Sabrient Commentary – April 2021 (as of 4/1/2020)

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This month's commentary can be summarized by the following talking points, which cover market conditions and their impact on the Q1 2020 *Baker's Dozen*, which terminates this month, as well as Sabrient's recent process enhancements for all new portfolios:

1. **The two years following China trade war escalation in mid-2018 created an *historic market bifurcation*** *with large caps, the growth factor, and the secular-growth Technology sector greatly outperforming small caps, the value factor, and cyclical-growth sectors* – and it was exacerbated by the COVID-19 pandemic. However, a powerful market rotation began on 11/1/2020, with **market breadth having greatly improved and small caps, the high-beta and value factors, and cyclical sectors outperforming** in anticipation of strong revenue and earnings growth in a sustained recovery/expansionary economic phase.
2. Moreover, **we expect fundamental active selection, strategic beta, and equal weighting will continue to outperform** the passive cap-weighted indexes. This should be favorable for Sabrient's enhanced GARP approach, which combines our proprietary value, growth, and quality factors.
3. **Sabrient implemented process enhancements** in December 2019 to make our portfolios more "all weather" by: (a) reducing downside volatility versus the benchmark, and (b) focusing more on earnings consistency & reliability by adding our new Growth Quality Rank (GQR) to the GARP model. As a result, many top-performing secular growth stocks have become competitive in our model with the more attractively valued (lower P/E) cyclical stocks, and our more recent portfolios have reflected a better balance between secular and cyclical growth, between growth and value factors, and across market caps.
4. **Indeed, our live portfolios have shown improved performance relative to the benchmark, with many of them substantially outperforming** during these evolving market conditions. As a result, our **theoretical rolling January *Baker's Dozen* Model Portfolio** has resumed its solid historical outperformance versus the benchmark over the past 12¼ years (2009-1Q2021).
5. In our view, **investors should invest in <u>both</u> the major secular growth trends <u>and</u> the value/cyclicals/small caps that typically thrive during economic expansion**. And with our enhanced selection process, we believe our portfolios provide exposure to both – including the recent ***Q1 2021 Baker's Dozen* that launched on 1/20/21, *Small Cap Growth* that launched on 3/15/21, *Sabrient Dividend* portfolio that launched on 3/19/21, and the upcoming *Q2 2021 Baker's Dozen* that will launch on 4/20/21.**
6. **The *Q1 2020 Baker's Dozen* portfolio**, which will terminate on 4/20/21 after 15 months, launched on 1/17/20 with equal position weights and overweight allocations (relative to the S&P 500 benchmark) to small/mid-caps, the value factor, and the Technology sectors, as indicated by our enhanced GARP quant model. **The portfolio has outperformed the S&P 500 benchmark** thanks to big winners from the Tech sector and strong recoveries in the travel & leisure names on reopening speculation.

Market observations:

The S&P 500 (SPY) was up +6.2% during Q1, while its equal weight counterpart (RSP) nearly doubled it at +11.5%, which illustrates improved market breadth and leadership from smaller names. The top performing sectors were deep cyclicals Energy, Financial, Industrial, and Basic Materials, while the worst performers were Consumer Staples, Info Tech, and Utilities, although Utilities and Staples came on quite strong during March in concert with dividend strategies in general. According to S&P Global, the top factor strategies for the S&P 500 during Q1 were High Beta (+22.7%) and Pure Value (+21.0%), while Momentum (+0.2%) and Pure Growth (+0.8%) were the worst performers. Notably, it was the *Value factor's largest quarterly outperformance versus Growth in 20 years*.

In addition, the High Beta factor has greatly outperformed all other factor-based strategies over the past 12 months of the pandemic selloff recovery, with the S&P 500 High Beta index at +141.7% and Pure Value +89.8%. This is a continuation of the risk-on market rotation since mid-May 2020 – and especially since 11/1/2020 – favoring mid, small, and micro caps, the high-beta and value factors, and cyclical sectors in anticipation of strong revenue and earnings growth in the near future given rapid vaccine rollout, reopening of the economy, massive fiscal and monetary stimulus/support, infrastructure spending, rising inflation, and the start of a powerful and sustained recovery/expansionary economic phase. In fact, the International Monetary Fund (IMF) estimates that without government support during the pandemic, the global recession would have been 3x worse – but instead it likely will have less lasting impact than the 2008 financial crisis. Nevertheless, with the nascent recovery at hand, value and cyclical companies must now begin to justify their valuations with actual earnings growth.

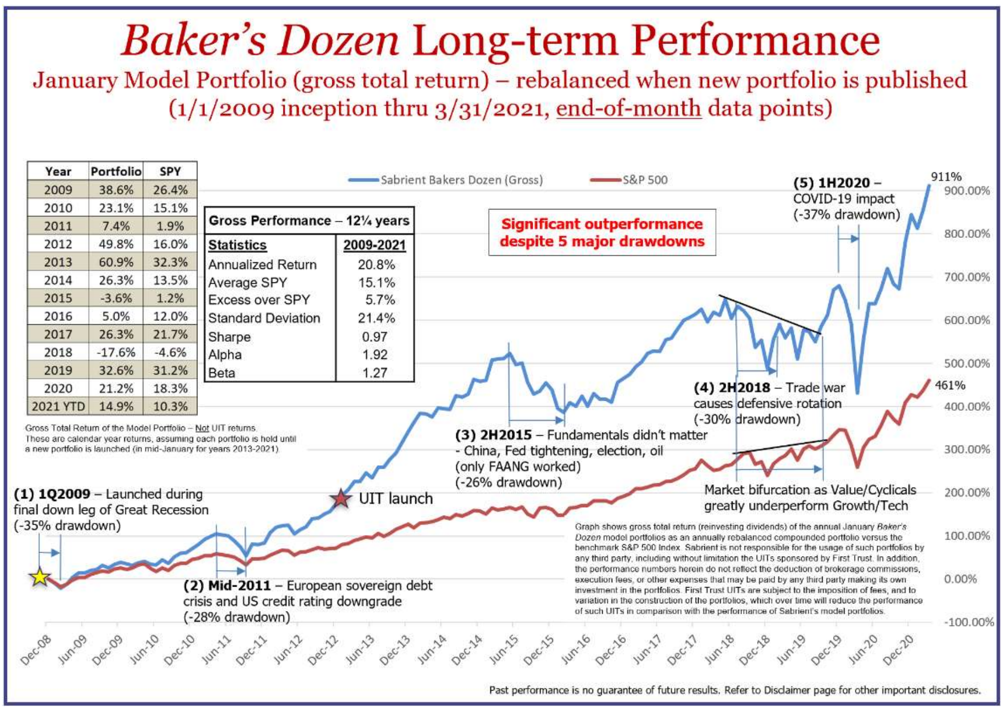
The S&P 500 aggregate earnings estimate stands at $175.75/share for 2021 and $202.11/share for 2022, according to FactSet, which implies forward P/E ratios of 22.8x and 19.8x, respectively. But analysts have been slow to increase estimates, and given the many tailwinds, I expect to see earnings to continue to beat expectations due to surging revenues and robust operating leverage.

The rapid rise in longer-term interest rates to pre-pandemic levels and steepening of the yield curve reflects investor confidence in economic recovery, but the pace of the rise has many growth investors spooked. They are worried about a commensurately fast rise in inflation and a discount rate that pressures the valuations of many high-P/E growth names. But the Fed has pledged its support, and I think it may even implement yield curve control (YCC). Moreover, I don't foresee a continuation of the recent spike in inflation, which was driven mainly by constraints on production capacity, simply because there are still so many disinflationary factors in play like aging demographics, slowing global population growth, re-globalization of trade and supply chains, and technological disruption.

So, I think we can look forward to a highly bullish combination of strong earnings growth with only a gradual rise in inflation and interest rates – which should keep pushing equities higher. However, investors should be selective with those secular growth favorites that sport high P/E multiples as they likely will need to "grow into" their current valuations through old-fashioned earnings growth rather than through further multiple expansion, which may limit their upside.

Baker's Dozen **Model Portfolio long-term performance update:**

Of course, Sabrient's flagship product since 2009 has been our *Baker's Dozen* portfolio, which is now published on a *quarterly* basis. Sabrient chief market strategist David Brown continues to lead the portfolio selection team (which includes our wholly owned subsidiary Gradient Analytics, a forensic accounting research firm that primarily serves the long/short hedge fund community).



On the left is a chart of the long-term performance of a theoretical **Model Portfolio rebalanced every January** upon publication of the newest stock list (equal weighted) since we started publishing the *Baker's Dozen* in 2009. The chart shows the tremendous outperformance versus the SPDR S&P 500 Trust (SPY) over the past 12¼ years *despite five major drawdowns and the historic 2-year market bifurcation*. The gross average annual return is **+20.8% vs. +15.1%** for SPY.

As illustrated by the June 2018-August 2019 market bifurcation (when Value and Cyclicals greatly underperformed Growth and Tech), there is little doubt that the China trade war severely impacted corporate visibility, supply chains, investor psyche, and most value- and cyclicals-oriented portfolios (including Sabrient's). But the market rotation into the value factor, cyclical sectors, and small/mid-caps – which first began during the last 4 months of 2019 and then regained traction in the recovery from the pandemic selloff – has been quite favorable for Sabrient's portfolios.

Regardless, we recognized that a "new normal" in market conditions and investor preferences necessitated enhancements to our legacy GARP model to make it more "all weather." Of course, we have enhanced it periodically in the past, including the addition of our proprietary *Earnings Quality Rank (EQR)* in 2013 as an alpha factor. So, in December 2019, we developed and added a new *Growth Quality Rank (GQR)* that favors companies with consistent and reliable earnings growth, thus *allowing many secular growth stocks to score more competitively in our rankings* with the lower-P/E cyclical and value stocks that our model historically has preferred. As a result, our newer GARP portfolios reflect a better balance between secular and cyclical growth, between growth and value factors, and across market caps, while also displaying better relative performance versus the benchmark.

With this enhanced selection process, we believe our portfolios are well-positioned for either continued broadening and rotation into value, cyclicals, and smaller caps or a return to narrow leadership from secular growth. Indeed, our live portfolios have shown improved performance relative to the benchmark, with most substantially outperforming. To illustrate, the table below shows the

Baker's Dozen & FLV - Gross performance thru: 4/1/2021

Portfolio	Launch Date	Portfolio Gross Return Since Launch	SPY Return Since Launch	Portfolio Gross Return Since 10/30/20	SPY Return Since 10/30/20
Q1 2020 BD	1/17/20	31.4%	23.3%	31.6%	23.6%
Q2 2020 BD	4/20/20	20.9%	44.5%	9.2%	23.6%
2020 FLV	7/2/20	32.2%	29.8%	31.2%	23.6%
Q3 2020 BD	7/20/20	44.5%	25.0%	43.6%	23.6%
Q4 2020 BD	10/20/20	33.5%	17.5%	38.5%	23.6%
Q1 2021 BD	1/20/21	6.5%	4.7%	N/A	

Small Cap Growth - Gross performance thru: 4/1/2021

Portfolio	Launch Date	Portfolio Gross Return Since Launch	SLYG Return Since Launch	Portfolio Gross Return Since 10/30/20	SLYG Return Since 10/30/20
SCG 26	3/11/20	99.9%	74.5%	59.0%	46.1%
SCG 27	6/9/20	56.6%	47.7%	53.8%	46.1%
SCG 28	9/4/20	54.7%	44.5%	50.7%	46.1%

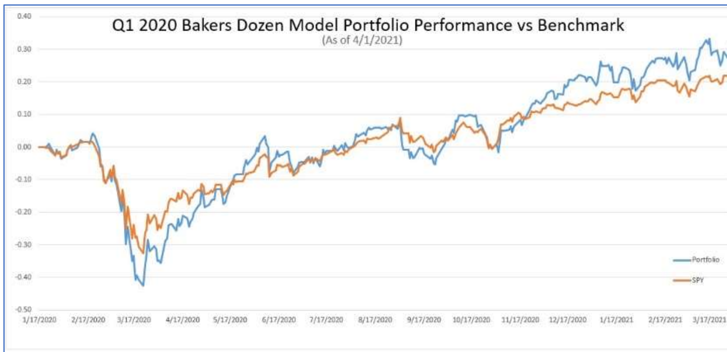
performance of the live *Baker's Dozen, Forward Looking Value,* and *Small Cap Growth* model portfolios, both from their launch dates and since the year-end market rotation into value commenced on 11/1/20, relative to the benchmark S&P 500 ETF (SPY) and S&P SmallCap 600 Growth ETF (SLYG), through 4/1/21. All but the Q2 2020 *Baker's Dozen* have nicely outperformed on a gross return basis. [As a reminder, the Q2 2020 *Baker's Dozen* was constructed during the depths of the pandemic when most companies had little or no forward visibility, which our model depends on.]

Going forward, Sabrient portfolios should continue to provide *exposure to both the major secular growth trends and the value, cyclicals, and smaller caps* that typically thrive during an expansionary economic phase. As an example, the latest **Q1 2021 *Baker's Dozen*** holds 3 large, 5 mid, and 5 small caps; 4 growth versus 9 value stocks; and 6 secular-growth Tech and Healthcare names to balance the 7 cyclical-growth stocks from Consumer, Industrial, and Materials sectors. There is even a goldminer in the group, given its strong earnings forecast based on gold's bull case in a climate of low real yields and a weak dollar.

Update on the Q1 2020 *Baker's Dozen* portfolio that terminates on 4/20/21:

The Q1 2020 *Baker's Dozen* portfolio was selected based on Sabrient's *forward-looking* GARP selection approach that relies upon the consensus EPS growth estimates of the sell-side analyst community. Although the broad market indexes continued to hit new highs last summer during the post-selloff recovery, many of the attractively valued cyclical sectors and smaller caps continued to languish due to the "K-shaped" nature of the recovery, with some market segments doing quite well and others falling into depression.

Upon launch on 1/17/20, the portfolio mostly favored the value factor and small/mid-caps due to their more attractive valuations. And even though narrow market leadership and an investor penchant for the more highly valued market segments created challenges at times, the portfolio has been boosted by some top performers from the Technology and Consumer sectors, *due to the balance between secular and cyclical growth that our enhanced model allows for*. Of course, in a concentrated 13-stock portfolio, one or two breakout winners can help offset several laggards, and this portfolio has been well-served by from Travel & Leisure, Industrials, and Energy.



Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	1/17/2020	31.37%	23.32%	24.09%	34.41%	43.50%

You can see in the chart that it has shown only modest volatility relative to the benchmark. Also, its balance between secular and cyclical growth and across market caps (which our enhanced model allows for) has been an advantage, as outperformance was first mainly driven by the Technology and Communications Services names despite extreme impacts from the pandemic selloff on the value/cyclical stocks, but then during the market rotation into the value/cyclicals/small-caps we saw leadership from the Travel & Leisure and Energy names (in a "Reopening Trade").

The portfolio launched with a slight *underweight* allocation (23% vs. 29% in the benchmark) to attractively valued "deep cyclical" sectors – Industrial (15.4% vs. 9.1%), Energy (7.7% vs. 4.3%), Materials (0.0% vs. 2.7%), and Financial (0.0% vs. 13.0%). Also, it had a significant allocation (23%) to Travel & Leisure companies that saw severe impact from the pandemic shutdown, although these names have come roaring back recently on reopening speculation. Also, unlike many prior portfolios, it was slight *overweight* (31% vs. 23%) the Information Technology sector, which was quite helpful as these names were among the best performers.

Moreover, it had a 46% underweight allocation (6 positions) to large caps (vs. the S&P 500 benchmark being solely a large cap index). In addition, our GARP portfolios typically have a value tilt (primarily based on price/book), and indeed the portfolio carried a large 77% allocation (10 positions) to the value factor (vs. the benchmark's roughly 40%).

In aggregate, despite the myriad challenges from the pandemic Black Swan, several of the holdings have lived up to earnings expectations, with 6 of the 13 having beat or come close to EPS estimates, and it has shown significant outperformance since the

3/23/20 selloff low through 4/1/21 with a return of **+125% versus +83%** for the S&P 500. Moreover, the year-end value rotation and "reopening trade" have been good for the portfolio as it grew **+32% versus +24%** for the SPY (10/30/20-4/1/21). For the full life of the portfolio so far (1/17/20-4/1/21), ***the Q1 2020* Baker's Dozen *has managed to handily outperform the benchmark*** – despite the market challenges and inability to rotate capital into "hot" market segments (due to the fixed nature of the portfolio).

Ticker	Company Name	Return	Fwd P/E at Launch	Current Fwd P/E	Est. NTM EPS Growth at Launch	Actual EPS Growth
SEDG	SolarEdge Technologies, Inc.	170.5%	21.0	54.5	43.0%	-7.4%
ADSK	Autodesk, Inc.	46.8%	48.5	58.0	69.6%	44.6%
WGO	Winnebago Industries, Inc.	43.8%	12.8	11.3	29.3%	44.7%
ADBE	Adobe Inc.	38.2%	35.2	41.0	24.5%	30.0%
VAC	Marriott Vacations Worldwide Corpo	35.5%	14.3	39.4	30.1%	-133.4%
CIEN	Ciena Corporation	34.0%	16.5	21.0	23.9%	28.4%
KBH	KB Home	32.0%	9.8	8.1	27.2%	8.7%
CHTR	Charter Communications, Inc.	21.1%	44.3	30.1	107.8%	108.0%
ANTM	Anthem, Inc.	17.8%	13.8	14.4	22.8%	15.4%
ALK	Alaska Air Group, Inc.	4.9%	9.7	NE	19.7%	-257.7%
BMY	Bristol-Myers Squibb Company	-1.9%	12.0	8.5	26.6%	37.9%
VLO	Valero Energy Corporation	-10.8%	9.8	55.0	71.5%	-157.3%
HII	Huntington Ingalls Industries, Inc.	-24.3%	15.1	17.0	25.6%	22.2%
	Average	**31.4%**	**20.2**	**29.9**	**40.1%**	**-16.6%**
SPY	SPDR S&P 500 ETF Trust	23.3%				
RSP	S&P 500 Equal-Weight	24.1%				
EWMC	S&P 400 MidCap Equal-Weight	34.4%				
EWSC	S&P 600 SmallCap Equal-Weight	43.5%				

The table on the left shows each holding in the Model Portfolio. You can see that the gross average return of the 13 equal-weight holdings (as of 4/1/21) is **+31.4% versus the S&P 500 cap-weight performance of +23.3%.** The top performer by far has been **SolarEdge Technologies (SEDG)**, a provider of solar power solutions. Other winners include software design and services firm **Autodesk (ADSK)**, recreational vehicle maker **Winnebago (WGO)**, which has prospered from the pandemic-driven popularity of "vacations in isolation," software & cloud solutions provider **Adobe (ADBE)**, resort & timeshare operator **Marriott Vacations Worldwide (VAC)**, communications equipment maker **Ciena (CIEN)**, and homebuilder **KB Home (KBH)**, which has come on strong of late.

The main laggards include military shipbuilder **Huntington Ingalls Industries (HII)**, oil & gas refiner **Valero Energy (VLO)**, drug maker **Bristol-Myers Squibb (BMY)**, and regional airliner **Alaska Air Group (ALK)**. However, it is notable that HII, VLO, and ALK all have recovered substantially over the past five months during the risk-on value rotation.

Final thoughts:

The economic tailwinds seem both powerful and durable, including a rapid emergence from the economic impacts of both the pandemic and the China trade war; a surge in corporate capex and manufacturing activity; "reflation" after 30 years of globalization and tech-induced disinflation; unlimited global liquidity and massive pro-cyclical fiscal and monetary stimulus here at home; low (and controlled) interest rates; low tax rates; rising (but still modest) inflation; and the innovation, disruption, and productivity gains of rapidly advancing technologies like 5G, IoT, robotics, autonomous vehicles, AI/ML, virtual reality, cloud computing, 3-D printing, blockchain, computer vision (CV), automated manufacturing, precision medicine, genomics, genetic sequencing, biologics – and the rapid development of diagnostics, therapeutics, and vaccines that may render future pandemics obsolete.

Thus, I continue to encourage investors to be *positioned for both the major secular growth trends and the cyclical growth opportunities over the next few years* – including the value/cyclicals/small caps that typically thrive during an expansionary economic phase. And with our enhanced selection process, we believe our portfolios – including the **Q1 2021 *Baker's Dozen* that launched on 1/20/21, *Small Cap Growth* portfolio that launched on 3/15/21, *Sabrient Dividend* portfolio that launched on 3/19/21, and the upcoming Q2 2021 *Baker's Dozen* that will launch on 4/20/21** – are positioned for any growth scenario.

I am particularly excited about these new portfolios because, whereas last year we were *hopeful* based on our testing that our enhanced portfolio selection process would provide better "all weather" performance, this year we have seen solid evidence (over quite a range of market conditions!) that a better balance between secular and cyclical growth companies and across market caps has indeed provided significantly improved performance relative to the benchmark.

As a reminder, we post on our public website my commentaries and presentation slide deck on the Marketing Materials tab at **https://bakersdozen.sabrient.com** which also includes performance information on all current and historical *Baker's Dozen* portfolios. In addition, I go into greater detail on market conditions and outlook in my monthly **Sector Detector newsletter** and blog post, which you can find (and subscribe to for free) on the **Sabrient.com** homepage.