

## ***Baker's Dozen Portfolios***

- 1. Market Conditions & Performance Review***
- 2. Process Overview & New Enhancements***
- 3. Introducing the new Q4 2020 Baker's Dozen***
- 4. Market Outlook***

***“Quantamental” GARP\* approach with a forensic accounting overlay***

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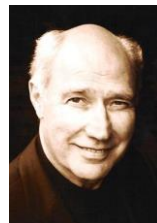
\* GARP = growth at a reasonable price



Scott Martindale  
President & CEO



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President of Gradient



David Brown  
Founder & Chief Market Strategist

**Sabrient Systems LLC**

*Quantitative equity research, rankings, strategies*

**Gradient Analytics LLC**

*Fundamental forensic accounting research*

# Talking Points Summary

- After 6-1/2 years of consistent market-beating performance for *Baker's Dozen*, market conditions for the past 5 years (and especially the past 2 years since the China trade war escalated in June 2018) have been unkind to valuation-based strategies, the value factor, and cyclical sectors despite a solid economic outlook
- Sabrient's longstanding GARP model was never tested in such unusual market conditions in which investor sentiment was persistently misaligned with analysts' forward estimates
- Despite spurts of promising performance, Sabrient felt it had become untenable to stick with a process that was struggling to provide the same consistently good results in this "new normal" of erratic investor sentiment and narrow market leadership
- This led to development of enhancements to make selection process more "all-weather" by reducing relative volatility vs. benchmark and focusing more on earnings consistency
- Secular growth names like ADBE, ADSK, AMD, APPS, AMZN, CHTR, NVDA, SEDG became viable; so new portfolios strike a better balance between cyclical and secular growers
- The process enhancements were introduced in December 2019, and indeed our portfolios have shown improvement in relative performance in the "new normal" market conditions – but are still well-positioned for a broadening market and rotation into value/cyclicals

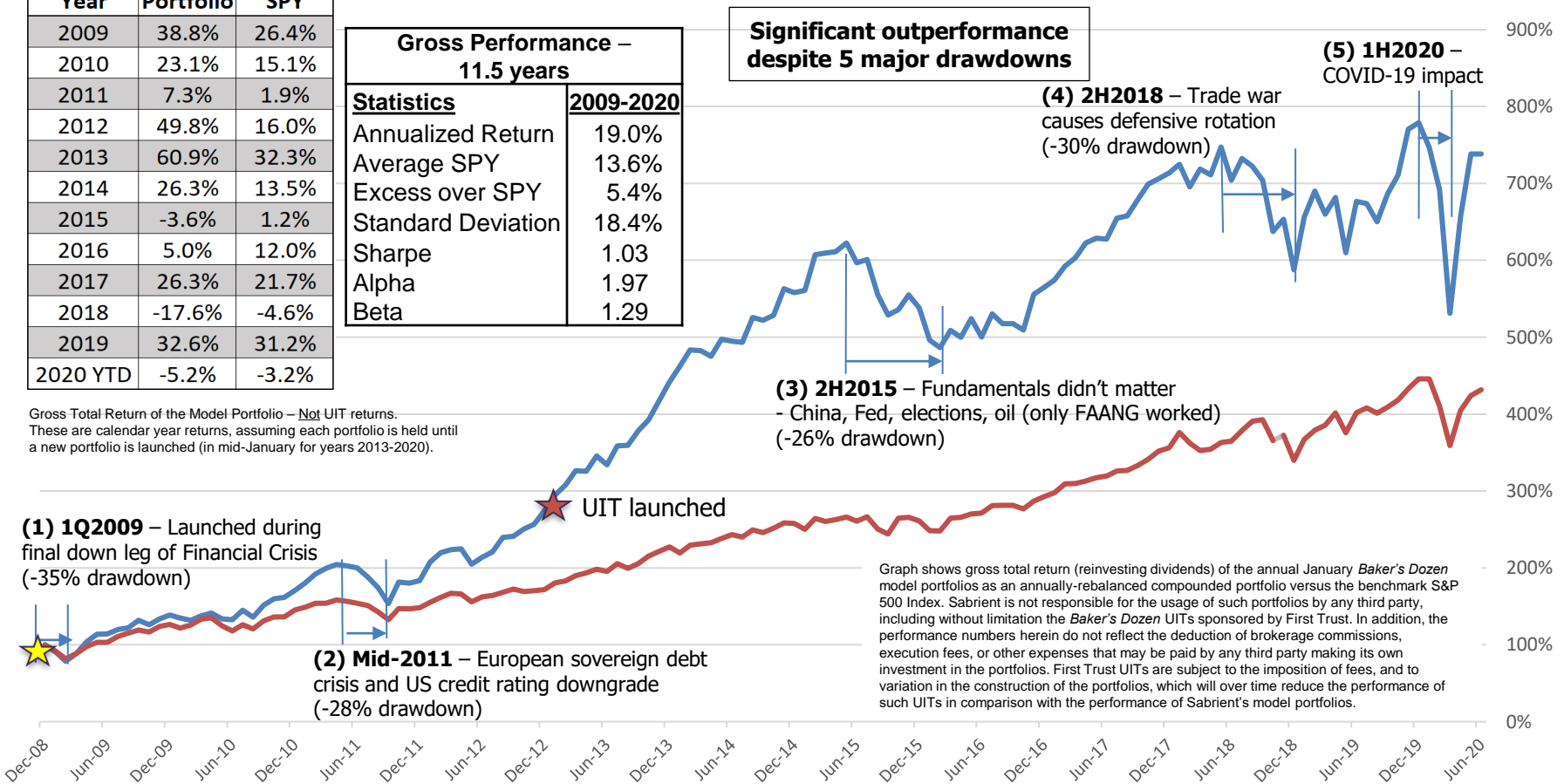
# Baker's Dozen Long-term Performance

January Model Portfolio (gross total return) – rebalanced when new portfolio is published (1/1/2009 inception thru 6/30/2020, end-of-month data points)

Year	Portfolio	SPY
2009	38.8%	26.4%
2010	23.1%	15.1%
2011	7.3%	1.9%
2012	49.8%	16.0%
2013	60.9%	32.3%
2014	26.3%	13.5%
2015	-3.6%	1.2%
2016	5.0%	12.0%
2017	26.3%	21.7%
2018	-17.6%	-4.6%
2019	32.6%	31.2%
2020 YTD	-5.2%	-3.2%

Gross Performance – 11.5 years	
Statistics	2009-2020
Annualized Return	19.0%
Average SPY	13.6%
Excess over SPY	5.4%
Standard Deviation	18.4%
Sharpe	1.03
Alpha	1.97
Beta	1.29

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



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# Market Conditions: 2015—2016

- **1H2015** – market up, Sabrient outperformance streak hits 6-1/2 years
- **2H2015** – market suddenly driven by news rather than fundamentals
  - ✓ Election rhetoric, Populism, China devaluation, oil falls, Fed targets rate hikes
  - ✓ Narrow breadth & leadership, led by FAANGM stocks (“FANG” acronym is born)
  - ✓ Smart/rich/successful investors and HFs down double digits; Sabrient performance takes a hit
  - ✓ “NEW NORMAL” of defensive/cautious/news-driven market conditions begins
- **1H2016** – market up, but it’s led by defensives (Utilities, Telecom, Staples)
- **2H2016** – risk-on rotation with all eyes on US presidential election
  - ✓ Post-election rally (as uncertainty is lifted), led by cyclicals
  - ✓ Greater market breadth, lower sector correlations

# Market Conditions: 2017–1H2018

- **2017** – risk-on “Trump Bump” driven by fundamentals (good for GARP)
  - ✓ Synchronized global growth, China strong, rising oil prices, Fed data-driven
  - ✓ New fiscal stimulus from deregulation and anticipation of tax reform
  - ✓ Strong breadth, record low volatility, cyclicals and small caps lead
  - ✓ Momentum factor dominates (versus Value, Quality, Low-Volatility factors)
  - ✓ P/E multiples expand
- **H1 2018** – market continues up, but sentiment turns cautious
  - ✓ Cyclicals and small caps still lead, but with higher volatility
  - ✓ With tax reform in place, investors watch for corporate behavior and capex
  - ✓ Trade war rhetoric worsens; investors turn cautious; P/E multiples compress

# Market Conditions: 2H2018–2019

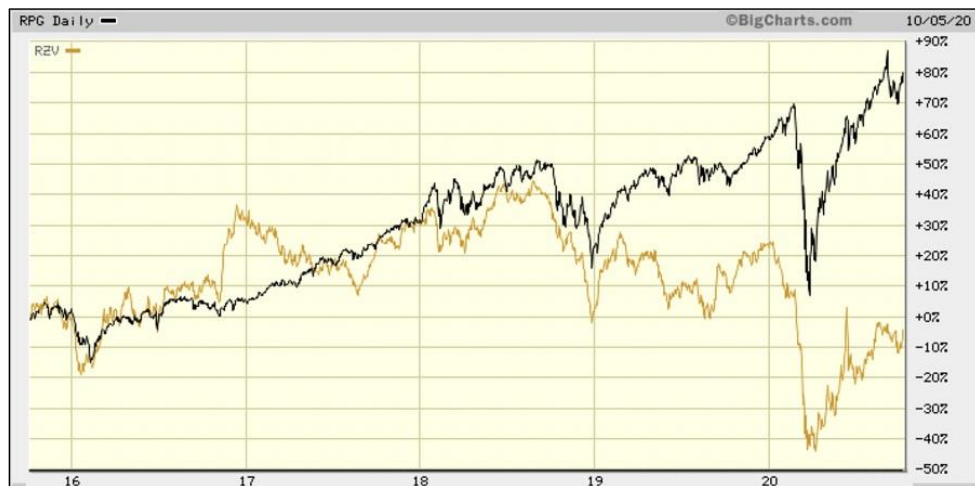
- **H2 2018** – trade war rhetoric becomes reality; defensive rotation begins
  - ✓ Rotation out of risk-on sectors (value, cyclicals, small caps, emerging markets)
  - ✓ Rotation into risk-off defensive sectors (large cap Utilities, Healthcare, Staples, Telecom) and mega-cap Tech (AAPL, MSFT, AMZN) ... until the Q4 selloff
- **Jan-Aug 2019** – market recovers but still mostly defensive sentiment
  - ✓ China trade negotiations resume; FOMC dovish (“Fed put”); low interest rates
  - ✓ P/E multiples expand despite persistent preference for risk-off momentum/low-volatility/bonds/defensive/mega-cap over risk-on value/cyclicals/small-mid caps
- **Sep-Dec 2019** – risk-on rotation emerges as optimism prevails
  - ✓ Phase 1 deal with China leads to improved corporate visibility
  - ✓ Sustained risk-on rotation into value/cyclicals/small-mid

# Market Conditions: 2020

- **H1 2020** – new highs, a COVID-19 selloff, and an historic recovery
  - ✓ Like H2 2018, market rises despite defensive rotation ... until the historic selloff
  - ✓ Historic rebound off 3/23/20 low; first had strong breadth led by smaller caps & cyclical sectors, but ultimately narrowed to favor secular-growth mega-cap Tech
  - ✓ High dispersion among stocks in a K-shaped economic recovery, with big winners (e.g., among WFH Tech) and big losers (e.g., travel/hospitality/leisure)
  
- **Q3 2020** – new highs, a correction, and a nascent risk-on rotation
  - ✓ Market goes straight up in July-August with mega-cap Tech leadership
  - ✓ September (and election jitters) brings a harsh correction
  - ✓ Market stabilizes with signs of a renewed rotation into value/cyclicals/small-mid
  - ✓ Political uncertainties, Trump catches COVID, worries of a contested election

# Market Bifurcation and Nascent Risk-on Rotation

Persistent divergences between Growth/Value and Large/Small shows renewed signs of convergence



5-year chart shows massive divergence between both Growth/Value and Large/Small.

RPG = S&P LargeCap 500 Pure Growth ETF  
RZV = S&P SmallCap 600 Pure Value ETF



3-month chart (7/13/20-10/19/20) shows nascent rotation into Small caps, Value factor, and Cyclical sectors – another promising attempt at convergence of the historic Growth/Value and Large/Small divergences.

RZV = S&P SmallCap 600 Value  
XLI = Industrial Select Sector SPDR (cyclicals)  
XLK = Technology Select Sector SPDR  
RPG = S&P LargeCap 500 Growth  
SPY = SPDR S&P 500



## *Baker's Dozen: Typical Allocation Tilts vs Benchmark*

All allocation tilts (which are typically *beneficial in a growing economy*) have shown **negative** attribution since “new normal” began in mid-2015

Category	Baker's Dozen Portfolios	S&P 500
Position weights:	Equal weighted	Market cap weighted
Sector allocations:	Cyclical growth oriented	Secular growth dominated
Capitalizations:	Small-mid cap focused	Mega-cap focused
Value/Growth factor:	Value-oriented	Growth-oriented

**→ This has led Sabrient to develop and implement New Process Enhancements**

# Process Enhancements

1. Add sector constraints relative to benchmark to reduce relative volatility
  - Still maintains the long-standing overall 30% sector maximum allocation
  - Limits extreme sector “tilts” away from S&P 500 allocations (15-30% range)
  
2. Add new proprietary **Growth Quality Rank (GQR)** to the model
  - Measures:
    - a) *Consistency* of past and expected earnings growth
    - b) Historical *reliability* of meeting forward estimates (i.e., “surprises”)
    - c) Probability that consensus earnings estimates will be achieved
  - Puts *secular* growth on more equal footing with *cyclical* growth in rankings
    - a) Secular growth stocks tend to have higher valuations but more consistent EPS growth
    - b) Cyclical growth stocks tend to have lower valuations but more volatile EPS growth

# Performance of live *Baker's Dozen* Portfolios

Since launch and since COVID-19 selloff low (3/23/20)

Gross performance thru 10/19/2020:

	Portfolio	Launch Date	Portfolio Gross Return Since Launch	SPY Return Since Launch	EWMC Return Since Launch	Portfolio Gross Return Since 3/23/20	SPY Return Since 3/23/20	EWMC Return Since 3/23/20
	Sep 2019 BD	9/20/19	-18.7%	16.9%	1.7%	51.4%	54.7%	65.8%
↑	Oct 2019 BD	10/18/19	-10.0%	17.0%	2.3%	70.3%	54.7%	65.8%
old process	Nov 2019 BD	11/20/19	-6.6%	12.2%	-0.5%	85.7%	54.7%	65.8%
new process	Dec 2019 BD	12/20/19	7.4%	8.2%	-4.6%	105.4%	54.7%	65.8%
↓	Q1 2020 BD-B	1/30/20	9.4%	5.9%	-2.7%	87.8%	54.7%	65.8%
	Q2 2020 BD	4/20/20	16.1%	22.5%	33.4%	N/A		
	2020 FLV	7/2/20	7.2%	10.0%	10.8%	N/A		
	Q3 2020 BD	7/20/20	10.6%	5.9%	8.2%	N/A		

Portfolios created with the *unenanced* "old process" were dominated by cyclical sectors and small caps, which were largely neglected until the recovery from the COVID selloff, hurting relative performance.

Portfolios created with the *enhanced* "new process" are more evenly balanced between secular and cyclical growth and across large/mid/small market caps, helping to boost relative performance.

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# ***Sabrient***<sup>®</sup>

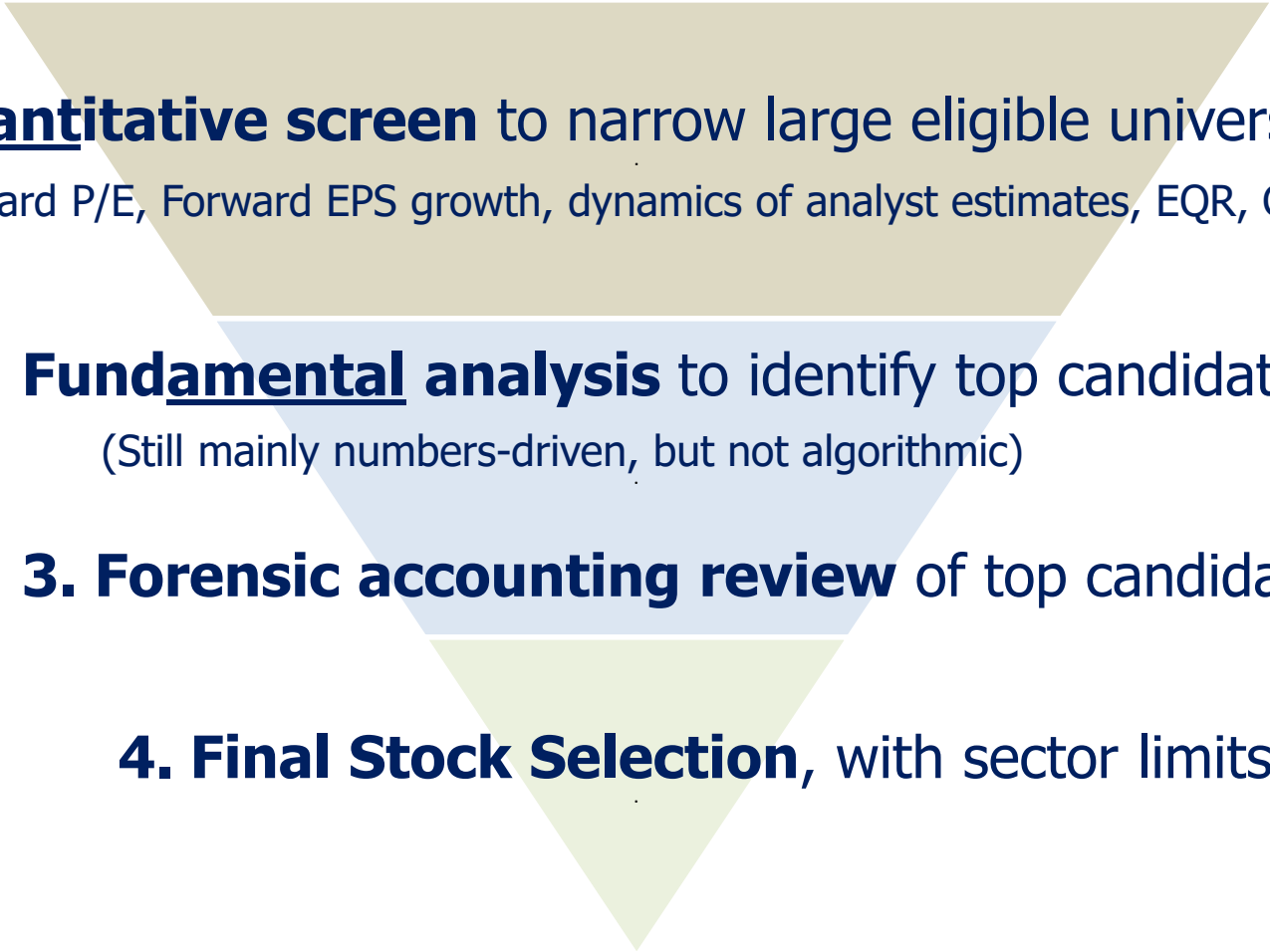
- **Quantitative** fundamentals-based multifactor models since 2000
- Diverse team of engineers/analysts/programmers, led by former NASA engineer (Apollo 11 moon landing) **David Brown**
- Numbers-driven; Bottom-up rather than top-down
- Focused on ***Growth At a Reasonable Price*** (GARP)
- Relies on database of sell-side analyst estimates  
=> Key metric: Forward PEG ratio (next 12 months)
- In 2009, introduced *quantamental* GARP approach to create the *Baker's Dozen* annual portfolio of 13 top picks

- **Fundamental** in-depth forensic accounting analysis since 2002
- Team of CFAs, CPAs – finance & accounting backgrounds, led by President & Director of Research **Brent Miller**, CFA
- Institutional clientele (mostly long/short hedge funds)
- Earnings quality and anomalous insider activity
- Acquired by Sabrient in 2011
  - ➔ Long vetting helps to “play defense”
  - ➔ Built **Earnings Quality Rank (EQR)** for use in GARP model  
[EQR is also licensed to hedge funds and to the *First Trust Long-Short ETF (FTLS)*]

# Gradient Vetting Process

- Identify aggressive accounting practices (“financial engineering”)
- Examine 10-K, 10-Q, earnings releases, conference call transcripts
- Review accruals, working capital, cash flow, GAAP/non-GAAP adjustments
- Identify overstating assets & revenue, understating liabilities & expenses
- Corporate integrity and governance
- Insider behavior (anomalous buying/selling)
- Sell-side reports, regulatory review, any circulating short thesis
- Involves only *publicly available* information

# Sabrient “Quantamental” Approach

- 
- 1. Quantitative screen** to narrow large eligible universe  
(Forward P/E, Forward EPS growth, dynamics of analyst estimates, EQR, GQR)
  - 2. Fundamental analysis** to identify top candidates  
(Still mainly numbers-driven, but not algorithmic)
  - 3. Forensic accounting review** of top candidates
  - 4. Final Stock Selection**, with sector limits

# Various GARP Portfolios

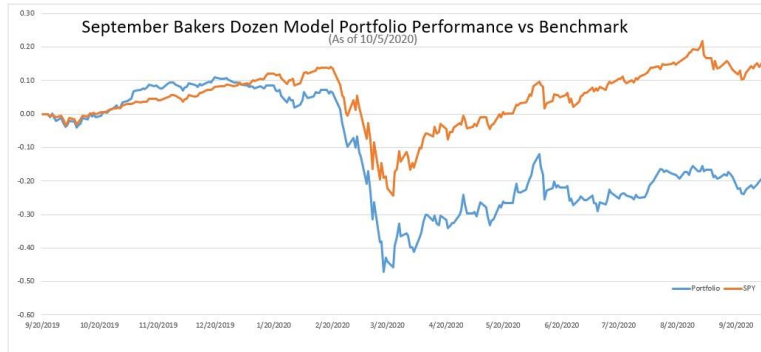
- 1. Baker's Dozen** – Sabrient's 13 top GARP picks (all caps), published quarterly
- 2. Forward Looking Value** – mid-year GARP portfolio of 30-35 stocks (all caps)
- 3. Dividend** – 50 stocks, GARP with solid dividends, 4-5% yield, quarterly
- 4. Small Cap Growth** – 50-stock GARP portfolio, all under \$3.7B cap, quarterly



# Sep–Nov 2019 *Baker's Dozens*

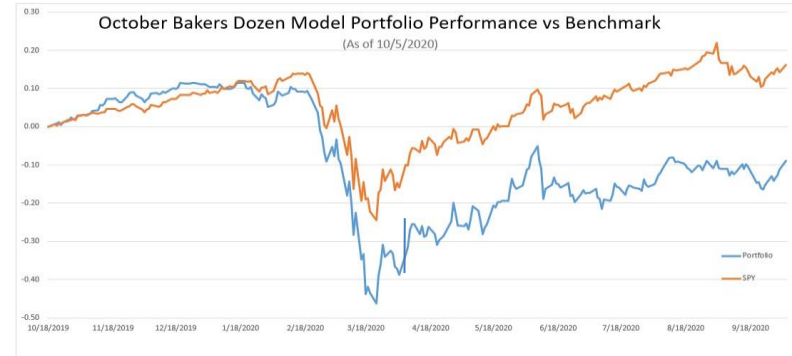
Risk-on optimism takes control, until COVID selloff/recovery

[Comparisons also include Equal-Weight indexes for S&P 500 (RSP), S&P 400 mid caps (EWMC), and S&P 600 small caps (EWSC)]



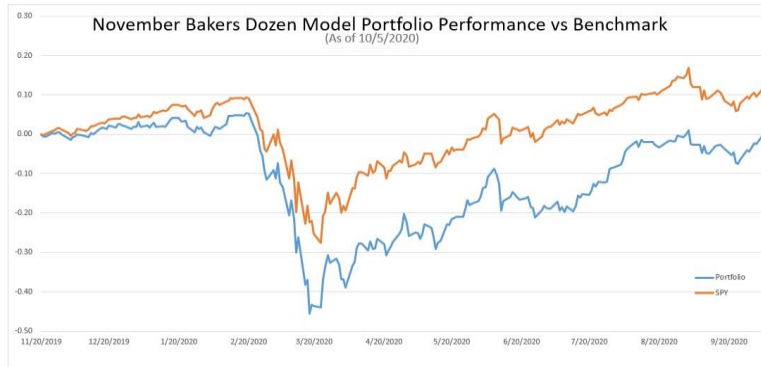
Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	9/20/2019	-18.37%	16.18%	4.66%	0.43%	-5.75%



Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	10/18/2019	-8.93%	16.26%	5.17%	1.04%	-3.96%



Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	11/20/2019	-0.38%	11.47%	1.35%	-1.67%	-5.97%

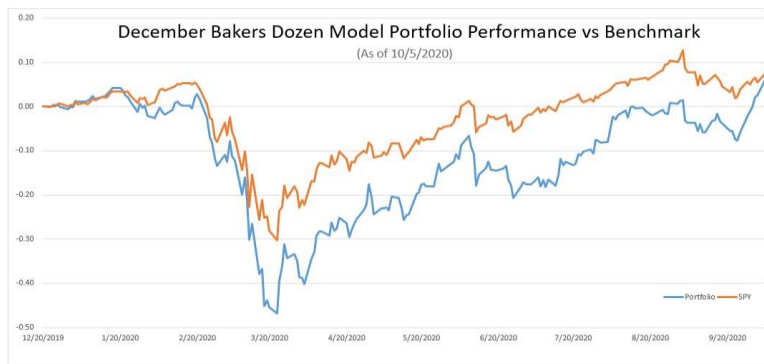
Graphs display Gross Total Return of the Model Portfolios – Not UIT returns. Sabrient tracks model performance from closing prices on launch date to closing prices 12 months + 1 day later, when the new portfolio launches. Sabrient is not responsible for the usage of such portfolios by any third party, including without limitation the *Baker's Dozen* 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 will over time reduce the performance of such UITs in comparison with the performance of Sabrient's model portfolios.

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# Dec 2019–Q1 2020 *Baker's Dozens*

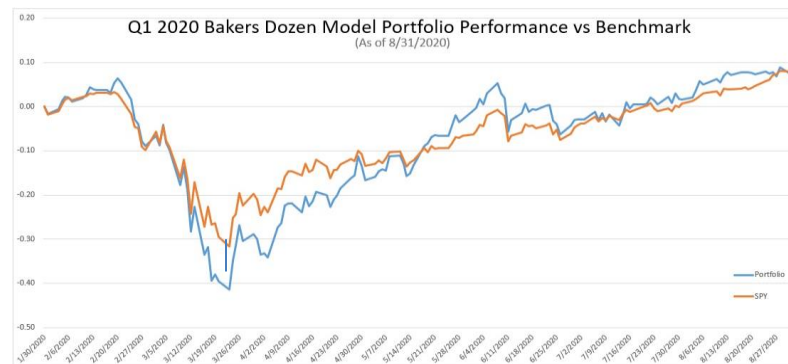
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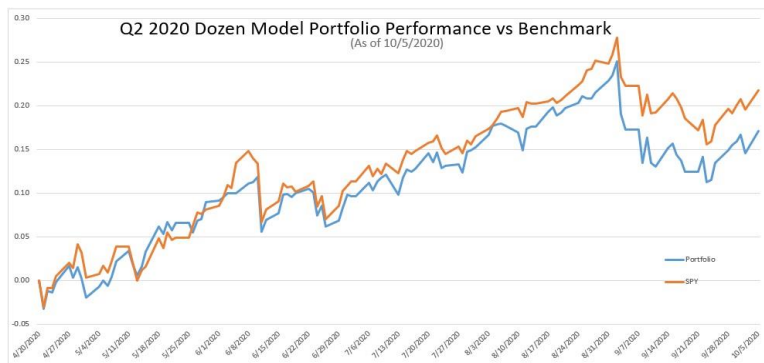
Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	12/20/2019	6.07%	7.39%	-2.17%	-5.72%	-11.11%



Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	1/30/2020	7.40%	7.85%	-2.49%	-4.37%	-7.08%



Total Returns Thru Current

Event	Date	Portfolio	SPY	RSP	EWMC	EWSC
Launch	4/20/2020	17.11%	21.75%	22.82%	31.76%	34.64%

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## Terminating Oct 2019 Baker's Dozen Model Portfolio

Ticker	Company Name	Return	Est. NTM EPS			
			Fwd P/E at Launch	Current Fwd P/E	Growth at Launch	Actual EPS Growth
RCII	Rent-A-Center, Inc.	31.1%	11.0	9.4	31.9%	35.5%
ANTM	Anthem, Inc.	18.7%	11.6	14.2	27.2%	44.4%
CMC	Commercial Metals Company	15.5%	8.1	10.4	26.0%	27.4%
KBH	KB Home	12.1%	11.0	10.5	30.5%	34.6%
CI	Cigna Corporation	2.9%	9.2	9.5	22.9%	33.4%
ARNC + HWM	Arconic + Howmet Aerospace	-9.4%	- Merger -			
RNR	RenaissanceRe Holdings Ltd.	-9.5%	14.6	16.3	45.5%	-36.9%
VAC	Marriott Vacations Worldwide Corpo	-13.5%	12.9	55.6	33.7%	-58.4%
ALL	The Allstate Corporation	-13.9%	10.6	8.5	32.9%	56.5%
NMIH	NMI Holdings, Inc.	-16.9%	10.2	12.8	33.1%	26.1%
CF	CF Industries Holdings, Inc.	-37.4%	18.4	24.0	54.8%	5.4%
ALK	Alaska Air Group, Inc.	-40.2%	10.0	NE	33.3%	-105.4%
PPC	Pilgrim's Pride Corporation	-43.9%	13.6	10.0	58.3%	-45.6%
<b>Average</b>		<b>-8.0%</b>	<b>11.8</b>	<b>16.5</b>	<b>35.9%</b>	<b>1.4%</b>
SPY	SPDR S&P 500 ETF Trust	17.0%	Portfolio was hindered by exposure tilts to small caps, value, and cyclicals (especially financial, travel, materials – plus stock-specific troubles at PPC)			
RSP	S&P 500 equal-weighted index	6.1%				
EWMC	S&P 400 equal-weighted index	2.6%				
EWSC	S&P 600 equal-weighted index	-2.1%				

# Market Outlook (implicit in our rankings)

1. Economic and earnings forecasts remain uncertain given COVID-19 uncertainty
2. Gradual resurgence in global growth, US corporate earnings and CapEx
3. Massive monetary & fiscal stimulus continues unabated
4. Low inflation and low interest rates persist; Supportive Federal Reserve & Congress
5. Equity valuations are elevated but supported by growing optimism, massive liquidity, and low interest rates => *Leading to further multiple expansion*
6. Broad economic recovery may not come until late-2021, but stocks forward-looking
7. Favors value factor and cyclical sectors, plus some high-quality secular growers

## ➤ Major Risks:

- (1) Prolonged global economic slowdown due to resurgence in COVID-19 pandemic (*elevated risk*)
- (2) Social unrest, political uncertainty, contested election (*elevated risk*)
- (3) Escalation in China trade war and global hegemony (*elevated risk*)
- (4) Geopolitical fallout from oil price meltdown (*elevated risk*)
- (5) US dollar meltdown due to massive stimulus (*low risk for now, as all central banks are doing same*)
- (6) Deleveraging a heavily-indebted global economy (*a longer-term issue*)

# Q4 2020 Baker's Dozen Portfolio

Statistics upon launch on 10/20/20

Ticker	Company Name	Sector	Industry	Mkt Cap (\$B)	NTM EPS Growth	Fwd PE	Fwd PEG	Div Yield	EQR	GQR
ABBV	AbbVie	Healthcare	Biotechnology	148.8	22.7%	7.4	0.33	5.5%	5	10
AMD	Advanced Micro Devices	Information Technology	Semiconductors	96.3	64.3%	58.1	0.90	0.0%	3	10
APPS	Digital Turbine	Information Technology	Application Software	3.2	66.7%	78.1	1.17	0.0%	3	10
BCC	Boise Cascade	Basic Materials	Forest Products	1.5	61.7%	10.3	0.17	5.0%	5	9
CHTR	Charter Communications	Communications Services	Cable and Satellite	126.6	61.8%	35.1	0.57	0.0%	3	9
FDX	FedEx Corp	Industrials	Air Freight and Logistics	74.0	36.5%	18.3	0.50	0.9%	3	9
GDDY	GoDaddy	Information Technology	Internet Services and Infrastructure	12.9	45.9%	18.6	0.40	0.0%	5	4
GTN	Gray Television	Communications Services	Broadcasting	1.2	43.9%	4.9	0.11	0.0%	5	8
MDC	M.D.C. Holdings	Consumer Discretionary	Homebuilding	3.1	39.7%	8.6	0.22	2.6%	4	6
OMI	Owens & Minor	Healthcare	Health Care Distributors	1.9	295.7%	9.4	0.03	0.0%	4	5
QDEL	Quidel Corp	Healthcare	Health Care Supplies	10.8	426.6%	10.2	0.02	0.0%	3	9
TPX	Tempur Sealy International	Consumer Discretionary	Home Furnishings	4.7	38.8%	14.1	0.36	0.0%	3	9
VECO	Veeco Instruments	Information Technology	Semiconductor Equipment	0.6	88.8%	13.8	0.16	0.0%	5	6

<b>Average:</b>	37.4	99.5%	22.1	0.22	1.1%	3.9	8.0
<b>Median:</b>	4.7	61.7%	13.8	0.22			

Portfolio launched with:

- a large/mid/small cap mix of 4/3/6
- a growth bias with 7 growth stocks versus 6 value
- *secular* growth Tech/HC companies (to balance the *cyclical* growth Consumer/Industrial/Materials names typical of a GARP portfolio)

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

# Talking Points Summary

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- Sabrient's longstanding GARP model was never tested in such unusual market conditions in which investor sentiment was persistently misaligned with analysts' forward estimates
- Despite spurts of promising performance, Sabrient felt it had become untenable to stick with a process that was struggling to provide the same consistently good results in this "new normal" of erratic investor sentiment and narrow market leadership
- This led to development of enhancements to make selection process more "all-weather" by reducing relative volatility vs. benchmark and focusing more on earnings consistency
- Secular growth names like ADBE, ADSK, AMD, APPS, AMZN, CHTR, NVDA, SEDG became viable; so new portfolios strike a better balance between cyclical and secular growers
- The process enhancements were introduced in December 2019, and indeed our portfolios have shown improvement in relative performance in the "new normal" market conditions – but are still well-positioned for a broadening market and rotation into value/cyclicals

# Resources

***Be sure to sign up for:***

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

- 2-pager with details on each pick (including fwd P/E, Growth Rate, fwd 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 (on Marketing Materials tab) an updated slide deck and commentary

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