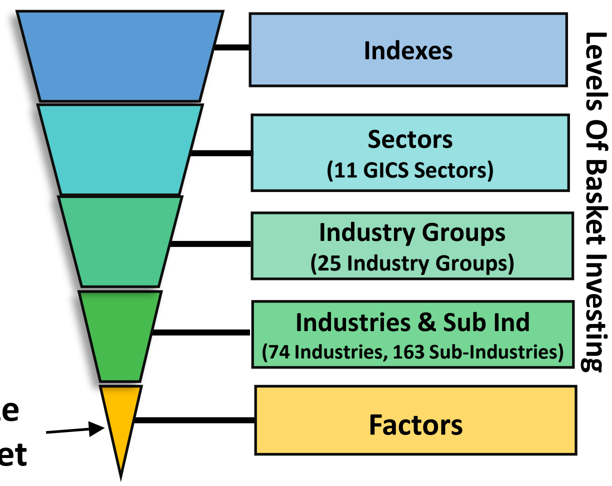
THE 2026 FIELD GUIDE TO FACTORS

AN INTRO TO FACTOR INVESTING AROUND THE CYCLE

What drives stock outperformance? Typically, it is investors gravitating toward specific attributes they perceive as advantageous within the current economic outlook. The most effective way to monitor which attributes are being bid up is through factor analysis. Factors provide the purest lens to isolate underlying investment themes, stripping away the noise inherent in sector and market-level data. Please reach out to the team at strategy@psc.com if you would like to discuss any of today's material.

Factors: The Purest Way To Express Macro Views



The Purest Way To Emphasize Specific Themes In The Market

In Today's Report:

If you've enjoyed our work this year, we'd really appreciate your support in the ***Institutional Investor All-America Equity Research Poll***. It's VERY important to us, and your support would mean a lot!

Click Here To Request A Ballot | ***Portfolio Strategy – Michael Kantrowitz | Quantitative Research – Stephen Gregory***

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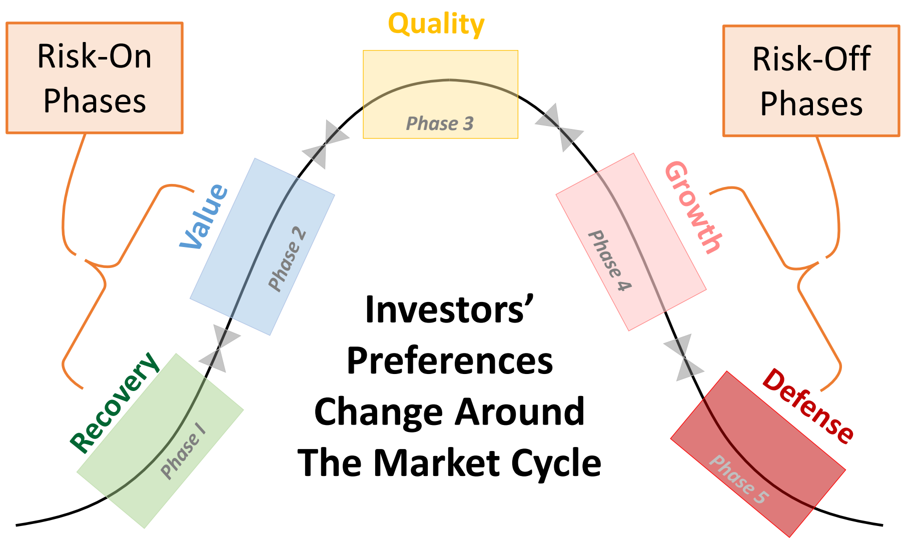
A Look At How Factor Leadership Rotates Around The Market Cycle

There is a cadence to how factor leadership rotates around the cycle. But first, what are factors? A factor is a characteristic common to a group of stocks. To invest in a factor means to choose stocks that all have relatively similar measurements for that characteristic. For example, investing in high Earnings Yield means to target a basket of stocks that all have relatively high earnings yields compared to their peers. On this page, we show how factor leadership tends to change around the business cycle. Generally, riskier factors like "high beta" tend to outperform during the recovery portion of the cycle while more defensive factors like strong profitability or interest coverage do relatively better later in the cycle.



Phase I

Recovery

Period of strongest returns led by strong P/E expansion

The Market is led by the riskiest assets whereas stability and defense lags.

Phase 2

Value

Period of strong market returns and narrowing leadership.

Risky assets pass the leadership baton to cheap valuation. Stability & defense continue to lag

Phase 3

Quality

Average returns are positive but low led by EPS growth.

Quality becomes more important with High Quality Cyclicals and Profitable firms leading.

Phase 4

Growth

Returns are typically still positive, but EPS growth begins to slow materially.

High growth becomes a dominant factor and high risk underperforms.

Phase 5

Defense

Returns are typically negative with BOTH EPS and P/E falling.

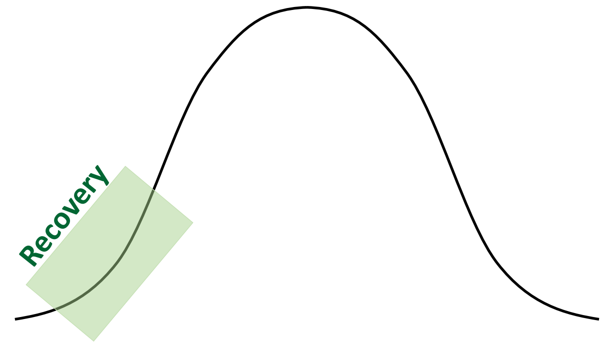
The most stable and defensive names outperform while riskier assets underperform.

*****For our analysis, we studied PMI cycles 1985-2019. We identified each peak and trough and then divided each cycle into five segments based on duration/percent of cycle completed. ****

Phase I

Recovery

Speculation, Risk-On



Characterized By: A sharp re-acceleration in growth expectations after a slowdown. This phase typically sees the strongest market returns led by P/E expansion. EPS growth expectations also typically begin to improve at this point.

Theme: The Recovery phase typically sees a major rotation in equities as the most speculative and risky assets go from worst to first. This is the time where most "junk" rallies occur. At this phase in the cycle, factors that represent stability, momentum, and profitability get left in the dust.

Best Performer In Phase 5
Stability, Coverage, Momentum

Best Performer In Phase 1
Risk & Speculation

Investment Trends (Factors):

Laggards:

Factor	Category
Low Beta	Stability
High EPS Momentum	Stability
High Debt Coverage	Coverage

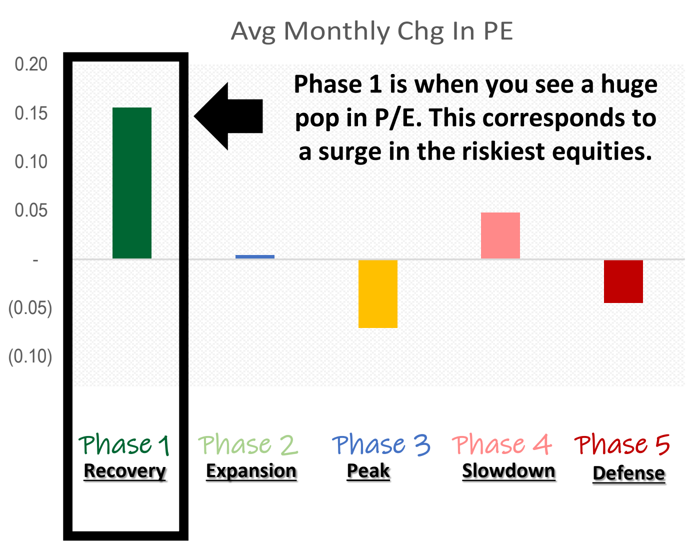
Leaders:

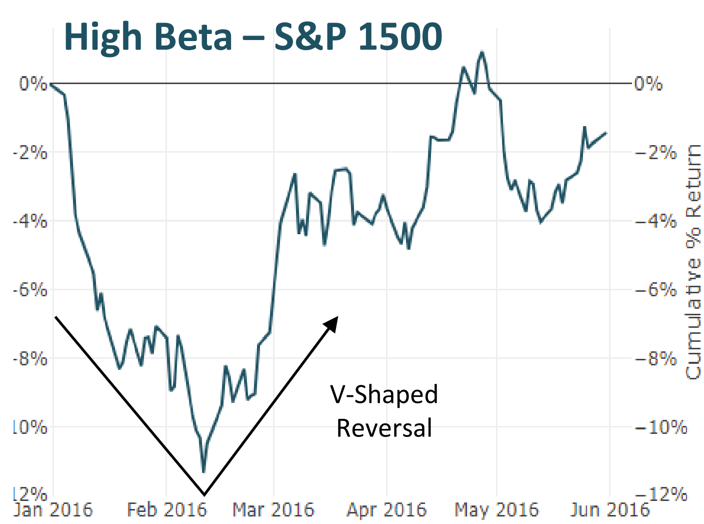
Factor	Category
High Beta	Risk
High Price Tgt Dispersion	Risk
Low PE NTM	Valuation

What Happens In Phase 1?

P/Es Rise Sharply

Risk-On Assets Surge

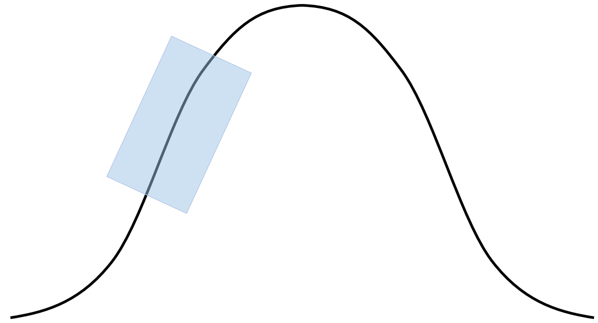




Phase 2

Expansion

Valuation, Risk



Characterized By: A continued improvement in growth expectations. A rise in EPS expectations becomes the driver of market returns as P/E expansion becomes much more muted. Market returns in Phase 2 are typically less than in Phase 1.

Theme: Cyclical leadership becomes more narrow in Phase 2. Valuation factors take the leadership baton from Risk and Speculation in the second phase. Stability and profitability continue to lag in Phase 2.

Best Performer In Phase 1
Risk & Speculation

Best Performer In Phase 2
Valuation & Risk

Investment Trends (Factors):

Laggards:

Factor	Category
High Margin	Profitability
High Div Payout	Stability
High Current Ratio	Coverage

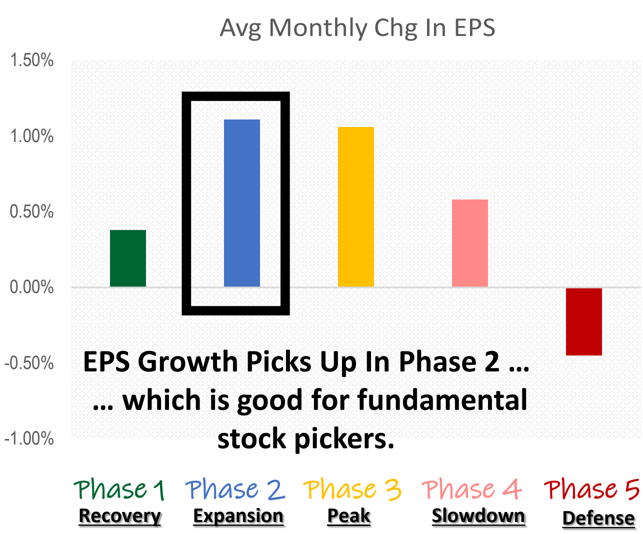
Leaders:

Factor	Category
High Book Yield	Valuation
Low PE NTM	Valuation
High Fundamental Beta	Risk

What Happens In Phase 2?

EPS Growth Accelerates

Prime Time For Valuation Factors



Average Monthly Return In Each Phase

Phases	1	2	3	4	5
High EBITDA to EV	0.41	0.53	0.01	0.05	-0.20
High Book Yield	0.20	0.40	0.01	-0.13	-0.36
High Cash Flow Yield	0.22	0.26	-0.04	0.19	-0.32
High Sales Yield	0.19	0.23	-0.01	-0.06	-0.47

Relative to Market

Many valuation factors outperform in Phase 1 ...

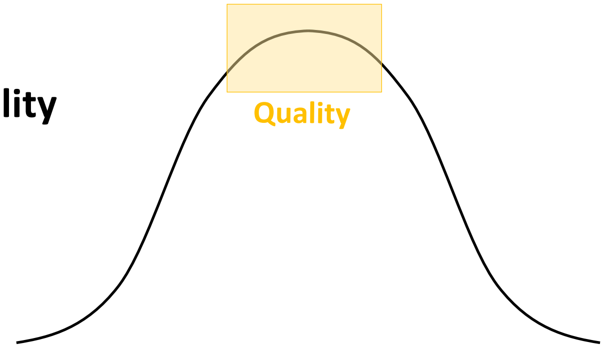
... but they really hit their stride in Phase 2!

Factors Around The Cycle

Phase 3

Quality

High Quality Valuation, Profitability



Characterized By: A peak in growth expectations. In this phase, market returns are typically positive and driven by eps growth with little, if any P/E expansion. This is often a great phase of the cycle for stock pickers.

Theme: Cyclical leadership narrows further in this phase of the cycle with *high-quality* cyclicals leading the pack. This is the part of the cycle where investors begin to reach for stability and profitability. The riskiest and most speculative equities typically fall to the bottom of the pack in this phase and stay there until the next recovery.

Best Performer In Phase 2
Valuation & Risk

Best Performer In Phase 3
High-Quality Valuation & Profitability

Investment Trends (Factors):

Laggards:

Factor	Category
High Price Tgt Dispersion	Risk
High Beta	Risk
High EPS Dispersion	Risk

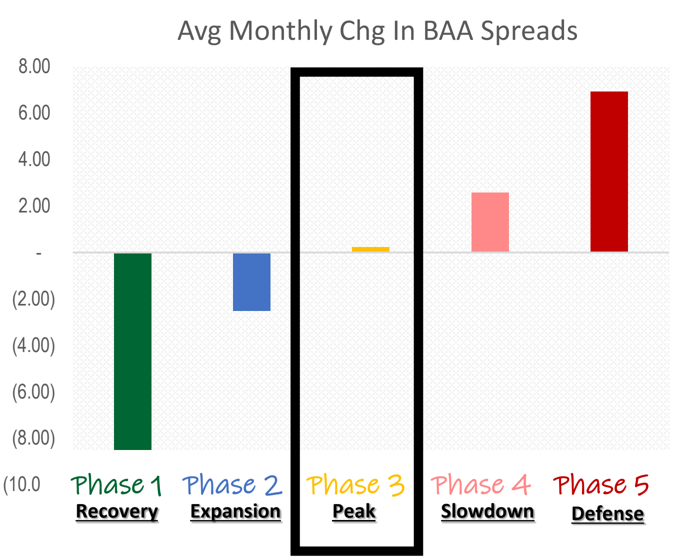
Leaders:

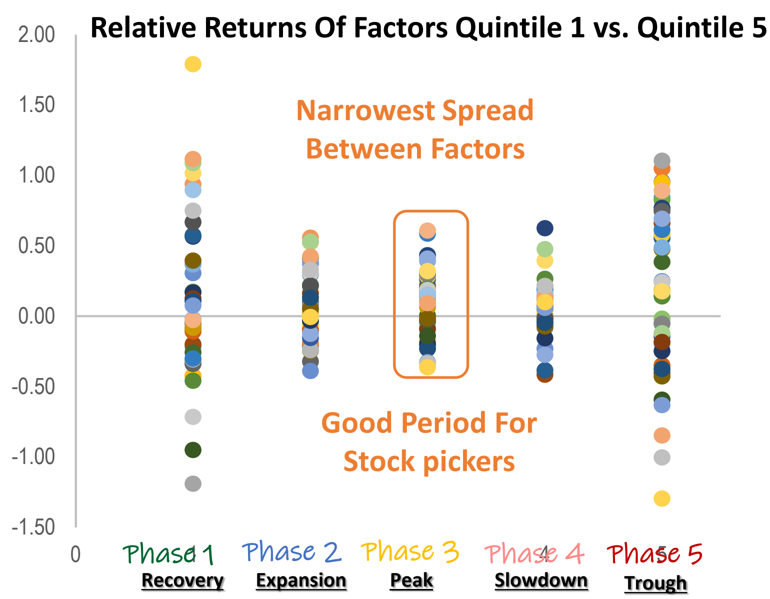
Factor	Category
High FCF Yield	Valuation
High ROE	Profitability
Low EPS Variance	Stability

What Happens In Phase 3?

Macro Risks Become More Balanced

Factor Dispersion Narrows, Good Time For Stockpickers!



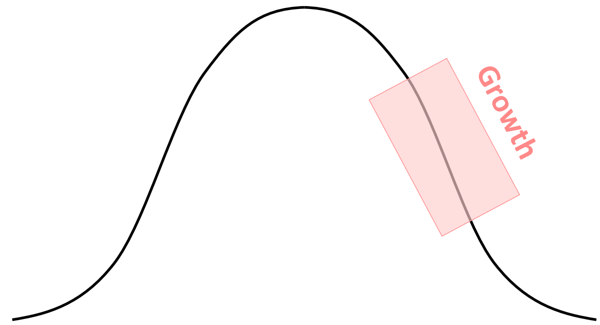


Factors Around The Cycle

Phase 4

Growth

High Quality Growth, Momentum



Characterized By: a continued slowdown in growth prospects. Market returns are typically still positive in Phase 4 driven by positive (but slowing) EPS growth. Yields are often falling in Phase 4 which supports the P/Es of long-duration growth stocks.

Theme: Phase 4 is where investors are paying up for growth where they can find it. Investors increasingly reach for Stability & Profitability. Particularly towards the end of Phase 4, high-quality growth names become highly attractive.

Best Performer In Phase 3
High-Quality Valuation & Profitability

Best Performer In Phase 4
High-Quality Growth & Momentum

Investment Trends (Factors):

Laggards:

Factor	Category
High EPS Dispersion	Risk
High Price Tgt Dispersion	Risk
High Book Yield	Valuation

Leaders:

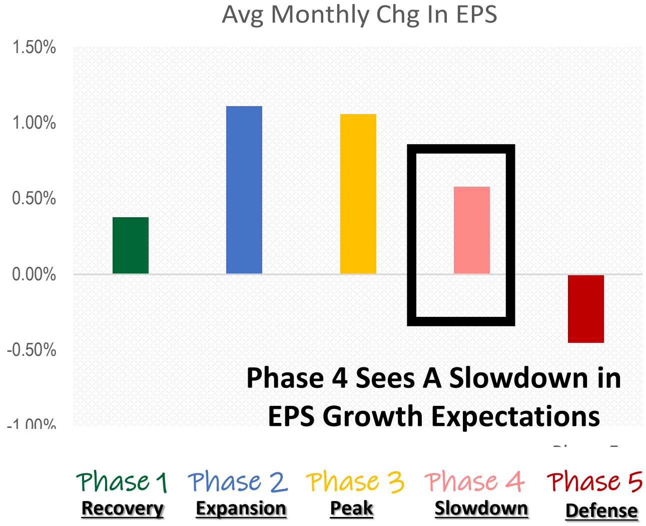
Factor	Category
High EPS Growth	Growth
High Momentum	Momentum
High ROIC	Profitability

What Happens In Phase 4?

Growth Slows Materially

Investors Pay Up For Quality Growth Where They Can Find It

Avg Monthly Chg In EPS



Average Monthly Return In Each Phase

Phases	1	2	3	4	5	Category
Earnings Growth	0.02	-0.12	-0.03	0.13	0.00	Growth
High Int. Coverage	-0.13	-0.08	-0.07	0.13	0.22	Coverage
Low Debt to Equity	-0.06	0.05	0.03	0.01	0.32	Stability
High ROIC	-0.04	-0.09	0.03	0.11	0.28	Profitability

Relative to Market

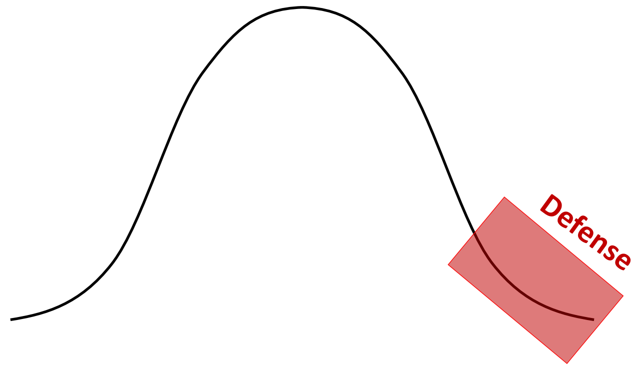
Phase 4 is the beginning of the best period for growth and defensive factors.

Phase 5

Defense

Stability, Coverage, Momentum

Characterized By: the last phase of a cycle where growth slows significantly before finding a footing. Market returns are typically negative in this phase due to both PE contraction and a slowdown in EPS expectations.



Theme: In Phase 5, risks rise and investors look to take shelter in the most stable and defensive names.

Best Performer In Phase 4	Best Performer In Phase 5
High-Quality Growth & Momentum	Stability, Defense,

Investment Trends (Factors):

Laggards:

Factor	Category
High EPS Dispersion	Risk
High Price Tgt Dispersion	Risk
High Book Yield	Valuation

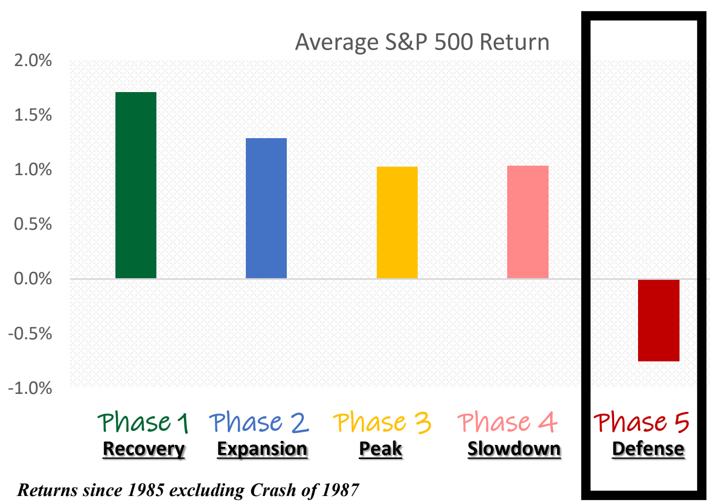
Leaders:

Factor	Category
Low Beta	Stability
Low Debt to Equity	Stability
High Interest Coverage	Coverage

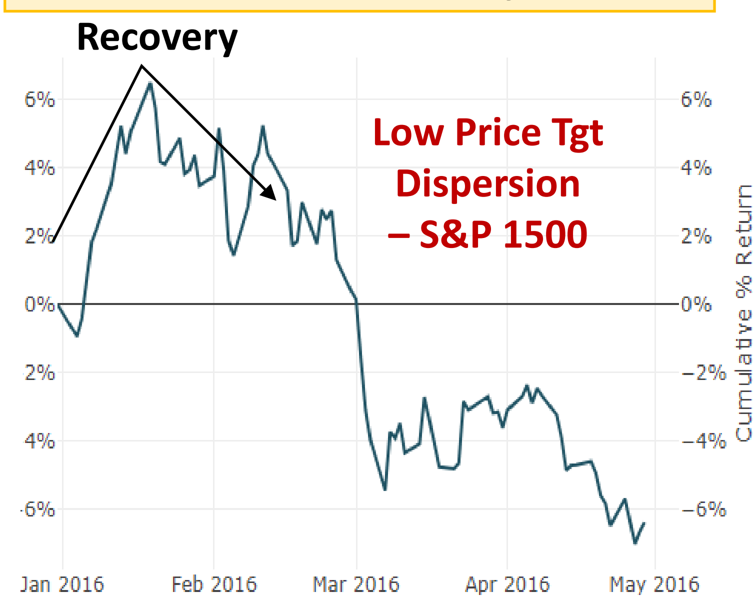
What Happens In Phase 5?

The Worst Phase For Mkt Returns

Investors Take Shelter In Defense Until The Recovery Starts

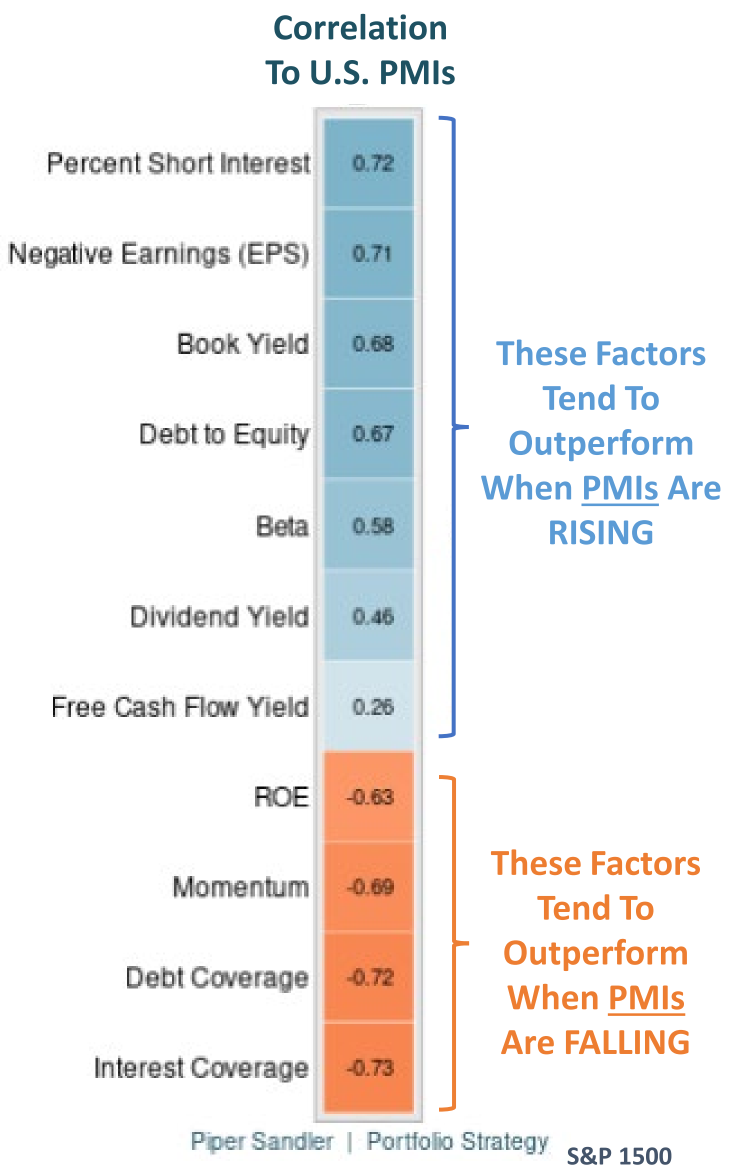


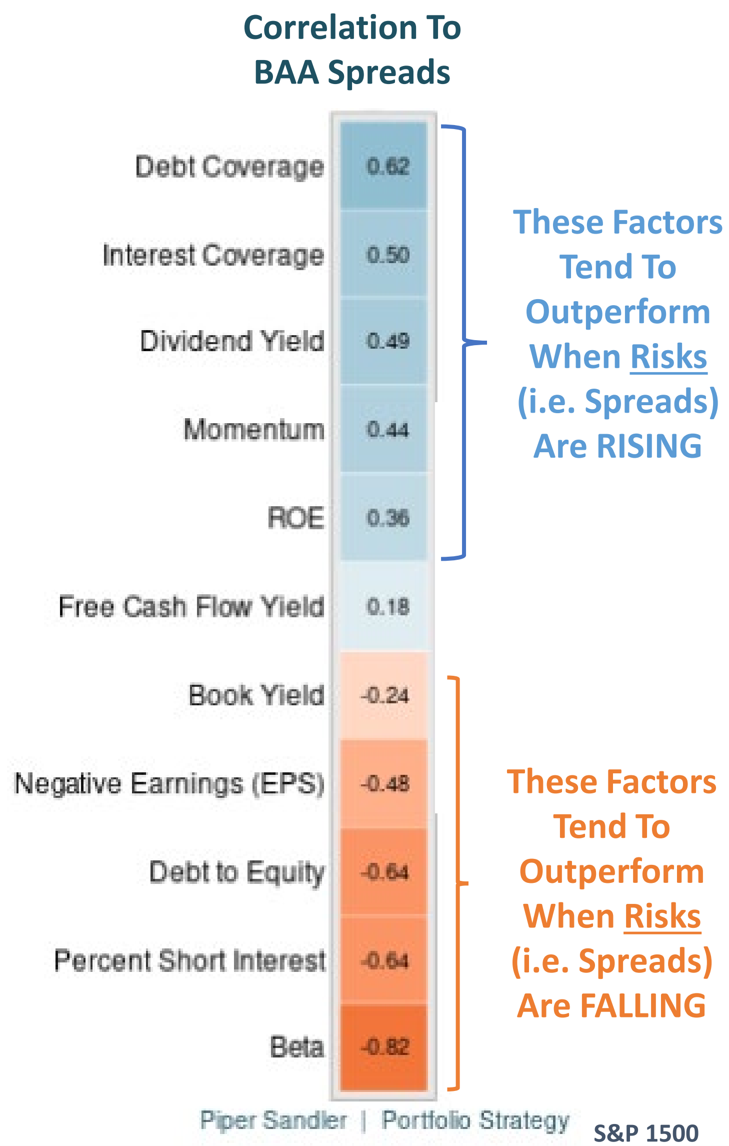
Returns since 1985 excluding Crash of 1987



Factor Sensitivities To Macro Economic Variables

Knowing a factor's exposure to different macro variables is essential for portfolio management. As we've shown, different factors take center stage during different parts of the market cycle. A large driver for this change in factor leadership is the relationship between different macro variables and factors.





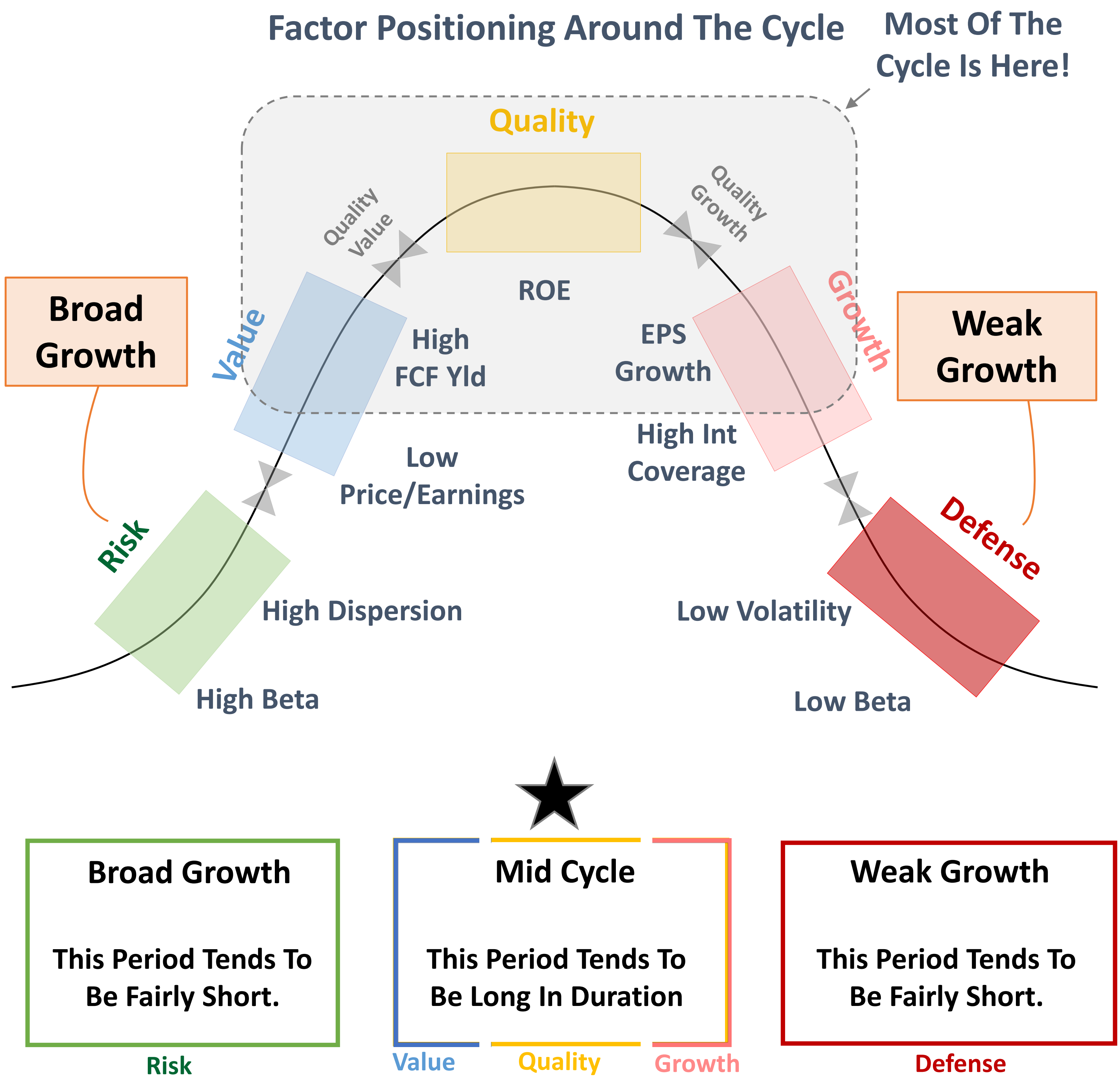
The analysis above shows factor correlations to the US PMI and credit spreads (a great barometer of risk). A key takeaway is that the factors that are most positively correlated to the US PMI (i.e. the most cyclical) include high % short interest, negative earnings and high beta. Alternatively when it comes to factors and their sensitivity to risk (i.e. baa spreads); defense, profitability and growth factors do best when risks are rising.

Note the analysis above comes from the "Econ Correlations" tab of our Factor Dashboard.

Most Of The Cycle We Are Somewhere In The Middle

While every factor has its time to shine depending on where we are in the cycle, there are significant differences in how factors perform over the long haul (throughout the entirety of the cycle). While high beta tends to outperform massively early in the cycle, its outperformance tends to be fairly brief. The same can be said for low beta which outperforms when growth is at its weakest of the cycle. The factors that perform best mid cycle tend to be the ones that outperform most often.

Factor Positioning Around The Cycle



Which Factors Perform Best Over The Long Haul

Quality Factors Tend To Outperform Most Often

To answer the frequently asked question "which factors outperform most often?" we conducted a study where we went back in history and calculated the percentage of quarters that different factors outperformed.

The table to the right shows that mid-cycle (i.e. quality) factors like FCF Yield, coverage, ROE, etc. outperform most frequently! Their rare underperformance tends to occur in strong and broad-based earnings recoveries where investors reach for risk (i.e. after recessions).

In contrast, the risk factors (i.e. negative earnings, high sales variance, etc.) outperform the least often.

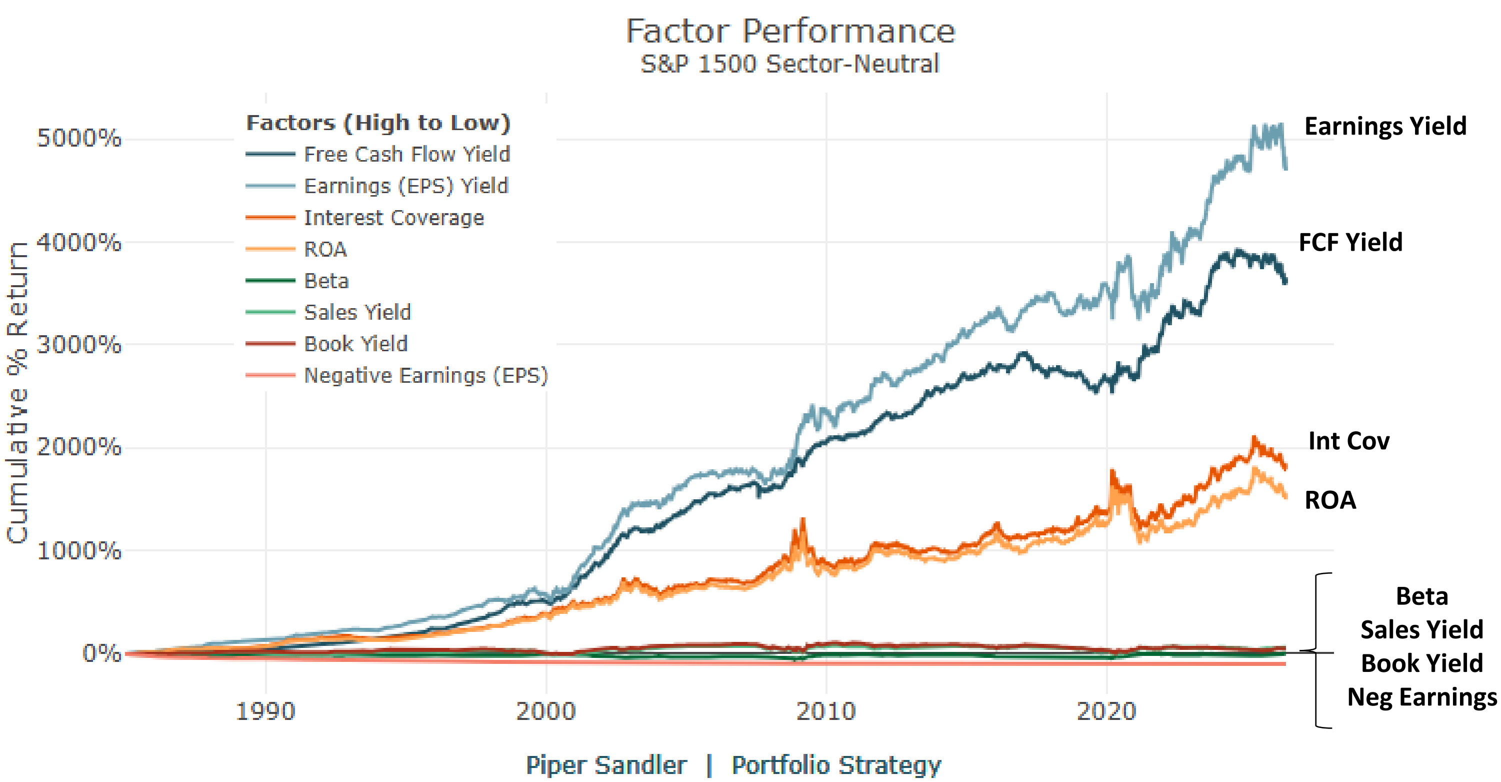
	% of Qtrs Outperforming
FCF Yield	80.6%
EPS Yield	75.2%
Int. Coverage	69.7%
ROE	68.5%
ROIC	67.3%
Market Value	64.8%
ROA	64.2%
Dividend Growth	64.2%
EPS Growth	59.4%
Dividend Yield	52.1%
Sales Yield	50.9%
Beta	50.9%
Book Yield	43.6%
Debt to Equity	40.6%
Sales Variance	37.0%
Negative EPS	32.1%

Higher Quality Factors Outperform Most Of The Time …

… Risk Factors Outperform Less Often (Usually Early In Recoveries)

S&P 1500, 1985 – Current, Top Quintile Relative To Bottom Quintile, Sector Neutral

If You Plan To Buy And Hold … Focus On Higher Quality Factors



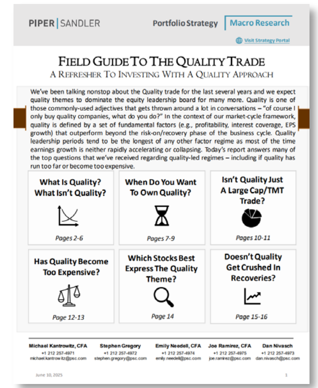
Which Quality Factors Are Best?

Over the long haul, quality factors tend to be the top performing of all the 100+ factors we track, but which quality factors are *best*?

There is a range of factors that would fall under the quality umbrella, and everyone seems to have a different definition of quality. Below we show that the top and most consistent outperformers amongst quality factors are the coverage ratios and ROIC/ROE. For more information on quality, check out our [field guide](#) to the quality trade.

The rare period where high quality factors *underperform* are typically early in recoveries when you tend to see "junk" rallies.

[Link To Full Field Guide To The Quality Trade Report](#)

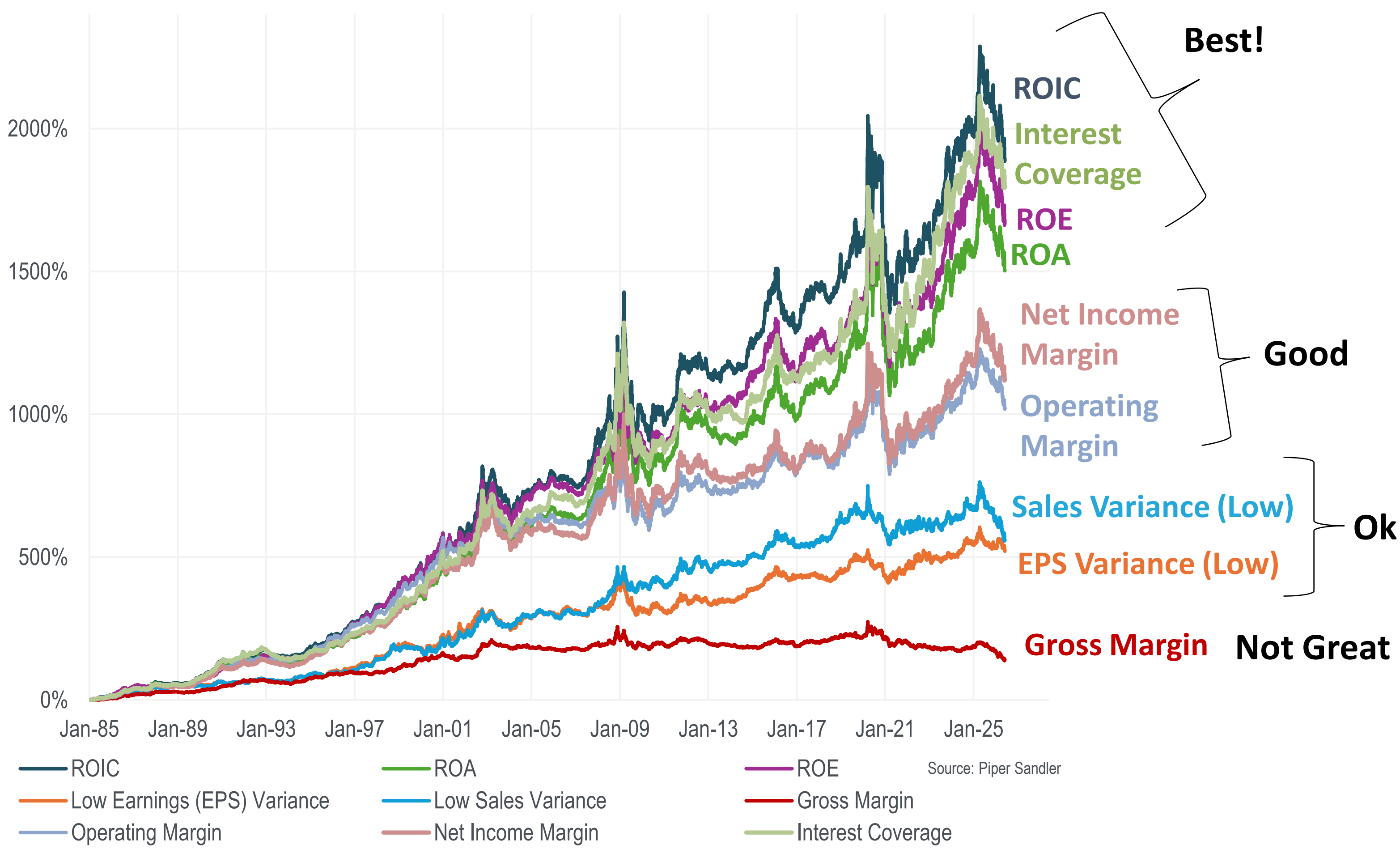


Top Quality Metrics

High ROE, ROIC, ROA

High Interest Coverage

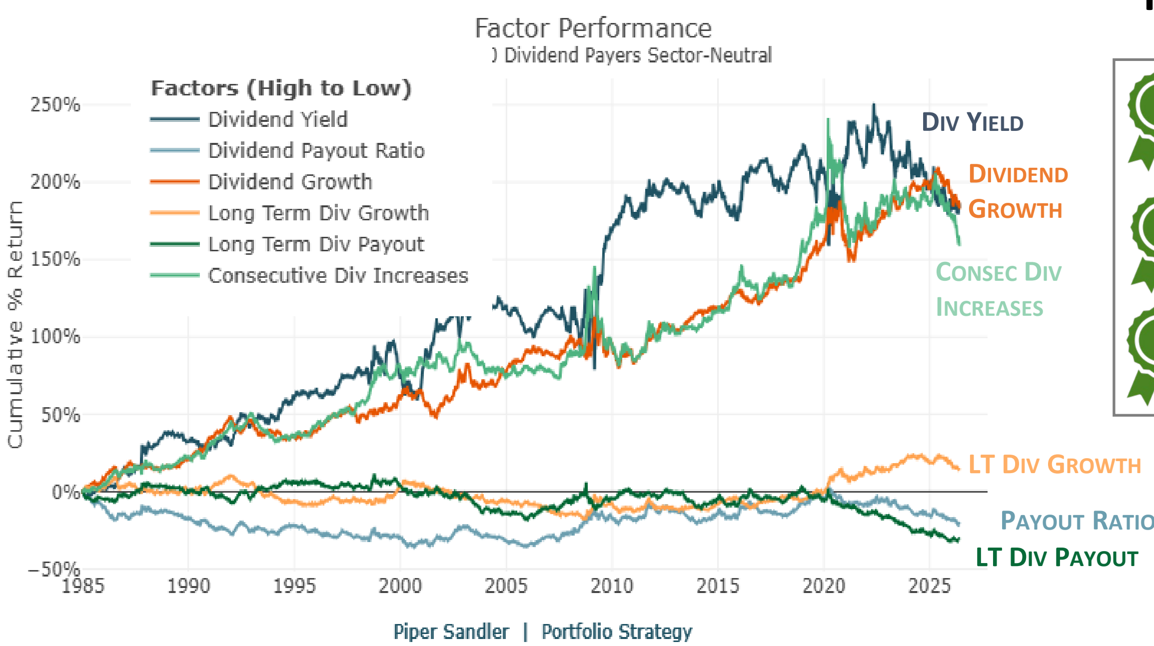
Quality Factor Performance Differs Greatly



S&P 1500 High To Low Factor Performance (Cumulative Return) Unless Otherwise Indicated

Which Are The Best Dividend Factors Over Time?

For those investors with an income mandate, we evaluated various dividend factors over time. Even though high dividend yield was historically thought of as a stable/high quality trait due to the cushion of the dividend payment, the factor is actually quite cyclical and there are alternative dividend factors with more consistent performance over time! *Note: High dividend yield has cyclical traits because: 1) dividend yield is inherently a value factor (yield = dividend/price) and 2) dividend cuts are business-cycle sensitive.* See a more detailed report on dividend stocks.



Top Income Metrics

- Dividend Growth
- Dividend Yield
- Consecutive Div Increases

Correlation Of Dividend Factors To:

US PMI (Most Cyclical → Least Cyclical)

	US PMI
Div Yield	0.71
Long Term Div Payout	0.16
Div Payout	0.05
Long Term Div Growth	-0.21
Div Growth	-0.49
Consecutive Div Increases	-0.58

ROE (Lower Quality → Higher Quality)

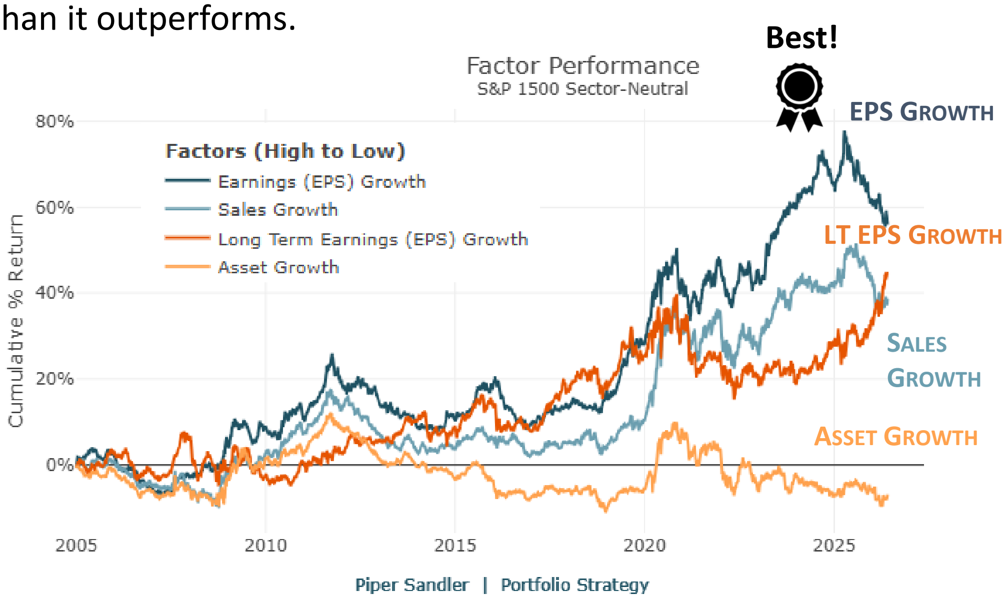
	ROE
Div Yield	-0.74
Long Term Div Payout	-0.32
Div Payout Ratio	-0.04
Long Term Div Growth	0.5
Consecutive Div Increases	0.63
Div Growth	0.71

Book Yield (Deep Value → Growth-y)

	Book Yield
Div Yield	0.8
Long Term Div Payout	0.04
Div Payout Ratio	-0.19
Long Term Div Growth	-0.27
Div Growth	-0.7
Consecutive Div Increases	-0.74

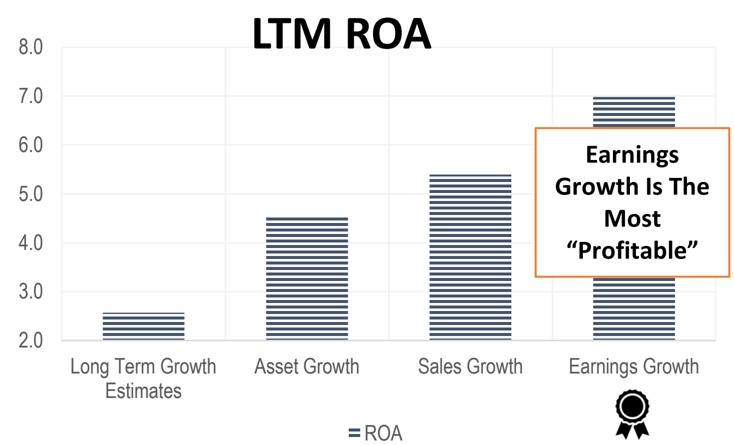
Which Are The Best Growth Factors Over Time?

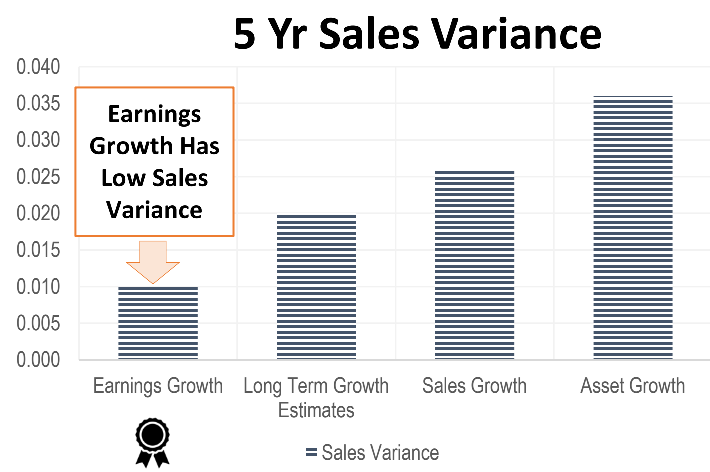
There are significant differences in the performance of various growth factors. Of the four growth factors listed below, realized earnings growth is the highest quality and has also delivered the strongest and most consistent outperformance. Sales growth is barely better than a coin toss when it comes to the % of quarters where it outperforms and asset growth underperforms more than it outperforms.

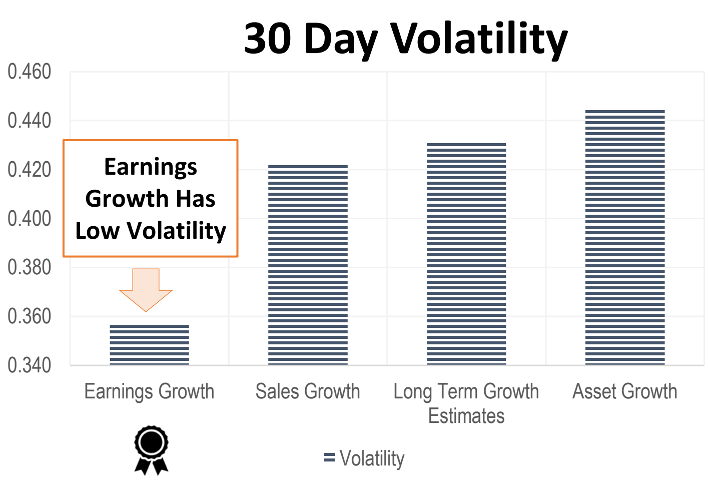


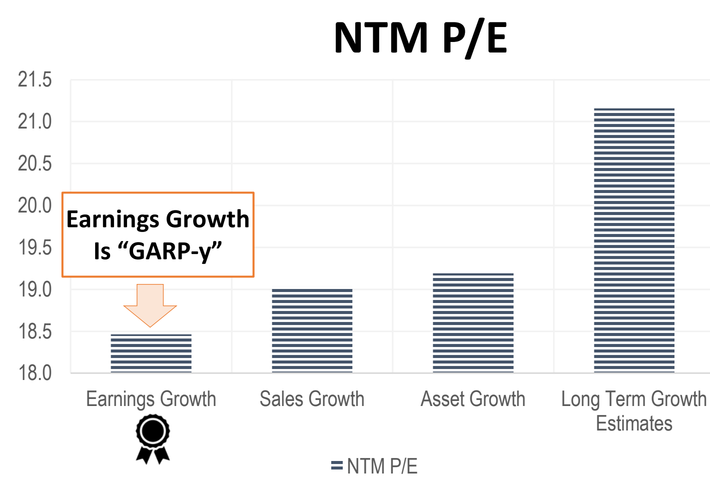
Top Growth Metrics

- EPS Growth
- Long-Term EPS Growth







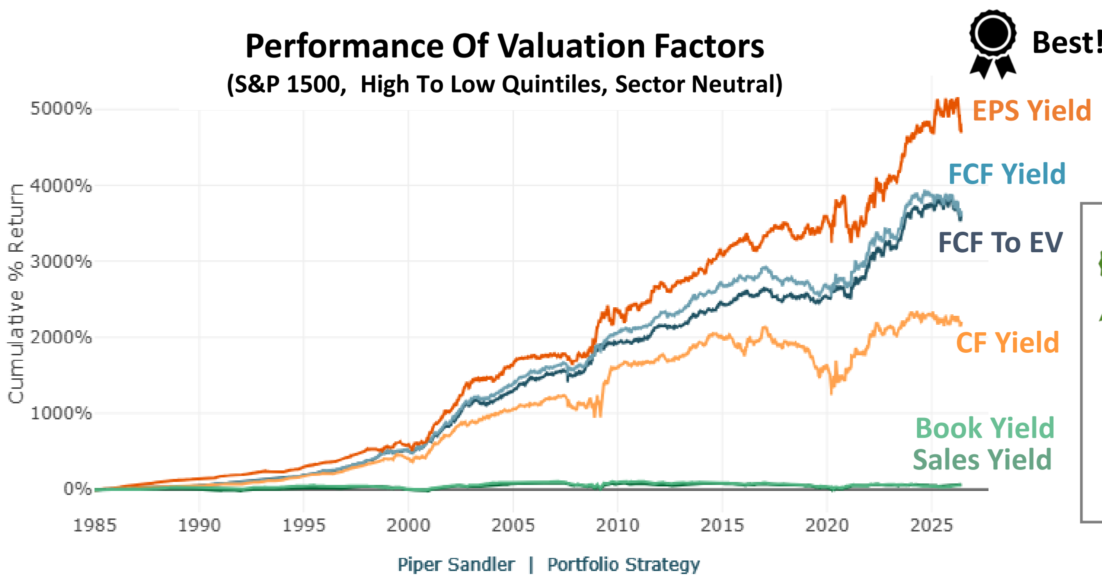


These Are Attributes Of Top Quintile Sector-Neutral Growth Factor Baskets From The S&P 1500

Which Are The Best Value Factors Over Time?

There are many different value factors out there and there is a very different performance profile across them. Different Income and Cash Flow Statement items represent different levels of quality. For example, free cash flow is a higher-quality financial item compared to net income. The charts below show that over time, the higher quality (i.e. less cyclical) valuation factors tend to outperform their lower quality peers.

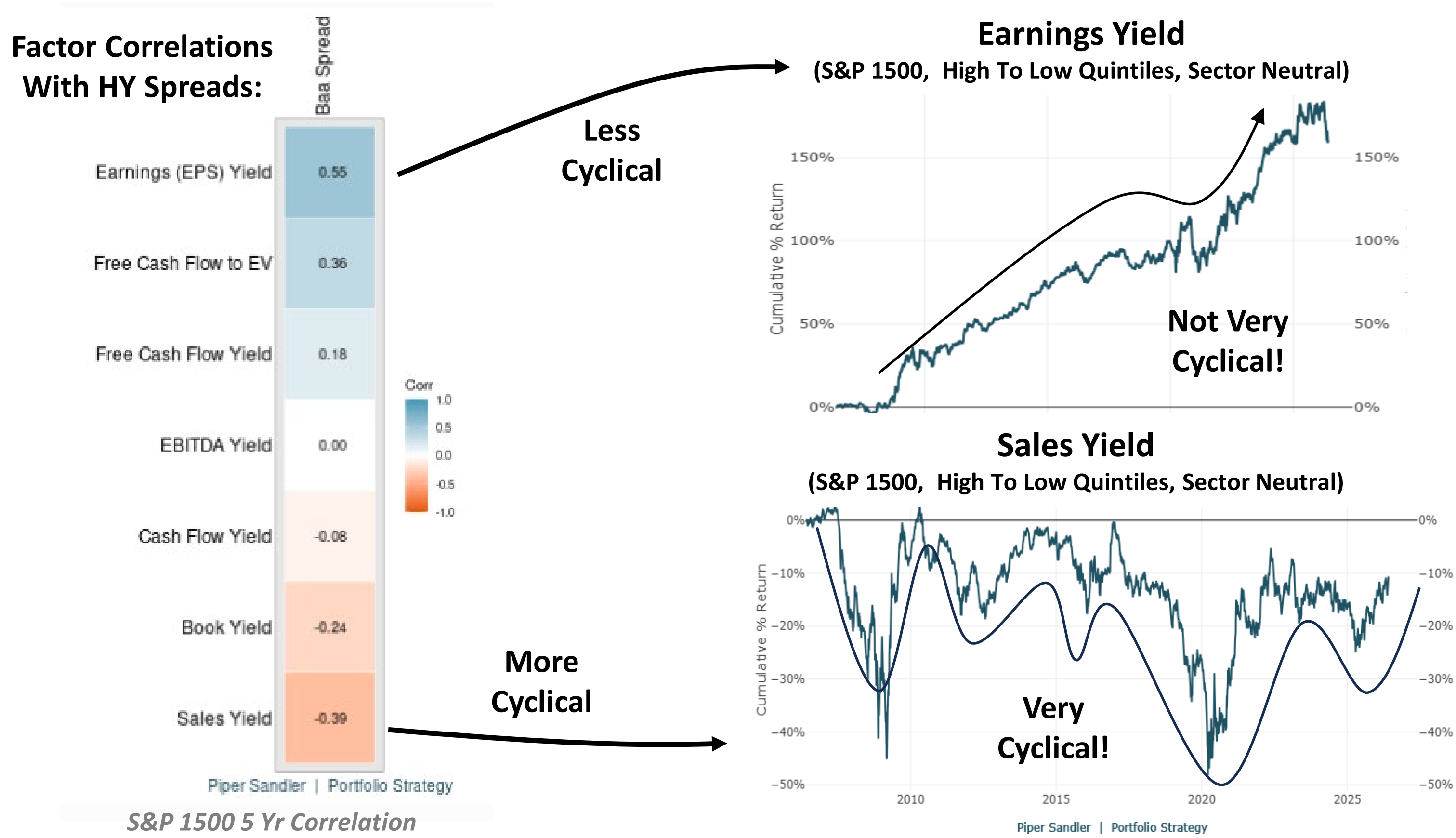
Over The Long Haul, Higher Quality Value Factors Outperform



Top Value Metrics

- Free Cash Flow to EV/Free Cash Flow Yield
- Earnings Yield

Cyclical Value Factors Tend To Lag Their High-Quality Peers



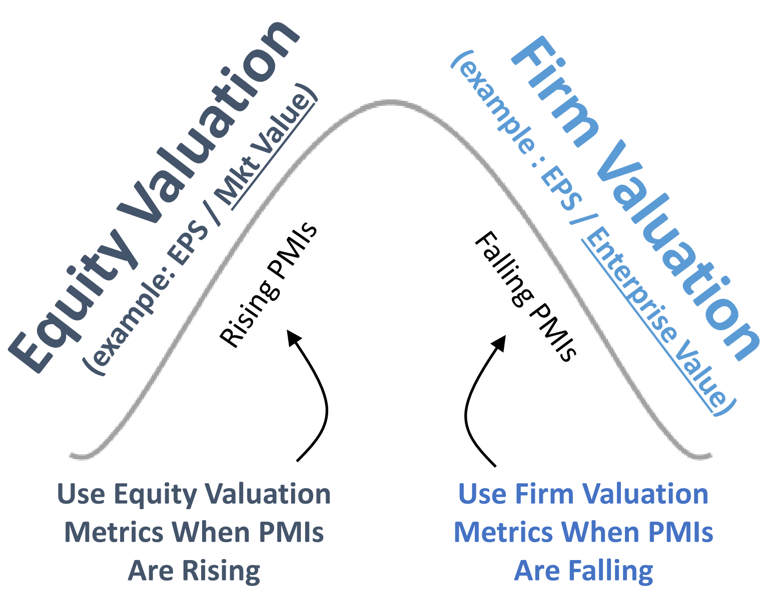
S&P 1500 5 Yr Correlation

Which Valuation Factors Work Best? It Depends Where You Are In The Cycle!

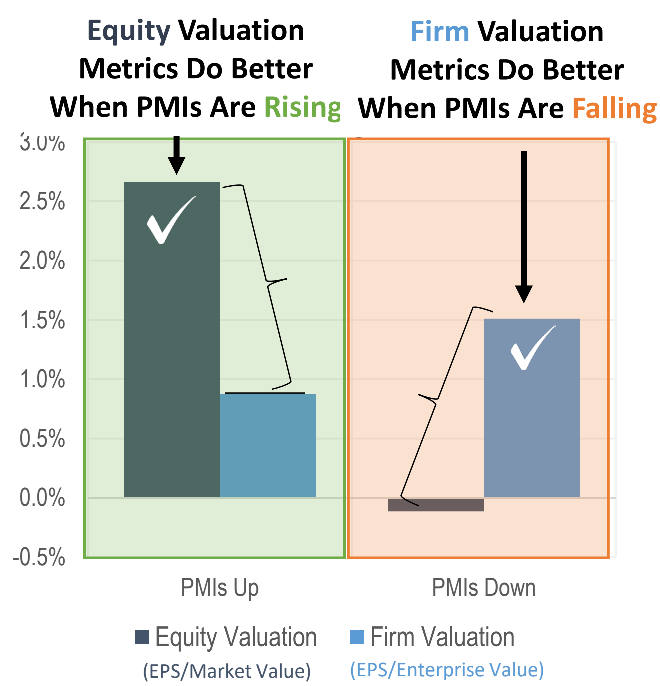
Being cycle aware can help investors with a value mandate outperform in different parts of the cycle. There are many different valuation metrics out there; When the economic backdrop is strong, investors tend to focus on equity valuation (i.e. P/E), as the positive effects of leverage are attractive. Conversely, when the economic backdrop is slowing, investors tend to focus on the entire capital structure and in turn focus more on firm valuation metrics (i.e. EBIT/EV). Using firm valuation factors as opposed to equity valuation factors in the latter stages of the cycle can make a difference between making and losing money.

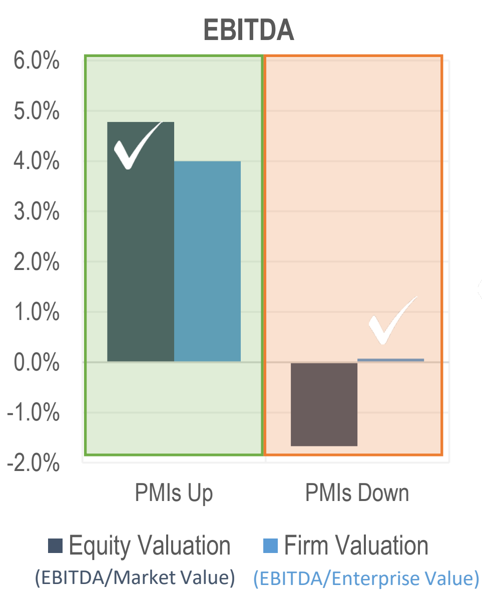
When To Use Equity Vs. Firm Valuation Metrics To Pick Stocks

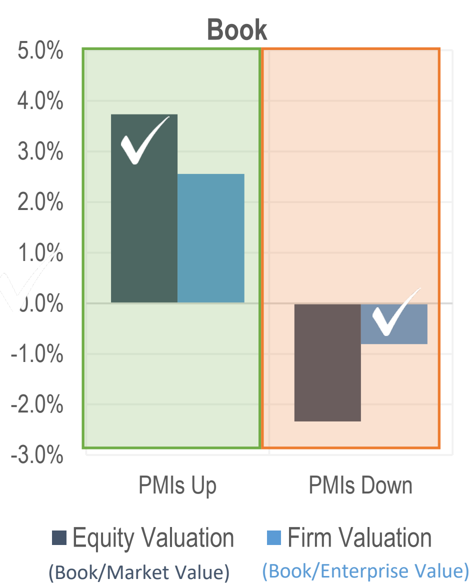
Equity Vs. Firm Valuation Around The Cycle:

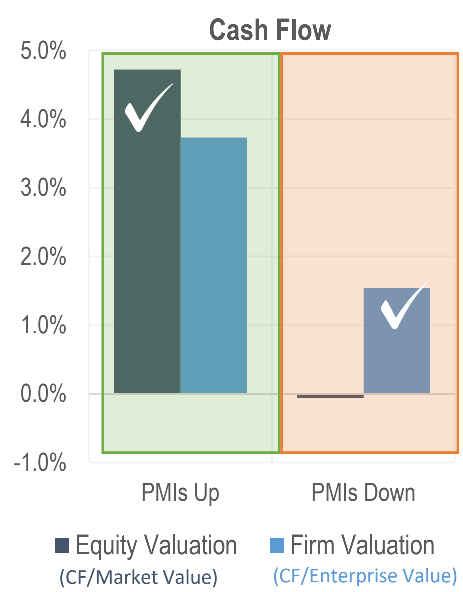


Earnings Example:





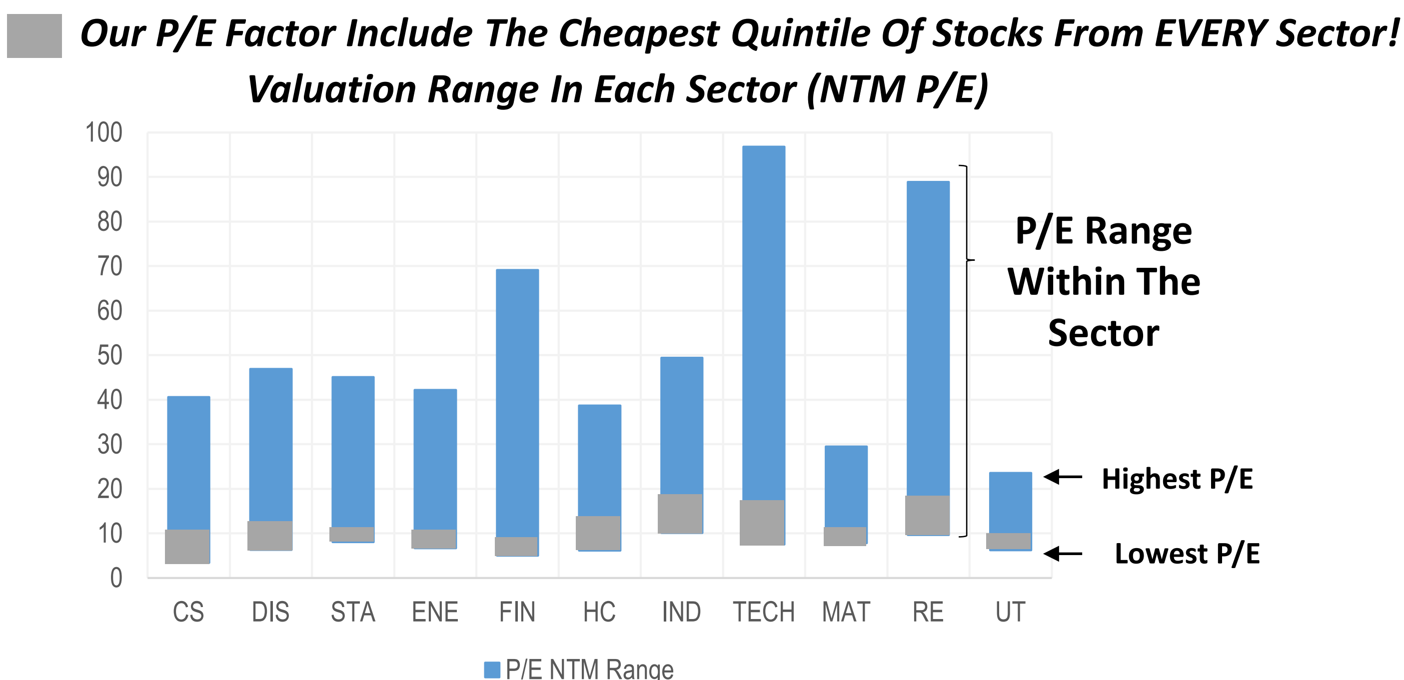




The Importance Of Sector Neutralizing Your Factors

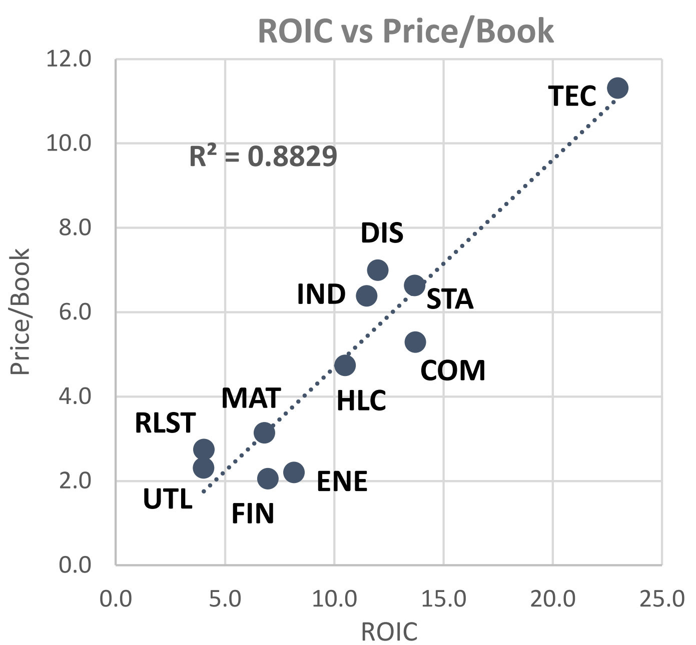
We often talk about the importance of sector neutralizing your factors to avoid having extreme sector biases in your factor baskets. Value factors are a great example of why this is important - if you don't sector adjust, your value basket will be massively overweight financials and underweight tech. We sector neutralize all of our factors by looking at performance of the highest quintile from *each* sector relative to the lowest quintile from each sector. This process removes any sector biases so we can isolate the *factor's* performance.

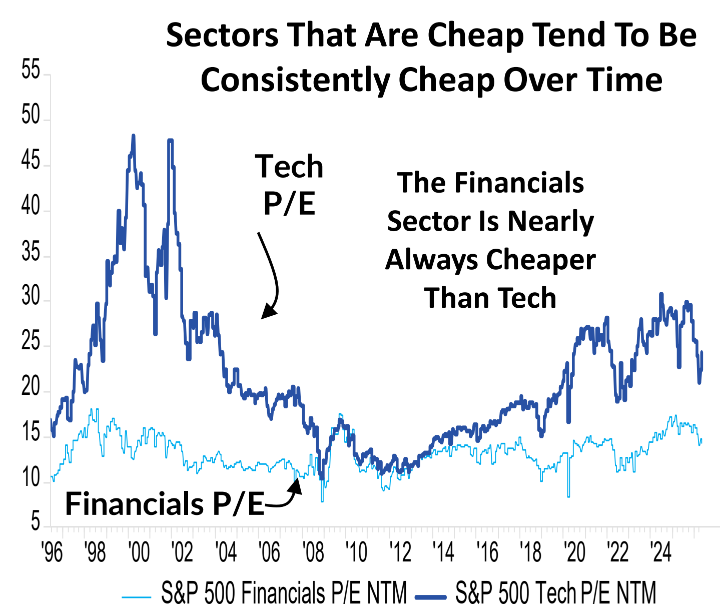
Sector Adjusting: P/E Example



Source: Piper Sandler

If You Don't Sector Adjust … You End Up With Sector Baskets, Not Factor Baskets





Factor Leadership – Two Resources For Monitoring Factor Trends

Monitoring factor trends is essential for investors to be aware of what is working under the surface of markets. We have two tools for clients that want to be more "factor informed". Our Chartbooks are an easy-to-digest set of charts that allow investors to quickly scroll through and see which themes and which commonly-followed factors are in (and out) of favor. The second tool is our interactive factor dashboard which allows investors to track performance of over 100 factors in a large variety of universes. The factor dashboard also has sophisticated factor analytics, portfolio analytics, stock screening capabilities and more.

A SIMPLE Update Of Which Factors Are Working!

1) To Visit Our CHARTBOOKS Click Here!

The Chartbook is an easy-to-digest set of charts that allow investors to scroll through and see which themes and which commonly-followed factors are in (and out) of favor.

Click The Links Below For Market & Sector-specific Chartbooks:

Large Cap	Small Cap	Value	Growth	Comm Srvs
Discretionary	Staples	Energy	Financials	Health Care
Industrials	Tech	Materials	Real Estate	Utilities
MSCI ACWI	MSCI EAFE	TSX Comp	Nikkei 225	MSCI China

An INTERACTIVE Analysis Of Over 100 Factors!

2) To Visit Our FACTOR DASHBOARD Click Here!

- **Track Factor Performance**
- **See Factor Correlations**
- **Factor Screener**
- **Portfolio Factor Attribution**
- **Etc.**

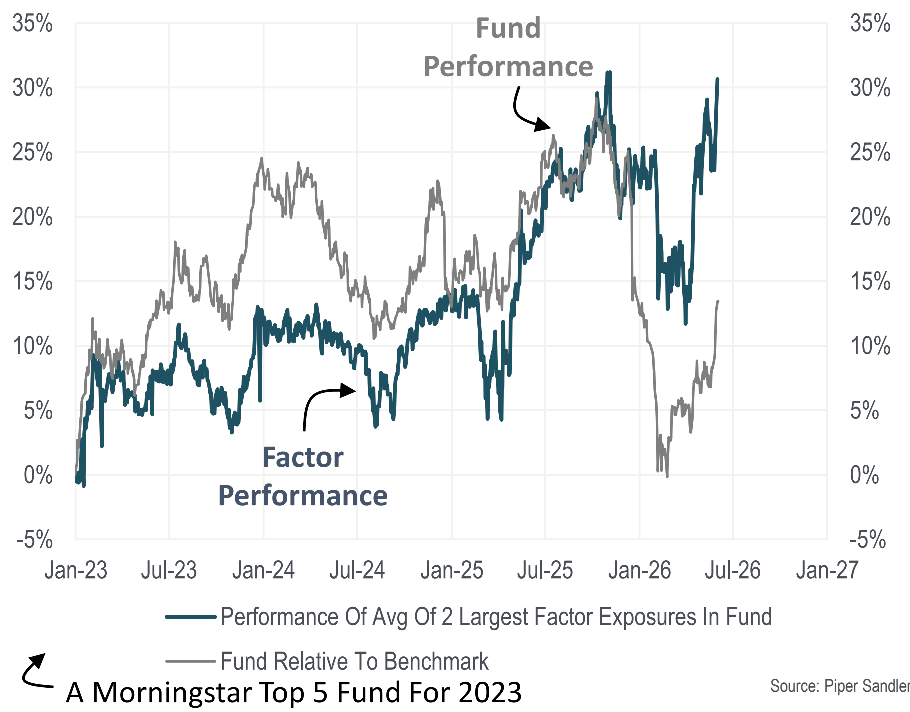
Which Factors Are YOU Most Exposed To?

Factor exposures often do a great job of explaining a portfolio's return profile. As an example, we took one of the top performing funds (per Morningstar) and pasted it into our portfolio attribution tool to find the top factor exposures. We then lined the fund's relative performance up with performance of the fund's largest two factor exposures. The result was the chart on the right.

To see the factor exposures of YOUR holdings, visit the Portfolio tab on our Factor Dashboard.

Email us at strategy@psc.com to set up a quick walkthrough on how to interpret the results.

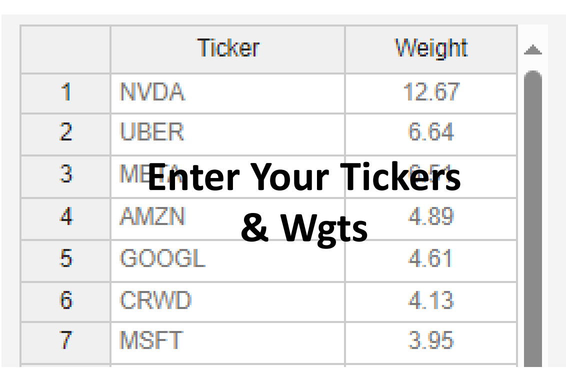
Factor Exposures Often Explain Fund Performance



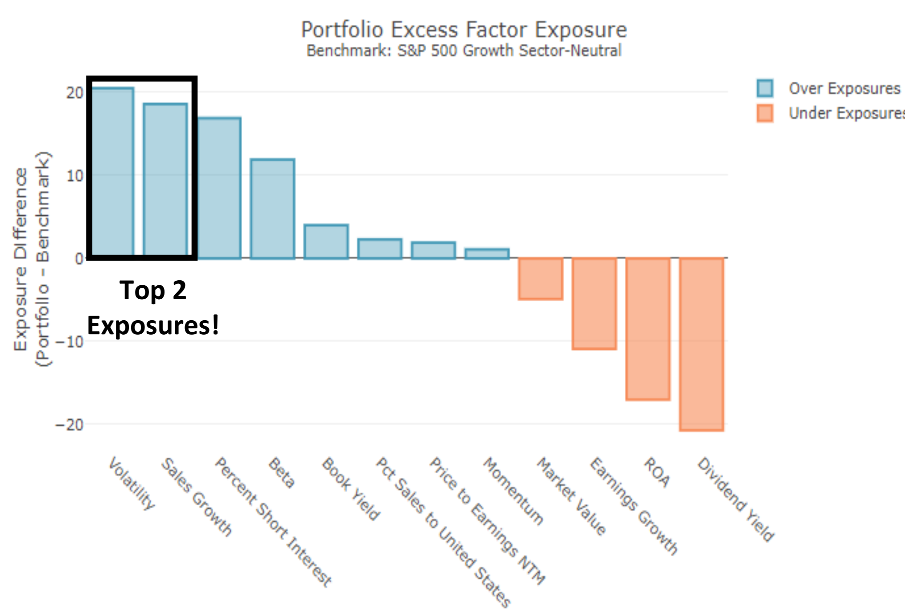
Visit Our Factor Dashboard To See Which Factors You Are Exposed To

Over 100 Fundamental Factors And 1000+ Macro Sensitivity "Factors" To Use In Your Portfolio Analysis

Click Here To Visit The Portfolio Tab Of Our Factor Dashboard

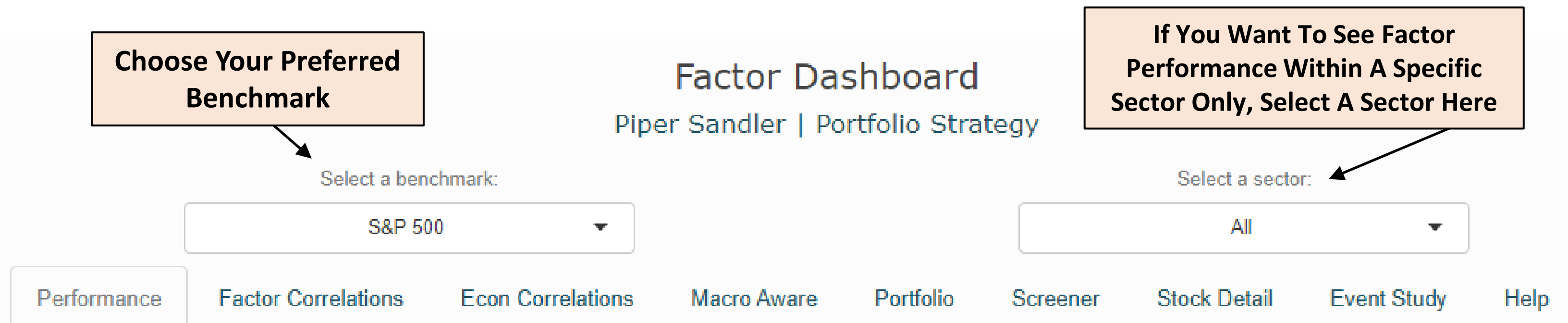


	Ticker	Weight
1	NVDA	12.67
2	UBER	6.64
3	ME[illegible]	[illegible]
4	AMZN	4.89
5	GOOGL	4.61
6	CRWD	4.13
7	MSFT	3.95



Our Factor Dashboard's Features & Tabs

Our Factor Dashboard is a one-stop-shop for all things factor related. The dashboard is highly interactive and allows investors to see factor data within a variety of different universes and even within sectors. So, for example, if a client only cares to see what factor performance looks like within small cap financials, that is an option! The dropdowns at the top of the page (that specify benchmark and sector) flow through to the entire dashboard. There are nine different tabs, each with a different purpose. Check out the summaries below and please reach out to us with questions/feedback at strategy@psc.com!



Most Popular Tabs On Factor Dashboard

Performance: Track the performance of over 100 fundamental factors (updated daily) and rank performance in table form.

Portfolio: Paste in your tickers and weights to see how your portfolio compares to a chosen benchmark in terms of factor/macro exposures.

Macro Aware: Take a deeper dive into our selection of over 1000 "Macro Sensitivity" factors alongside the data they are sensitive to.

Screener: Screen for stocks with specific factor traits within any of the available equity universes. The screener allows investors to select up to eight factors.

Stock Detail: Select a ticker and view factor data for that individual stock. See how that stock compares to sector peers in terms of factor/macro portfolio quintiles.

Help: There is information on the Help tab about how to use each tab on the dashboard. Factor/Macro Basket definitions can also be found here.

More Field Guides From The Strategy Team

Field Guide to Macro & Markets ← **We Hope You Enjoyed Today's Guide**

Field Guide to Factors

Field Guide to the Strategy Portal

Field Guide To Quality

Field Guide To NBER Recessions

Field Guide To Market Corrections

Field Guide To Momentum

Field Guide To Asset Bubbles

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Links To Qtrly Market Recaps

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1Q24	2Q24	3Q24	2024
1Q25	2Q25	3Q25	2025
1Q26			

Weekly Audio & Video Updates

Click Here To View Our Friday Video Catalogue

Click Here To Listen To The Podcast (New Episodes Every Weekend)

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