

LOOKING BACK AT EQUITY FACTORS IN Q2 2023 WITH WISDOMTREE

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Equity markets continued to rise in the second quarter of the year, albeit more slowly than in the first quarter. The [MSCI World Index](#) gained 6.8% over the quarter, U.S. equities rose 8.6% and European equities rose 2.3%. The performance drivers remained the same with mega caps, particularly tech [mega caps](#), behind the bulk of the performance.

This installment of the WisdomTree Quarterly Equity Factor Review aims to shed some light on how equity factors behaved in this complicated quarter, and how this may have impacted investors' portfolios.

- In a sharp reversal from 2022, [growth](#) stocks continued to lead in developed market equities
- The best factors for 2022 continued to suffer as well, with [value](#) and high [dividends](#) posting sharp underperformance
- In [emerging markets](#), the picture is quite different, with value and size leading the way

Year-to-date equity gains have been concentrated in a handful of expensive names. Equity markets are currently pricing in for a perfect outcome, with [inflation](#) coming down nicely, growth remaining resilient and unemployment staying low. Uncertainty remains very high and there are potential opportunities to be found among the laggards, including in the defensive, or cheaper, side of the markets.

Performance in Focus: Reverse 2022

The second quarter saw a continuation of the trend that started in Q1. Big tech stocks benefitted from the positive sentiment around generative [AI](#) and AI in general, with stocks like Nvidia posting returns of 52.3% during the quarter (after gaining 90% in Q1). Equity markets overall were buoyed by optimism about the trajectory of U.S. inflation and by unemployment remaining surprisingly resilient. Overall, 2023 continues to look like the anti-2022: growth stocks are up, [Bitcoin](#) is up (83.7% YTD), and high dividend and value are down. This sharp turnaround highlights, once again, the importance of diversification.

The year remains a difficult period for factor investing in developed markets:

- Growth stocks performed the best in Q2, outperforming by 3.6% globally and by 5.2% in the U.S.
- [quality](#) continued to be the second-best factor for the quarter in developed markets, in particular when loading on more expensive tech stocks
- In developed markets, other factors like value, high dividend and min [volatility](#) all suffered from the change in regimes compared to last year

- As a testament to the sharp reversal in sentiment/performance, momentum posted the worst performance year-to-date globally and in the U.S., as it could not adjust to the rapid change
- In emerging markets, size and value dominated but most factors were able to produce outperformance over the quarter

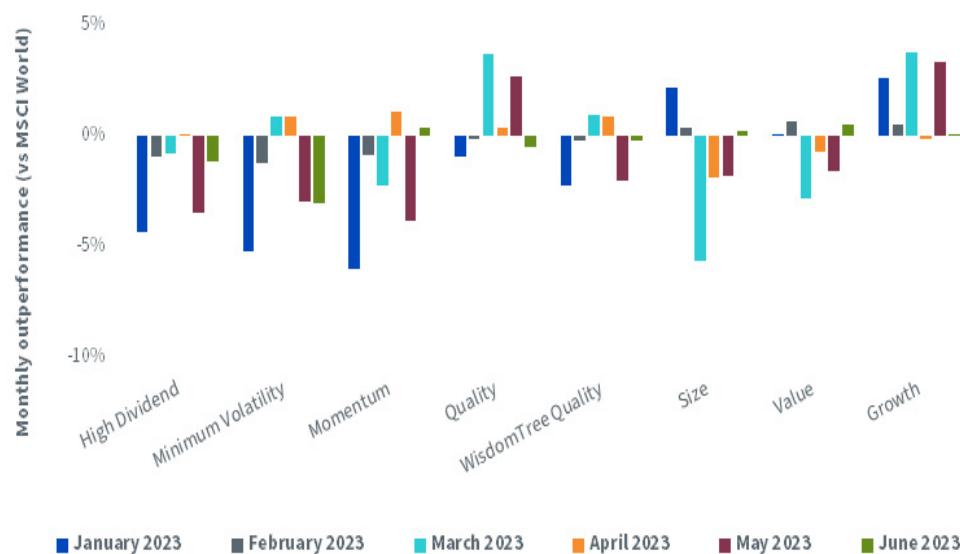
Figure 1: Equity Factor Outperformance in Q1 2023 across Regions

| | World Q2 2023: 6.8% | USA Q2 2023: 8.6% | Europe Q2 2023: 2.3% | Emerging Markets Q2 2023: 0.9% |
|--------------------|--------------------------------|------------------------------|---------------------------------|---|
| High Dividend | -4.8% | -7.4% | -1.4% | 1.0% |
| Minimum Volatility | -5.2% | -6.1% | -1.0% | 0.8% |
| Momentum | -2.6% | -4.4% | 0.9% | 2.9% |
| Quality | 2.9% | 3.0% | -0.8% | -1.9% |
| WisdomTree Quality | -1.4% | -1.3% | -0.3% | 0.6% |
| Size | -3.6% | -3.5% | -2.5% | 5.5% |
| Value | -1.9% | -6.9% | -0.3% | 4.1% |
| Growth | 3.6% | 5.2% | 0.2% | 1.3% |

Sources: WisdomTree, Bloomberg, 3/31/23–6/30/23. Calculated in U.S. dollars for all regions except Europe, where calculations are in euros. Past performance is not indicative of future results.

2023 Has Been Very Consistent Factor-wise

Looking back at the full six months, the picture is quite coherent. Growth outperformed in five out of six months, underperforming only by -0.2% in April. It outperformed by more than 2% in half the months (January, March and May). High dividend underperformed almost every month with a 0.1% outperformance in April, saving it from a “perfect” streak.

Figure 2: World Equity Factor Outperformance Month by Month in the H1 2023

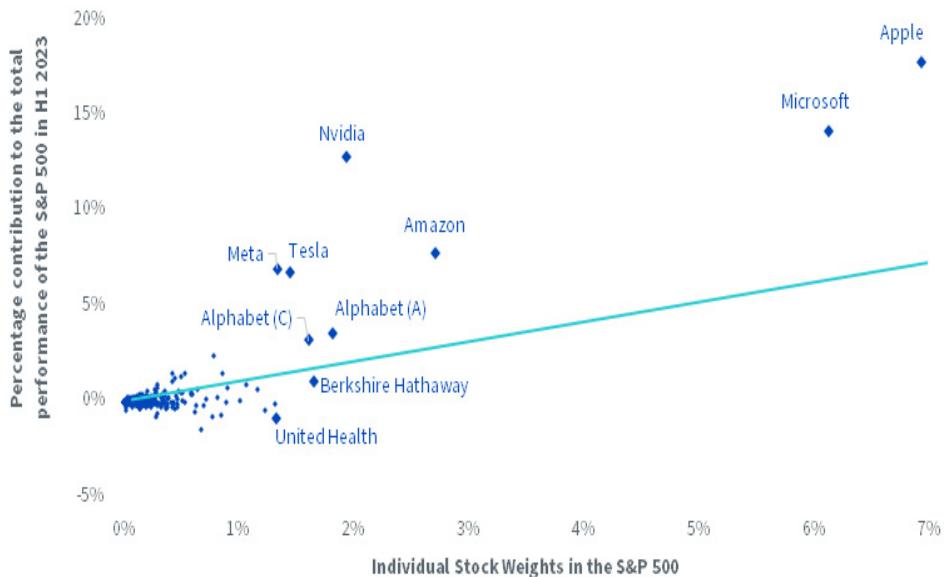
Sources: WisdomTree, Bloomberg, 12/31/22–6/30/23. Calculated in U.S. dollars for all regions except Europe, where calculations are in euros. Past performance is not indicative of future results.

A Very Concentrated Recovery

Looking at the performance of the S&P 500 year-to-date (+16.6%), almost three-quarters of it has been created by the 10 biggest stocks in the index. Those stocks only

represent 27% of the weight in the index. Figure 3 shows, for each stock, its weight and how much it contributed to the index's half-year performance. Every stock that sits above the red line contributed more than its weight would suggest. Clearly, the eight tech stocks in the S&P 500 top 10 have all contributed very positively, explaining most of the performance of the index.

Figure 3: Weights and Contribution to H1 2023 Performance of Individual Stocks in the S&P 500



Sources: WisdomTree, Bloomberg, 12/31/22–6/30/23. Past performance is not indicative of future results.

Valuations Continued to Increase in Q1

In Q2 2023, markets continued to get more expensive on the back of good performance. However, this average increase hides discrepancies. Growth got more expensive quickly and is showing a price-to-earnings ratio of more than 30 in the U.S. However, value remains very cheap at 7.2 in the U.S. and 9.4 for developed markets. This is also the case for high dividends with low double-digit valuations. Momentum's valuation is rising fast, a clear sign that the basket is shifting away from cheap value to expensive growth. The next few months will tell us if it was too late.

Figure 4: 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 | 17.9 | ↑ 1.1 | 20.4 | ↑ 1.6 | 13.1 | ↓ -0.1 | 13.2 | ↑ 0.8 |
| High Dividend | 13.1 | ↓ -0.3 | 15.0 | ↑ 0.3 | 9.9 | ↓ -0.3 | 7.9 | ↑ 0.3 |
| Minimum Volatility | 17.4 | ↓ -0.2 | 18.5 | ↓ -0.2 | 16.1 | ↓ -0.5 | 14.4 | ↑ 1.5 |
| Momentum | 18.9 | ↑ 6.1 | 23.4 | ↑ 9.0 | 14.5 | ↑ 3.1 | 9.3 | ↓ -2.4 |
| Quality | 22.3 | ↑ 1.6 | 23.0 | ↑ 1.3 | 18.6 | ↑ 0.8 | 15.4 | ↑ 0.0 |
| Size | 17.4 | ↑ 1.0 | 20.7 | ↑ 1.6 | 12.9 | ↓ -0.1 | 13.9 | ↑ 1.8 |
| Value | 9.4 | ↑ 0.0 | 7.2 | ↓ 0.0 | 8.0 | ↓ -0.5 | 6.4 | ↑ 0.1 |
| Growth | 27.3 | ↑ 2.6 | 30.5 | ↑ 3.5 | 22.9 | ↑ 0.2 | 23.6 | ↑ 0.4 |

Sources: WisdomTree, Bloomberg, as of 6/30/23. Past performance is not indicative of future results. "World" = MSCI World Index net total return (TR). "USA" = MSCI USA Index net TR. "Europe" = MSCI Europe Index net TR. "Emerging Markets" = MSCI Emerging Markets Index net TR. "Minimum volatility" = the relevant MSCI Min Volatility net TR index. "Quality" = the relevant MSCI Quality net TR index. "Momentum" = the relevant MSCI Momentum net TR index. "High Dividend" = the relevant MSCI High Dividend net TR index. "Size" = the relevant MSCI Small Cap net TR index. "Value" = the relevant MSCI Enhanced Value net TR index. "WisdomTree Quality" = the relevant WisdomTree Quality Dividend Growth Index.

For definitions of terms and indexes in the table, please visit our [glossary](#).

Looking forward to the rest of 2023, it feels like markets are pricing in for a perfect outcome with inflation coming down nicely, growth remaining resilient and unemployment staying low. Overall uncertainty remains high and interest rate volatility continues to be elevated across the world. U.S. optimism could unravel quickly.

With year-to-date gains concentrated in a handful of expensive names, there are potential opportunities in some of the laggards, including in the defensive, or cheaper, side of the markets.

Pierre Debru is an employee of wisdomTree UK Limited, a European subsidiary of wisdomTree Asset Management Inc.'s parent company, wisdomTree, Inc.

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DEFINITIONS

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

Mega Cap : Market Capitalization over \$100 Billion.

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.

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.

Inflation : Characterized by rising price levels.

Artificial intelligence : machine analysis and decision-making.

Bitcoin (the currency) : A digital currency (also called a cryptocurrency) created in 2009, which is operated by a decentralized authority as opposed to a traditional central bank or monetary authority.

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.

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

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.

Size : Characterized by smaller companies rather than larger companies by market capitalization. This term is also related to the Size Factor, which associates smaller market-cap stocks with excess returns vs the market over time.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

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.

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.