markets remain quite cheap, leading to factors being cheap as well. Emerging market value is currently priced at a 4.9 [P/E ratio](#).

Figure 3: Historical Evolution of Price-to-Earnings Ratios of Equity Factors

| | World | | USA | | Europe | | Emerging Markets | |
|--------------------|-----------|----------|-----------|----------|-----------|----------|------------------|----------|
| | P/E Ratio | Δ3Months | P/E Ratio | Δ3Months | P/E Ratio | Δ3Months | P/E Ratio | Δ3Months |
| Market | 15.5 | ↑ 1.2 | 17.5 | ↑ 1.5 | 11.9 | ↑ 1.3 | 11.4 | ↑ 0.7 |
| High Dividend | 12.5 | ↑ 1.1 | 14.0 | ↑ 1.6 | 8.4 | ↑ 0.1 | 6.7 | ↑ 0.0 |
| Minimum Volatility | 17.3 | ↑ 0.5 | 18.6 | ↑ 1.1 | 15.0 | ↑ 0.8 | 12.9 | ↑ 0.2 |
| Momentum | 12.0 | ↑ 1.3 | 14.2 | ↑ 1.6 | 10.2 | ↑ 1.2 | 12.5 | ↑ 3.0 |
| Quality | 17.8 | ↑ 0.9 | 18.9 | ↑ 1.6 | 14.5 | ↑ 0.3 | 13.2 | ↑ 0.3 |
| Size | 15.7 | ↑ 1.7 | 17.7 | ↑ 2.2 | 13.1 | ↑ 1.7 | 12.2 | ↑ 0.4 |
| Value | 7.9 | ↑ 0.7 | 9.9 | ↑ 1.7 | 7.4 | ↑ 0.9 | 4.9 | ↑ 0.2 |

Sources: WisdomTree, Bloomberg, as of 12/31/22. Past performance is not indicative of future results.

Looking forward to 2023, [recession](#) risk is continuing to rise. The [International Monetary Fund \(IMF\)](#) is warning of a recession in the U.S., a deep slowdown in Europe and a drawn-out recession in the United Kingdom. While inflation has shown signs of easing, we expect central banks to remain hawkish around the globe as inflation is still very meaningfully above targets. The Federal Reserve made clear in its December meeting that “substantially” more progress will need to happen on the inflation front before hiking stops. The European Central Bank (ECB) projections show inflation is unlikely to reach the 2% target until late 2025, leading to a hawkish turn there as well. The Bank of Japan also surprised markets in December with its own hawkish move.

Overall, as we transition to 2023, three questions remain unanswered from 2022:

1. How sticky will the underlying inflation be?
2. How intense will the recession be?
3. Will we find a solution to Europe's energy crisis?

With markets facing the same issues in 2023 that they faced in the second half of 2022, we continue to tilt toward the strategies that delivered for investors in 2022, i.e., high dividend, value and high-quality dividend payers.

"World" = [MSCI World Index](#)

"U.S." = [MSCI USA Index](#)

"Europe" = [MSCI Europe Index](#)

"Emerging Markets" = [MSCI Emerging Markets Index](#)

"Minimum Volatility" = the relevant [MSCI Min Volatility Index](#)

"Quality" = the relevant [MSCI Quality Index](#)

"Momentum" = the relevant [MSCI Momentum Index](#)

"High Dividend" = the relevant [MSCI High Dividend Index](#)

"Size" = the relevant [MSCI Small Cap Index](#)

"Value" = the relevant [MSCI Enhanced Value Index](#)

"WisdomTree Quality" = the relevant [WisdomTree Quality Dividend Growth Index](#)

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DEFINITIONS

Inflation: Characterized by rising price levels.

Factor: Attributes that based on its fundamentals or share price behavior, are associated with higher return.

Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Dividend: A portion of corporate profits paid out to shareholders.

Small caps: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Hawkish: Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Interest rates: The rate at which interest is paid by a borrower for the use of money.

Volatility: A measure of the dispersion of actual returns around a particular average level.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

MSCI World Value Index: Captures large and mid cap securities exhibiting overall value style characteristics across 23 Developed Markets (DM) countries.

Federal Open Market Committee (FOMC): The branch of the Federal Reserve Board that determines the direction of monetary policy.

Quality: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Momentum: Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Minimum Volatility: Funds that use an optimization that will consider the correlation of companies to each other in order to get a lower volatility index overall.

Emerging market: Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

MSCI World Quality Index: Aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage.

MSCI USA Index: is designed to measure the performance of large and mid cap segments of the US market.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

International Monetary Fund: international organization for global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth around the world.

MSCI World Index: Captures large and mid-cap representation across 23 Developed Markets (DM) countries.

MSCI Europe Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe.

MSCI Emerging Market Index: The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

MSCI World Minimum Volatility Index: Aims to reflect the performance characteristics of a minimum variance strategy applied to the MSCI large and mid cap equity universe across 23 Developed Markets countries*

MSCI Momentum Index: designed to embody the performance of an equity momentum strategy by to emphasizing stocks with high price momentum, while also maintaining reasonably high trading liquidity, investment capacity and moderate investment turnover.

MSCI World High Dividend Yield Index: Designed to reflect the performance of equities in the parent index (excluding REITs) with higher dividend income and quality characteristics than average dividend yields that are both sustainable and persistent.

MSCI World Small Cap Index: Captures small cap representation across 23 Developed Markets (DM) countries.

MSCI world Enhanced Value Index: Is designed to represent the performance of securities that exhibit higher value characteristics relative to their peers within the corresponding GICS® sector.