Convergence Long/Short Strategy

Q1-2021 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 fifteen 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	Price Reversal	RiskOn	RiskOn	Price Reversal	Price Reversal	Price Reversal
	RiskOn	Price Reversal	Price Reversal	Price Momentum	Sales Growth	Relative Value
	Traditional Value	Traditional Value	Expected Growth	Expected Growth	Price Momentum	Traditional Value
Bottom 3	Profits	Earnings Risk	Historical Growth	Accruals	Size	Historical Growth
	Capital Discipline	Historical Growth	Profits	Earnings Risk	Traditional Value	Expected Growth
	Historical Growth	Profits	Earnings Risk	Traditional Value	Accruals	Size

As of 03/31/2021. Source: Convergence Investment Partners, Wilshire Analytics. Production Long Q1 - Short Q5.

Much like last quarter, the markets rewarded risk-seeking behavior with RiskOn and more technically-focused factors outperforming. Additionally, the recent surge in performance in our Traditional Value (TV) composite is very exciting. Historically, TV has been one of the best performing factor composites but has suffered through a horrendous performance slump over the past five to ten years. Our TV composite includes familiar factors such as Cash Flow to Price, Free Cash Flow to Price, Earnings to Price and other ratios that compare to enterprise value. The "Growth At Any Price" theme had really run wild. However, it is showing signs of topping out. Calling an inflection point is a dangerous game, but when looking at long-term charts of growth versus value, it seems we may be overdue for some reversion.

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The charts below show an analysis of which factors worked in Q1-2021 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
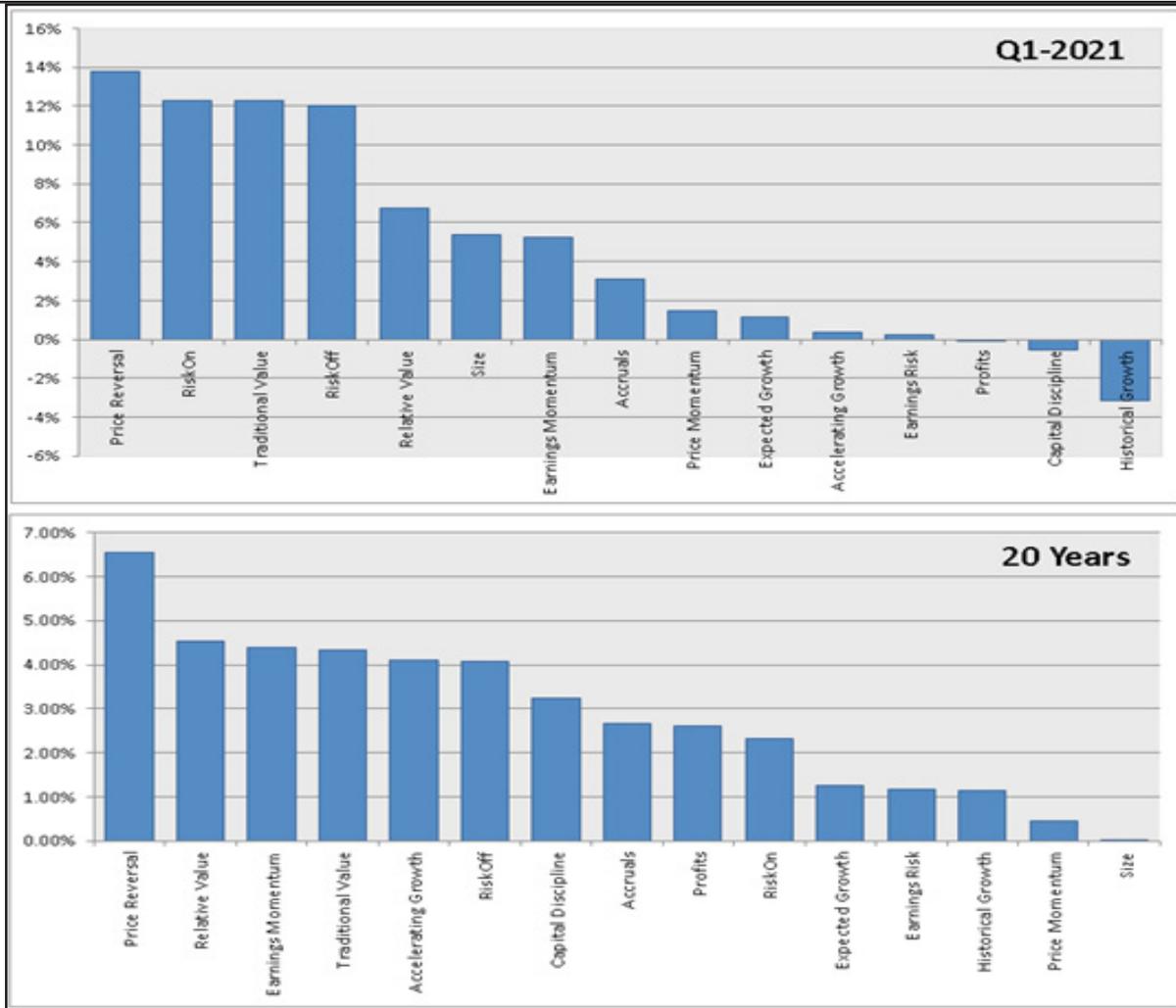
As of 03/31/2021. Source: Convergence Investment Partners, Wilshire Analytics. Production Long Q1 - Short Q5.

What a difference a quarter makes! The composite returns for Q4-2020 were quite poor with only four of our fifteen factor composites generating a positive spread during those three months. As the chart above shows, in Q1-2021 twelve of the fifteen composites generated a positive spread for the quarter. Additionally, it seems investors are complementing their risk-seeking behavior with a bit of forward-looking stock selection, especially when looking at, the strong performance of Traditional Value (TV) and Earnings Momentum (EM). Investors rewarded oversold companies with strong EM scores, which quantifies improving earnings forecasts. It is also interesting to note the poor performance of Historical Growth, which may indicate that investors were largely unconcerned with the historical trend of earnings through the pandemic period. It seems that reasonable valuations paired with high debt levels and improving earnings forecasts were the winning combination in Q1-2021. This makes sense to us at Convergence as the reopening trade matures. We expect pure risk-seeking behavior to trend towards valuation, and future earnings growth.

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[1] These returns are linked monthly spread returns as opposed to the difference between the 3-month long and short holdings.

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In order to better observe 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-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
CD 3.22	PM 3.9	ER 8.87	PR 1.74	PM 4.25	ER 4.44	RON 4.02	HG 8.15	PR 10.75	PM 8.19	RON 11.25	TV 13.96
PM 2.86	AG 2.52	SZ 5.69	RV 1.63	EM 1.46	SZ 3.5	RV 3.39	PM 7.54	RV 3.51	EM 2.51	PR 3.17	PR 13.54
AG 2.22	PT 2.04	RSK 4.19	CD 0.4	EG 1.05	AG 2.58	TV 2.32	CD 5.26	RON 2.84	HG 1.84	EG 2.31	RSK 13.36
RON 1.86	EM 1.98	PT 3.19	EM -0.6	SZ 1.01	PT 2.32	RSK 1.95	PT 4.87	EG 2.16	AG 1.12	RV 1.16	RON 12.3
ACC 0.94	ER 1.73	HG 3.05	HG -0.93	AG 0.8	PR 1.85	AG 1.58	EM 3.84	EM 2.15	SZ 0.96	RSK 0.1	RV 6.75
EG 0.65	CD 1.38	CD 1.34	RON -0.97	ER 0.7	EM 1.82	PR 0.98	ER 0.27	RSK 0.77	RON 0.19	CD 0.05	SZ 5.39
RV 0.43	PR 1.22	EG 1.29	EG -1.77	HG 0.23	ACC 0.66	SZ 0.26	AG 0.03	AG 0.01	EG -0.26	TV -1.52	EM 5.1
HG 0.1	HG 0.86	TV 0.52	ACC -2.01	PT 0.06	RON 0.57	CD -0.15	EG -0.08	PM -0.56	PT -0.68	EM -1.54	PM 3.14
PR -0.31	EG 0.4	RV 0	AG -2.09	PR -0.53	RSK 0.55	EG -0.96	ACC -2.69	CD -0.69	PR -3.14	ACC -3.53	ACC 1.81
EM -0.62	ACC -0.61	PR -0.19	RSK -2.44	RON -1.76	PM 0.36	PT -1.04	SZ -6.12	ACC -3.45	ER -3.83	PM -3.61	EG 0.85
RSK -1.18	RSK -0.95	ACC -0.33	SZ -2.87	RSK -1.86	TV 0.07	HG -1.18	PR -7.26	HG -3.5	RSK -3.96	SZ -9.67	PT -0.06
ER -1.34	SZ -1.73	EM -0.63	PT -3.02	RV -2.12	HG -0.09	EM -2.81	RSK -9.39	PT -6.5	CD -5.3	ER -9.84	AG -0.17
PT -1.5	RON -2.85	PM -0.63	PM -3.06	CD -2.13	RV -0.62	ACC -3.67	RV -9.94	SZ -6.6	RV -5.42	AG -11.24	ER -0.76
TV -4.16	TV -3.18	AG -1.41	TV -4.87	ACC -2.94	EG -1.16	ER -3.69	TV -15.44	TV -7.3	TV -5.64	HG -11.31	HG -2.67
SZ -6.81	RV -4.46	RON -3.8	ER -5.14	TV -2.96	CD -2.1	PM -3.89	RON -17.47	ER -13.29	ACC -5.96	PT -15.49	CD -3.26

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

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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.

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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

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