Sabrient Commentary – July 2022 (as of 7/20/2022)
Scott Martindale, President & CEO, Sabrient Systems, LLC

Key talking points this month include:

1. Sabrient Systems and subsidiary Gradient Analytics form a **unique collaboration of engineers and forensic accountants** who leverage quantitative models, a **process-driven approach**, and expertise in financial statement analysis.
2. Our portfolios displayed consistently strong performance in 2009–2014, but the market became narrow/news-driven, causing **historic divergences** in Growth/Value factors and Large/Small caps. But these divergences have shown **notable mean reversion**.
3. Sabrient implemented **process enhancements** in December 2019 to make our *Growth at a Reasonable Price* (aka GARP) model more "all-weather," including adding proprietary new alpha factors: *Earnings Quality Rank (EQRv2)* and *Growth Quality Rank (GQR)*. Thus, our newer GARP portfolios provide diversified exposure to Value & Growth, cyclical & secular growth, and across market caps. We have seen significant improvement in performance relative to the benchmarks across all Sabrient's portfolios.
4. **15 of our 18 live portfolios are outperforming** their benchmarks (gross total return as of 7/19/2022), despite the market volatility and depressed consumer and investor sentiment. These portfolios encompass ***Baker's Dozen*, Dividend, Small Cap Growth, and Forward Looking Value.**
5. Our **Dividend portfolios have performed particularly well** (illustrating a prevailing value/quality/income preference). Rather than a pure income orientation, it employs a GARP + Income strategy that seeks quality stocks displaying a solid growth forecast, a history of raising dividends, a solid coverage ratio, and an aggregate dividend yield approaching 4% or more.
6. The **Q2 2021 *Baker's Dozen*** is the latest to terminate – today, 7/20/2022. It has slightly underperformed the benchmark, with a gross return of -7.5% vs. -3.2% for the S&P 500. However, 9 of the 13 stocks met or exceeded EPS estimates (several by a wide margin), and yet 6 of the 9 finished in the red. Notably, the portfolio has outperformed mid-cap and small-cap indexes.
7. Although volatility will likely persist, **inflation and bond yields may have already peaked** while supply chains and labor markets recover, the US dollar remains strong, and the Fed reduces monetary accommodation, leading to some demand destruction, slower growth, and a lower excess demand gap.
8. **Equity valuations have shrunk**, with the S&P 500 and S&P 600 small caps having fallen to a forward P/E of 16.8x and 11.7x, respectively, due to deleveraging and concerns about recession and weaker corporate earnings, as the Fed has "talked up" interest rates with hawkish rhetoric. Share prices are now based more on *earnings growth rather than multiple expansion*.
9. Stocks could be setting up for a **2nd-half market rally** (and perhaps some multiple expansion) as positive catalysts emerge, such as an end to Russia's war on Ukraine or a dovish/neutral Fed pivot. Indeed, stocks are attempting an upside breakout this week.
10. W**e suggest staying long but hedged***,* with a heightened emphasis on quality and a balance between value/cyclicals and high-quality secular growers & dividend payers. Moreover, rather than investing in the major cap-weighted index ETFs, **stocks outside of the mega-caps may offer better opportunities** due to lower valuations and higher growth rates. Active selection, strategic beta, equal weighting, and the Quality factor should thrive, which should be favorable for Sabrient's portfolios.
11. The new **Q3 2022 *Baker's Dozen*** launched today, 7/20/2022, with equal position weights and a diverse mix across market caps, Value and Growth factors, and cyclical and secular growth exposures.

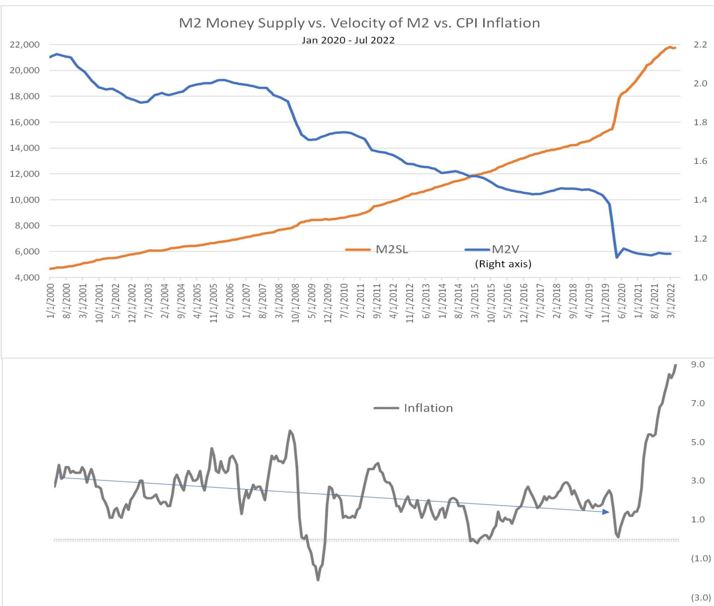
Market observations:

The S&P 500 officially entered a bear market by falling more than -20% from its January all-time high, with a max peak-to-trough drawdown of nearly -25% (as of 6/17). The Nasdaq Composite was down as much as -35% from its November all-time high. During the selloff, there was no place to hide as all asset classes floundered – even formerly uncorrelated cryptocurrencies went into a death spiral (primarily due to forced unwinding of excessive leverage). But now all the major indexes are staging a third attempt at an upside breakout from a sideways trading channel (370-390 on the SPY).

Earlier this year when stocks began their initial descent, laggards and more speculative names sold-off first, but later, as the selling accelerated, the proverbial baby was thrown out with the bathwater as investors either were forced to deleverage (i.e., margin calls) or elected to protect profits (and their principal). Even the high-flying Energy sector sold off on this latest down leg, falling over -25% intraday in just 10 days, as the algorithmic momentum trading programs reversed from leveraged buying of Energy to leveraged selling/shorting. These are common signs of capitulation – as are the historically low consumer and investor sentiment readings, which have generally hit all-time lows.

But despite the negative headlines and ugly numbers, it mostly has been an orderly selloff, with few signs of panic. The VIX has not reached 40 and has generally remained in the 20-30 range. Moreover, equity valuations have shrunk considerably, with the S&P 500 and S&P 600 small caps falling to forward P/Es of 15.6x and 10.8x, respectively, at the depths of the selloff on 6/17, but have risen to 16.8x and 11.7x. Moreover, Energy stocks are back on the upswing over the past week. Note that Energy stocks are selling at quite low forward P/Es, such as the Energy Select Sector SPDR (XLE) at 7.0x and the SPDR S&P Oil & Gas Exploration & Production (XOP) at a lowly 4.3x.

There now appears to be an investor mindset that "bad news is good news," as a mild recession is becoming more likely and in fact desirable to many as a way to hasten a reduction in inflationary pressures – and ultimately lead to a dovish or neutral Fed pivot earlier than expected. Although volatility will likely persist for the foreseeable future, I think inflation and the bond yields have already hit their highs (or at least entered a topping pattern). In addition, supply chains and labor markets continue their gradual recovery, the US dollar remains strong, and the Fed is reducing monetary accommodation, leading to demand destruction and slower growth, which would reduce the excess demand that has worsened inflationary pressures.



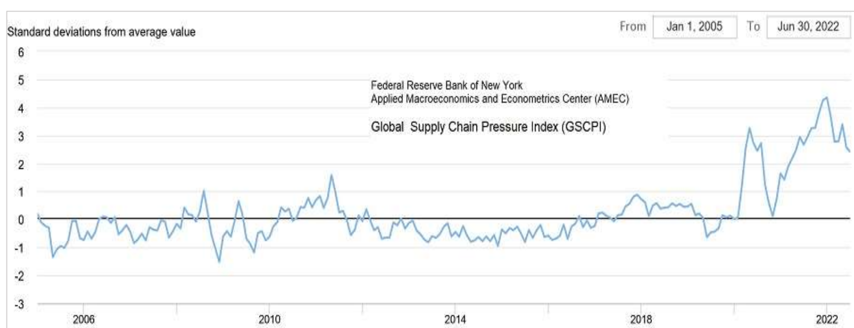
The chart to the left is instructive. M2 money supply has risen rapidly since late 1990's while velocity of money supply has fallen rapidly such that CPI inflation remained low. When the pandemic hit, M2 surged and velocity of M2 tumbled, and yet inflation suddenly spiked due to:

1. M2 continuing to rise while velocity flatlined
2. Surging excess demand caused by severe supply chain disruptions from the COVID lockdowns while fiscal and monetary stimulus quickly returned demand to pre-pandemic levels.

So, to bring down inflation, either supply chains must be repaired or demand must fall … or a bit of both. Indeed, supply chains are gradually mending, and the Fed is pursuing "demand destruction" through hawkish language, rate hikes, and reduced M2 growth.

Although the June CPI (released 7/13) showed a red-hot 9.1% print, the last several weeks have seen key prices (like oil & commodities) falling.

Notably, the New York Fed's Applied Macroeconomics and Econometrics Center (AMEC) has begun monthly publication of a Global Supply Chain Pressure Index (GSCPI) to assess the intensity of global supply chain disruptions based on data from the transportation and manufacturing sectors. *This index has been falling rapidly*, as shown in the chart to the right – another indicator that inflation may have peaked.



Bullish catalysts for equity investors would be a ceasefire or settlement of the Russian/Ukraine conflict and/or China abandoning its zero-tolerance COVID lockdowns, which would be expected to help supply chains and further spur a meaningful decline in inflation, potentially leading to a Fed pivot to dovish or neutral – and perhaps a melt-up in stocks (likely led by the secular growth leaders). Nevertheless, I think it might be premature to think that the current market breakout is "the one." Instead, there likely will be more backing & filling through the summer, particularly as weaker corporate earnings are reported.

We suggest staying net long but hedged, with a heightened emphasis on quality and a balance between value/cyclicals/dividend payers and high-quality secular growers – but not the highly speculative growth names (although some could become surprisingly strong). Moreover, rather than investing in the major cap-weighted index ETFs, stocks outside of the mega-caps may offer better opportunities due to lower valuations and higher growth rates.

Regardless, Sabrient's Baker's Dozen, Dividend, and Small Cap Growth portfolios leverage our enhanced model-driven selection approach (which combines Quality, Value, and Growth factors) to provide exposure to both the longer-term secular growth trends and the shorter-term cyclical growth and value-based opportunities.

Performance update:

Sabrient's models combine growth, value, and quality factors while searching across all market caps to find opportunities. Our portfolio line-up comprises the quarterly Baker's Dozen, Dividend, and Small Cap Growth portfolios, and the annual Forward Looking Value portfolio. As I have explained in the past, market conditions in 2018-19 (especially due to the trade war with China) were different from anything we had seen in developing our previously high performing "growth at a reasonable price" (aka GARP) model and portfolio selection process, and our portfolio performance, as well as most other value-oriented strategies.

Baker's Dozen & FLV - Gross return thru: 7/19/2022

Portfolio	Launch	Close	Gross Return (FTP website)	SPY Return	Diff
Q2 2021 BD	4/20/21		-7.5%	-3.2%	-4.4%
2021 FLV	7/7/21		-7.5%	-8.4%	0.9%
Q3 2021 BD	7/20/21		-2.3%	-7.7%	5.5%
Q4 2021 BD	10/20/21		-8.7%	-12.3%	3.7%
Q1 2022 BD	1/20/22		-10.2%	-11.5%	1.3%
Q2 2022 BD	4/20/22		-9.6%	-11.4%	1.8%

Sabrient Dividend - Gross return thru: 7/19/2022

Portfolio	Launch	Close	Gross Return	SPY Return	Diff
Div 33	9/28/20		40.5%	20.3%	20.1%
Div 34	12/21/20		18.2%	8.9%	9.3%
Div 35	3/19/21		-0.1%	2.5%	-2.6%
Div 36	6/22/21		0.8%	-6.0%	6.8%
Div 37	9/20/21		7.1%	-8.6%	15.8%
Div 38	12/20/21		3.3%	-13.1%	16.5%
Div 39	3/18/22		-5.6%	-11.4%	5.8%

Small Cap Growth - Gross return thru: 7/19/2022

Portfolio	Launch	Close	Gross Return	IWM Return	Diff
SCG 30	6/11/21		-10.6%	-22.1%	11.4%
SCG 31	9/8/21		-0.4%	-19.3%	19.0%
SCG 32	12/6/21		-11.2%	-17.8%	6.5%
SCG 33	3/4/22		-7.2%	-9.6%	2.4%
SCG 34	6/1/22		-9.2%	-2.8%	-6.4%

However, rather than simply wait for our model to start "working again," we created and implemented new process enhancements in December 2019 to produce portfolios displaying a better balance between cyclical and secular growth companies and across market caps, lower volatility relative to the benchmarks, and greater portfolio resiliency (i.e., "all weather"). Indeed, the enhanced process has improved relative performance across all our portfolios, as has the market's rotation away from a preference for aggressive growth and speculative stocks into a preference for value and quality.

In fact, **15 of the 18 live portfolios** are outperforming their benchmarks (SPY is the S&P 500, IWM is the Russell 2000) despite the volatile market conditions this year, as shown in the **table** on the left. The table displays gross total returns through 7/19 as shown on the ftportfolios.com website (without transactional sales charge).

Notably, our **Sabrient Dividend Portfolio** has been performing quite well. It is different from most high-yielding dividend products in that it seeks both capital appreciation and steady income by identifying quality companies selling at a reasonable price with a solid growth forecast, a history of raising dividends, a good coverage ratio, and an aggregate dividend yield approaching 4% or more.

Update on the terminating Q2 2021 *Baker's Dozen* portfolio:

The ***Q2 2021 Baker's Dozen*** terminates today, 7/20/2022, (and the new Q3 2022 *Baker's Dozen* has launched). Like all our portfolios, the Q2 2021 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.

Q2 2021 Baker's Dozen Portfolio

Ticker	Company Name	Return	Fwd P/E at Launch	Current Fwd P/E	Est. NTM EPS Growth at Launch	Actual EPS Growth
CTRA	Coterra Energy Inc.	88.7%	11.2	5.3	173.2%	235.9%
REGN	Regeneron Pharmaceuticals, Inc.	18.1%	10.8	14.5	46.8%	118.6%
ACGL	Arch Capital Group Ltd.	11.8%	14.2	9.7	106.4%	177.7%
KFY	Korn Ferry	-0.3%	19.8	10.7	69.9%	147.6%
DBX	Dropbox, Inc.	-12.9%	20.7	14.1	36.0%	40.5%
TOL	Toll Brothers, Inc.	-15.3%	11.0	4.3	45.7%	89.1%
VSH	Vishay Intertechnology, Inc.	-20.9%	14.3	7.9	96.4%	119.7%
SEM	Select Medical Holdings Corporation	-22.5%	15.7	10.8	22.9%	8.6%
AMAT	Applied Materials, Inc.	-22.9%	21.2	12.7	34.8%	42.2%
AXTA	Axalta Coating Systems Ltd.	-23.1%	16.8	12.7	42.0%	-2.6%
MBUU	Malibu Boats, Inc.	-27.7%	13.2	7.3	63.7%	60.2%
XPO/GXO	XPO Logistics / GXO Logistics	-31.3%				
nyse:MGA	Magna International Inc.	-32.5%	12.5	11.9	91.4%	-7.9%
	Average	**-7.0%**	**15.1**	**10.2**	**69.1%**	**85.8%**
SPY	SPDR S&P 500 ETF Trust	-3.2%				
RSP	S&P 500 Equal-Weight	-2.5%				
MDY	SPDR S&P MidCap 400 ETF Trust	-9.6%				
IWM	iShares Russell 2000 ETF	-16.7%				
EWMC	S&P 400 MidCap Equal-Weight	-8.7%				
EWSC	S&P 600 SmallCap Equal-Weight	-8.4%				

It launched with an overweight allocation (46% vs. 24% in the benchmark) to attractively valued "deep cyclical" sectors (Financials, Industrials, Materials, and Energy), i.e., 6 positions out of 13. Also, it approximately matched the benchmark (38% vs. 40%) for secular growth Technology and Healthcare sectors (5 positions). As for Value vs. Growth exposure, the portfolio launched with a 54% allocation (7 positions) to the Growth factor, versus the benchmark's 60% weight (as the cap-weighted index is dominated by mega-cap Growth stocks).

Lastly, it had a small-cap bias relative to the S&P 500 large cap benchmark, with 3 large, 5 mid, and 5 small caps. Unfortunately, small caps in general have lagged the large/mega caps, as shown in the performance table to the left. Indeed, the top two performers are both large caps.

Nevertheless, most of the holdings have lived up to expectations, with 9 of the 13 having met or exceeded EPS estimates – and yet they still were subjected to significant P/E multiple contraction, and 6 of the 9 that met or beat estimates still finished in the red. Over the life of the portfolio (4/20/2021-7/19/2022), the gross average return of the Model Portfolio's equal-weighted holdings is **-7.0% versus -3.2%** for the S&P 500 cap-weighted index. The **table** above shows each of the holdings. Top performers include oil & gas firm **Coterra Energy (CTRA)**; biopharma **Regeneron Pharmaceuticals (REGN)**; and insurer/reinsurer **Arch Capital Group (ACGL)**.

Of course, in a concentrated 13-stock portfolio, one or two breakout winners can offset a few laggards, but only CTRA has provided a big return. Worst among the laggards are OEM auto parts maker **Magna International (MGA),** recreational power-boat maker **Malibu Boats (MBUU)**, and trucking firm **XPO Logistics (XPO)**, which spun off part of its operations as **GXO Logistics (GXO)**. Notably, although MGA badly missed EPS estimates, MBUU actually came quite lose to meeting estimates and yet saw its P/E multiple nearly cut in half. Other laggards like **Toll Brothers (TOL), Applied Materials (AMAT),** and **Vishay Intertechnology (VSH)** also handily beat estimates but were not rewarded. Again, 6 of the 9 companies that met or exceeded estimates were punished.

Introducing the new Q3 2022 *Baker's Dozen* portfolio:

The latest **Q3 2022 *Baker's Dozen*** launched today, 7/20/2022. Its 13 holdings are shown in table below, along with statistics on forward valuation, consensus next-12-months (NTM) EPS growth expectations, forward PEG ratio (P/E divided by EPS growth) and two key scores: Earnings Quality Rank (EQR, 1-5 scale, with 5 the best) and Growth Quality Rank (GQR, 1-10 scale, with 10 the best).

Ticker	Company Name	Sector	Industry	Mkt Cap ($B)	NTM EPS Growth	Fwd PE	Fwd PEG	Div Yield	EQR	GQR
AVGO	Broadcom	Information Technology	Semiconductors	205.5	22.5%	12.9	0.57	3.3%	5	8
BOX	Box	Information Technology	Application Software	3.9	36.6%	22.2	0.61	0.0%	5	10
CF	CF Industries Holdings	Materials	Fertilizers and Agricultural Chemicals	18.1	82.6%	5.0	0.06	1.9%	5	9
CHDN	Churchill Downs	Consumer Discretionary	Casinos and Gaming	7.9	48.7%	19.8	0.41	0.3%	5	8
DVN	Devon Energy	Energy	Oil & Gas Exploration and Production	37.8	101.2%	5.7	0.06	9.3%	5	9
HRI	Herc Holdings	Industrials	Trading Companies and Distributors	3.0	46.8%	8.2	0.18	2.4%	3	8
LNTH	Lantheus Holdings	Health Care	Health Care Supplies	4.9	112.9%	23.8	0.21	0.0%	5	10
MRO	Marathon Oil	Energy	Oil & Gas Exploration and Production	15.9	118.2%	4.3	0.04	1.5%	3	9
ON	ON Semiconductor	Information Technology	Semiconductors	25.5	26.2%	12.2	0.47	0.0%	4	10
PGR	The Progressive	Financials	Property and Casualty Insurance	65.5	81.5%	19.5	0.24	1.7%	3	10
PLAB	Photronics	Information Technology	Semiconductor Equipment	1.3	41.0%	9.9	0.24	0.0%	5	8
TMHC	Taylor Morrison Home	Consumer Discretionary	Homebuilding	3.2	54.4%	2.9	0.05	0.0%	3	7
VLO	Valero Energy	Energy	Oil & Gas Refining and Marketing	44.4	262.2%	4.6	0.02	3.7%	3	8
			Average:	33.6	79.6%	11.6	0.15	1.9%	4.2	8.8

The portfolio comprises a diverse mix across market caps, with 5 large caps, 4 mid-caps, and 4 small caps; a 6/7 split between value and growth stocks; and a 7/6 split between cyclical and secular growth companies. As for sectors, there are 4 Technology names, 3 Energy, 2 Consumer Discretionary, 1 Materials, 1 Industrials, 1 Healthcare, and 1 from Financials. Some like **The Progressive (PGR)** and **Broadcom (AVGO)** are familiar names to most investors, while others like photomask maker (for semiconductor manufacturing) **Photronics (PLAB)** and medical diagnostics firm **Lantheus Holdings (LNTH)** are more "under the radar."

You can find more detail by downloading the full Holdings report on the *Baker's Dozen* website: https://bakersdozen.sabrient.com/bakers-dozen-marketing-materials. The report describes each of the 13 stock picks in greater detail, including a brief description of each company and what makes them attractive. You also can download my latest slide deck and market commentary. In addition, I go into greater detail on market conditions and outlook in my periodic **Sector Detector newsletter** and blog post, which you can find (and subscribe to for free) on the **http://Sabrient.com** homepage.

Final thoughts:

As a reminder, in response to persistent market conditions characterized by narrow market leadership and performance divergences in Growth/Value factors and Large/Small capitalizations, Sabrient developed and implemented in mid-December 2019 **process enhancements** that seek to make our portfolios more "all weather" by reducing volatility relative to the benchmark and allowing companies that display *consistent and reliable earnings growth* to score more competitively in our GARP model, even if they display 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.*

Regardless, we believe Sabrient's portfolios – including the new **Q3 2022 *Baker's Dozen*** (launched on 7/20), **Sabrient Dividend 40** (launched on 6/15), **Small Cap Growth 34** (launched on 6/1), and **Forward Looking Value 10** (launched last week on 7/15) – are positioned for any growth scenario. If indeed the market has put in a bottom and the Fed refrains from a policy mistake, ***this may be a great buying opportunity for our portfolios***.