Sabrient Commentary – July 2021 (as of 6/30/2021)

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This month's commentary can be summarized by the following talking points:

1. After **6½ years of strong performance** from 2009 thru mid-2015 in Sabrient's *Baker's Dozen*, the market became narrow and news-driven, playing havoc with active selection and leading cap-weighted indexes to greatly outperform equal-weight indexes. Although the "Trump Bump" in 2016-17 was more favorable, the China trade war in 2018 resumed the *stark divergences in Growth over Value and Large over Small caps* that hurt Value and Growth-At-Reasonable-Price (GARP) strategies. Also, many of the best growth stocks were bid up to such high valuations that they did not score well in our quantitative rankings, while most cyclical sectors sold off.
2. This led Sabrient to implement **process enhancements in December 2019** to make our portfolios more "all-weather" – primarily by adding a new Growth Quality Rank (GQR) to our quant model that rewards a history of *earnings consistency & reliability*, in addition to attractive forward valuations and earnings quality that the model has long favored – thus allowing for *exposure to both the long-term secular growth trends and the shorter-term cyclical growth opportunities*. (Also, we continue to have the *forensic accounting* team from Sabrient subsidiary **Gradient Analytics** review every candidate for the portfolios.)
3. Indeed, Sabrient's newer portfolios since December 2019 have shown **significantly improved performance** relative to the benchmark, with some *substantially outperforming* during quite a range of evolving market conditions. However, although strongly positive, the terminating **Q2 2020 *Baker's Dozen*** has underperformed the S&P 500 – but it was constructed during the depths of the pandemic in April 2020 when most companies had poor forward visibility, which our model depends upon.
4. Given a favorable outlook of robust economic recovery, strong corporate earnings growth, and generous fiscal and monetary policy support, plus high valuations among mega cap Tech names, we expect continued market breadth and convergence of Value/Growth and Small/Large performance divergences such that *active selection, strategic beta, and equal weighting should thrive*, which is **favorable for Sabrient's strategies**.
5. Regardless, our new portfolios – including **Q2 2021 *Baker's Dozen*, *Small Cap Growth*, *Sabrient Dividend*, and the upcoming Q3 2021 *Baker's Dozen* (that launches on 7/20/21)** – reflect a balance between cyclical and secular growth and across market caps.

Market observations:

Q2 2021 was the fifth straight quarter that the market gained at least 5% – an achievement that has only happened once before – way back in 1953-1954. However, performance attribution during Q2 was quite different from Q1. Whereas Q1 was dominated by small caps, the Value factor, and strong market breadth, Q2 was more of a throwback period characterized by narrow leadership from Big Tech, with the famed FAAAM stocks – Facebook, Amazon.com, Alphabet, Apple, Microsoft – all rising more than 10% during the quarter, which allowed Large-Cap Growth to handily outperform Large-Cap Value. However, Russell 2000 Value was still able to eke out a slight outperformance versus R2000 Growth for Q2. So, it would be a stretch to say that the resurgence in Small-Cap Value has petered out. No doubt, the contraction in longer-term Treasury yields provided a tailwind to Large Cap Growth to the detriment of small caps, value stocks, cyclical sectors, and higher-dividend payers that have been leading the way since 11/1/2020.

With today's 12-month forward P/E on the S&P 500 at around 21.4x, valuations remain historically frothy, which understandably makes many experienced investors and traders feel anxious. But in my view, today's lofty valuations generally reflect investor confidence in sustainable economic recovery and a supportive Federal Reserve. Specifically, we have: 1) low interest rates, with the 10-year Treasury yield holding below 1.5% and corporate bond spreads near all-time lows as inflation expectations appear to have plateaued and may be rolling over, and 2) rising corporate earnings expectations, as there has been a surge in positive guidance from the companies themselves. According to FactSet, a record number of companies have provided positive guidance for Q2, leading analysts to raise consensus earnings estimates by 6.7% versus their estimates 3 months ago such that the S&P 500 is now expected to achieve 62.8% aggregate YOY earnings growth and 19.5% revenue growth.

According to S&P DJI, the top factor-based strategies for the S&P 500 during Q2 were Momentum, Growth, and Quality, although on a YTD basis, the top performers were High Beta, Enhanced Value, and Dividend Income. Moreover, Pure Growth topped the Q2 performance table while Pure Value was at the bottom, and 6-month correlations between the Growth and Value indices hit a *record low*. In addition, the Quality factor seems to be gaining traction, giving hope that the "dash for trash" or "junk rally" may have run its course.

Indeed, my hope and expectation are that we finally have entered a stock-picker's market. The past several years created historic divergences in Value/Growth and Small/Large performance ratios with narrow market leadership. But after a COVID-selloff recovery rally, fueled by a $13.5 trillion increase in US household wealth in 2020 (compared to an $8.0 trillion *decrease* in 2008 during the Financial Crisis), that pushed abundant cheap capital into speculative market segments, SPACs, altcoins, NFTs, meme stocks, and other high-risk investments (or "mal-investments"), it appears that the divergences are converging, leadership is broadening, and Quality is ready for a comeback, which should allow active selection, strategic beta, and equal weighting to thrive once again.

Performance update:

The first annual *Baker's Dozen* launched in January 2009 and each year displayed consistently strong performance for 6½ years until mid-2015 (including as a First Trust UIT starting in January 2013), the market became narrow and news-driven, playing havoc with active selection and leading cap-weighted indexes to greatly outperform equal-weight indexes. Although the "Trump Bump" in 2016-17 was more favorable, the China trade war in 2018 resumed the *stark divergences in Growth over Value and Large over Small caps* that hurt Value and Growth-At-Reasonable-Price (GARP) strategies. Also, many of the best growth stocks were bid up to such high valuations that they did not score well in our quantitative rankings, while most cyclical sectors sold off.

This led Sabrient to develop and implement (in mid-December 2019) process enhancements that reduce volatility relative to the benchmark and allow companies that display *consistent and reliable earnings growth* to score more competitively in our GARP model, even at somewhat higher valuations. The enhanced process allows for exposure to both the *longer-term secular* growth trends and the *shorter-term cyclical* growth opportunities *without sacrificing strong performance potential.* Of course, Sabrient continues to have the forensic accounting team from subsidiary Gradient Analytics review every candidate for each portfolio.

Thus, 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 significantly improved performance relative to the benchmark, with some substantially outperforming during quite a range of evolving market conditions.

Baker's Dozen & FLV - Gross performance thru: 6/30/2021

Portfolio	Launch Date	Close Date	Model Portfolio Gross Return Since Launch	SPY Return Since Launch	Portfolio Gross Return Since 10/30/20	SPY Return Since 10/30/20
Dec 2019 BD	12/20/19	1/20/21	**21.4%**	21.9%	**23.6%**	18.1%
Q1 2020 BD	1/20/20	4/20/21	**29.0%**	26.9%	**29.2%**	27.2%
Q2 2020 BD	4/20/20		**32.4%**	55.0%	**19.6%**	32.5%
2020 FLV	7/2/20		**36.9%**	39.1%	**34.3%**	32.5%
Q3 2020 BD	7/20/20		**46.2%**	34.0%	**45.2%**	32.5%
Q4 2020 BD	10/20/20		**40.4%**	26.0%	**45.6%**	32.5%
Q1 2021 BD	1/20/21		**4.4%**	12.2%	**N/A**	
Sabrient Dividend - Gross performance thru: 6/30/2021						
Div 28	7/12/19		**22.1%**	47.4%	**57.0%**	32.5%
Div 29	10/7/19		**33.4%**	50.5%	**46.5%**	32.5%
Div 30	1/3/20		**17.4%**	36.1%	**47.2%**	32.5%
Div 31	4/1/20		**89.2%**	77.3%	**47.4%**	32.5%
Div 32	6/30/20		**38.8%**	40.9%	**39.6%**	32.5%
Div 33	9/28/20		**39.0%**	29.5%	**35.2%**	32.5%
Div 34	12/21/20		**20.9%**	17.1%	**N/A**	
Div 35	3/19/21		**2.5%**	10.3%	**N/A**	
Small Cap Growth - Gross performance thru: 6/30/2021						
				SLYG Return Since Launch		**Since 10/30/20**
SCG 26	3/11/20	6/11/21	**108.9%**	77.7%	**68.5%**	48.2%
SCG 27	6/9/20		**57.3%**	50.4%	**54.6%**	48.8%
SCG 28	9/4/20		**54.8%**	47.2%	**50.8%**	48.8%
SCG 29	3/15/21		**-2.1%**	-1.1%	**N/A**	

To illustrate, the **table** to the left shows the performance of the *Baker's Dozen, Forward Looking Value, Small Cap Growth* and *Dividend* Model Portfolios that are either still live or were created after enhancements were implemented, both from their launch dates and since the year-end Value rotation commenced on 11/1/20, relative to the benchmark S&P 500 ETF (SPY) and S&P SmallCap 600 Growth ETF (SLYG), through 6/30/21. Most are outperforming on a gross total return basis in both timeframes. The most notable underperformer is ***Q2 2020 Baker's Dozen***, but it should be mentioned that it was constructed in April 2020 during the depths of the pandemic when most companies had poor forward visibility, which our model depends upon.

Going forward, Sabrient portfolios should continue to provide *diversified exposure to* both *the secular growers and the value, cyclicals, and smaller caps* that typically thrive during an expansionary economic phase. As an example, the latest **Q2 2021 *Baker's Dozen*** holds 3 large, 6 mid, and 4 small caps; 6 growth versus 7 value stocks; and 5 secular-growth Tech and Healthcare names to balance the 8 cyclical-growth stocks from Consumer, Industrial, Materials, Energy, and Financial sectors.

Update on the terminating Q2 2020 *Baker's Dozen* portfolio:

The **Q2 2020 *Baker's Dozen*** portfolio will terminate on 7/20/2021, at which time **the new Q3 2021 *Baker's Dozen* will launch**. Like all our portfolios, the Q2 2020 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. But in this case, the portfolio *was constructed during the* *depths of the pandemic when most companies had little or no forward visibility*. This negatively impacted the predictiveness of our relative-ranking model and its relative performance versus the benchmark. In particular, small caps (which have surged greatly over the past year on economic recovery speculation) generally did not score well during this awkward time, and so the portfolio had none. As shown in the **chart**, the portfolio stayed in line with the cap-weighted benchmark but then negatively diverged when the risk-on rotation into value and smaller caps kicked into high gear in November 2020.

Upon launch on 4/20/20, the portfolio was about evenly split between value and growth and between large and mid caps (no small caps). And even though the best performers were large-cap secular-growth leaders from the Technology sector (plus pseudo-Tech juggernaut Amazon.com), they could not overcome several disappointing laggards, including a few secular-growth Healthcare/Biotech names. Of course, in a concentrated 13-stock portfolio, one or two breakout winners can help offset several laggards, but the big performance from NVIDIA hasn't been quite enough.

Unlike most of our prior portfolios, it launched with a heavily *underweight* allocation (15% vs. 29% in the benchmark) to attractively valued "deep cyclical" sectors – Industrial (15.4% vs. 9.1%), Energy (0.0% vs. 4.3%), Materials (0.0% vs. 2.7%), and Financial (0.0% vs. 13.0%). Many from these sectors had poor visibility when the portfolio was selected, but later turned into winners based on the recovery speculation (not sound fundamentals). Also, it matched (23% vs. 23%) the benchmark weighting in the Information Technology sector. Moreover, it had a 54% *underweight* allocation (7 positions) to large caps (vs. the S&P 500 benchmark being solely a large cap index). And as for value vs. growth exposure, the portfolio launched with an *overweight* 54% allocation (7 positions) to the value factor (vs. the benchmark's roughly 40%), which is typical of a GARP portfolio.

Despite challenges from the pandemic, several holdings have lived up to earnings expectations, with 8 of the 13 having beat or come close to EPS estimates. Over the full life of the portfolio so far (4/20/20-6/30/21), performance is strongly positive but still well behind a benchmark that had the ability to rotate capital into the "hot" segments during evolving market conditions.

The **table** below shows each holding in the Model Portfolio. You can see that the gross average return of the 13 equal-weight holdings (as of 6/30/21) is **+32.4% versus the S&P 500 cap-weight performance of +55.0%.** The top performer by far (+179.2%) has been **NVIDIA Corp (NVDA)**, a provider of graphics processors for applications like gaming, networking, robotics, and crypto mining. Other winners include semiconductor maker **Advanced Micro Devices (AMD)** and software design and services firm **Autodesk (ADSK)**.

The main laggards include biotech firms **Vertex Pharmaceuticals (VRTX)** and **Neurocrine Biosciences (NBIX)**, both of which failed to achieve the traction expected of them despite solid earnings reports, as well as reinsurer **RenaissanceRe (RNR)**.

Ticker	Company Name	Return	Fwd P/E at Launch	Current Fwd P/E	Est. NTM EPS Growth at Launch	Actual EPS Growth
NVDA	NVIDIA Corporation	179.2%	38.4	50.8	31.4%	76.6%
AMD	Advanced Micro Devices, Inc.	64.9%	51.5	43.9	71.7%	114.5%
ADSK	Autodesk, Inc.	64.1%	43.1	55.6	50.0%	32.2%
CHTR	Charter Communications, Inc.	44.7%	37.2	32.8	76.0%	113.2%
AMZN	Amazon.com, Inc.	43.7%	84.1	61.2	22.7%	151.1%
VST	Vistra Corp.	14.0%	7.3	4.7	106.0%	-220.2%
HII	Huntington Ingalls Industries, Inc.	12.9%	9.5	16.3	47.9%	7.7%
BMY	Bristol-Myers Squibb Company	11.7%	9.9	8.6	30.7%	22.1%
CAG	Conagra Brands, Inc.	11.2%	13.9	14.3	28.2%	50.8%
CACI	CACI International Inc	6.9%	18.4	14.0	27.4%	49.8%
RNR	RenaissanceRe Holdings Ltd.	-2.0%	10.7	9.6	60.4%	-101.3%
NBIX	Neurocrine Biosciences, Inc.	-4.2%	26.6	29.4	1029.0%	67.0%
VRTX	Vertex Pharmaceuticals Incorporated	-26.2%	35.4	19.6	43.5%	59.1%
	Average	**32.4%**	**29.7**	**27.8**	**125.0%**	**32.5%**
SPY	SPDR S&P 500 ETF Trust	55.0%				

Final thoughts:

With reopening nearly complete, the economic reports and forecasts are stellar. Q1 GDP YOY growth was reconfirmed at +6.4%, Q2 GDP is estimated to come in at +9.7%, and full-year 2021 GDP is expected to be +7.0%, which would be the *fastest growth rate in 37 years*. So, looking ahead, I expect the highly bullish combination of robust economic growth, strong earnings growth, modest inflation, and low interest rates to persist. However, investors should be more selective among the secular growth favorites that sport high P/E multiples as they now must justify their valuations with earnings growth rather than through further multiple expansion. That means meeting (and preferably exceeding) expectations and guiding estimates higher for the future.