

The views expressed in these posts are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance fund. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness.

EQUITIES

Looking Under the Hood: Not All Equity Returns Are Equal

By: Aaron Dunn, CFA | & Bradley Galko, CFA | October 19, 2022

Boston - Investing in portfolios that track benchmark indexes can be a great investment approach when the market is going up. However, in certain market periods when interest rates are rising, inflation is surging and geopolitical tensions are high — 2022 is a good example — having an active manager who can identify leading companies priced at a discount to their intrinsic value may become essential.

Volatile markets underscore the need for identifying such gems, which can be discovered with the right fundamental due diligence. But not all bottom-up, fundamental managers are equal. It's important to know what's driving your manager's underlying returns. What type of exposure do they have? Can they provide downside protection, and will they also be able to deliver on the upside?

Definition of value investing continues to evolve

We believe there is a long runway for traditional value investing, and choosing the right manager matters — particularly in today's market environment. A manager may apply their experience and sector specialization to seek returns through security selection — allocating to stocks at different weights in the portfolio relative to the benchmark. Or they can expose the portfolio to certain common factors that have historically demonstrated the potential to drive stock returns.

As we have discussed in previous blogs, when the definition of traditional value investing evolves, we must focus on offering the most consistent way to generate equity returns over time and through economic cycles.

Look under the hood of your portfolio

The time is ripe to look under the hood of your portfolio to understand what is driving returns and eschew unintended risk. In strenuous economic times like these, we believe looking under the hood can be the best way to help ensure that you are more protected against market downturns.

Security selection and factor exposure also drive tracking error.¹ Regardless of your appetite for low or high tracking error, it's vital to know what is driving the tracking error. Is your portfolio primarily driven by residual volatility² or long-term reversal³ factors? If so, how might it perform across various market environments?

Know what's in your portfolio and why

Within our Value Equity team, we seek to run strategies where roughly between 75% and 85% of returns and risk are driven by security selection. Because of this, we can run relatively low tracking error strategies, despite being concentrated. Regardless of market volatility, we aim for minimal cash exposure in an effort to create true bottom-up, fundamental equity exposure in the broader asset allocation of a portfolio.

Just like managers, not all large value equity strategies are created equal, and not all are truly differentiated in their methods of security selection and generating alpha.⁴ That's why it's always essential to know what you own. The right bottom-up investor can unearth those hidden gems, even in rough markets.

Bottom line: Soaring interest rates, elevated inflation and heightened geopolitical worries are all top of mind for investors. There's an urgent focus on generating consistent equity returns over time, regardless of market conditions. Equally important for long-term returns is knowing what drives portfolio return and risk.

¹ Tracking error is the difference in performance between a portfolio and its underlying benchmark.

² Residual volatility measures how much a stock price fluctuates relative to a benchmark index.

³ Long-term reversal is the tendency of a stock with high returns over the past three to five years to underperform relative to a stock with low returns during the same period.

⁴ Alpha is the value added by a manager to the portfolio's return relative to the benchmark's return.

Risk Considerations: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility.

Active management attempts to outperform a passive benchmark through proactive security selection and assumes considerable risk should managers incorrectly anticipate changing conditions. There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long term, especially during periods of downturn in the market.



Aaron Dunn, CFA
Co-Head of Value Equity
Portfolio Manager
Eaton Vance Equity



Bradley Galko, CFA
Co-Head of Value Equity
Portfolio Manager
Eaton Vance Equity

"In strenuous economic times like these, we believe looking under the hood can be the best way to help ensure that you are more protected against market downturns."

Marketing Communication

To report a website vulnerability, please go to [Responsible Disclosure](#).

Eaton Vance is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley.

This site (<https://global.eatonvance.com>) is operated by Eaton Vance Management (International) Limited ("We"). We are a limited company, registered in England and Wales under company number 4228294 and have our registered office at 125 Old Broad Street, London, EC2N 1AR. Our VAT number is 762717416. Eaton Vance Management (International) Limited is authorised and regulated by the Financial Conduct Authority ("FCA") and is entered on the FCA's register with register number 208634.

Eaton Vance Management (Registration No. 1121368) and Parametric Portfolio Associates LLC (Registration No. 1217626) are the registered trade marks of The Eaton Vance Group.

Information on this website does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer. It is your responsibility to be aware of and to observe all applicable laws and regulations of any relevant jurisdiction. The information on this webpage is not intended for U.S. residents. To visit our U.S. website please click [here](#). Information on this website does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer. It is your responsibility to be aware of and to observe all applicable laws and regulations of any relevant jurisdiction. The information on this webpage is not intended for U.S. residents. To visit our U.S. website please click [here](#).

The views expressed are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance fund. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness.

In the EU this website is operated by MSIM Fund Management (Ireland) Limited (MSIM FMIL). The business of Eaton Vance Global Advisors Limited was transferred to MSIM FMIL on 1 October 2021. MSIM FMIL has been appointed as management company of the Eaton Vance International (Ireland) Funds plc and is responsible for the distribution of the funds together with the distribution of Eaton Vance strategies and strategies of Eaton Vance affiliates. For any queries in respect of the products and strategies referred to on this website, please contact MSIM FMIL at 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM FMIL is regulated by the Central Bank of Ireland with Company Number: 616661.

Outside of the US and EU, this material is issued by Eaton Vance Management (International) Limited ("EVMIL") 125 Old Broad Street, London, EC2N 1AR, UK, and is which is authorised and regulated in the United Kingdom by the Financial Conduct Authority.

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

This material does not constitute an offer to sell or the solicitation of an offer to buy any services referred to expressly or impliedly in the material in the People's Republic of China (excluding Hong Kong, Macau and Taiwan, the "PRC") to any person to whom it is unlawful to make the offer or solicitation in the PRC.

The material may not be provided, sold, distributed or delivered, or provided or sold or distributed or delivered to any person for forwarding or resale or redelivery, in any such case directly or indirectly, in the People's Republic of China (the PRC, excluding Hong Kong, Macau and Taiwan) in contravention of any applicable laws.

EVMIL is registered as a Discretionary Investment Manager in South Korea pursuant to Article 18 of Financial Investment Services and Capital Markets Act of South Korea.

Morgan Stanley Investment Management (Australia) Pty Limited ACN 122 040 037, AFSL No. 314182 arranges for Eaton Vance Management International Limited to provide financial services to Australian wholesale clients. This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accepts responsibility for its content. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

We are actively incorporating accessibility practices, such as those outlined in the Web Content Accessibility Guidelines, into our go-forward website design and content development to make information more accessible and user-friendly. In addition, we are developing a multi-year accessibility strategy and content guidelines that further support the use of assistive and adaptive tools. Our ultimate goal is to meet federal guidelines and policies or provide equivalent accommodations and service support for all customers.