Convergence Long/Short Strategies

Q1-2020 Factor Analysis

Factor Research

The following table shows the three top and bottom performing factors within the U.S. Equity market over different time periods. We ranked all 15 factor composites by quintile spread return to show that what can work over the long term is not always true in the short term (see disclosures for a definition of quintile spread return).

	3 mo	6 mo	12 mo	5 yr	10 yr	20 yr
Top 3	Historical Growth	Historical Growth	Price Momentum	Price Momentum	Sales Growth	Traditional Value
	Price Momentum	Profits	Historical Growth	Profits	Capital Discipline	Price Reversal
	Earnings Momentum	Price Momentum	Profits	Earnings Risk	Profits	Relative Value
Bottom 3	Relative Value	RiskOff	Relative Value	Relative Value	RiskOff	Earnings Momentum
	Traditional Value	Traditional Value	RiskOn	Traditional Value	Traditional Value	Price Momentum
	RiskOn	RiskOn	Traditional Value	RiskOn	RiskOn	Expected Growth

As of 03/31/2020. Source: Convergence Investment Partners, Wilshire Analytics.

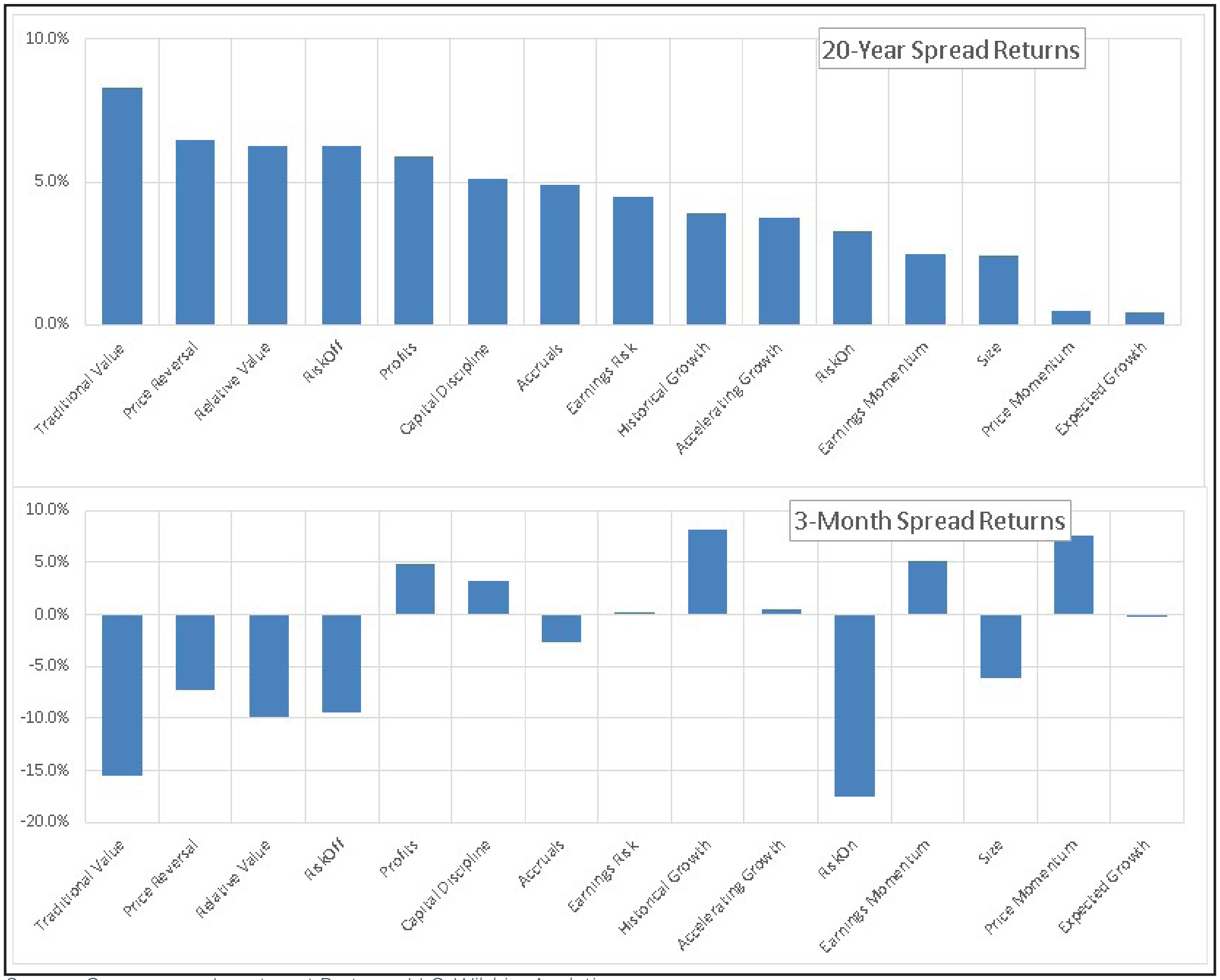
The above table might not be showing the entire picture of what is going on from a fundamental factor perspective. Periods of extreme crosswinds are challenging to analyze on a calendar based monthly process. For example, our long-term clients and investors know that we have a Price Reversal composite, that is only used on our short portfolio. This is similar to a much shorter-term version of our Price Momentum composite. In order to keep these two composites from trading against each other, it is very common in the factor investing world to put a lag on your long momentum factor. Our PM composite is lagged 20 trading days, which is about a calendar month. Therefore, (unless we are following different markets), it might be important to include the market action of March in with an evaluation of the past 3-, 6-, and 12-month periods. So, let's take a look at March. The following table shows factor returns for March 2020.

Factor	Mar-20
Profits	7.0%
Earnings Risk	4.4%
Hist Growth	4.3%
Earnings Momentum	3.3%
Price Momentum	2.8%
Capital Discipline	1.8%
Accelerating Sales	0.8%
Accruals/Quality	0.4%
Expected Growth	-0.9%
Size	-2.5%
Risk Off	-3.7%
Price Reversal	-4.8%
Relative Value	-4.9%
Traditional Value	-7.1%
Risk On	-12.8%

We can see in the table above that investors held on to profitable firms and sold high risk (highly leveraged) stocks. This is shown by Profits being #1 and Risk On being #15. Interestingly, valuation did not hold up well in the sell off, but this is typical as most investors dump (nearly) everything except for high quality and high profitability and then seek for undervalued names in the rubble. Typically, valuation tends to shine AFTER the sell off, not during.

The charts below show an analysis of which factors worked in Q1-2020 versus their trailing 20-year returns. These tables show the long-short quintile spread returns of all the factor composites we monitor at Convergence Investment Partners.[1]

Factor metrics rewarded by market participants within the US equity markets



Source: Convergence Investment Partners, LLC, Wilshire Analytics

Some factors generated significant negative spread in the third quarter, led by RiskOn and Traditional Value. This seems logical as discussed above. If sentiment turns in Q2 it might be reasonable to expect these names to rebound sharply. However, if more risk, fear and uncertainlty enters the fray owners of these names might be disappointed. Given the uncertainly of these times it might make sense to hold a portfolio of higher quality names and still benefit from short positions in low quality, highly leveraged cash burners.

[1] These returns are linked monthly spread returns as opposed to the difference between the 12 month long and short holdings.

In order to better observe thematic changes in factor efficacy, we created the following chart which shows spread returns of 3-month periods over the past 3 years. These are ranked from highest spread return to lowest spread return for each quarter (see the legend below).

Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
HG 2.75	PM 5.38	ER 3.96	PM 2.87	PM 2.86	PM 3.9	ER 8.87	PR 1.74	PM 4.25	ER 4.44	RON 4.02	HG 8.15
PM 2.07	EM 3.5	PT 3.43	EG 1.68	AG 1.98	PT 2.04	SZ 5.69	RV 1.63	AG 1.34	SZ 3.5	RV 3.39	PM 7.54
EM 1.63	CD 1.65	SZ 2.69	ACC 1.56	RON 1.86	ER 1.73	RSK 4.19	CD -0.26	EG 1.05	PT 2.32	TV 2.32	EM 5.08
SZ 1.19	PT 1.34	PM 2.51	HG 1.15	ACC 0.94	PR 1.22	PT 3.19	HG -0.93	SZ 1.01	AG 2.08	RSK 1.95	PT 4.87
PT 0.59	HG 0.93	RV 2.37	AG 1.11	EG 0.65	AG 1.12	HG 3.05	RON -0.97	ER 0.7	PR 1.85	AG 1.65	CD 3.26
CD 0.57	EG 0.9	TV 1.92	CD 0.88	CD 0.51	CD 1.09	CD 1.59	EM -1.37	EM 0.41	EM 1.25	PR 0.98	AG 0.55
ER 0.43	PR 0.84	EM 1.42	EM 0.8	RV 0.43	EM 1.06	EG 1.29	EG -1.77	HG 0.23	CD 0.91	SZ 0.26	ER 0.27
AG -0.22	ACC 0.81	AG 0.96	ER 0.18	HG 0.1	HG 0.86	TV 0.52	ACC -2.01	PT 0.06	ACC 0.66	CD -0.13	EG -0.08
PR -0.35	RV 0.75	RSK 0.39	PT 0.17	EM -0.31	EG 0.4	RV 0	AG -2.09	PR -0.53	RON 0.57	EG -0.96	ACC -2.69
EG -0.37	AG -0.03	EG -0.18	RSK -0.42	PR -0.31	ACC -0.61	PR -0.19	RSK -2.44	CD -1.21	RSK 0.55	PT -1.04	SZ -6.12
ACC -0.64	ER -0.2	HG -0.38	PR -0.43	RSK -1.18	RSK -0.95	ACC -0.33	SZ -2.87	RON -1.76	PM 0.36	HG -1.18	PR -7.26
RV -1.5	RON -0.6	PR -0.63	SZ -0.64	ER -1.34	SZ -1.73	PM -0.63	PT -3.02	RSK -1.86	TV 0.07	EM -3.19	RSK -9.39
RON -2.08	TV -0.76	CD -0.74	RV -2.27	PT -1.5	RON -2.85	EM -1.35	PM -3.06	RV -2.12	HG -0.09	ACC -3.67	RV -9.94
TV -2.45	SZ -1.19	ACC -1.6	RON -3.46	TV -4.16	TV -3.18	AG -2.17	TV -4.87	ACC -2.94	RV -0.62	ER -3.69	TV -15.44
RSK -2.71	RSK -1.82	RON -2.03	TV -4.61	SZ -6.81	RV -4.46	RON -3.8	ER -5.14	TV -2.96	EG -1.16	PM -3.89	RON -17.47

ACC	Accruals	HG	Historical Growth	RV	Relative Value
AG	Accelerating Growth	PM	Price Momentum	SZ	Size
CD	Capital Discipline	PR	Price Reversal	TV	Traditional Value
EM	Earnings Momentum	PT	Profits	RON	RiskOn
ER	Earnings Risk	RSK	RiskOff	EG	Expected Growth

Disclosures

Past performance is no guarantee of future results. Any investment contains risk including the risk of total loss. There is no guarantee that an investment or strategy will meet its investment objectives.

This communication is limited to the dissemination of general information pertaining to Convergence Investment Partners, LLC's (Convergence) services and general economic market conditions. The information contained herein is not intended to be personal legal or investment advice or a solicitation to buy or sell any security or engage in a particular investment strategy. There is no guarantee that the views and opinions expressed in this letter will come to pass. The views expressed do not take into account any individual personal, financial, or tax considerations. The opinions and forecasts herein are based on information and sources of information deemed to be reliable, but Convergence Investment Partners does not warrant the accuracy of the information that this opinion and forecast is based upon. Opinions expressed are subject to change without notice.

Source of all factor data: Convergence Investment Partners.

No graph, chart, or formula should in and of itself be used to determine which securities to buy or sell.

FACTOR COMPOSITE RESULTS

Factor Composites (factors) are composed of securities in the Russell 3000 Index ranked by Convergence in terms of the identified metrics. Thus, individual stocks appear in multiple composites. No client portfolios are managed to any one factor and all factor results reflect backtested data. Factor composites are not available for direct investment. Factor composite results are measured in terms of their quintile spread return ("spread return"): the difference between the index-weighted average results of the highest ranked 20% less that of the lowest ranked 20%. Higher positive numbers indicate that the factor was more relevant to / indicative of stocks that performed well. Negative results are similarly indicative of factors that could have made effective shorts. Convergence views most factors on an industry group neutral basis where industry group weights are fixed based on the selection universe/index weights.

The Russell 3000 Index measures the performance of the largest 3000 US companies. It is constructed to provide a comprehensive, unbiased, and stable barometer of the broad market and it is reconstituted annually to ensure new and growing equities are reflected. Comparison to any index is for illustrative purposes only and the volatility of the benchmark may be materially different from the volatility of the strategies due to varying degrees of diversification and/or other factors. Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged. You cannot invest directly in an index.