Equity factor report

2025 Q3: Value outperformance

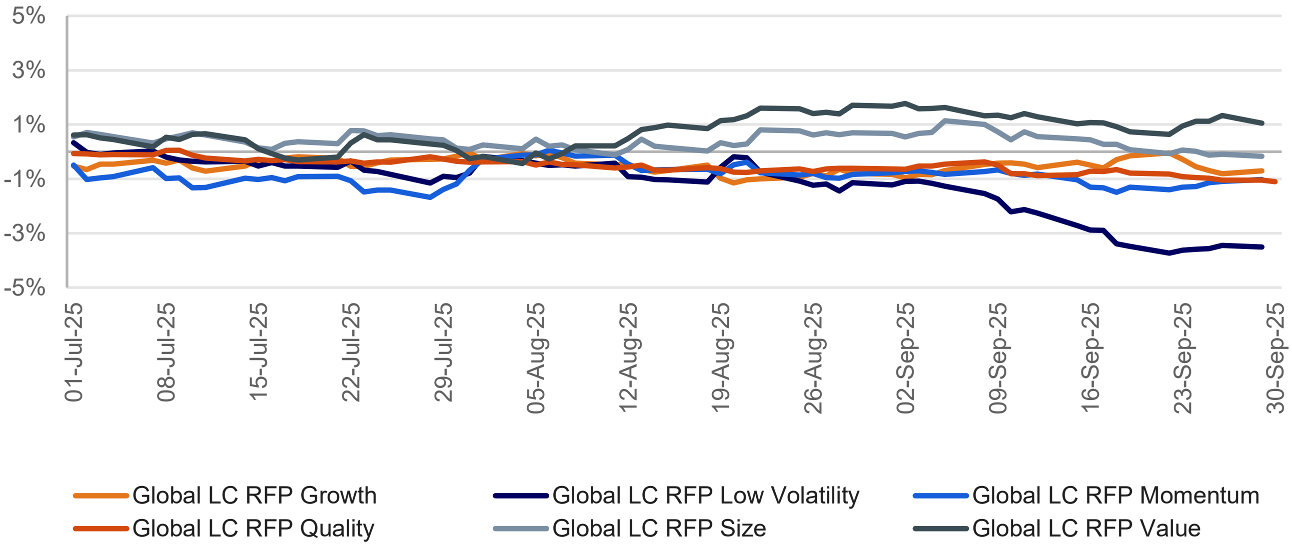
Overview

Equity indices continued their rally in Q3 2025. In the U.S., anticipated rate cuts resulted in small-cap stocks outperforming large-cap stocks, with the Russell 2000 Index gaining 12.4% compared to 8% for the Russell 1000 Index. Large-cap stocks also continued to rally, though at a slower pace than the previous quarter. This uptick was mostly driven by strong earnings growth and easing trade tensions, with the Russell 1000 Index and the MSCI World ex USA Index returning 8% and 5.4%, respectively.

There was a shift in factor performance, with Value outperforming Growth—a reversal from the second quarter. In the prevailing risk-on environment, Low Volatility strategies saw relatively lower returns. Momentum and Quality, meanwhile, remained largely neutral.

Exhibit 1: Cumulative Excess Returns

For Global Russell Investments Portfolios vs. MSCI ACWI



Source: Russell Investments and MSCI; July 1, 2025, to September 30, 2025.

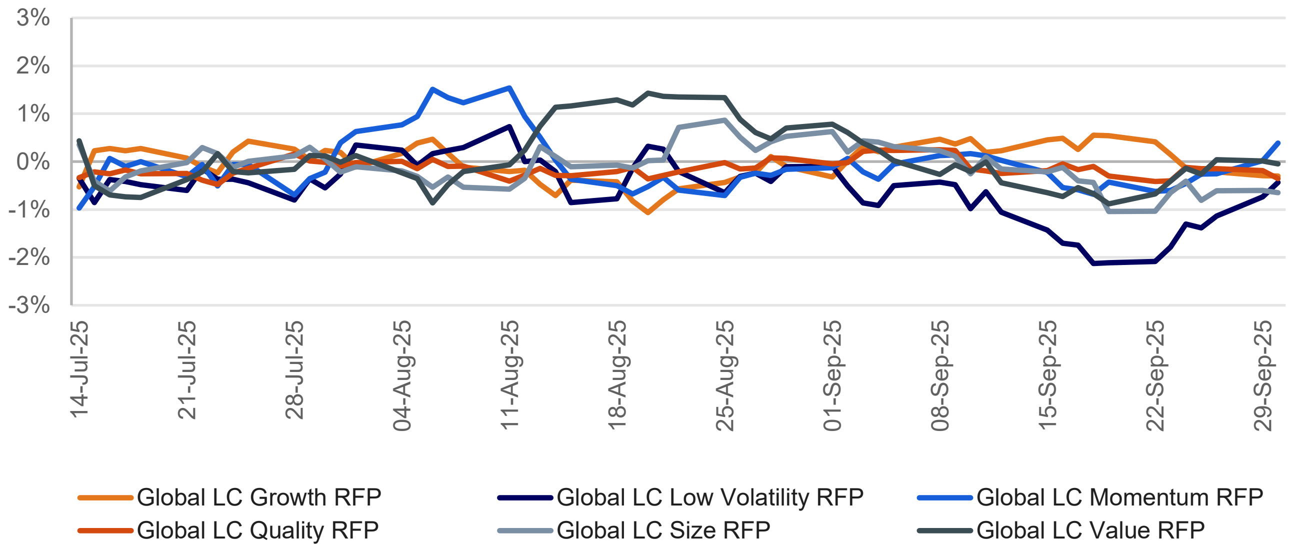
Factor performance

Global Russell Investments
Factor Portfolios' performance dynamics

Value Russell Factor Portfolios (RFPs) rallied in the middle of the third quarter after underperforming earlier in the quarter and in the previous quarter. Following strong performance by Growth RFPs in Q2, their returns slowed this quarter. Low Volatility continued to underperform, particularly in the second half of the third quarter, while the remaining factors stayed close to index performance.

Exhibit 2: 10-Day Rolling Excess Returns

For Global RFPs vs. MSCI ACWI

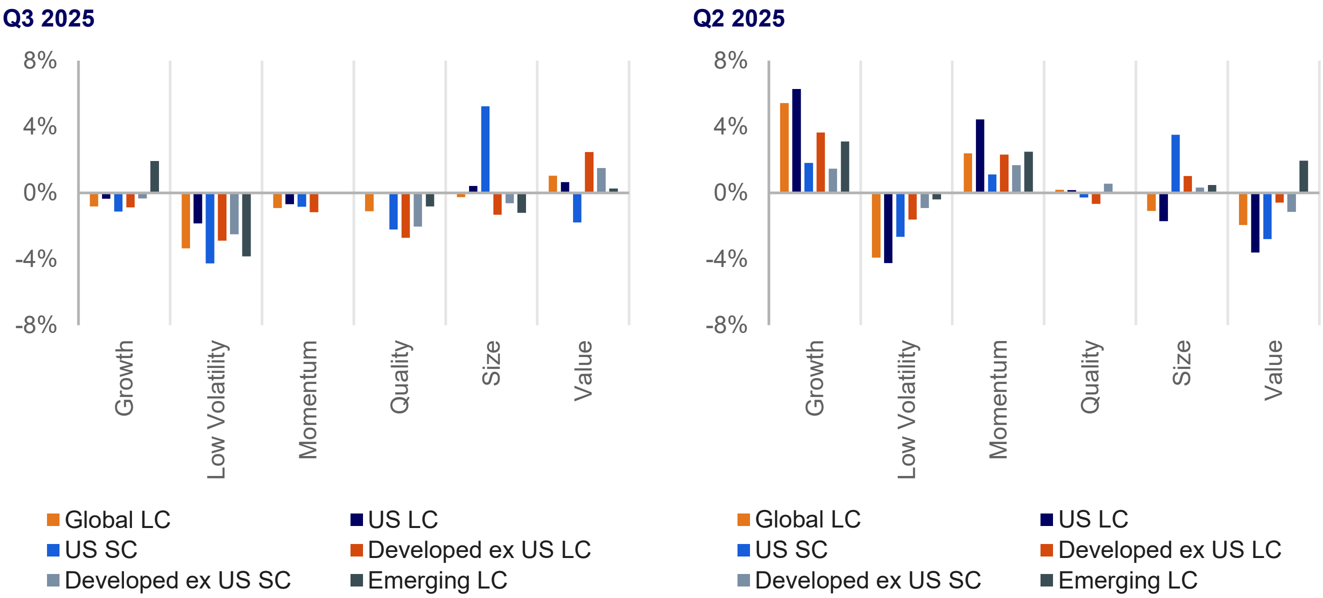


Source: Russell Investments and MSCI; Data as of July 14, 2025, to September 30, 2025.

Russell Investments
Factor Portfolios' performance across regions

Value outperformed in all regions except U.S. Small Cap. This represents a shift compared to the previous quarter, as Growth and Momentum—after a strong performance last quarter—were mostly muted and underperformed. The exception to this was Growth in Emerging Large Cap, which posted positive returns. Low Volatility and Quality underperformed across all regions. Meanwhile, U.S. Small Cap significantly outperformed, delivering 5.2% excess return versus the Russell 2000.

Exhibit 3: Excess Returns of RFPs vs. Corresponding Benchmarks



Source: Russell Investments; FTSE Russell; MSCI

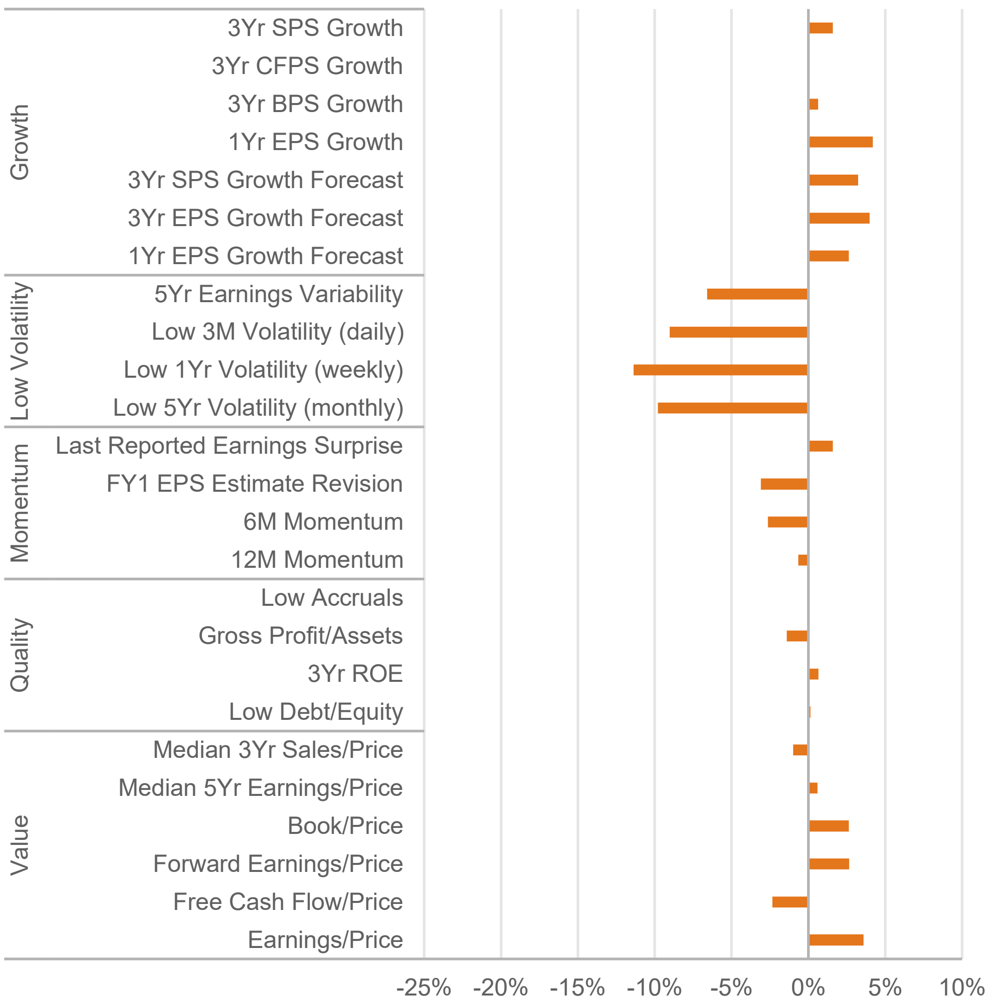
Performance of subfactors in the global universe

Exhibit 4 below illustrates the performance of various subfactors in the MSCI All-Country World Index (ACWI) universe for the last quarter, represented by top-minus-bottom quintile portfolios. Value subfactors performed better than in the previous quarter, with significant improvements in Earnings-to-Price, Book-to-Price, and Forward Earnings-to-Price ratios, which boosted Value RFP performance this quarter. All Growth subfactors delivered positive returns in Q3, continuing the trend from the prior quarter. Momentum and Quality subfactors were mostly muted, while Low Volatility subfactors continued to underperform, with Low 1-Year Weekly Volatility posting the largest negative return for the quarter at -11.38%.

Subfactor Performance

In a reversal from the prior quarter, Value subfactors performed better in Q3. All Growth subfactors posted positive returns, continuing the trend from the previous quarter. Momentum and Quality subfactors were mostly muted, while Low Volatility subfactors continued to underperform.

Exhibit 4: Performance of Cap-weighted Top-minus-bottom Quintiles – Q3 2025



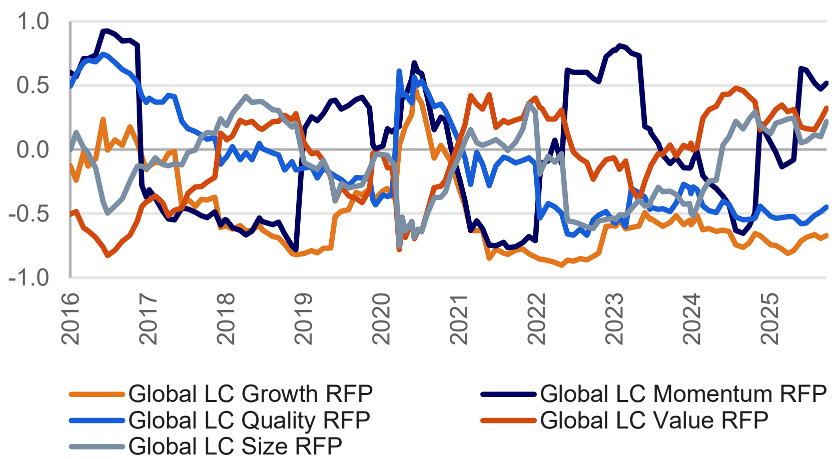
Source: Russell Investments; MSCI; LSEG

Ex-ante correlations and active risk of Global Russell Investments Factor Portfolios

In the third quarter, correlations between Low Volatility and Value and Low Volatility and Size increased, while the correlation with Momentum decreased. Quality and Growth remained steady, as shown in **Exhibit 5** below.

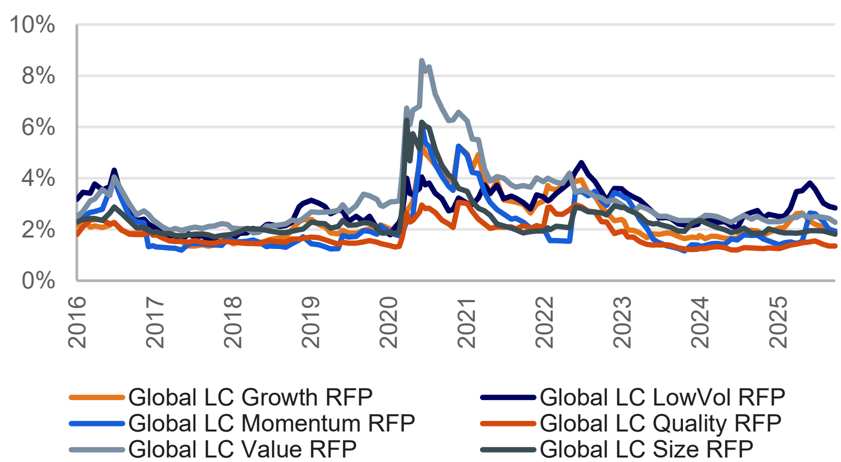
Ex-ante active risk levels—predictive measures of the active risk associated with factor portfolios shown in Exhibit 6—remained steady throughout the quarter, except for Low Volatility, which declined over the period.

Exhibit 5: Ex-ante Correlations with Global LC Low Volatility RFP



Source: Russell Investments; Axioma; MSCI;
Data as of January 8, 2016-September 30, 2025.

Exhibit 6: Ex-ante Tracking Errors of Global RFPs



Source: Russell Investments; Axioma; MSCI;
Data as of January 8, 2016-September 30, 2025.

Ex-ante Correlations and Active Risk

The correlation between Momentum and Low Volatility reversed during the third quarter, while the correlation between Global LC Value and Size RFPs and Global LC Low Volatility RFP increased. Ex-ante active risk levels—predictive measures of the active risk associated with factor portfolios—continued to flatten, with Low Volatility experiencing a sharp decline following its rise in the previous quarter.

Spotlight On: OAS Signal

We observe that corporate credit option-adjusted spreads (OAS) in the U.S. fixed income market exhibit a mean-reverting pattern, characterized by cyclical upward and downward movements. Periods of historically elevated OAS are often followed by subsequent declines, creating meaningful return opportunities in U.S. credit markets.

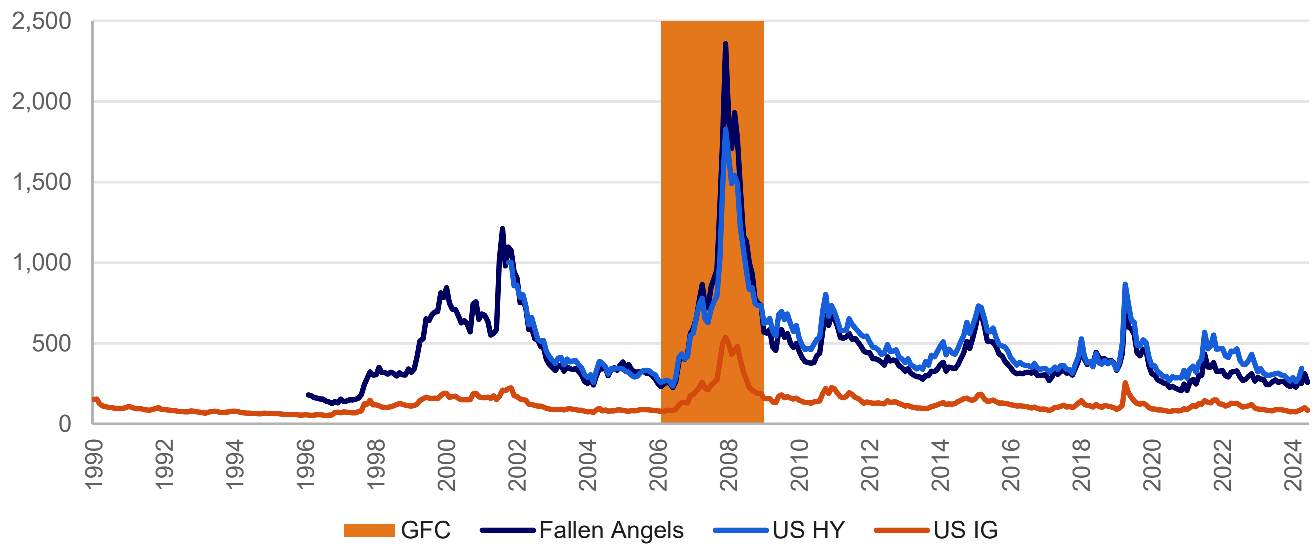
We examine the efficacy of this signal in forecasting turning points of equity factor performance.

Methodology

We calculate the monthly percentile rank of option-adjusted spreads (OAS) for the Bloomberg U.S. Credit, Bloomberg U.S. High Yield, and Bloomberg U.S. Fallen Angel indices, relative to their respective histories since index inception.

We exclude the **Global Financial Crisis (2007–2009)** period from the analysis, as its extreme market dislocation would introduce significant skew into the results. This exclusion removes both the sharp rise in OAS spreads during the crisis and their subsequent recovery phase.

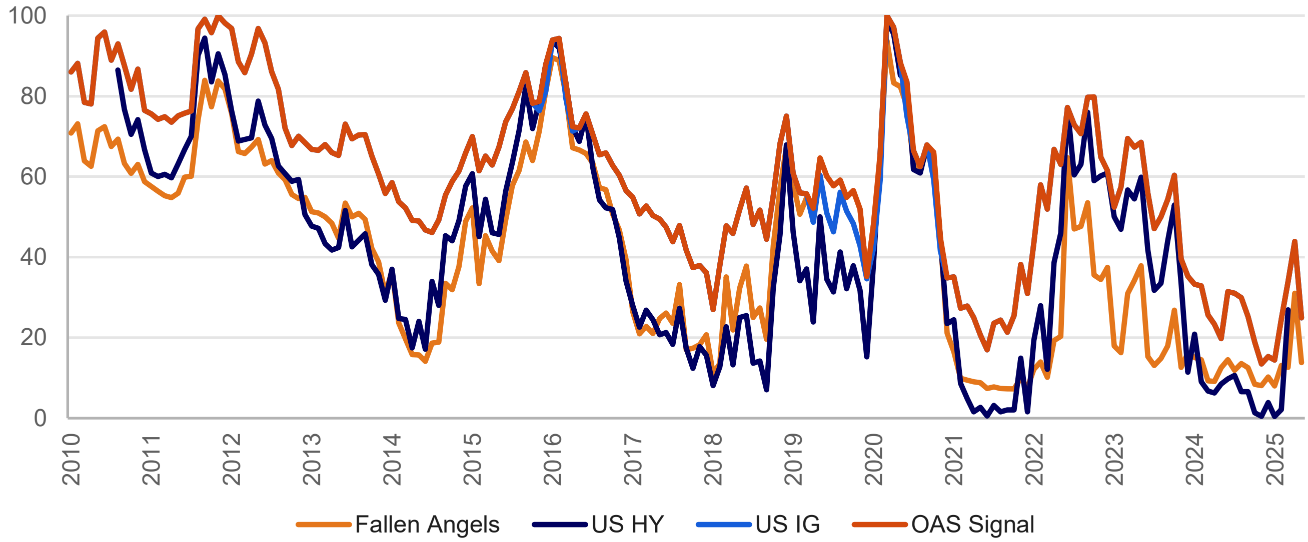
Exhibit 7: Fixed Income OAS



Source: Bloomberg, Bank of America Merrill Lynch

The **OAS Percentile Signal** is defined as the maximum of these three percentiles. A signal is considered *triggered* when it reaches the 90th percentile for the first time within the prior 12 months. Over the available data, this condition was met on four occasions: May 2010, August 2011, January 2016, and March 2020. The chart below illustrates that the three indices exhibit synchronized movements, with both upward and downward trends occurring in tandem.

Exhibit 8: OAS Signal



Source: Bloomberg, Bank of America Merrill Lynch

We begin by comparing the timing of recovery indicated by the OAS Signal with equity index performance. In most cases, equity markets do not exhibit strong or consistent positive returns in the first few months following a trigger, suggesting a lag between credit spread normalization and equity market recovery. The 2020 episode stands as an exception, where markets rebounded immediately after the trigger, reflecting the unprecedented scale and speed of policy intervention during the pandemic.

Exhibit 9a: Recovery timing after trigger

Base Index: Russell 1000

Year Month	Base Index Return	Months Since Trigger	Growth	Low Volatility	Momentum	Quality	Size	Value
2010-05	-7.9%	0	2	1	4	5	6	3
2010-06	-5.6%	1	3	1	6	2	5	4
2010-07	6.9%	2	4	6	1	5	3	2
2010-08	-4.5%	3	5	1	6	2	4	3
2011-08	-5.8%	0	6	1	4	2	5	3
2011-09	-7.5%	1	6	1	5	2	4	3
2011-10	11.2%	2	2	6	1	5	3	4
2011-11	-0.3%	3	6	1	5	2	3	4
2016-01	-5.4%	0	6	1	3	2	4	5
2016-02	0.0%	1	5	4	6	3	2	1
2016-03	7.0%	2	4	3	6	5	1	2
2016-04	0.5%	3	5	3	4	6	1	2
2020-03	-13.2%	0	2	4	3	1	5	6
2020-04	13.2%	1	2	6	5	4	1	3
2020-05	5.3%	2	1	4	2	3	5	6
2020-06	2.2%	3	2	6	3	4	1	5

Source: FTSE-Russell, Russell Investments

Exhibit 9b: Recovery timing after trigger

Base Index: Russell 2000

Year Month	Base Index Return	Months Since Trigger	Growth	Low Volatility	Momentum	Quality	Size	Value
2010-05	-7.6%	0	3	1	4	2	6	5
2010-06	-7.8%	1	3	1	5	2	6	4
2010-07	6.9%	2	3	6	1	5	4	2
2010-08	-7.4%	3	3	1	4	2	6	5
2011-08	-8.7%	0	5	1	4	2	6	3
2011-09	-11.2%	1	5	1	6	2	4	3
2011-10	15.1%	2	2	6	1	4	5	3
2011-11	-0.4%	3	5	1	3	4	6	2
2016-01	-8.8%	0	5	1	4	3	6	2
2016-02	0.0%	1	4	3	6	2	5	1
2016-03	8.0%	2	4	3	6	5	1	2
2016-04	1.6%	3	3	5	4	6	1	2
2020-03	-21.7%	0	4	3	2	1	5	6
2020-04	13.7%	1	3	6	4	5	1	2
2020-05	6.5%	2	1	6	2	3	5	4
2020-06	3.5%	3	2	6	4	5	1	3

Source: FTSE-Russell, Russell Investments

We calculate the forward excess returns for each equity factor portfolio over two horizons: the first 3 months following the triggered month (month 1-3), and an additional 12 months thereafter (month 4-16). For each return observation, we also compute its rank among the factors. The 3-month horizon captures the short-term signal (denoted *short term* in the tables below) at the onset of an OAS mean-reversion period, while the 12-month horizon reflects the medium-term signal (denoted *medium term*) further into the mean-reversion phase.

As shown in Exhibit 9, for the Russell 1000, the **Quality** factor delivered positive excess returns in the short term and consistently ranked among the top-performing factors across all events. This pattern aligns with the broader tendency of Quality to be rewarded near the bottom of recessionary phases, when markets are under peak stress and investors favor exposure to companies with stronger, more resilient fundamentals.

The **Low Volatility** factor delivered strong excess returns during the first three triggers, consistent with its defensive profile being rewarded in uncertain or stressed market environments. However, it severely underperformed following the March 2020 trigger, when the rapid recovery and risk-on sentiment reduced the appeal of defensive exposures. In contrast, both **Momentum** and **Size** factors lagged during the earlier triggers but outperformed strongly after March 2020, reflecting a market regime shift where pro-cyclical and higher-beta exposures were favored as liquidity surged and risk appetite rebounded. This aligns with our earlier observation that the 2020 trigger was followed by a rapid recovery, unlike the other three occasions.

Exhibit 10: Russell 1000 Short-Term Excess Return Factor Performance

	Annualized Excess Return				Rank			
Factor	**2010-05**	**2011-08**	**2016-01**	**2020-03**	**2010-05**	**2011-08**	**2016-01**	**2020-03**
Growth	4.3%	-7.1%	-1.5%	11.8%	3	6	4	2
Low Volatility	19.2%	24.8%	10.8%	-27.6%	1	1	2	6
Momentum	-4.5%	-6.3%	-2.8%	3.7%	5	5	6	4
Quality	9.4%	10.1%	7.7%	6.2%	2	2	3	3
Size	-9.9%	-5.3%	-2.0%	23.6%	6	4	5	1
Value	-1.4%	6.3%	11.4%	-1.4%	4	3	1	5

The table below summarizes the **medium-term** performance for the **Russell 1000**. The **Low Volatility** factor consistently underperformed across all four triggers, reflecting reduced investor preference for defensive exposures during mid-cycle recoveries. In contrast, the **Size** factor, which favors small-cap stocks, generally delivered positive performance, demonstrating the persistent advantage of smaller-cap names in the mid-phase of the mean-reversion periods.

Exhibit 11: Russell 1000 Medium-Term Excess Return Factor Performance

	Annualized Excess Return				Rank			
Factor	**2010-05**	**2011-08**	**2016-01**	**2020-03**	**2010-05**	**2011-08**	**2016-01**	**2020-03**
Growth	3.5%	2.0%	-2.7%	6.8%	2	3	5	1
Low Volatility	-7.1%	-6.5%	-2.0%	-7.7%	6	6	3	6
Momentum	4.2%	-0.7%	-3.5%	2.6%	1	5	6	2
Quality	0.0%	-0.3%	-2.4%	0.2%	4	4	4	3
Size	0.4%	3.7%	1.6%	-0.8%	3	1	1	4
Value	-2.0%	2.2%	0.4%	-4.6%	5	2	2	5

As shown in **Exhibit 12**, for the **Russell 2000** in the **short term**, both **Low Volatility** and **Quality** factors generally outperformed, with the exception of **2020**, reflecting their typical defensive and resilient characteristics being rewarded during the bottom of a recession period.

Exhibit 12: Russell 2000 Short-Term Excess Return Factor Performance

	Annualized Excess Return				Rank			
Factor	**2010-05**	**2011-08**	**2016-01**	**2020-03**	**2010-05**	**2011-08**	**2016-01**	**2020-03**
Growth	0.0%	-0.6%	-3.1%	19.8%	3	6	5	2
Low Volatility	9.6%	5.8%	1.1%	-32.9%	1	2	4	6
Momentum	-2.7%	0.9%	-7.9%	5.4%	5	5	6	3
Quality	2.4%	6.6%	2.2%	-0.3%	2	1	3	5
Size	-7.7%	0.9%	6.5%	21.8%	6	4	2	1
Value	-2.2%	4.2%	8.5%	2.7%	4	3	1	4

The table below shows **medium-term** performance for the **Russell 2000**. The **Low Volatility** factor exhibited pronounced underperformance, reflecting diminished demand for defensive exposures in a risk-on environment, while **Size** consistently outperformed the base index. This highlights the persistent advantage of smaller-cap stocks during the mid-phase of the mean-reversion periods.

Exhibit 13: Russell 2000 Medium-Term Excess Return Factor Performance

	Annualized Excess Return				Rank			
Factor	**2010-05**	**2011-08**	**2016-01**	**2020-03**	**2010-05**	**2011-08**	**2016-01**	**2020-03**
Growth	3.8%	0.6%	-2.4%	4.0%	1	3	4	1
Low Volatility	-6.3%	-2.6%	-2.7%	-10.2%	6	6	5	6
Momentum	2.9%	-1.6%	-3.0%	-0.4%	2	5	6	3
Quality	0.9%	-0.4%	-2.1%	-1.9%	3	4	3	5
Size	0.8%	2.5%	0.4%	1.6%	4	1	1	2
Value	-1.6%	1.1%	-0.4%	-0.5%	5	2	2	4

Conclusion

Across both the **Russell 1000** and **Russell 2000** indices, we analyze factor performance following triggers identified by the **OAS Signal**, considering both **short-term** (first 3 months) and **medium-term** (up to 12 months) horizons.

Among the four triggers, **2020** stands out as an outlier, as the market collapse was driven by a global pandemic rather than a typical recession-induced compression. Across both the **Russell 1000** and **Russell 2000** indices, we generally observe that **Quality** and **Low Volatility** factors outperform in the **short term** immediately at the bottom of a recession, when the market still prices in elevated default probabilities. As the recovery progresses and the market begins to price in improving conditions, the **Size** factor, which favors small-cap stocks, tends to outperform, while **Low Volatility** typically underperforms.

Defensive factors like **Quality** and **Low Volatility** tend to be rewarded during the recession-bottoming process while the **Size** factor gains prominence as markets adjust to improving conditions. The **OAS Signal** effectively identified the start of the bottoming of the recessionary periods, making it a meaningful addition to the set of indicators that can inform **factor timing strategies**. Nevertheless, the limited number of triggers and the exceptional nature of events like 2020 indicate that caution is warranted when generalizing results.

The bottom line

This quarter saw a reversal in factor trends, with Value outpacing Growth after trailing in the previous period. Low Volatility strategies experienced softer returns in the risk-on environment, while Momentum and Quality factors were relatively stable.

Correlations with Low Volatility also shifted in the third quarter, as relationships with Value and Size strengthened while the correlation with Momentum declined.

Where to next?

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