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"Quantamental GARP approach with a forensic accounting overlay"

Baker's Dozen, Dividend, Small Cap Growth Portfolios

1. *Process Description*
2. *Performance Review*
3. *Baker's Dozen Overview*
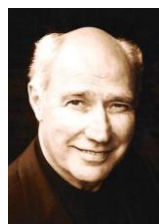4. *Market Outlook*

Updated 1/20/2022

Scott Martindale
President & CEO

Brent Miller, CFA
President of Gradient

David Brown
Founder & Chief Market Strategist

Sabrient Systems LLC
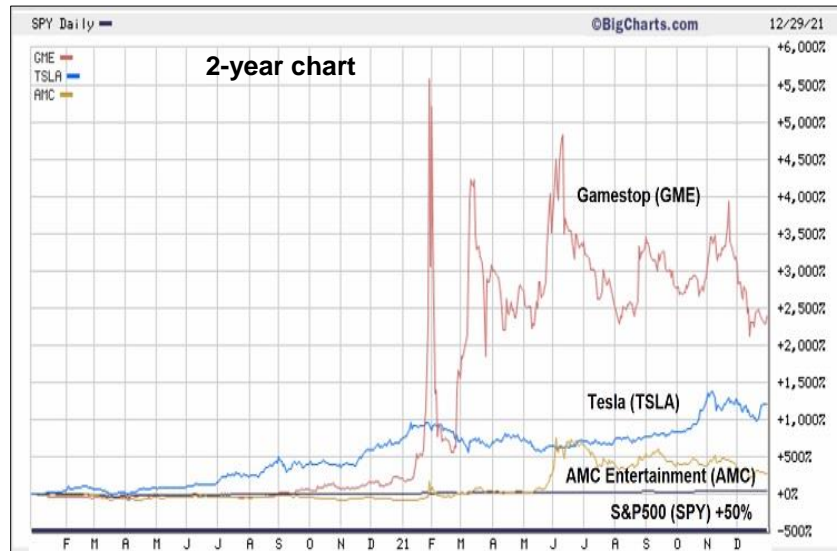*Quantitative equity research, rankings, strategies*

Gradient Analytics LLC
Fundamental forensic accounting research

Massive liquidity led to speculation, asset inflation, "malinvestments"

Meme stocks:

2-year chart

NFTs:

EtherRock #55, which sold for $3.8 million in October [Source: Fractional]

Cryptos

Dogecoin

CryptoPunk #2338: $4.4 Million

Image: Larva Labs

The First Tweet: $2.9 Million

jack
@jack

just setting up my twttr

12:50 PM · Mar 21, 2006

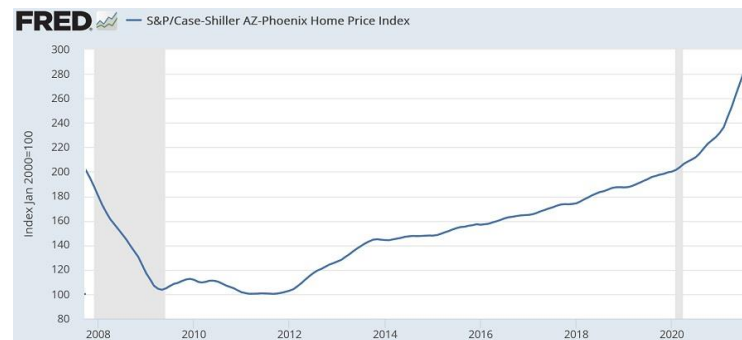♡ 173.1K   ↩ Reply   ↑ Share this T...
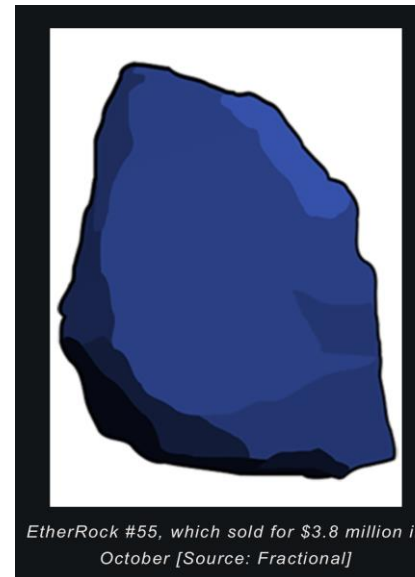
Read 10K replies

SPACs:

Social Capital Hedosophia IV or VI (NYSE: IPOD or IPOF)

IPOD and IPOF are the fourth and sixth of Charmath Palihapitya's growing series of SPACs and are currently trading at around $10 per share.

Housing:

=> We expect a preference for <u>Quality</u> to return

Company Overview

➢ **Sabrient Systems LLC** – founded in 2000 in Santa Barbara, CA

- *Quantitative* fundamentals-based multifactor models

- Diverse team of engineers/analysts/programmers, led by former **NASA** engineer (Apollo 11 moon landing) David Brown and former **Chevron** engineer Scott Martindale

- Numbers-driven; Bottom-up rather than top-down

- In 2009, introduced "*quantamental*" GARP approach for *Baker's Dozen* annual portfolio (13 top picks) => with periodic process enhancements (most recently in Dec 2019)

➢ **Gradient Analytics LLC** – founded in 1996 in Phoenix, AZ and acquired by Sabrient in 2011

- *Fundamental* forensic accounting analysis (earnings quality)

- Team of finance & accounting analysts, led by Brent Miller, CFA

- Together we built proprietary **Earnings Quality Rank (EQR)**

➢ Combined team leverages a unique **collaboration of engineers and forensic accountants**:

- Engineers bring **process-driven** methodology and **scientific** hypothesis-testing approach

- Forensic accountants bring unique insights into **financial statement analysis**

- Together we offer quantitative and fundamental equity research, datasets, rankings, tools, strategies => *including portfolios for UITs, indexes for ETFs, and insightful market commentaries*

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"Quantamental" approach with a forensic accounting overlay

1. Quantitative screen to narrow large eligible universe (50-100 names)

Forward P/E, Forward EPS growth, recent dynamics of analyst consensus estimates, proprietary Earnings Quality Rank (EQR), and our new Growth Quality Rank (GQR)

2. Fundamental analysis to identify top candidates (~25 names)

Still mainly numbers-driven, but not algorithmic

3. Forensic accounting review of top candidates

Earnings quality, aggressive practices, insider selling, governance

4. Final Stock Selection (13 names)
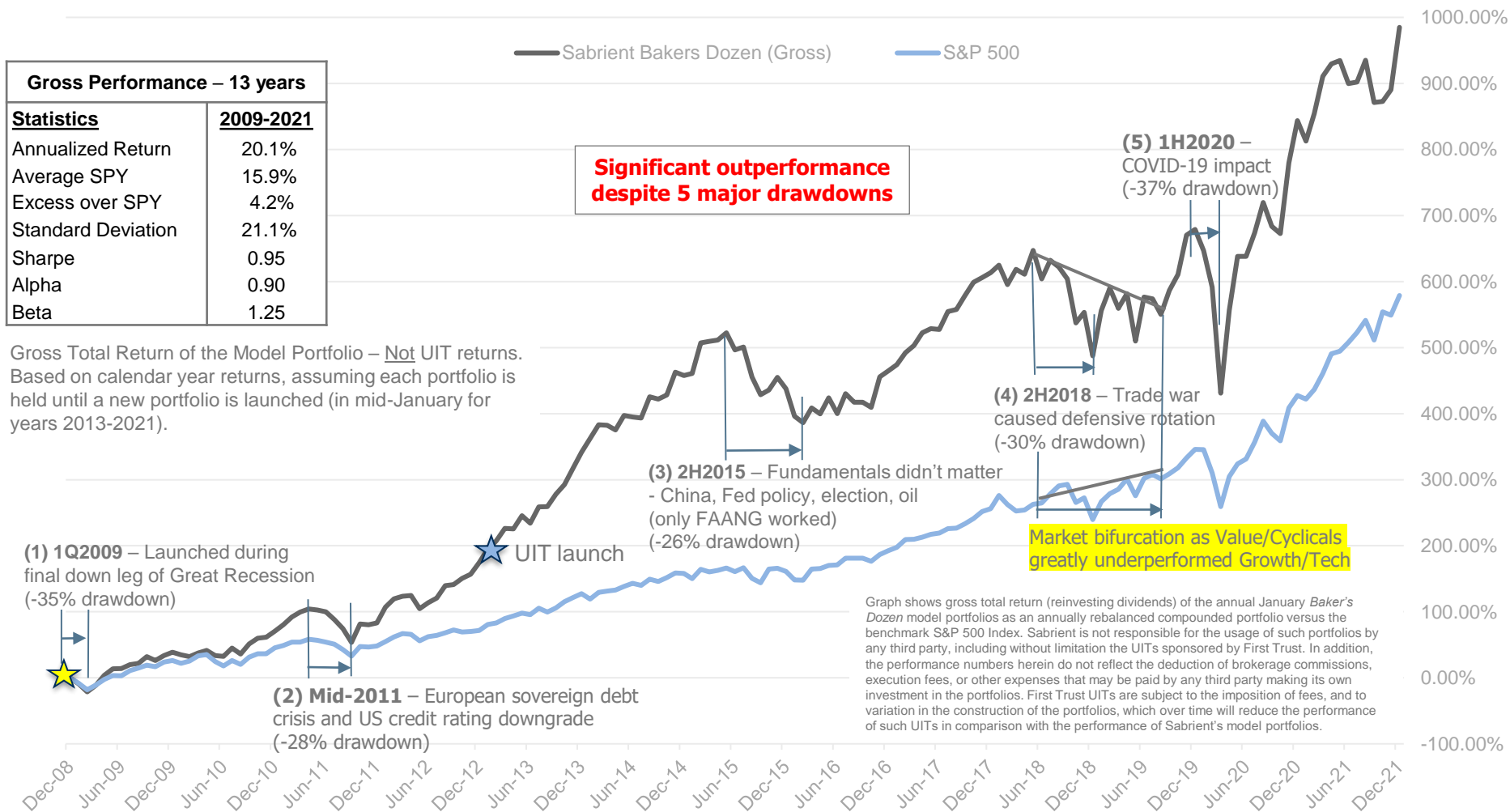
Manual process, adhering to sector concentration limits

Note: Similar approach is used for our other portfolios as well

Baker's Dozen – Model Portfolio Performance (rebalanced each January)

(1/1/2009 inception thru 12/31/2021, end-of-month data points)

Legend: Sabrient Bakers Dozen (Gross) — S&P 500

Gross Performance – 13 years

Statistics	2009-2021
Annualized Return	20.1%
Average SPY	15.9%
Excess over SPY	4.2%
Standard Deviation	21.1%
Sharpe	0.95
Alpha	0.90
Beta	1.25

Gross Total Return of the Model Portfolio – Not UIT returns. Based on calendar year returns, assuming each portfolio is held until a new portfolio is launched (in mid-January for years 2013-2021).

Significant outperformance despite 5 major drawdowns

(5) 1H2020 – COVID-19 impact (-37% drawdown)

(4) 2H2018 – Trade war caused defensive rotation (-30% drawdown)

(3) 2H2015 – Fundamentals didn't matter - China, Fed policy, election, oil (only FAANG worked) (-26% drawdown)

Market bifurcation as Value/Cyclicals greatly underperformed Growth/Tech

UIT launch

(1) 1Q2009 – Launched during final down leg of Great Recession (-35% drawdown)

(2) Mid-2011 – European sovereign debt crisis and US credit rating downgrade (-28% drawdown)

Graph shows gross total return (reinvesting dividends) of the annual January *Baker's Dozen* model portfolios as an annually rebalanced compounded portfolio versus the benchmark S&P 500 Index. Sabrient is not responsible for the usage of such portfolios by any third party, including without limitation the UITs sponsored by First Trust. In addition, the performance numbers herein do not reflect the deduction of brokerage commissions, execution fees, or other expenses that may be paid by any third party making its own investment in the portfolios. First Trust UITs are subject to the imposition of fees, and to variation in the construction of the portfolios, which over time will reduce the performance of such UITs in comparison with the performance of Sabrient's model portfolios.

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Performance (following process enhancements in Dec 2019) – as of 1/19/2021

Baker's Dozen & FLV - Gross return thru: 1/19/2022

Portfolio	Launch	Close	MODEL PORTFOLIO Gross Return	SPY Return
Dec 2019 BD	12/20/19	1/20/21	21.4%	21.9%
Q1 2020 BD	1/20/20	4/20/21	29.0%	26.9%
Q2 2020 BD	4/20/20	7/20/21	29.9%	56.0%
2020 FLV	7/2/20	10/12/21	33.6%	41.4%
Q3 2020 BD	7/20/20	10/20/21	53.5%	42.0%
Q4 2020 BD	10/20/20		41.1%	33.9%
Q1 2021 BD	1/20/21		6.1%	19.2%
Q2 2021 BD	4/20/21		0.6%	10.7%
2021 FLV	7/7/21		9.6%	4.7%
Q3 2021 BD	7/20/21		17.7%	5.5%
Q4 2021 BD	10/20/21		2.1%	0.2%

All portfolios launched since December 2019 were created with the *enhanced* GARP model and selection process, which allows for a balance between secular and cyclical growth and across market caps. This appears to have helped boost relative performance versus benchmarks while striving for consistent "all-weather" performance … *and the potential for significant outperformance.*

Sabrient Dividend - Gross return thru: 1/19/2022

Portfolio	Launch	Close	Gross Return	SPY Return
Div 30	1/3/20	1/3/22	29.0%	52.9%
Div 31	4/1/20		105.5%	88.3%
Div 32	6/30/20		48.9%	49.7%
Div 33	9/28/20		49.1%	37.6%
Div 34	12/21/20		27.7%	24.4%
Div 35	3/19/21		8.7%	17.2%
Div 36	6/22/21		7.7%	7.5%
Div 37	9/20/21		12.7%	4.4%
Div 38	12/20/21		6.6%	-0.7%

The Dividend portfolio is a GARP + Income strategy that seeks growth at a reasonable price stocks and an aggregate dividend yield approaching 4% or more.

Small Cap Growth - Gross return thru: 1/19/2022

Portfolio	Launch	Close	Gross Return	SLYG Return
SCG 26	3/11/20	6/11/21	108.9%	77.0%
SCG 27	6/9/20	9/9/21	53.0%	51.6%
SCG 28	9/4/20	12/6/21	64.2%	49.9%
SCG 29	3/15/21		1.3%	-4.8%
SCG 30	6/11/21		4.2%	-3.4%
SCG 31	9/8/21		8.2%	-4.7%
SCG 32	12/6/21		-1.2%	-5.5%

Notably, all the Small Cap Growth Model Portfolios have outperformed the S&P SmallCap 600 Growth (SLYG) benchmark on a gross return basis since the latest process enhancements were implemented in Dec 2019.

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Q4 2020 *Baker's Dozen* Model Portfolio – performance

Launch date (10/20/2020) compared to recent (1/19/2021) – **terminates on 1/20/2022**

Q4 2020 Baker's Dozen Model Portfolio

Ticker	Company Name	Return	Fwd P/E at Launch	Current Fwd P/E	Est. NTM EPS Growth at Launch	Actual EPS Growth
VECO	Veeco Instruments Inc.	124.6%	13.8	18.8	88.8%	97.0%
BCC	Boise Cascade Company	91.9%	10.3	8.4	61.7%	218.9%
TPX	Tempur Sealy International, Inc.	77.5%	14.1	11.2	38.8%	88.3%
GTN	Gray Television, Inc.	76.9%	4.9	NE	43.9%	15.2%
OMI	Owens & Minor, Inc.	76.7%	9.4	14.4	295.7%	249.6%
ABBV	AbbVie Inc.	69.9%	7.4	10.0	22.7%	25.6%
AMD	Advanced Micro Devices, Inc.	57.3%	58.0	41.2	64.3%	120.2%
APPS	Digital Turbine, Inc.	21.0%	78.1	25.6	66.7%	226.3%
MDC	M.D.C. Holdings, Inc.	13.6%	8.6	5.3	39.7%	75.1%
CHTR	Charter Communications, Inc.	-4.4%	37.1	19.5	53.0%	64.8%
GDDY	GoDaddy Inc.	-5.2%	18.6	23.5	32.3%	-15.3%
FDX	FedEx Corporation	-11.1%	18.3	11.3	36.5%	29.6%
QDEL	Quidel Corporation	-55.0%	10.2	11.2	426.6%	118.7%
	Average	**41.1%**	**22.2**	**16.7**	**97.7%**	**101.1%**
SPY	SPDR S&P 500 ETF Trust	**33.9%**				

Portfolio has several solid performers from various sectors. Overall, 10 of the 13 have exceeded or come close to meeting EPS estimates – several by a wide margin.

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Latest Q1 2022 *Baker's Dozen* Portfolio – statistics upon launch

Launch date 1/20/2022 – terminates on 4/20/2023

Ticker	Company Name	Sector	Industry	Mkt Cap ($B)	NTM EPS Growth	Fwd PE	Fwd PEG	Div Yield	EQR	GQR
ACGL	Arch Capital Group	Financials	Property and Casualty Insurance	17.7	45.1%	11.0	0.24	0.0%	3	10
ACLS	Axcelis Technologies	Information Technology	Semiconductor Equipment	2.1	64.7%	16.8	0.26	0.0%	5	10
AEL	American Equity Investment Life	Financials	Life and Health Insurance	4.2	51.0%	9.2	0.18	0.8%	3	8
ARCB	ArcBest	Industrials	Trucking	2.3	36.0%	10.2	0.28	0.3%	5	9
CHTR	Charter Communications	Communication Services	Cable and Satellite	104.2	37.3%	19.4	0.52	0.0%	4	7
DAR	Darling Ingredients	Consumer Staples	Agricultural Products	10.8	50.9%	13.0	0.26	0.0%	4	8
DVN	Devon Energy	Energy	Oil & Gas Exploration and Production	33.1	146.2%	9.3	0.06	6.7%	5	9
HRI	Herc Holdings	Industrials	Trading Companies and Distributors	4.7	61.4%	15.3	0.25	1.3%	3	10
KLAC	KLA Corp	Information Technology	Semiconductor Equipment	59.6	35.5%	18.0	0.51	1.0%	4	10
PFE	Pfizer	Health Care	Pharmaceuticals	300.5	56.2%	9.1	0.16	3.0%	4	9
TEX	Terex	Industrials	Construction Machinery and Heavy Trucks	3.0	31.2%	12.0	0.39	1.0%	3	10
TOL	Toll Brothers	Consumer Discretionary	Homebuilding	7.3	53.2%	5.9	0.11	1.1%	4	10
WDC	Western Digital	Information Technology	Technology Hardware, Storage, Peripherals	19.3	32.2%	7.4	0.23	0.0%	3	7
			Average:	43.8	53.9%	12.0	0.22	1.2%	3.8	9.0

Notes:

➢ Diverse Large/Mid/Small cap mix of 4/4/5
➢ Balanced between 8 Value and 5 Growth stocks
➢ 6 *secular* growth Tech/Healthcare/Comm Services/Staples companies
   balanced with 7 *cyclical* growth Consumer/Financials/Industrials/Energy names

EQR has quintile scale of 1-5 (5 is best)
GQR has decile scale of 1-10 (10 is best)

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Summary Talking Points

1. Sabrient leverages a unique <u>collaboration of engineers and forensic accountants,</u> quantitative models, and a process-driven methodology.

2. <u>Consistently strong performance</u> in 2009–2014, but then market became narrow/news-driven causing historic performance divergences in Growth/Value and Large/Small caps.

3. We continually implement <u>process enhancements</u> to make our ***Growth at a Reasonable Price*** (aka GARP) model more all-weather, including adding proprietary new alpha factors: *Earnings <u>Quality</u> Rank* (EQR) and the *Growth <u>Quality</u> Rank* (GQR).

4. Thus, Sabrient's newer GARP portfolios provide <u>diversified exposure</u> to Value & Growth, cyclical & secular growth, and across market caps.

5. We believe a GARP approach is "all-weather," so what could go wrong? Two things:
    1) *consensus EPS estimates are cut after portfolio launch or fail to materialize*
    2) *investor sentiment turns defensive, leading to narrow market breadth*

7. Active selection, strategic beta, equal weighting, and the Quality factor should thrive in 2022 => favorable for Sabrient's ***Baker's Dozen*, Dividend, Small Cap Growth portfolios**

8. Terminating Q4 2020 *Baker's Dozen* has nicely outperformed its benchmark (S&P 500), and the **new Q1 2022 *Baker's Dozen* launches on 1/20/2022**

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Market Outlook - 1

1. <u>Elevated volatility</u> is likely to persist given ongoing supply chain disruptions and COVID impacts, midterm elections, divergent global government policy responses, geopolitical tensions, lingering inflationary pressures, and possible slower growth in China.

2. However, <u>inflation should begin to moderate</u> in 2022 as supply chains (factories, transport, logistics, energy, labor) gradually recover and disinflationary structural trends resume (e.g., aging demographics, globalization, technological disruption, automation, productivity).

3. <u>Interest rates should remain low</u> in 2022, with the 10-year US Treasury yield likely staying <u>below 2.0%</u> due to US dollar strength as global safe haven, lower rates in most developed markets, moderating inflation, "financialization" of global economy, regulatory or investor mandates for holding "cash or cash equivalents."

4. <u>Equity valuations should moderate</u> in 2022 – although current elevated multiples (e.g., P/E ratio) are mostly justified by robust earnings growth, strong earnings leverage, abundant global liquidity, low interest rates, and a lack of good alternatives ("TINA").

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Market Outlook - 2

5. Broadening market leadership and <u>performance reversion</u> in Value/Growth and Small/Large, and <u>share price reliance on earnings growth</u> rather than multiple expansion, which would be favorable for active selection, equal weighting, and the Quality factor.

6. Many <u>stocks outside of the Big Tech favorites may offer better opportunities</u> for investors due to lower valuations and/or higher growth rates.

7. We <u>suggest staying</u> *long but hedged,* with a heightened <u>emphasis on quality</u> and a balance between 1) value/cyclicals and 2) high-quality secular growers & dividend payers.

➢ **Risks:**

(1) Double-dip global recession from COVID mutations or China crackdown/slowdown

(2) Sustained rise in energy prices, wages, and inflation makes Fed turn overly hawkish

(3) Corporate earnings growth falls short of justifying high valuations

(4) Escalation in global financial/technological/military conflicts

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Inflation likely to slow in 2022
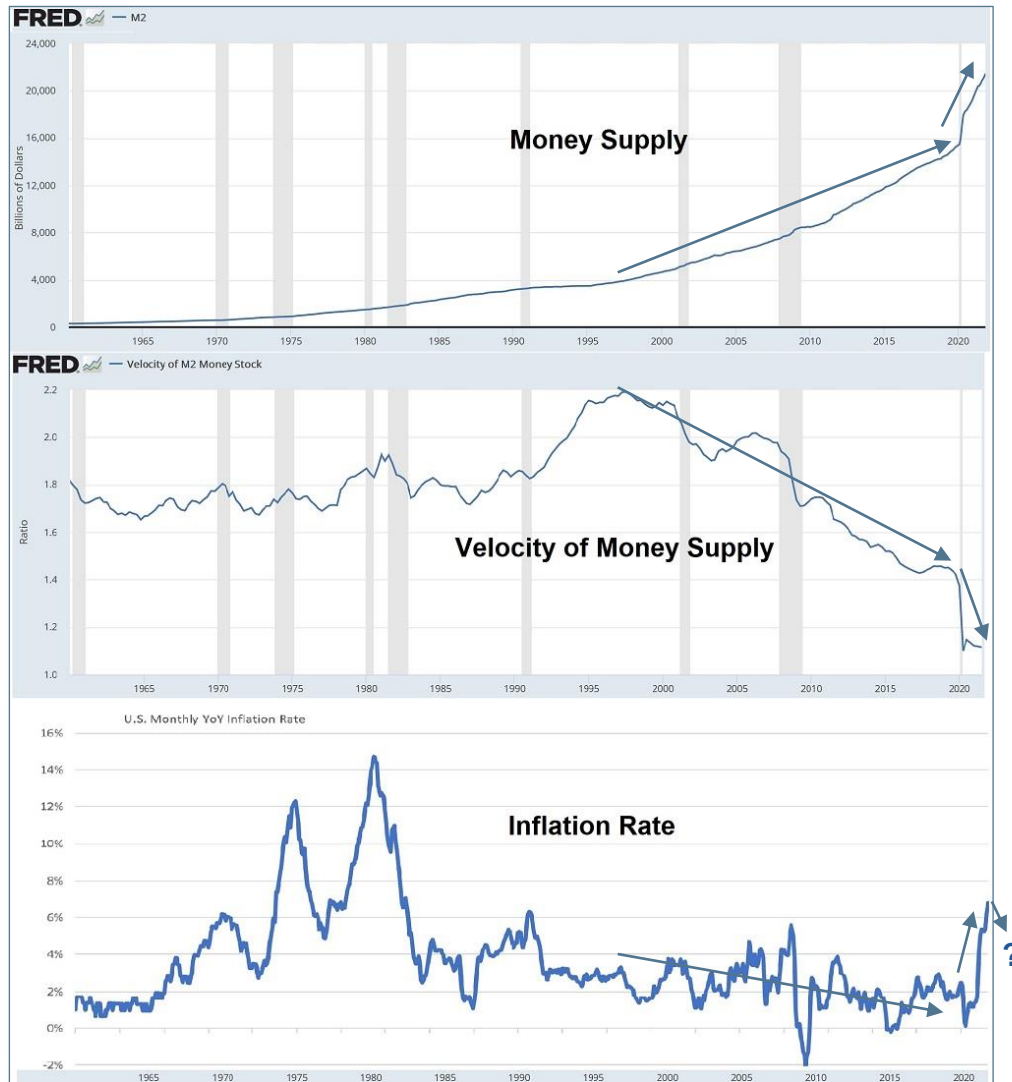
Key Points:

1. Money supply has risen rapidly since late 1990's while *velocity* of money has fallen rapidly such that CPI inflation remained low.

2. Government policy response to the pandemic brought massive new liquidity injections that caused a big spike in money supply but a <u>big fall in velocity</u>.

3. Consumer demand quickly returned to pre-COVID levels while supply chains have been slow to recover, leading to CPI inflation due to excess demand.

4. Inflation (both in asset values and CPI) is likely to slow (and keep long-duration bond rates in check) due to:

- high YoY comparisons
- Fed tapering/unwinding of QE
- strong US dollar as global safe haven
- low velocity of money supply
- private sector savings greatly exceeds capital investment
- capacity utilization remains under 80% threshold
- gradual recovery in supply chains and labor markets
- long-term disinflationary secular trends:
    - aging demographics
    - slowing global population growth
    - automation/robotics and productivity growth
    - relentless/unstoppable disruptive innovation

Growth vs. Value factor and Large vs. Small cap

RPG Daily —
RZV —

RPG = Large Cap Pure Growth (defensive)
RZV = Small Cap Pure Value (speculative)

©BigCharts.com 12/31/21

RPG Daily —
IWM — IWM = Russell 2000 Small Caps
SLY — SLY = S&P SmallCap 600 (higher quality)
RZV —

Expanded from 11/1/2020

12/31/21

Sabrient SectorCast ETF Rankings				
Look forward 30-90 Days, as of Close on Friday 12/31/2021				
Dow Jones U.S. Sector Index	Tracking ETF	Bull Score	Bear Score	Outlook Score
BASIC MATERIALS	IYM	57	54	90
FINANCIALS	IYF	56	50	76
ENERGY	IYE	58	44	56
TECHNOLOGY	IYW	68	45	54
HEALTHCARE	IYH	53	64	50
TELECOMMUNICATIONS	IYZ	53	61	46
CONSUMER DISCRETIONARY	IYC	57	48	43
INDUSTRIALS	IYJ	60	52	41
CONSUMER STAPLES	IYK	51	69	36
UTILITIES	IDU	51	66	25

ETFs are ranked according to the *Outlook Score*, which employs a forward-looking fundamentals-based scoring algorithm to create a composite profile of the constituent stocks. *Bull Score* and *Bear Score* are based on price behavior of the underlying stocks on particularly strong and weak days over the prior 40 market days. High *Bull* indicates a tendency for outperformance in strong markets, and high *Bear* indicates a tendency for good relative performance in weak markets (i.e., safe havens). High for all scores is 100, and higher is better.

Rankings favor "deep cyclical" sectors, while defensive sectors are at the bottom

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Proposal: Sabrient Quality Index Series (for ETF licensing)

Comprises 5 broad-market and 5 sector-specific, rules-based, quarterly rebalanced, strategic beta and thematic indexes for ETF licensing, as such:

1. **Sabrient Quality Plus Momentum 50 Index** (similar to *Baker's Dozen* quant prescreen)

2. **Sabrient SMID Quality Plus Momentum 50 Index** (similar to *Small Cap Growth* portfolio)

3. **Sabrient Earnings Quality Leaders Index** (focusing on Gradient's EQR model)

4. **Sabrient Quality Plus Income Index** (combines solid growth with high dividend yield)

5. **Sabrient Armageddon Portfolio** (for tumultuous market conditions)

6. **Sabrient Quality Plus Momentum Healthcare Index**

7. **Sabrient Quality Plus Momentum InfoTech Index**

8. **Sabrient Quality Plus Momentum Infrastructure Index**

9. **Sabrient Quality Energy Index**

10. **Sabrient Quality Legacy & Green Energy Index**

Bonus: **Sabrient Space Exploration & Sustainability Portfolio**, an actively managed strategy that leverages Sabrient founder David Brown's NASA (Apollo 11) pedigree

Resources

Be sure to sign up for:

1. Quarterly *Baker's Dozen* "talking points" tear sheet

➤ 2-pager with details on each pick (e.g., EQR, GQR, forward P/E, EPS growth, forward PEG)

➤ Send email request to: **support@Sabrient.com**

2. Monthly *Sector Detector* newsletter

➤ Market commentary and SectorCast ETF rankings, written by Scott Martindale

➤ Go to sign-up box on **Sabrient.com** home page

Also, visit http://BakersDozen.Sabrient.com to find performance information and updated slide deck, commentary, and the latest portfolio tear sheet

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