



Schroders Equity Lens

Strategic Research Unit

February 2024

Marketing material for Professional
Clients only.

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Summary

- Stocks have returned 11% above inflation in the 12-months after the Federal Reserve ("Fed") starts cutting rates, on average – based on analysis of 22 rate cutting cycles since 1928 (slides 5 and 6 and [read more](#)).
- Average returns have been better if a recession is avoided but good even if one has not. Stocks have beaten bonds and have obliterated cash, on average (slides 5 and 6).
- The Magnificent-7 are up 89% since start of 2023, the rest of the world 17%. They make up more of MSCI ACWI than Japan, UK, China, France, and now Canada too, combined (slides 7-8).
- But this masks cracks among the seven. They are not a homogenous group in terms of their businesses or share price performance. Three of the seven have underperformed the rest of the market since September (slide 9)
- Deviating from the market has been a winning strategy when concentration has been high (slide 10 and [read more](#))
- EM earnings are forecast to accelerate 18% this year: will this revive stock market returns? (slide 18)

Past performance is not a guide to future performance and may not be repeated.

Magnificent-7 portfolio is portfolio of seven largest companies in MSCI USA by free float market capitalisation. These are Apple, Microsoft, Alphabet (Google), Amazon, Nvidia, Tesla, Meta (Facebook). Please see relevant disclaimers on slide 38



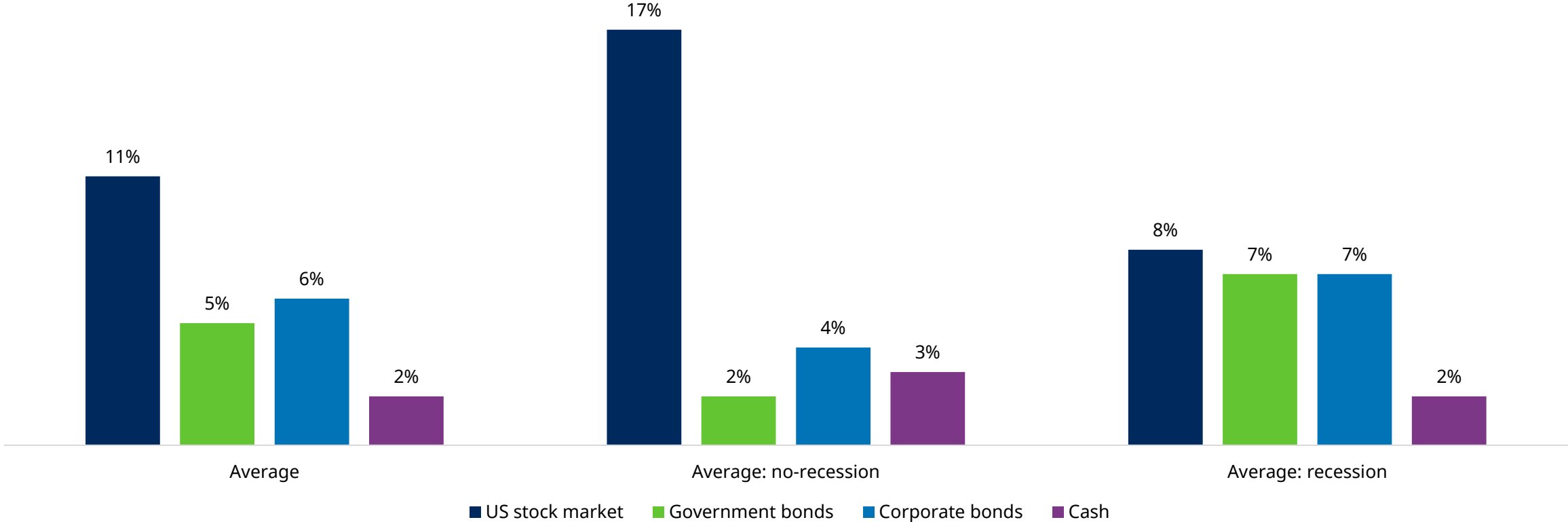


Global equities

Charts of the month

Stocks have outperformed bonds which have beaten cash when the Fed has started cutting rates, on average (*more*)

Average 12-month real returns from the date of first cut, since 1928

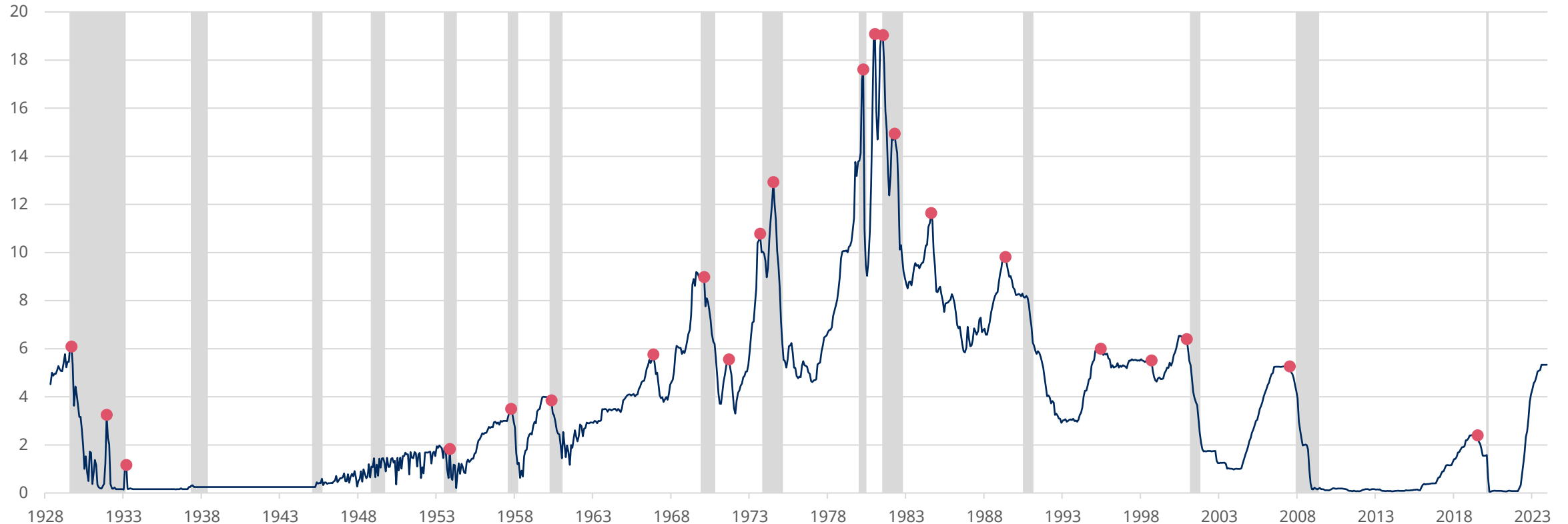


Past performance is not a guide to future performance and may not be repeated.

Source for return data: CFA Institute Stocks, Bonds, Bills, and Inflation (SBBI®) database, and Schroders. Source for Fed Funds data: Post-1954 is direct from FRED. Earlier data is based on the Federal Funds rate published in the New York Tribune and Wall Street Journal, also sourced from FRED. An approach consistent with that outlined in A New Daily Federal Funds Rate Series and History of the Federal Funds Market, 1928-54, St Louis Fed, has been followed. For that earlier data, a 7-day average has been taken to remove daily volatility i.e. the month-end figure is the average in the 7 days leading up to month-end. Please see relevant disclaimers on slide 38

The 22 main rate cutting cycles since 1928 ([read more](#))

Dots show when rates started to be cut, shaded areas represent recessions

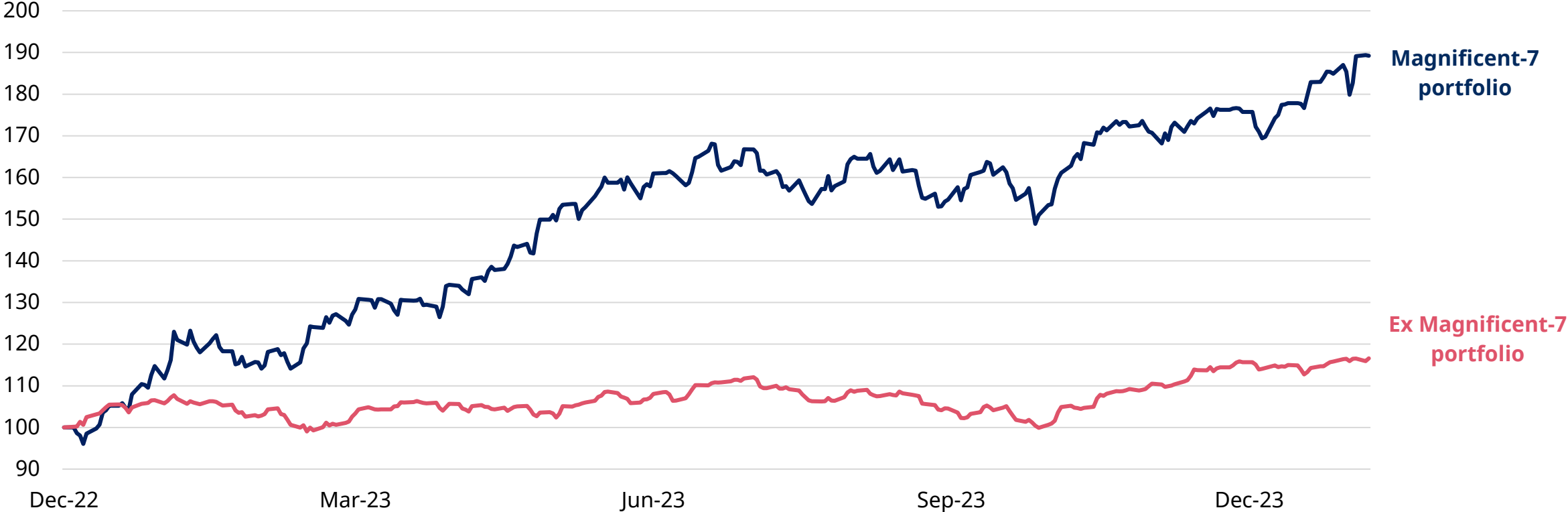


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Monthly series shown. Post-1954 data is direct from FRED. Earlier data is based on the Federal Funds rate published in the New York Tribune and Wall Street Journal, also sourced from FRED. An approach consistent with that outlined in *A New Daily Federal Funds Rate Series and History of the Federal Funds Market, 1928-54*, St Louis Fed, has been followed. For that earlier data, a seven-day average has been taken to remove daily volatility i.e. the month-end figure is the average in the seven days leading up to month-end. Please see relevant disclaimers on slide 38

The Magnificent-7 are up 89% since start of 2023, the rest of the world 17%

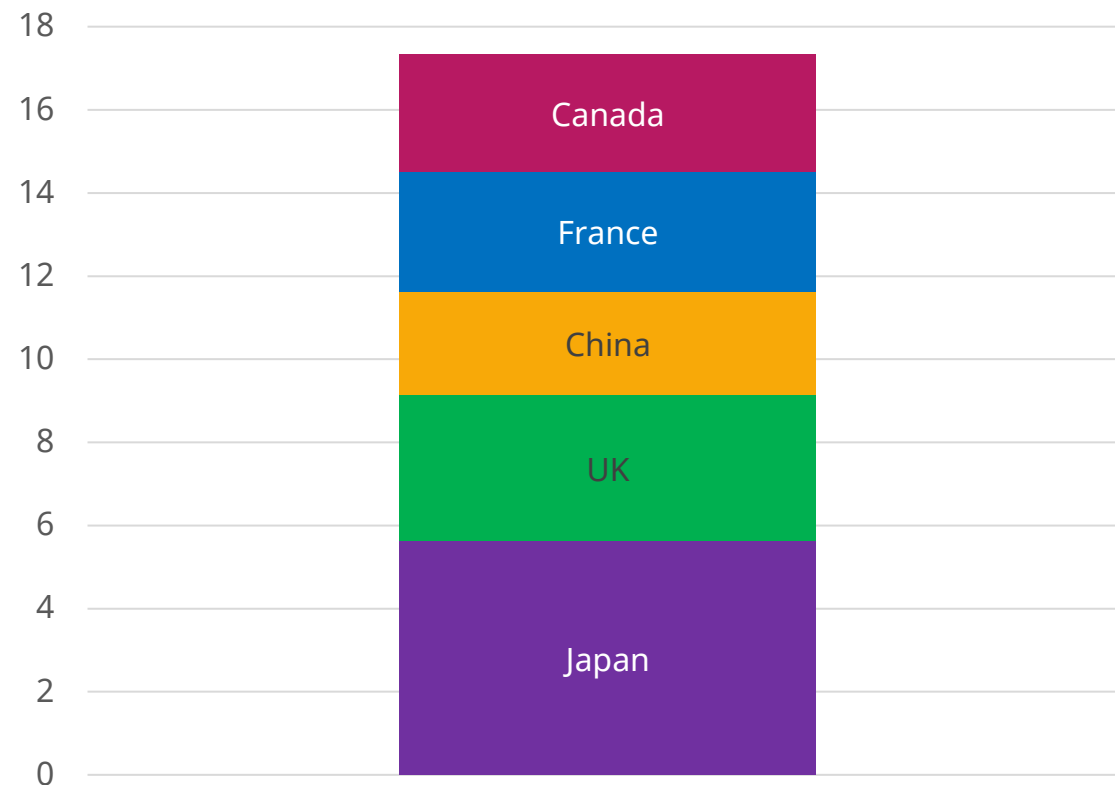
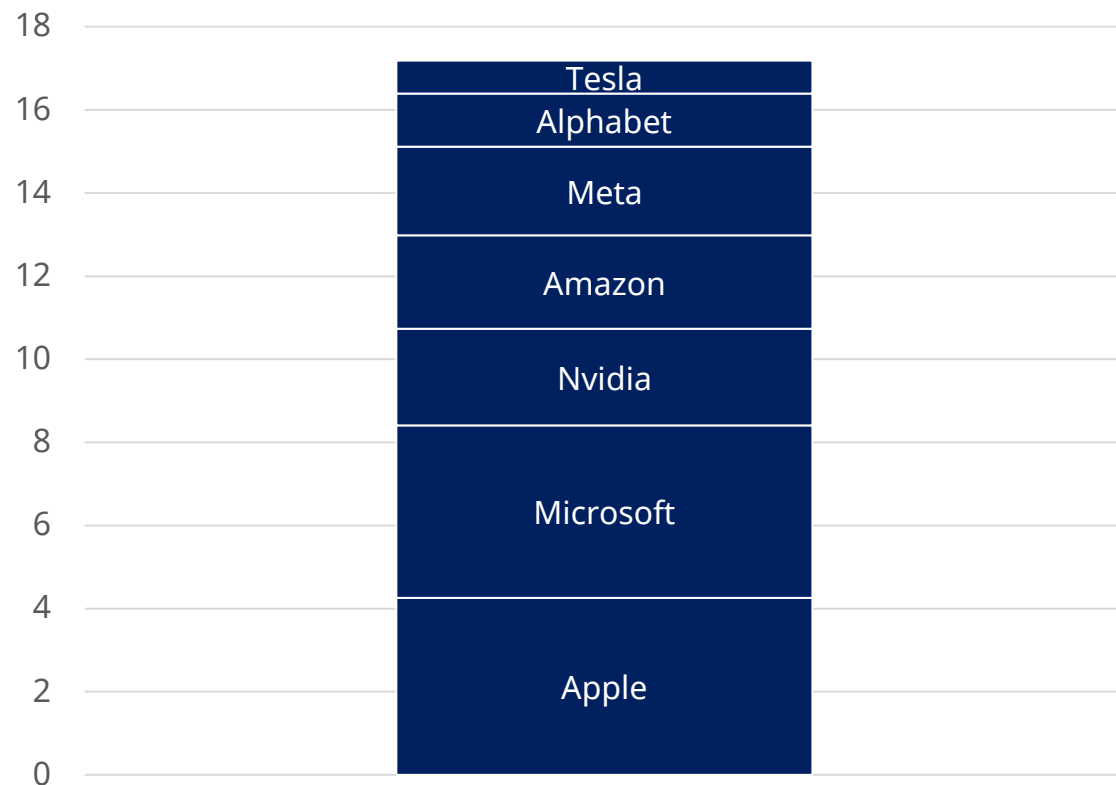
Return index to 31 January 2024, rebased to 100 on 31 December 2022



Past performance is not a guide to future performance and may not be repeated.
For illustrative purposes only and not a recommendation to buy/sell. Magnificent-7 portfolio is portfolio of seven largest companies in MSCI ACWI by free float market capitalisation. These are Apple, Microsoft, Alphabet (Google), Amazon, Nvidia, Tesla, Meta (Facebook). Ex Magnificent-7 is a portfolio of the remaining constituents of MSCI ACWI. Data to 6 February 2024. Source: LSEG Datastream, Schroders. Please see relevant disclaimers on slide 38

The Magnificent-7 make up almost the same of MSCI ACWI as Japan, UK, China, France, and Canada too, combined

Weight in MSCI ACWI

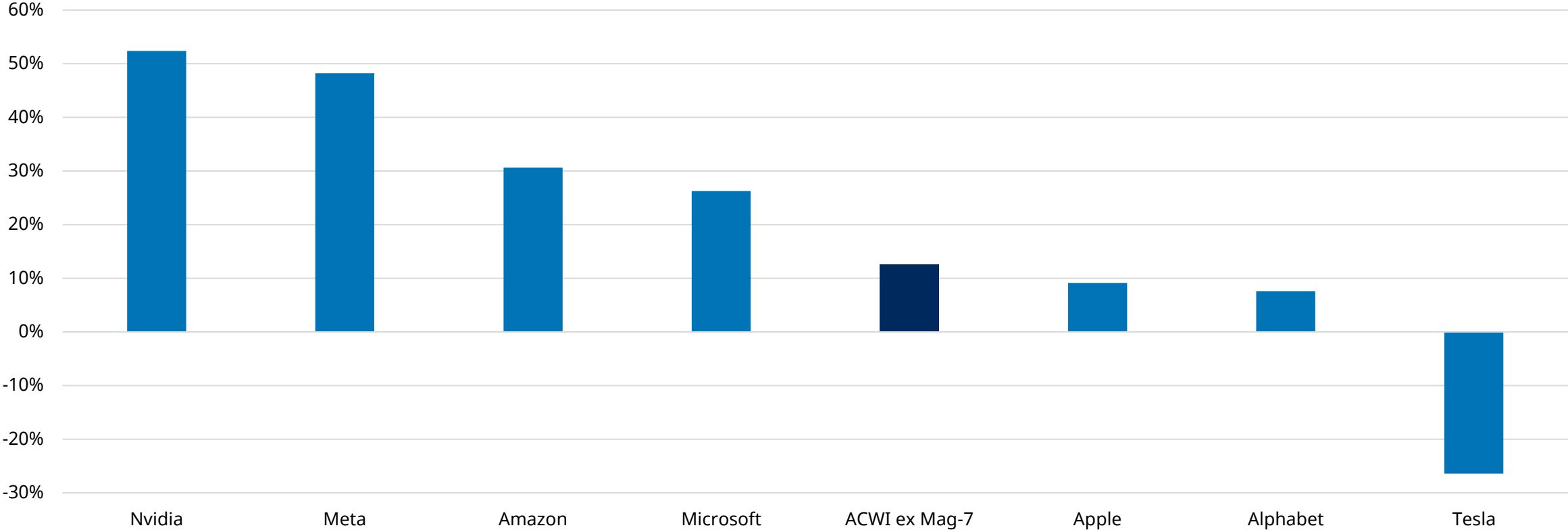


Past performance is not a guide to future performance and may not be repeated.

For illustrative purposes only and not a recommendation to buy/sell. Data as at 31 January 2024. Source: LSEG Datastream, Schroders. Please see relevant disclaimers on slide 38

But they are not homogenous: 3/7 have underperformed the rest of the market since end-September [\(read more\)](#)

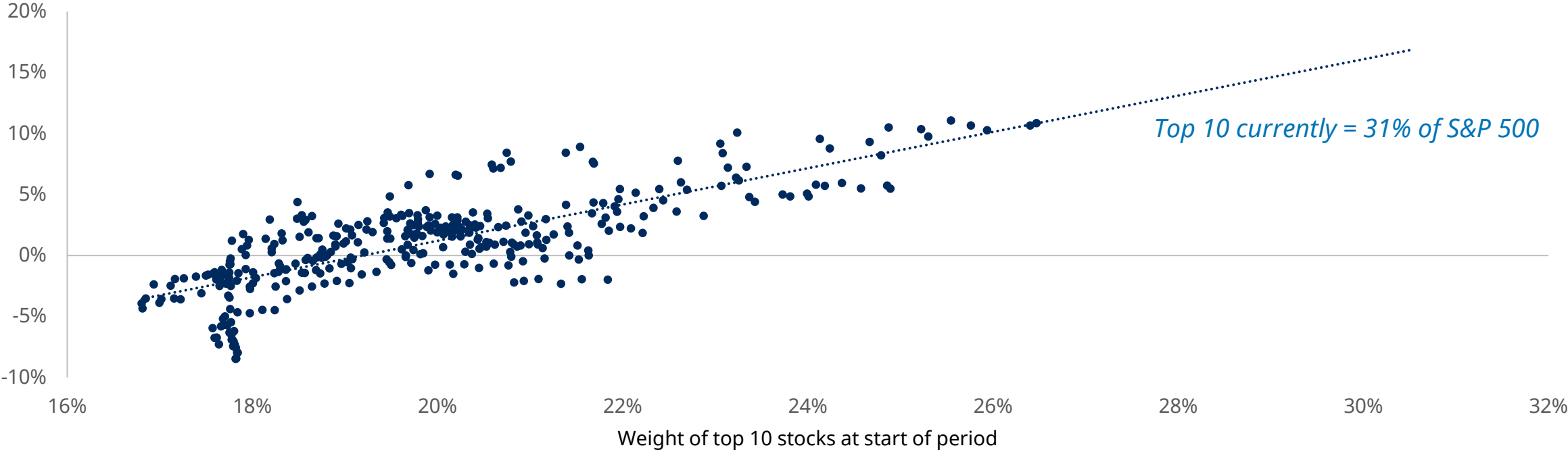
Returns since 30 September 2023



Past performance is not a guide to future performance and may not be repeated.
For illustrative purposes only and not a recommendation to buy/sell. Data to 6 February 2024. Source: LSEG Datastream, Schroders. Please see relevant disclaimers on slide 38

Deviating from the market has been a winning strategy when concentration has been high ([read more](#))

Five-year outperformance of equal-weighted S&P 500 vs market-cap weighted S&P 500 (positive means equal-weighted outperforming)



Past performance is not a guide to future performance and may not be repeated.
Data to 31 December 1989 to 31 January 2024. Constituent weights are available monthly since May 1996 and annually previously. For those earlier periods, we have linearly interpolated between the annual figures to generate a monthly series. Redoing the analysis but only using annual figures for the earlier periods does not impact our conclusions. Rolling 60-month returns have been analysed. Statistical note: the rolling 60-month analysis includes overlapping periods and serial correlation is present in the data. This biases the standard errors in regular statistical tests, which can result in a false positive result i.e. a conclusion of a relationship when there is none. We have applied a Newey-West adjustment to the standard errors to correct for this. The conclusion of statistical significance is robust to this adjustment.
Source: LSEG Datastream, S&P, and Schroders. Please see relevant disclaimers on slide 38



Global equities

Regional performance

Japan has started 2024 strongly, UK and EM continue to struggle

Total \$ return, %

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 YTD
Best ↑	US 13.4%	Japan 9.9%	US 11.6%	EM 37.8%	US -4.5%	US 31.6%	US 21.4%	US 27.0%	UK -4.8%	US 27.1%	Japan 4.6%
	EM -1.8%	US 1.3%	EM 11.6%	Europe 27.8%	Japan -12.6%	Europe 25.9%	EM 18.7%	UK 18.5%	Japan -16.3%	Europe 22.7%	US 1.6%
	Japan -3.7%	Europe 0.1%	Japan 2.7%	Japan 24.4%	UK -14.1%	UK 21.1%	Japan 14.9%	Europe 16.5%	Europe -17.3%	Japan 20.8%	Europe 0.3%
	UK -5.4%	UK -7.5%	Europe 0.3%	UK 22.4%	EM -14.2%	Japan 20.1%	Europe 11.6%	Japan 2.0%	US -19.5%	UK 14.1%	UK -1.3%
↓ Worst	Europe -5.8%	EM -14.6%	UK 0.0%	US 21.9%	Europe -14.4%	EM 18.9%	UK -10.4%	EM -2.2%	EM -19.7%	EM 10.3%	EM -4.6%

Past performance is not a guide to future performance and may not be repeated.

Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024 in US dollars. Please see relevant disclaimers on slide 38

Europe = Europe ex UK.

Japan has started 2024 strongly, UK and EM continue to struggle

2024 YTD \$ return by source, %



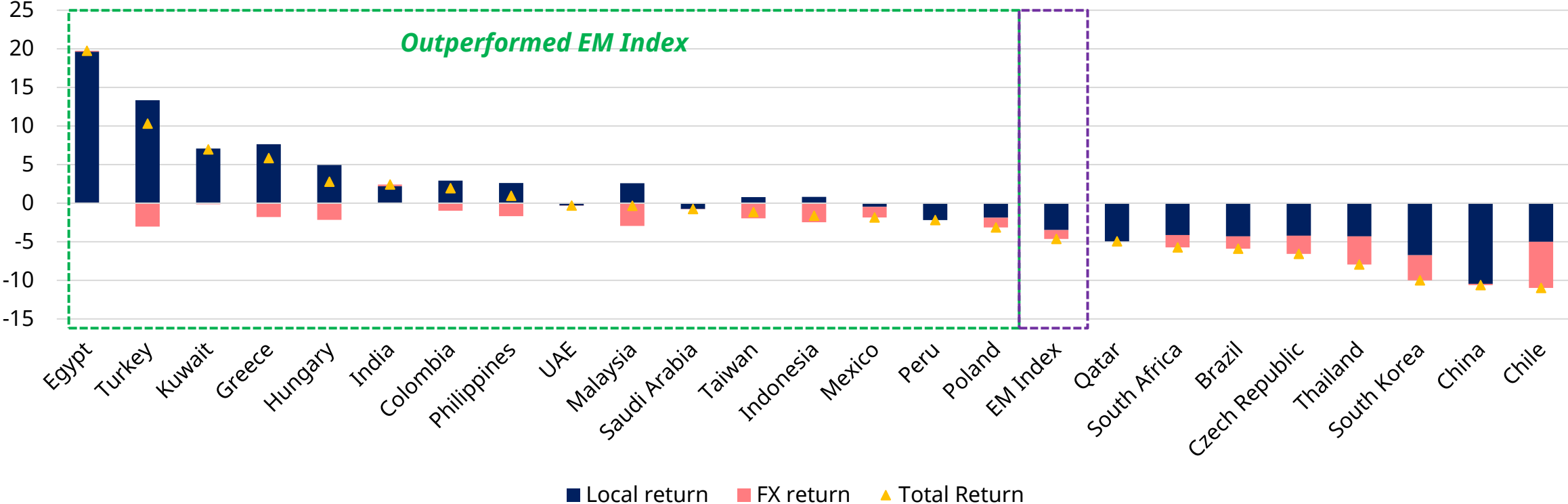
Past performance is not a guide to future performance and may not be repeated.

Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024 in US dollars. Please see relevant disclaimers on slide 38

China continues to drag on EM index performance

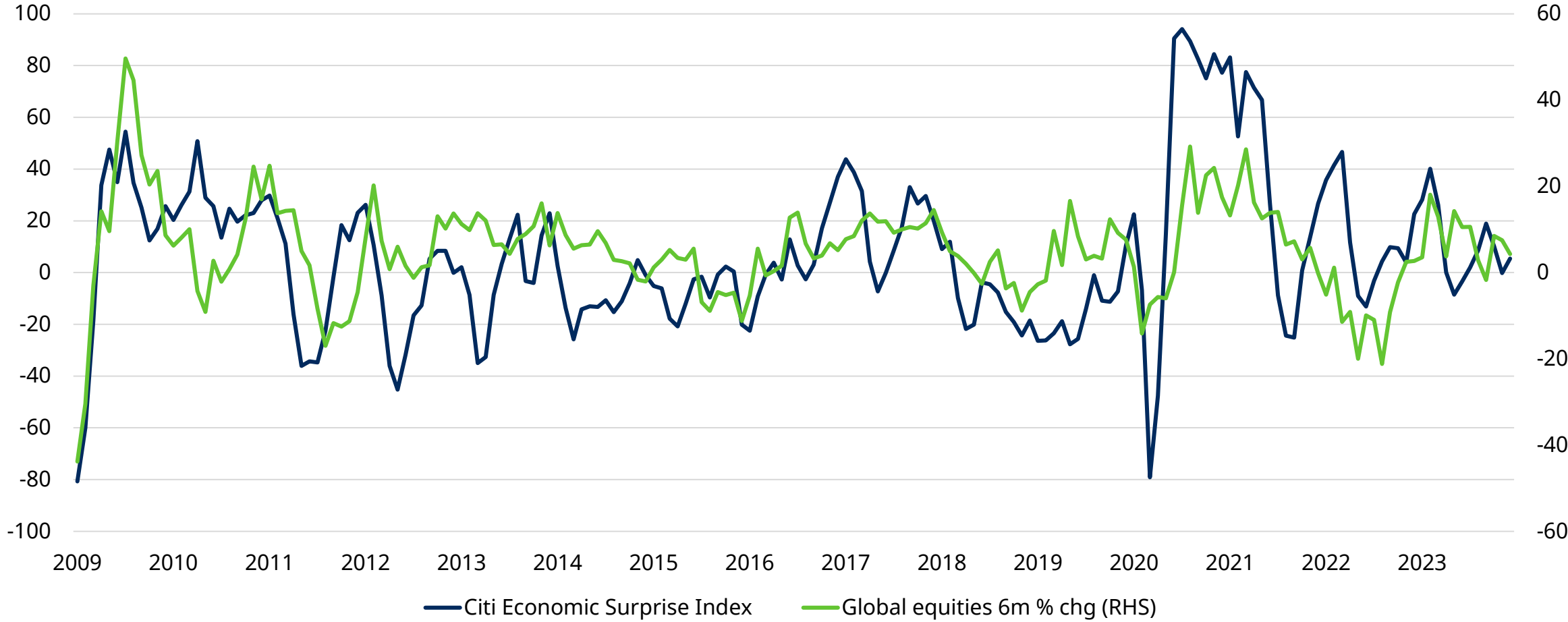
Divergence between countries has been wide

2024 YTD total return, %



Past performance is not a guide to future performance and may not be repeated.
 Source: LSEG Datastream, IBES, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Economic surprises are have started the year positively



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Source: LSEG Datastream and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

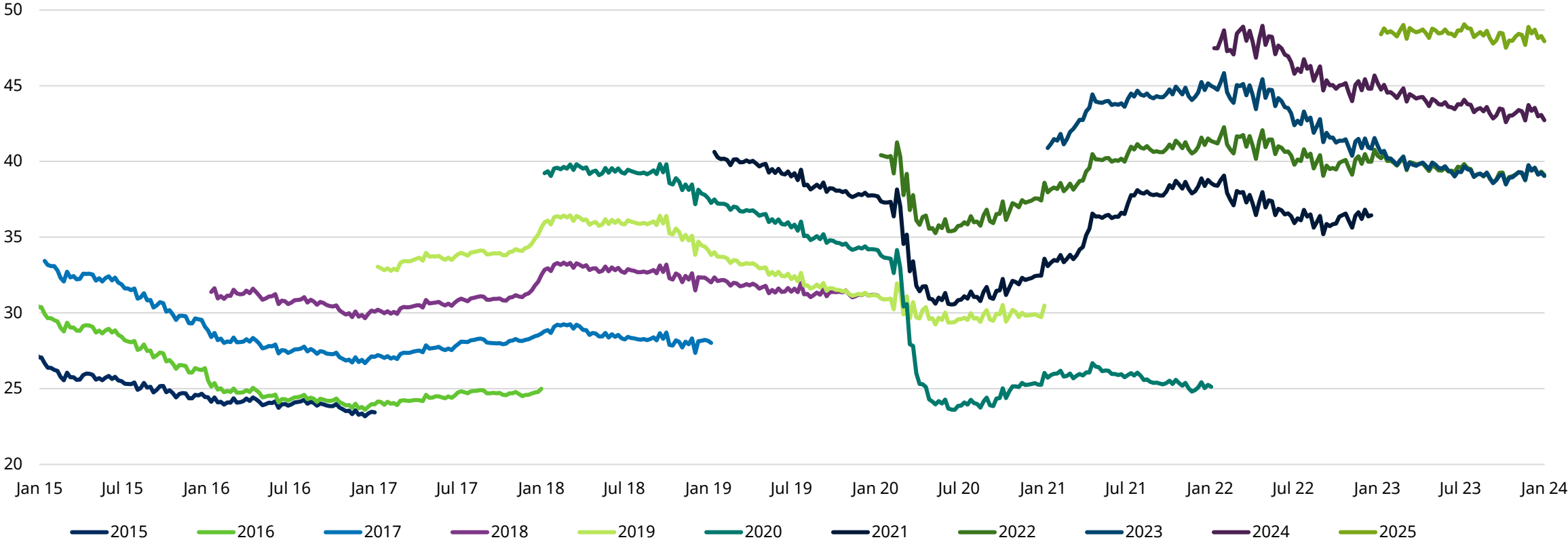


Global equities

Fundamentals and valuations

Consensus expectations are for 0% earnings growth in 2023 but then a strong rebound

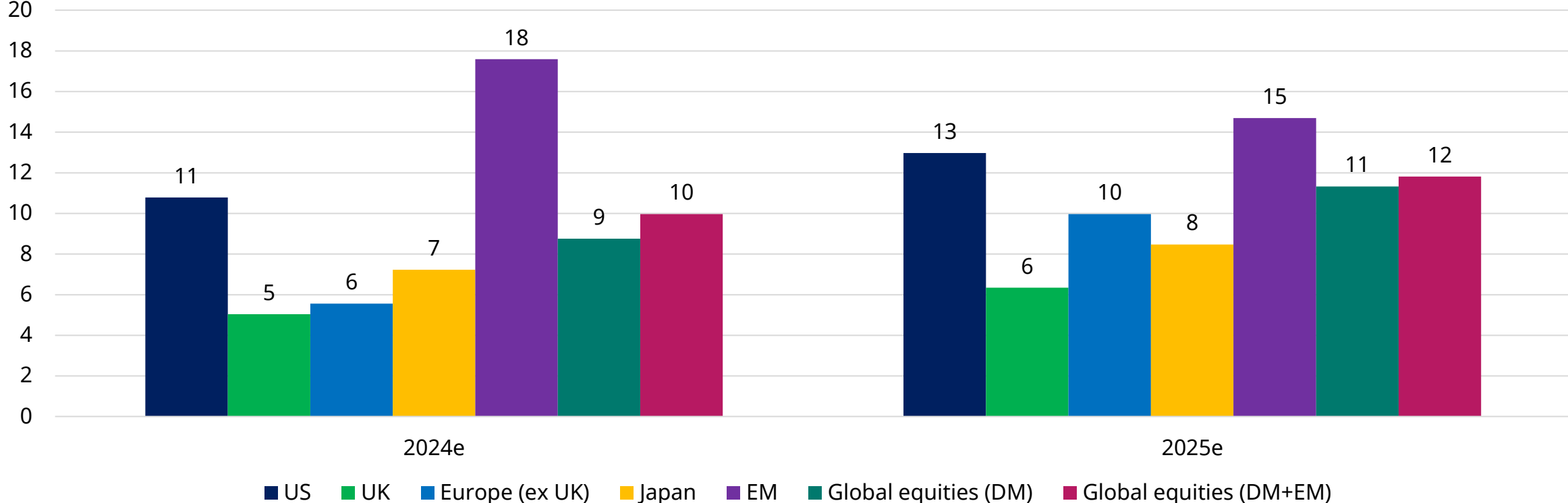
Global equities EPS forecast, \$



Forecasts included are not guaranteed and should not be relied upon.
 Source: LSEG Datastream, IBES, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38
 Notes: Figures in USD

EM earnings are forecast to accelerate 18% this year: will this revive stock market returns?

Corporate earnings: Consensus YoY EPS growth forecasts, %



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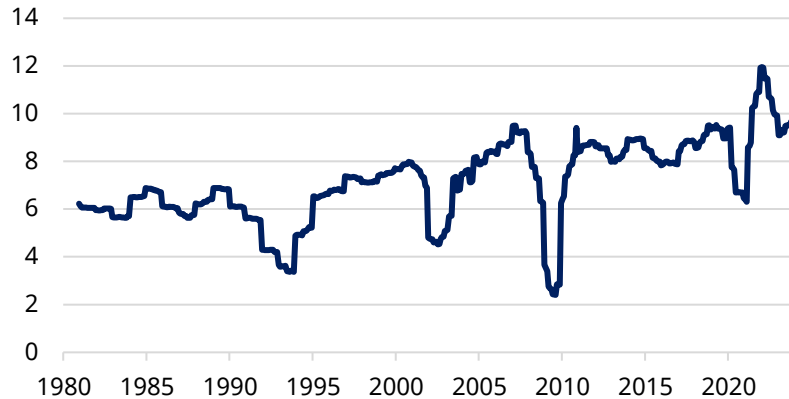
Source: LSEG Datastream and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Notes: Japan EPS for 2022 is 4 quarter sum until 31 March of next calendar year, e.g. 2023 = 31/03/2023 - 31/03/2024.

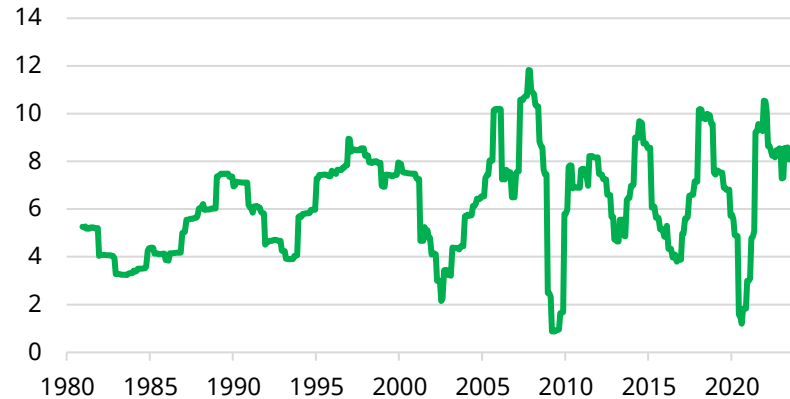
Profit margins are starting to rebound in several markets

Net profit margins, %

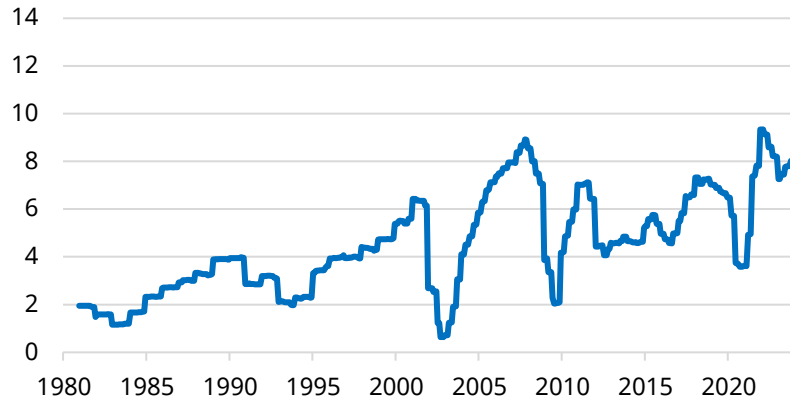
US



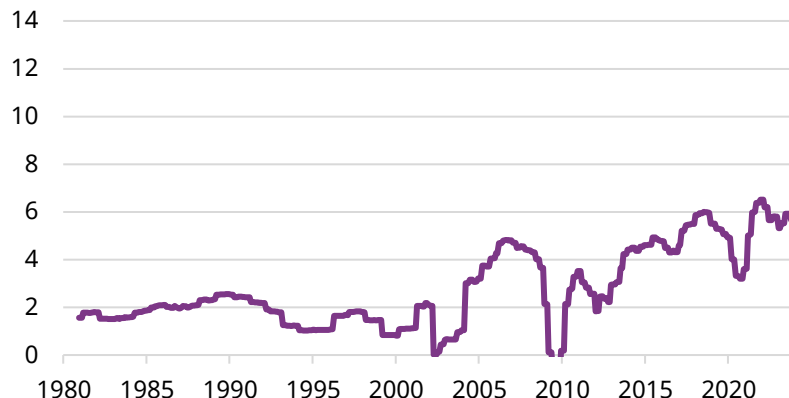
UK



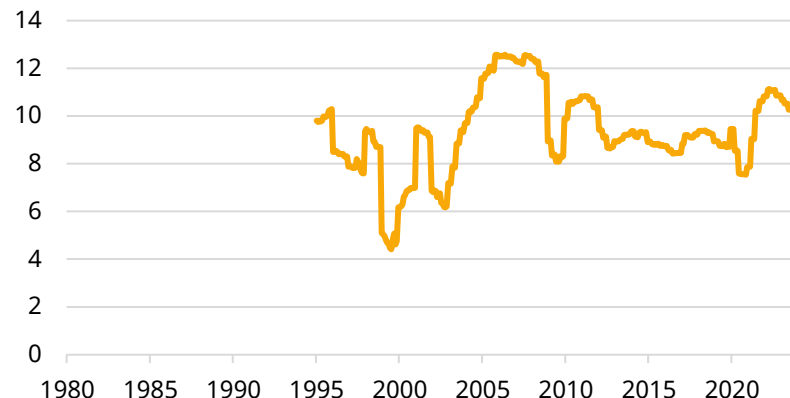
Europe ex UK



Japan



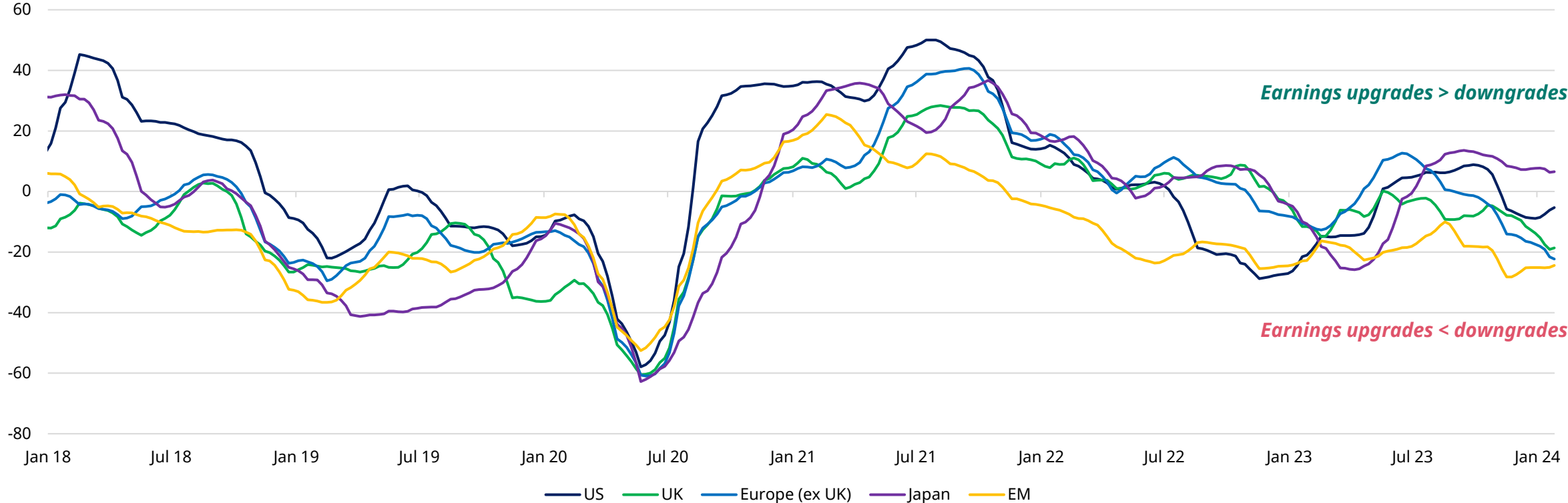
EM



Based on Datastream total market equity indices for each region. Source: LSEG Datastream and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Earnings are being upgraded in Japan, but downgraded elsewhere

13-week earnings revisions ratio %, (upgrades - downgrades) / total revisions



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 Source: LSEG Datastream and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38
 Notes; 13w earnings revisions = sum of 13 week positive minus negative 12m forward EPS revisions / total revisions.

There are few signs of cheapness in absolute terms, but UK and EM valuations are depressed relative to other markets

Valuation vs 15-year median (% above or below)

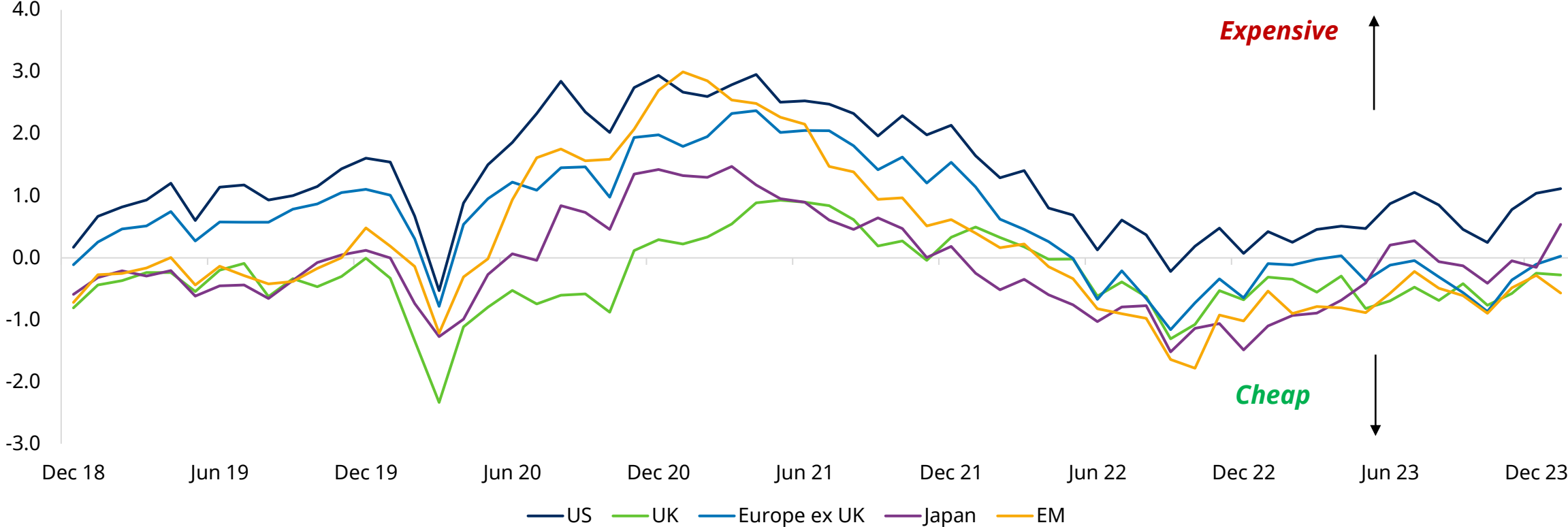
Equity market	CAPE	Forward P/E	Trailing P/E	P/B
US	31 (28%)	20 (21%)	25 (23%)	4.6 (59%)
UK	14 (6%)	11 (-11%)	12 (-18%)	1.8 (0%)
Europe ex. UK	20 (18%)	14 (0%)	16 (-8%)	2.1 (17%)
Japan	21 (0%)	15 (9%)	17 (6%)	1.5 (16%)
EM	11 (-18%)	11 (-2%)	14 (3%)	1.6 (-3%)

Key:	<-25%	-25% to -15%	-15% to -5%	-5% to 0%	0% to 5%	5% to 15%	15% to 25%	>25%
	Cheap			Neutral		Expensive		

Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38
 Figures are shown on a rounded basis. Assessment of cheap/expensive is relative to 15-year median.

Strong performance from Japan means it is no longer cheap

Composite valuation metric = Average Z-score* across five valuation metrics

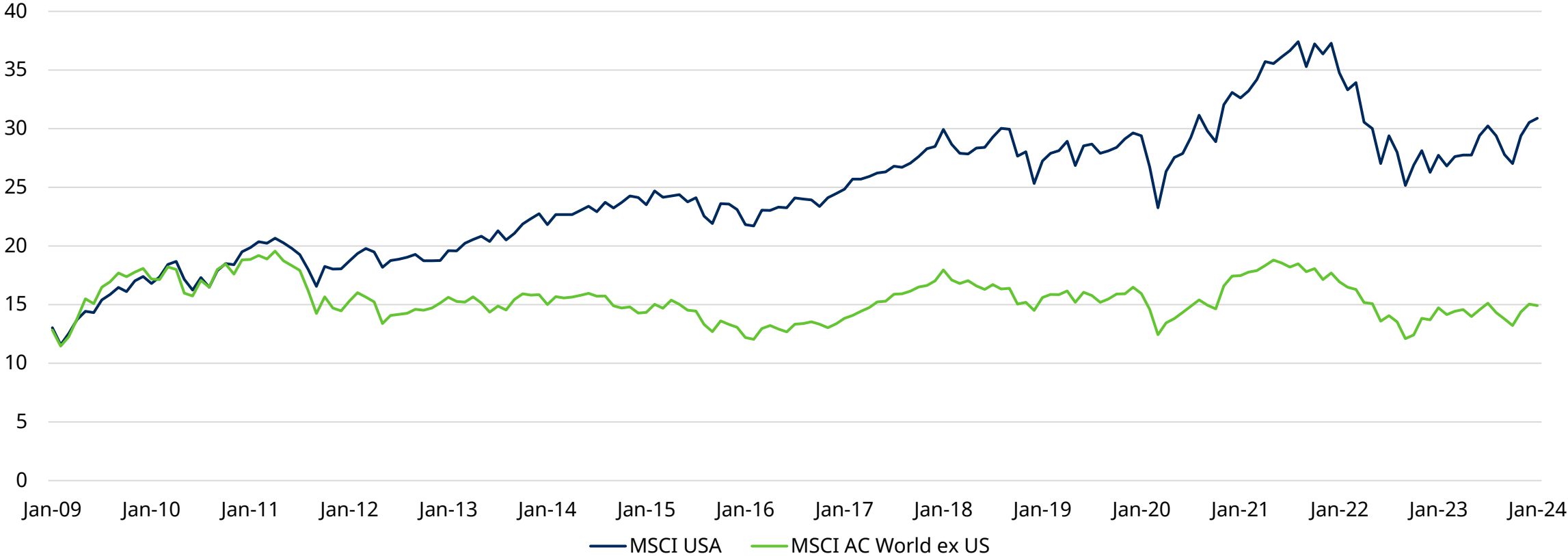


Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38. *Z-score measures the number of standard deviations above or below the average. Our assessment of expensive/cheap is relative to a 10-year rolling average of each market across five valuation metrics: cyclically-adjusted price-to-earnings, forward price-to-earnings, trailing price-to-earnings, price-to-book and dividend yield. Unlike slide 21 (which uses a 15-year median), this chart uses a 10-year average to increase the number of data points and give a better indication of the variability of valuations over time. US valuations appear less expensive when assessed on this basis, mainly because valuations were higher over the past 10 years than over the past 15.

US CAPE still stretched versus rest of world

Relative valuations: US vs Rest of World

Cyclically adjusted price-to-earnings ratio



Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Wide variation in global sector valuations

MSCI ACWI: End of month valuation vs 15-year median (% above or below)

Sector	CAPE	Forward P/E	Trailing P/E	P/B	Dividend yield
Energy	32%	-14%	-29%	11%	-16%
Cons stap	-12%	-1%	-4%	4%	-1%
Utilities	2%	-8%	-5%	4%	-5%
Materials	-2%	7%	-7%	2%	-12%
Financials	4%	0%	2%	21%	3%
Health care	2%	12%	10%	17%	12%
Cons disc	-1%	8%	8%	22%	37%
Industrials	16%	14%	6%	27%	14%
IT	47%	53%	67%	117%	55%
Comm Svcs	27%	19%	44%	42%	242%

Key: <-25% -25% to -15% -15% to -5% -5% to 0% 0% to 5% 5% to 15% 15% to 25% >25%

Cheap

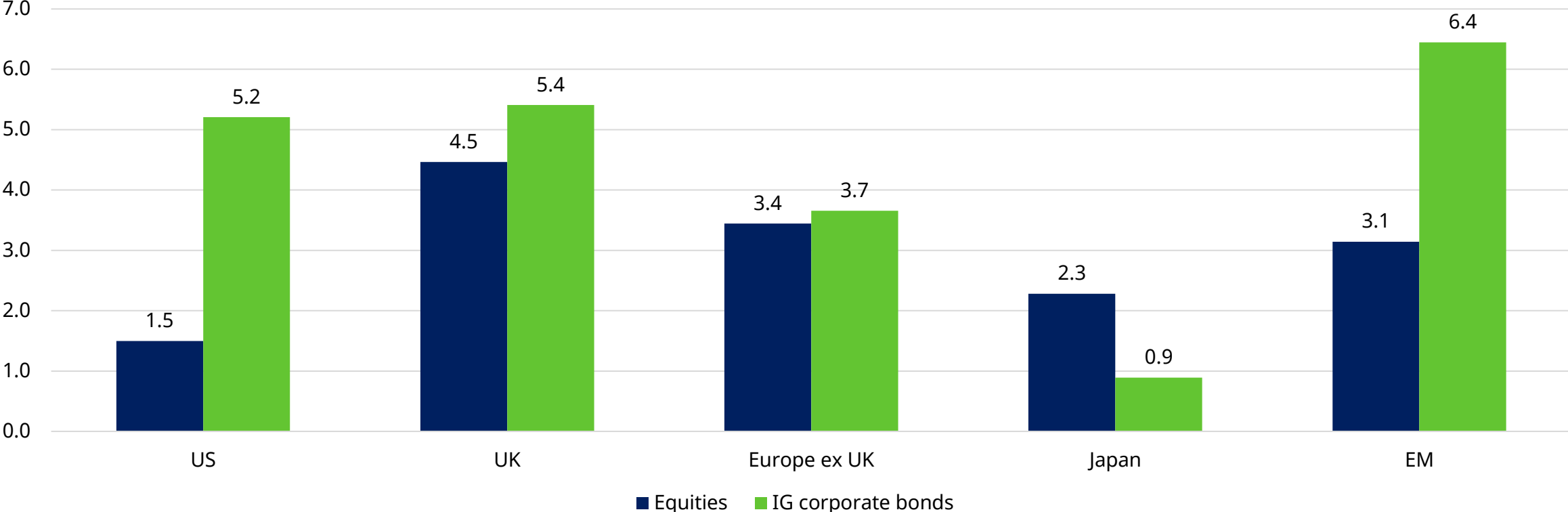
Neutral

Expensive

Real estate has been excluded due to data only being available since 2016. Note that the dividend yield on the communication services sector is very low vs history. This is down to compositional changes over time e.g. Alphabet is now the biggest constituent by a long way, with Meta the next biggest. These are very different to the higher yielding companies in the sector in the past. Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Bond yields are comfortably above dividend yields in most markets

Forward 12-month equity dividend vs corporate bond yield, %

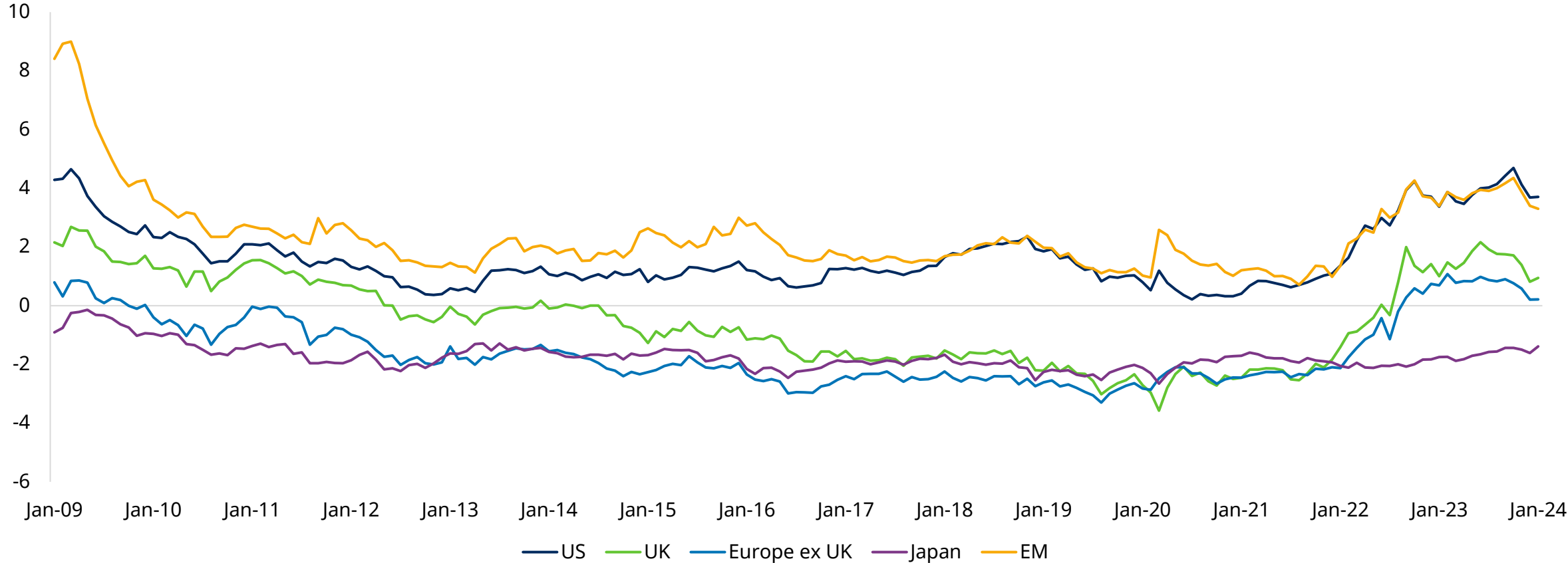


Forecasts included are not guaranteed and should not be relied upon.

Source: IBES, LSEG Datastream, MSCI, ICE and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38. Corporate bond yield = unhedged local currency yield e.g. US = USD corporate bond yield, except for EM which is in USD.

Corporate bonds' yield advantage over dividend yields has been declining

IG corporate bond yield - forward dividend yield, %



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Source: IBES, LSEG Datastream, MSCI, ICE and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38. Corporate bond yield = unhedged local currency yield, except for EM which is in USD.

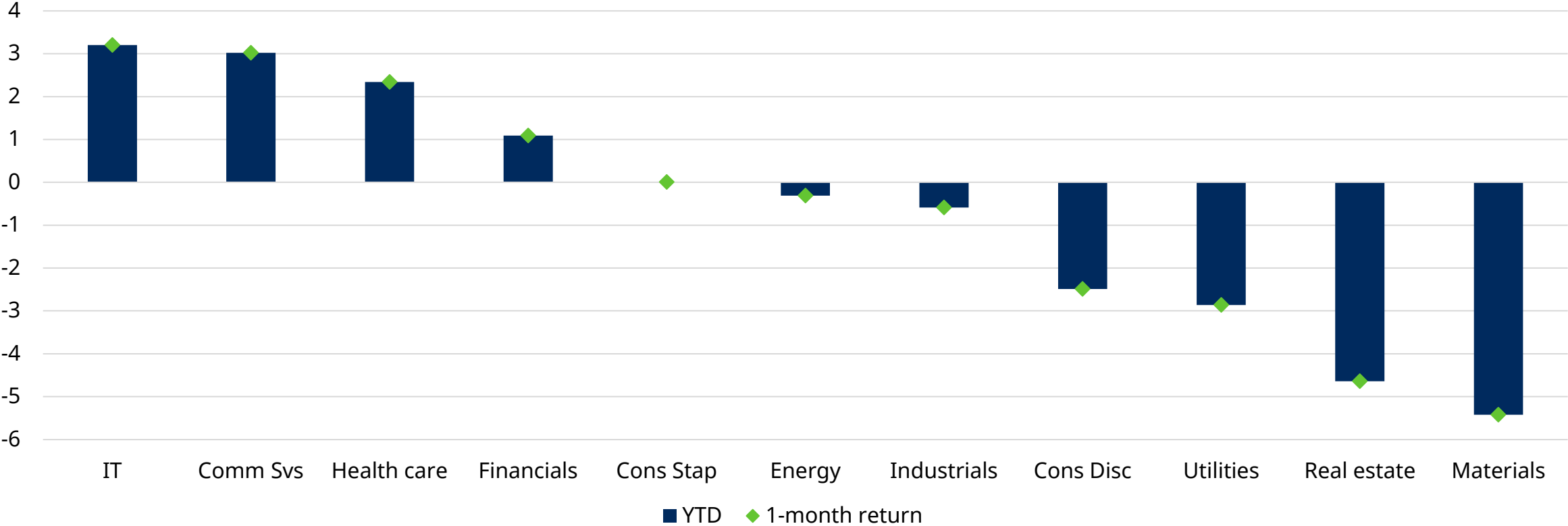


Global equities

Sectors & Styles

Divergence between sectors continues to be high

Global \$ sector return, %

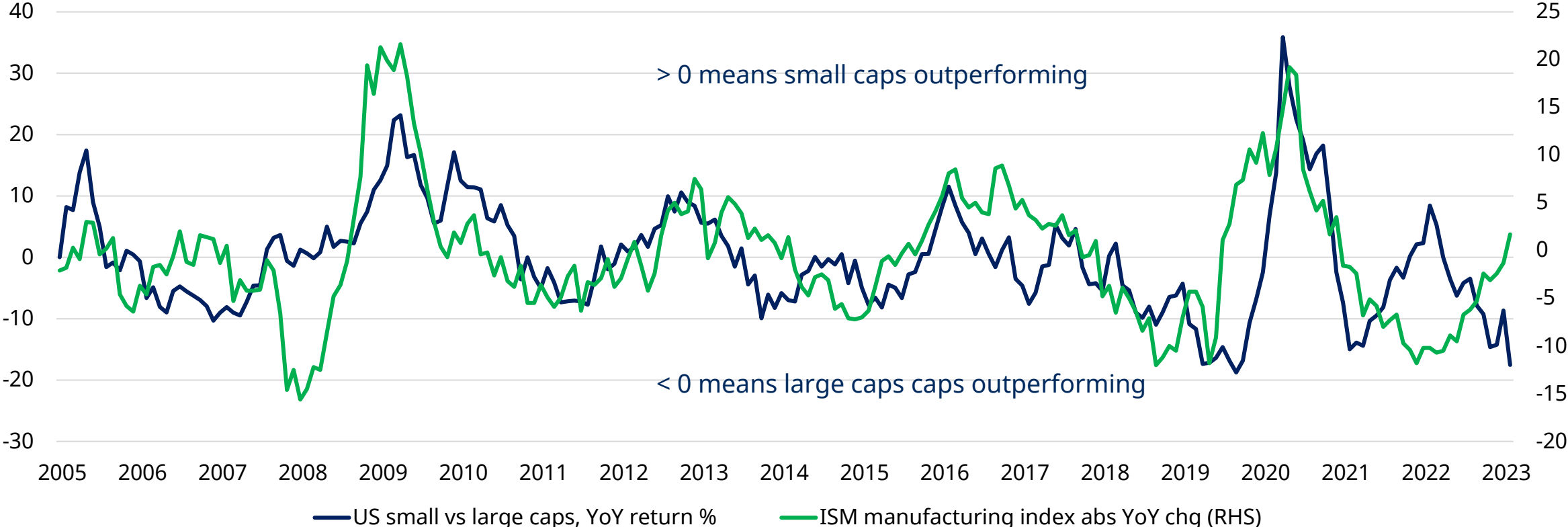


Past performance is not a guide to future performance and may not be repeated.

Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024 in US dollars. Please see relevant disclaimers on slide 38

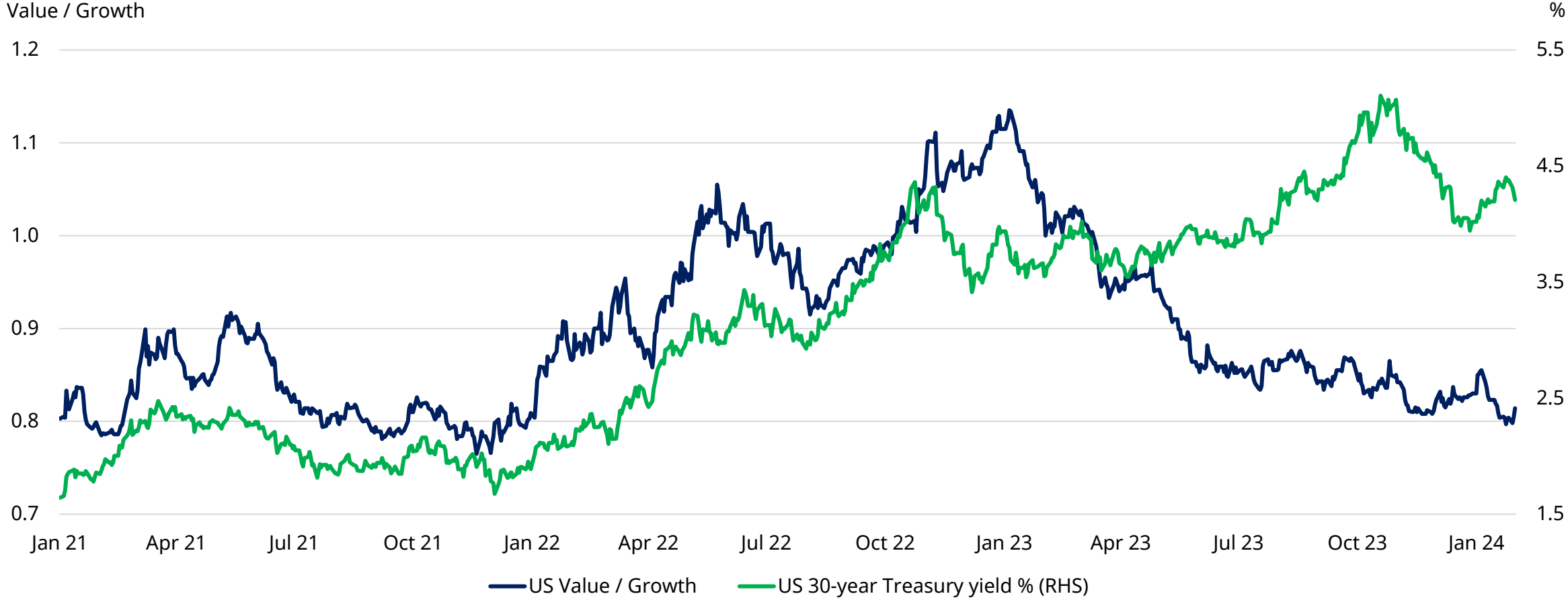
US large caps have been beating small caps

The normal relationship between manufacturing activity and small cap performance has broken down in recent years



Past performance is not a guide to future performance and may not be repeated. Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data to 31 January 2024. Please see relevant disclaimers on slide 38

Growth has been beating value: earnings growth (next slide) has mattered more than bond yields

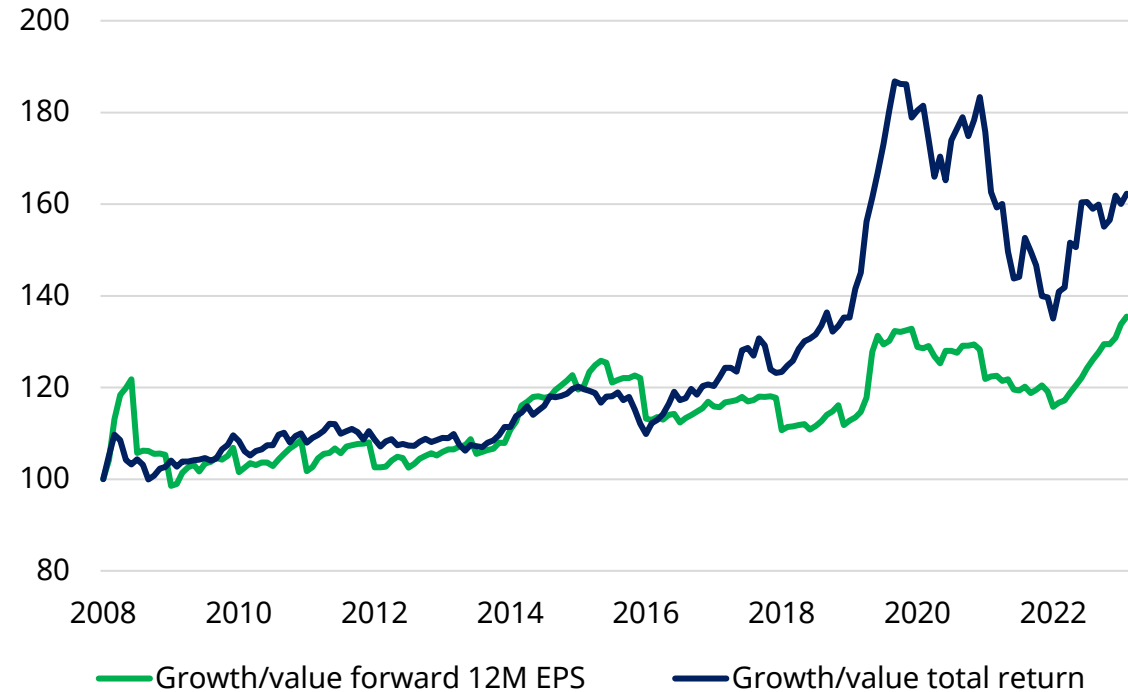


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Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data as at 31 January 2024. Please see relevant disclaimers on slide 38

Growth's recent outperformance of value (globally) has been underpinned by accelerating earnings expectations

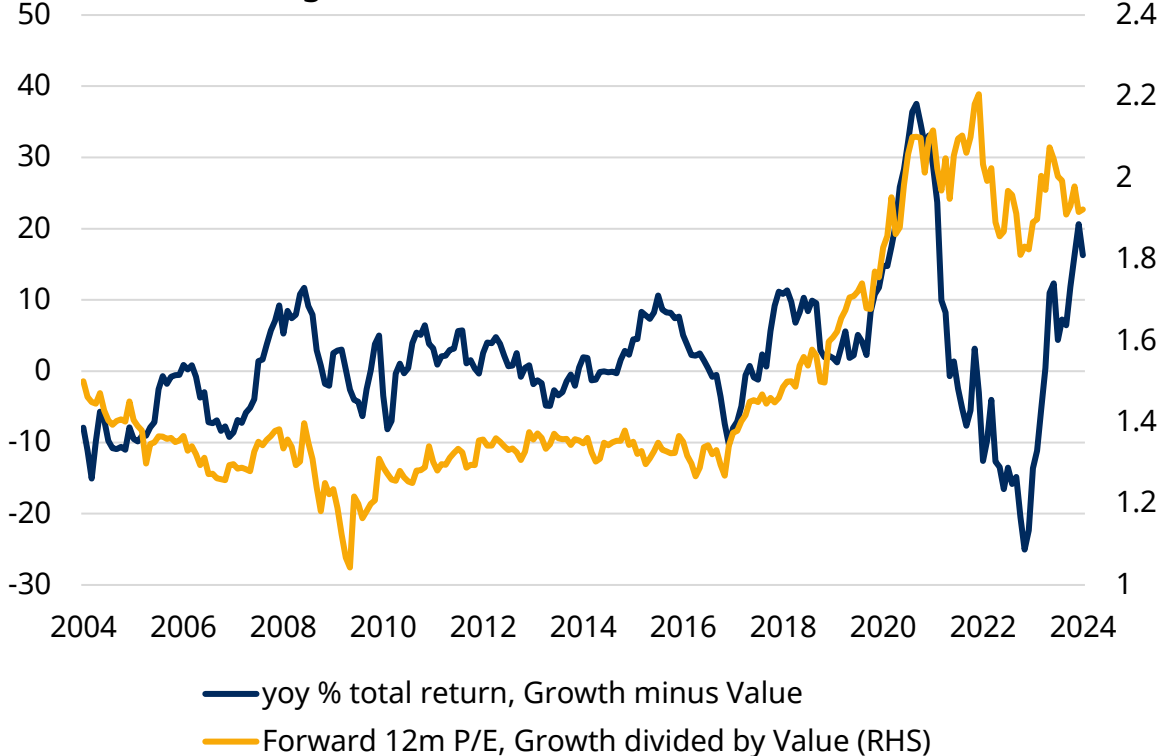
Earnings expectations for growth companies have risen strongly

Growth / Value, rebased to 100



Relative valuations remain high by historical standards

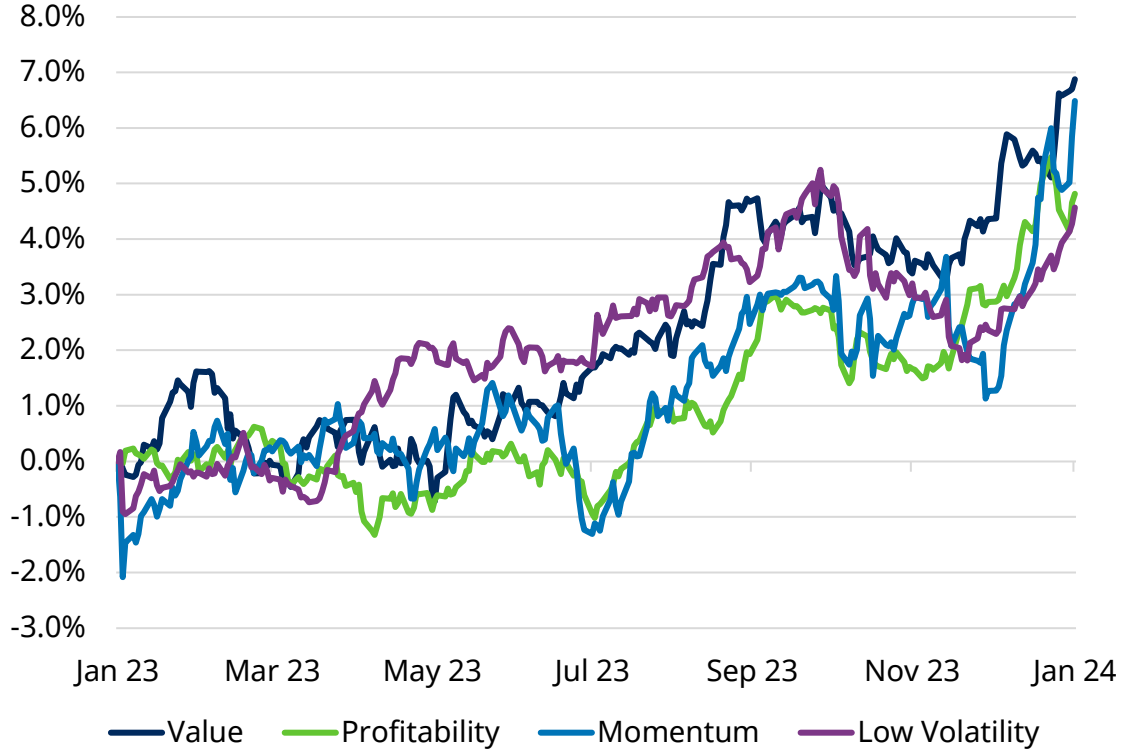
Growth vs Value (global)



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 Source: LSEG Datastream and Schroders Strategic Research Unit. Data to 31 January 2024 in US dollars. Based on MSCI ACWI World. Please see relevant disclaimers on slide 38

Performance of the momentum factor has accelerated in 2024

1-year cumulative long short return



	Value	Profitability	Momentum	Low Volatility
YTD	2.4%	1.9%	5.2%	2.2%
1 year	6.9%	4.8%	6.5%	4.6%
5 yr pa	1.1%	1.9%	2.6%	2.4%
10 yr pa	1.9%	2.6%	2.1%	2.4%

Returns are based on factor-mimicking, long-short, global equity portfolios that are scaled to target a volatility of 2.2% per year. The factor mimicking portfolios calculate the factor score on an industry basis. These portfolios aim to capture the returns attributable to specific fundamental characteristics within each industry.

For illustrative purposes only. Past performance is not a guide to future performance and may not be repeated.

Source: Schroders Systematic Investments. Data as at 31 January 2024. Notes: based on portfolios formed using the MSCI ACWI Universe. Please see relevant disclaimers on slide 38



Global equities

Index composition

Regional market composition

UK is more defensive than ACWI, while Europe, Japan and EM are more cyclical

Sector	Beta*	Cyclical/defensive	Sector Group Index Weight						Sector Group Index Weight vs ACWI				
			US	UK	EMU	Japan	EM	ACWI	US	UK	EMU	Japan	EM
IT	1.17	Cyclical	30%	1%	14%	15%	23%	24%	6%	-23%	-10%	-8%	-1%
Cons disc	1.15	Cyclical	10%	7%	15%	20%	12%	11%	0%	-3%	4%	9%	1%
Financials	1.09	Cyclical	13%	18%	19%	13%	23%	16%	-3%	2%	3%	-3%	7%
Industrials	1.12	Cyclical	9%	12%	17%	23%	7%	11%	-2%	2%	6%	12%	-4%
Energy	1.11	Cyclical	4%	13%	5%	1%	6%	5%	-1%	8%	0%	-4%	1%
Materials	1.15	Cyclical	2%	10%	5%	5%	8%	4%	-2%	6%	1%	1%	3%
Real estate	0.98	Defensive	2%	1%	1%	1%	0%	2%	1%	-1%	-1%	-1%	-2%
Comm Servs	0.94	Defensive	9%	3%	4%	7%	9%	8%	1%	-5%	-3%	0%	1%
Cons stap	0.61	Defensive	6%	17%	8%	6%	6%	7%	-1%	11%	1%	-1%	-1%
Utilities	0.67	Defensive	2%	4%	6%	1%	3%	3%	0%	2%	3%	-1%	0%
Health care	0.67	Defensive	13%	13%	7%	8%	4%	11%	1%	1%	-4%	-3%	-8%
% cyclical			68%	62%	74%	76%	78%	70%	-2%	-8%	4%	7%	9%

Source: LSEG Datastream and Schroders Strategic Research Unit. Data as at 31 January 2024. Please see relevant disclaimers on slide 38. Notes: market beta is a measure of how sensitive sector returns are to changes in the overall market index. Cyclical sectors are defined as having a market beta greater than 1, (i.e. they outperform when the index rises), whereas defensive sectors have a beta less than 1 (i.e. they underperform when the index rises). Our calculation is based on the last five years of monthly returns vs the MSCI ACWI Index.

Style market composition

Min. vol., quality and value all have defensive biases vs ACWI

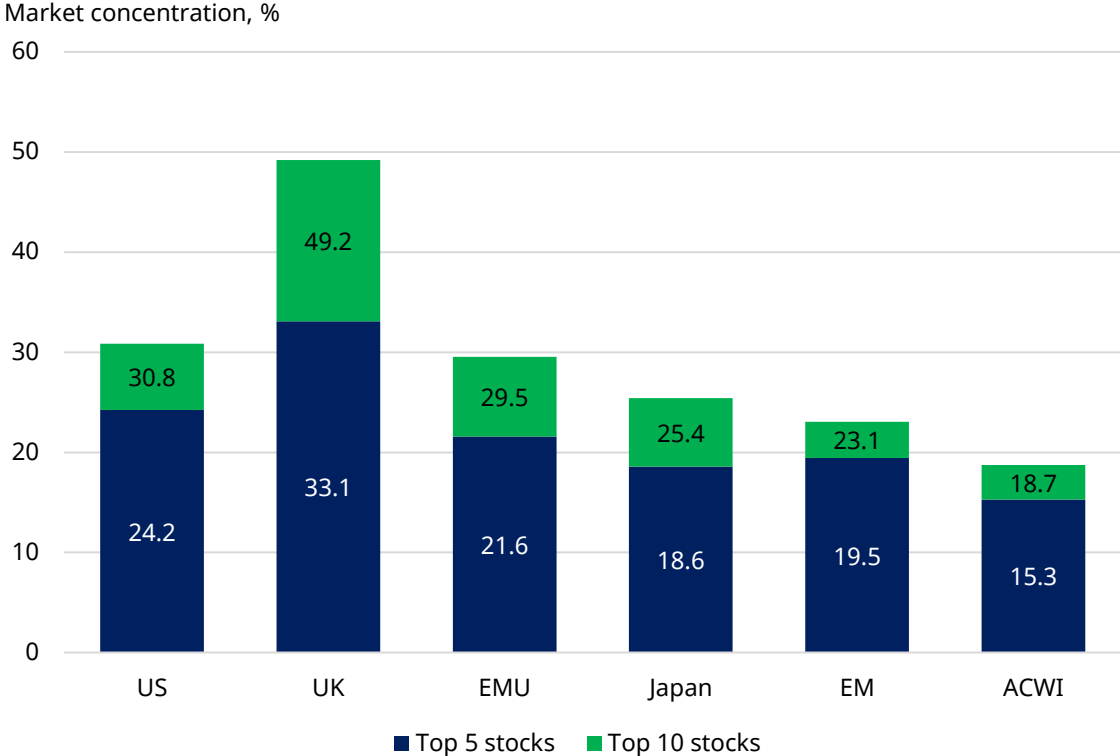
Sector	Beta vs ACWI	Cyclical/defensive	Sector Group Index Weight						Sector Group Index Weight vs Benchmark*					
			Value	Growth	Quality	Momentum	Min Vol*	US small caps*	Value	Growth	Quality	Momentum	Min Vol*	US small caps*
IT	1.2	Cyclical	10%	37%	37%	37%	18%	15%	-14%	13%	13%	13%	-6%	-15%
Cons disc	1.2	Cyclical	7%	14%	6%	13%	6%	12%	-4%	3%	-5%	2%	-5%	1%
Financials	1.1	Cyclical	24%	9%	7%	11%	15%	15%	8%	-8%	-9%	-5%	0%	2%
Industrials	1.1	Cyclical	12%	10%	10%	12%	9%	18%	1%	-1%	0%	1%	-2%	9%
Energy	1.1	Cyclical	8%	1%	2%	2%	2%	4%	3%	-3%	-3%	-3%	-2%	0%
Materials	1.2	Cyclical	6%	3%	3%	2%	2%	6%	1%	-1%	-1%	-2%	-2%	3%
Real estate	1.0	Defensive	4%	1%	0%	1%	0%	7%	2%	-1%	-1%	-1%	-2%	5%
Comm Servs	0.9	Defensive	4%	11%	10%	12%	13%	4%	-3%	3%	2%	5%	6%	-5%
Cons stap	0.6	Defensive	8%	5%	9%	2%	12%	4%	1%	-1%	2%	-5%	5%	-2%
Utilities	0.7	Defensive	5%	0%	0%	1%	6%	5%	2%	-2%	-2%	-1%	4%	2%
Health care	0.7	Defensive	14%	9%	17%	8%	16%	11%	2%	-2%	5%	-3%	4%	-1%
% cyclical			66%	73%	65%	76%	52%	69%	-4%	3%	-5%	6%	-17%	1%

Source: LSEG Datastream and Schroders Strategic Research Unit. Data as at 31 January 2024. Please see relevant disclaimers on slide 38. Notes: market beta is a measure of how sensitive sector returns are to changes in the overall market index. Cyclical sectors are defined as having a market beta greater than 1, (i.e. they outperform when the index rises), whereas defensive sectors have a beta less than 1 (i.e. they underperform when the index rises). Our calculation is based on the last five years of monthly returns vs the MSCI ACWI Index. Min Vol index is based on and relative to MSCI World, US small caps are relative to MSCI USA. All other indices are based on MSCI ACWI universe.

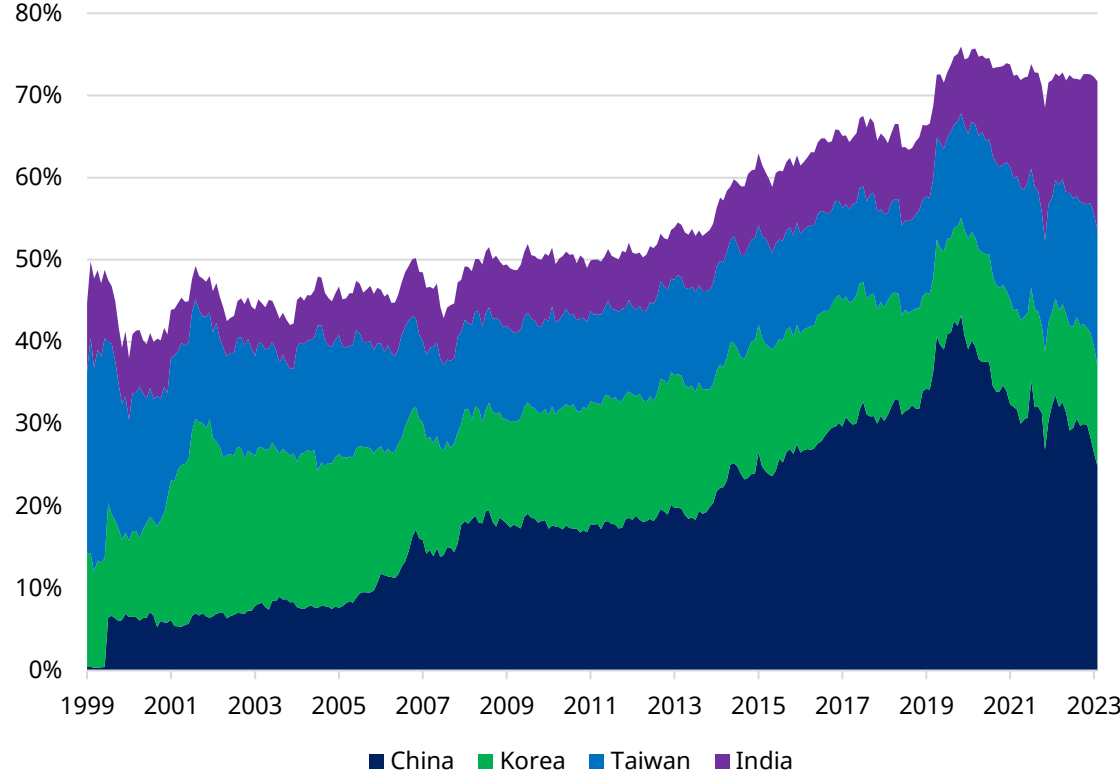
Market concentration is global phenomenon

Top constituents by market share

UK equities heavily weighted towards top 10 stocks



China's weight has fallen sharply but India and Taiwan have risen, keeping overall EM exposure to Asia very high



Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data as at 31 January 2024. Please see relevant disclaimers on slide 38



Appendix

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List of indices (1 of 2)

Large cap equities

US – MSCI USA Index, or S&P 500 Index where specified

UK – MSCI UK Index

Europe ex UK – MSCI Europe ex UK Index

Japan – MSCI Japan Index

Developed markets – MSCI World Index

Emerging markets – MSCI EM Index

China – MSCI China Index

Global – MSCI All Country World Index

Rest of world – MSCI All Country World ex US Index

Slide 7 shows profit margins for Datastream total market equity indices, due to longer data history

Small cap equities

US – MSCI USA Small Cap Index

UK – MSCI UK Small Cap Index

Europe ex UK – MSCI Europe ex UK Small Cap Index

Japan – MSCI Japan Small Cap Index

Emerging Markets – MSCI EM Small Cap Index

World ex-US – MSCI World ex-US Small Cap Index

Factor and sector indices

US Value – MSCI USA Value Index

US Growth – MSCI USA Growth Index

US Cyclical – MSCI USA materials, industrials, consumer discretionary, energy, financials, IT

US Defensive – MSCI USA utilities, consumer staples, health care, communication services

Global Value – MSCI All Country World Value Index

Global Growth – MSCI All Country World Growth Index

List of indices (2 of 2)

Bond indices

US Treasuries – ICE BofA US Treasury Index

Euro government bonds – ICE BofA Euro Government Index

US IG Corps – ICE BofA US Corporate Index

UK IG Corps – ICE BofA Sterling Corporate Index

Europe IG Corps - ICE BofA Euro Corporate Index

Japan IG Corps - ICE BofA Japan Corporate Index

EM IG Corps - ICE BofA Emerging Markets Corporate Plus Index

Currency indices

US Dollar – DXY US Dollar Currency Index

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