Q3 2018 Factor Report

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In Q3, we saw a continued strong run by US equity indices relative to their active and factor-based counterparts. This comparatively strong index performance has been a outlier relative to recent history; however, it is undeniable that over the last 18 months, the index (as represented here by the S&P 500) has outperformed respective factor portfolios. A prime reason for this is the fact that factor indices are often alternatively-weighted in a manner that underweights the very largest (or "mega" cap) holdings relative to an index, and these stocks are simply the ones that have been on a run.

Here is the performance (Quarterly and YTD) of the index, and the "Top 100" (i.e. mega cap) stocks which are driving much of this strength, side-by-side with our OAM individual factor strands:

	S&P 500	Top 100	Low Vol	Quality	Momentum	Value
Q3:	7.71%	9.15%	7.60%	5.18%	5.29%	4.64%
YTD:	10.56%	12.38%	9.93%	9.30%	9.34%	5.17%

You never know when a run is over until it's over, so there's no way to predict when this trend will reverse, and when or if a more historically-charted pattern comes back. But it is constructive to set it in context, specifically looking at the last 15 years (60 quarters), and placing the S&P 500 index against OAM's factor portfolios:

Index Ranking (Relative to the four factors)	# of Quarters (Out of 60 total)
Index in 1st Place:	7 (including last two quarters)
Index in 2nd Place:	13
Index in 3rd Place:	15
Index in 4th Place:	18
Index in Last Place:	7

Interestingly, for the first time in this entire 15-year period, the index was the strongest performer against all the individual factor portfolios *in two consecutive quarters.*

Here at Optimal, we shy away from opinions or predictions, but underlying data is always worth looking into, to understand 1) why a certain condition has persisted, and 2) whether there is reason to believe those conditions are trending in a way that may change that condition.

Let's look at equity market volatility (as measured by the VIX index) and interest rates (as measured by the 10 year Treasury rate). It can be seen that macro-trends held very steady throughout the quarter. The VIX in fact moved lower, although interest rates started to kick up a bit, crossing 3%, which has acted as a psychological threshold for many investors, towards the end of the quarter.

VIX at end of Q2:	16.19%	10Yr interest rate at end of Q2:	2.85%
VIX at end of Q3:	12.12%	10Yr interest rate at end of Q3:	3.05%

<u>Early October Update:</u>

Since the end of the quarter, however, we have seen indications of a new context. The VIX has surged in recent days, and the 10 year rate has hit levels not seen since the summer of 2011. While volatility did rise as well in the spring of this year, it soon reverted back to the lower levels it has exhibited over the last few years, and of course, we may see that happen again this year. However, unlike the last surge, this one is accompanied by higher interest rates, which is a historically much more persistent long-term indicator than the VIX.

ViX at end of Q2:	16.19%	10Yr interest rate at end of Q2:	2.85%
VIX at end of Q3:	12.12%	10Yr interest rate at end of Q3:	3.05%
VIX as of 10/10:	22.96%	10Y interest rate as of 10/10:	3.22%