ALLOCATOR'S ALERT

Timely market insights from **IORisk Aware**

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KEY TAKEAWAYS:

- In our prior Allocator's Angle, we presented evidence that equity style factor returns are becoming tightly coupled, which may lead to elevated factor volatility. Since then, expectations of a Fed pivot triggered one of the largest weekly reversals in the Momentum factor in history.

- We continue to see signs that bouts of intra-market volatility are likely to persist, thus creating opportunity and risk for active equity managers. In the absence of a clear view on factor volatility, allocators may consider passive exposure to help sidestep intra-market volatility.

CIO OUTLOOK

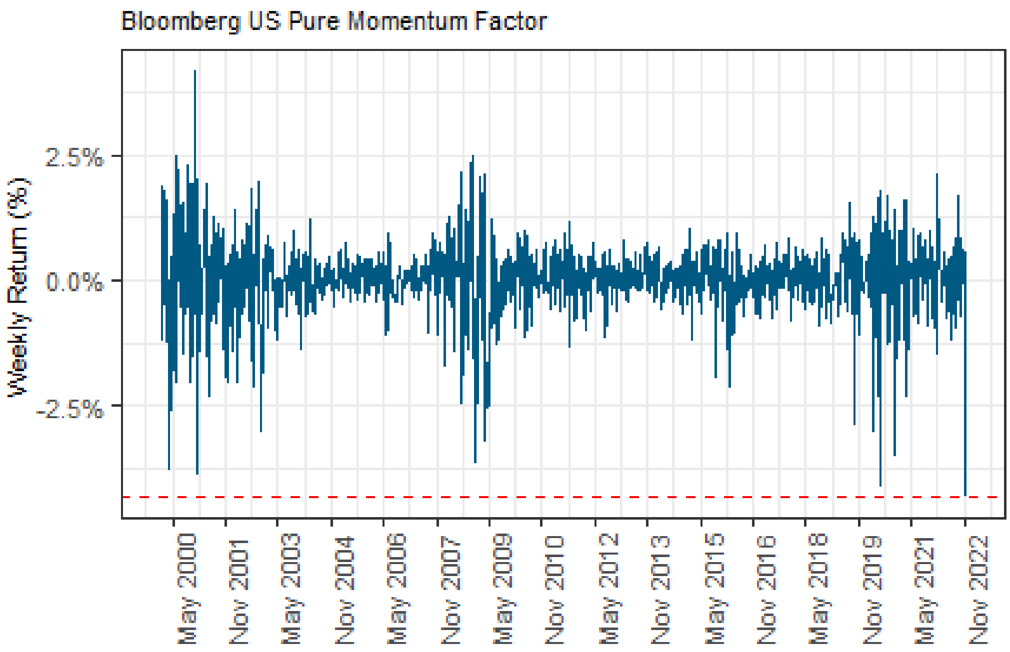
Our quarterly publication, **Allocator's Angle**, is intended to deliver timely insights and research on topics that are relevant to CIOs and institutional asset allocators. At times, however, we see emerging risks that may warrant immediate attention – for that reason we are introducing **Allocator's Alert**, which aims to highlight risks as they emerge. In this edition, we provide an update on our Breadth Indicator, which alerted us to increased risk for heightened equity style factor volatility – something we highlighted in the Q4 edition of **Allocator's Angle**.

In the weeks since that publication we have indeed seen violent factor rotations, as the Bloomberg Pure Momentum factor experienced its sharpest weekly decline on record. As of this writing, the Breadth Indicator remains elevated, thus creating opportunities and risks for active equity managers. Given this backdrop, allocators should reconsider how their equity managers may respond to rising intra-market volatility to help ensure they are not caught flat-footed by potentially violent factor rotations. As an alternative, allocators may consider passive equity exposure to sidestep factor volatility. For more insight on how style factors may impact your portfolio, please contact us.

ONGOING EQUITY MARKET FRAGILITY

In our last edition of Allocator's Angle, we introduced our proprietary Breadth Indicator, a statistical tool that quantifies the extent to which equity style factors are trading as a single source of risk. We noted this indicator had risen to a level that suggests style factors are more fragile and shocks may propagate more widely and violently than is typical. For weeks, factor volatility remained subdued until news of cooler than expected CPI fueled hopes of a Fed pivot. In response, the Bloomberg Pure Momentum factor experienced its sharpest weekly drawdown on record as investors scrambled to add exposure to low interest rate beneficiaries **(Exhibit 1)**.

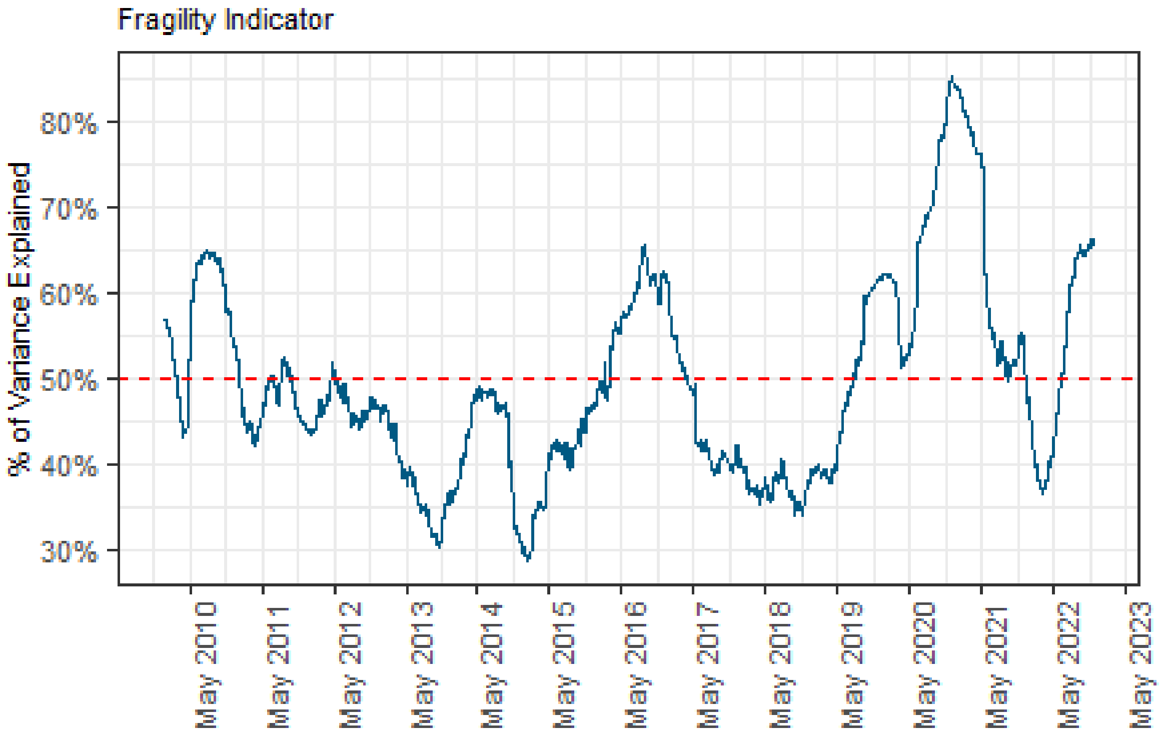
Exhibit 1: Equity Factor Volatility



Source: Bloomberg, IOR Calculations

Factor rotations such as this may have a material impact on active managers who knowingly or unknowingly find themselves exposed to style factors. Given that our Breadth Indicator has continued to rise in recent weeks **(Exhibit 2)**, we expect bouts of intra-market volatility to persist. Amid this environment, allocators should re-underwrite their active equity managers to ensure factor exposures are known and intended. By carefully weighing exposure to both active and passive equity managers, allocators can help ensure their portfolios reflect their views on rising intra-market volatility.

Exhibit 2: Factor Risks Remain Concentrated



Source: Bloomberg, IOR Calculations

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