Understanding Factors

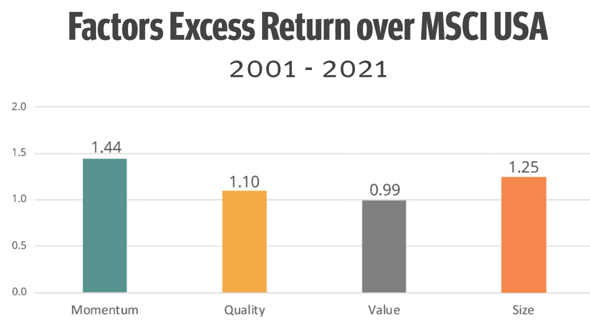
First Ascent Asset Management

What Are Factors?

Factors are characteristics common to a group of securities that help explain their returns. These characteristics are distinct and quantifiable and give rise to similar patterns of performance.

Why Are Factors Important?

The research documents that factors like value, size, quality, and momentum have produced historical performance advantages. An example of this performance edge is quantified below:



Data source: Morningstar. Momentum: MSCI USA Momentum Index; Quality: MSCI USA Sector Neutral Quality Index; Value: MSCI USA Enhanced Value Index; Size: MSCI USA Risk Weighted Index. Equal Weighted: equal weighted annual return of each index.

Diversification Can Help

Factors tend to be cyclical. Their benefits tend to be "lumpy" and are manifested intermittently. This provides the opportunity to diversify among factors to generate a more stable return stream.

As you can see below, historically, an equal weighted portfolio (shown in blue below) combining value, size, quality, and momentum resulted in a portfolio with solid returns and relatively low volatility.

Excess Returns over MSCI USA

2001-2021

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	Momentum 10.56									
Value 13.73	Size 8.56		Value 9.17	Momentum 13.59			Quality 5.89			Quality 5.49
Size 11.69	Equal Weighted 6.98		Size 7.14	Value 7.45		Momentum 11.78	Size 3.14	Value 11.66	Size 3.60	Size 4.31
Equal Weighted 5.37	Value 6.84	Value 4.01	Momentum 6.14	Equal Weighted 5.61	Value 4.38	Quality 4.04	Equal Weighted 1.49	Size 4.17	Momentum 2.76	Momentum 4.10
Quality 1.71	Quality 1.48	Size 0.70	Equal Weighted 5.09	Size 1.96	Size 2.07	Equal Weighted 1.29	Value 0.19	Equal Weighted 0.99	Equal Weighted 0.63	Equal Weighted 2.31
Momentum -5.18		Equal Weighted -0.88	Quality -2.04	Quality -0.3	Equal Weighted -0.14	Value -4.96	Momentum -3.75	Quality -2.20	Quality -1.25	Value -4.65
		Momentum -2.94			Quality -2.54	Size -5.08		Momentum -9.50	Value -2.76	
		Quality -5.33			Momentum -4.57					

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Value 10.56	Value 4.32			Momentum 15.92				
	Equal Weighted 3.32	Size 2.61	Momentum 7.98		Equal Weighted 3.34				
	Momentum 2.19	Equal Weighted 1.44	Quality 3.29	Value 4.33	Quality 0.59			Momentum 8.25	Value 2.23
Value 0.65	Quality 1.69	Momentum 1.32	Equal Weighted 0.56	Size 1.88	Value 0.28	Momentum 2.89	Quality 2.75	Quality 1.55	Quality 0.63
Momentum -1.04	Size -1.07	Quality -2.63	Size -0.88	Equal Weighted -0.61	Size -2.84	Size -0.69	Equal Weighted -1.54	Equal Weighted -4.18	Size -1.76
Size -1.09			Value -7.69	Quality -2.24		Quality -1.13	Size -1.89	Size -4.92	Equal Weighted -3.25
Equal Weighted -1.14				Momentum -6.48		Equal Weighted -1.36	Momentum -3.55	Value -21.60	Momentum -14.09
Quality -3.36						Value -6.56	Value -3.98		

Data source: Morningstar. Momentum: MSCI USA Momentum Index; Quality: MSCI USA Sector Neutral Quality Index; Value: MSCI USA Enhanced Value Index; Size: MSCI USA Risk Weighted Index. Equal Weighted: equal weighted annual return of each index.

The Bottom Line

The performance of portfolios that are tilted toward stocks that exhibit these "factors" will outperform the broad market over some periods and underperform over others. However, academic research suggests that their historic performance benefits are likely to persist over the long-term.