An Update to Using Value, Momentum and Quality as an Active Approach to Investing

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What is a truly active approach?

A strategy that purposely deviates from the traditional, market-cap-weighted indexes.

If You Want to Beat the Market, Don't Invest Like an Index Fund

Vanguard S&P 500 ETF (VOO)

Also available as an Admiral™ Shares mutual fund.

Overview | Price & Performance | Portfolio & Management | Fees | Distributions | News & Reviews

Product summary

- Invests in stocks in the S&P 500 Index, representing 500 of the largest U.S. companies.
- Goal is to closely track the index's return, which is considered a gauge of overall U.S. stock returns.
- Offers high potential for investment growth; share value rises and falls more sharply than that of funds holding bonds.
- More appropriate for long-term goals where your money's growth is essential.

View prospectus and reports

ETF facts

Asset class	Domestic Stock - General
Category	Large Blend
IOV ticker symbol	VOO.IV
Expense ratio as of 04/28/2020	0.03%
CUSIP	922908363
ETF advisor	Vanguard Equity Index Group

Source: Vanguard.

The Money Manager's Dilemma

Investment Success (Long-Term)	vs.	**Career Risk** (Short-Term)

Two Big Advantages Individual Investors Have

- Never having to report performance
- The ability to invest in stocks of all sizes

Keys to Active Investing

- Base the approach on research about what has worked historically
- Have a systematic, well-defined manner of applying it
- Be willing to sacrifice shorter-term underperformance for long-term outperformance

Focus on Factors

Value

Strong Momentum

Good Quality

Small Size

Risk-Adjusted Expected Return

Growth

Weak Momentum

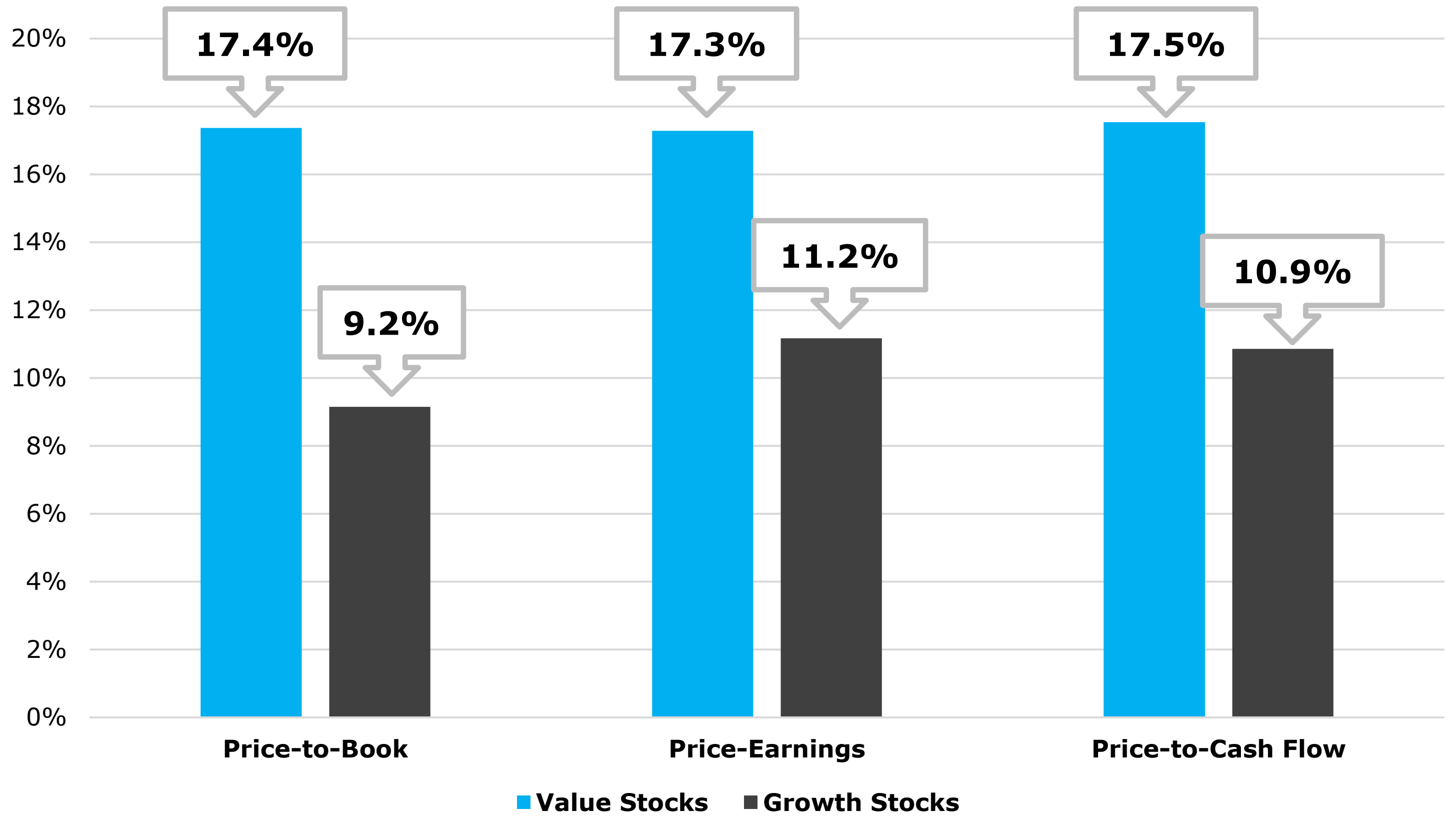
Poor Quality

Large Size

VMQ Stocks is a good an example of a how to use factors in a systematic, active approach.

Two Cornerstones

Value Beats Growth



Source: Kenneth French Data Library, lowest and highest 30% book-to-market equal-weight portfolios, data from 1952 to 2020.

High Valuations

=

High Expectations

=

More Room for Disappointment

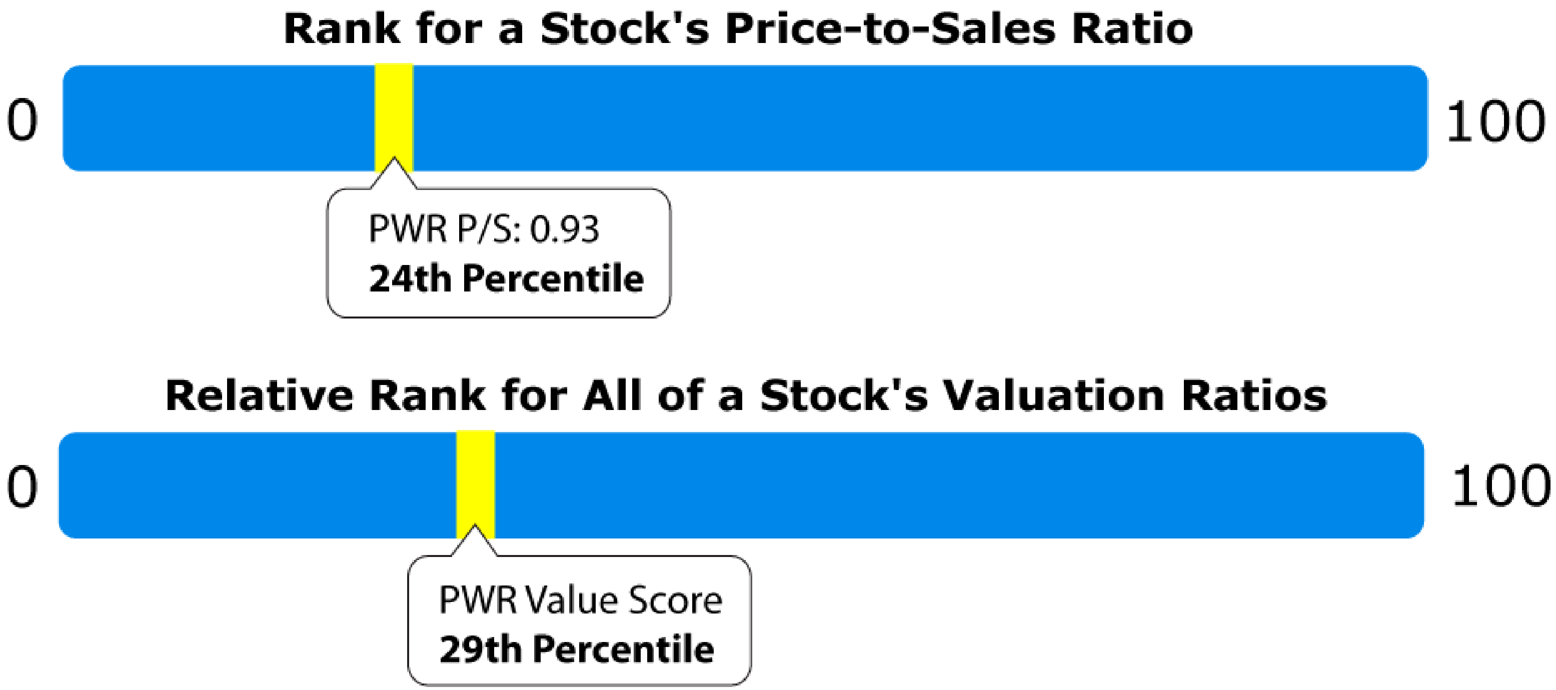
Valuation Considerations

- Academic research uses relative (e.g., cheapest 40%); always finds stocks
- Absolute limits (e.g., price-to-book ratio below 3.0, price-earnings ratio below 20.0) prevent paying up, but can be restrictive
- Some stocks are cheap for a reason

Combine Value Measures

- Price to sales
- Price to earnings
- Enterprise value to EBITDA
- Shareholder yield
- Price to book value
- Price to free cash flow

VMQ Value Score
Two-Step Process

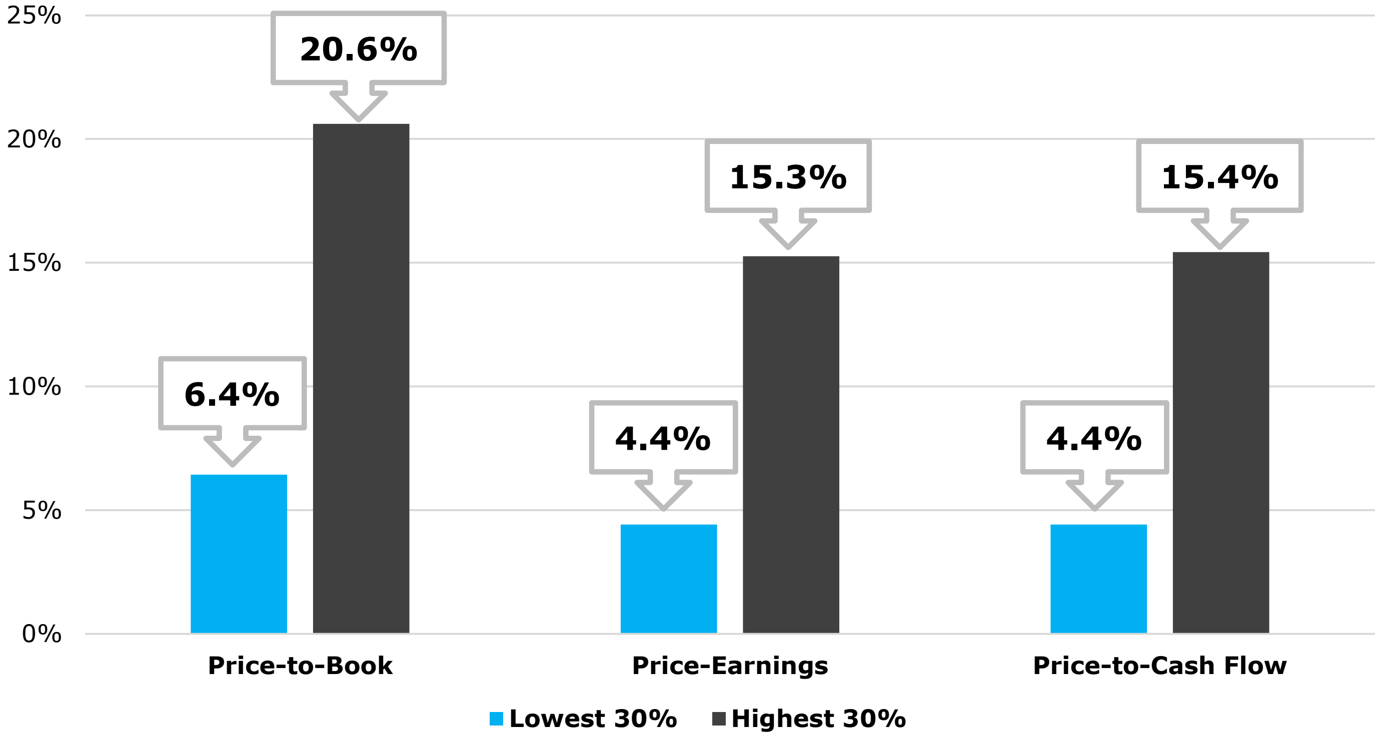


Source: VMQ Stocks; data as of 1/26/21.

VMQ Value Score

- Must have valid ratio for at least two of the six ratios
- Two-step process:
  - First, the percentage rankings for all valid ratios are calculated
  - Second, a stock’s average valuation rank is compared against the average rank of all other stocks
- Put another way, stocks are ranked based on how their composite valuation compares to all other stocks

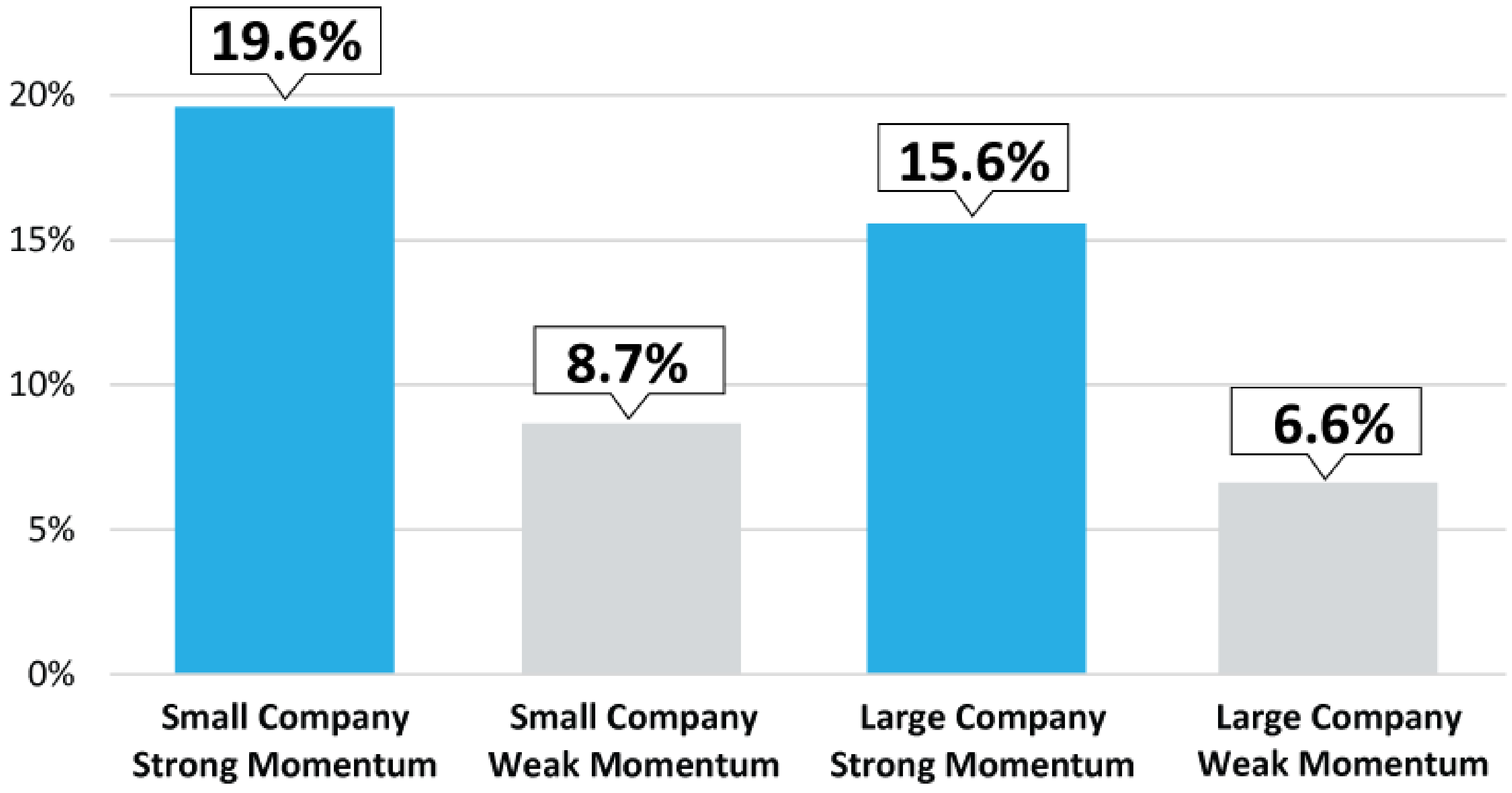
Value Droughts Can Occur



Source: Kenneth French Data Library, lowest and highest 30% 12-month price returns for equal-weight portfolios, data from 2017 to 2020.

The fear of incurring periods of underperformance is one of the reasons factor premiums, including the excess long-term return from favoring value, continue to exist.

Momentum: Investors Prefer Winners



Source: Kenneth French Data Library, lowest and highest 30% 12-month price momentum for equal-weight portfolios, data from 1952 to 2020.

Momentum Considerations

- Stocks with relative strength rankings of 60% or higher tend to outperform
- Look at longer periods of 13 weeks or more; can be mean-reverting over four-week periods
- Momentum strategies have more turnover, and therefore are more costly

Measure Relative Strength Over Four Quarters

Source: QuoteMedia, Quanta Services Inc. (PWR), data as of 1/26/2021; annotations from AAII.

Weighted Four-Quarter Relative Strength Rank

- 40% weight to most recent quarterly relative strength rank
- 20% weight to relative strength rank of each of the previous three quarters
- Fared better than other momentum indicators, including 26-week and 50/50 26-week/52-week relative strength ranks

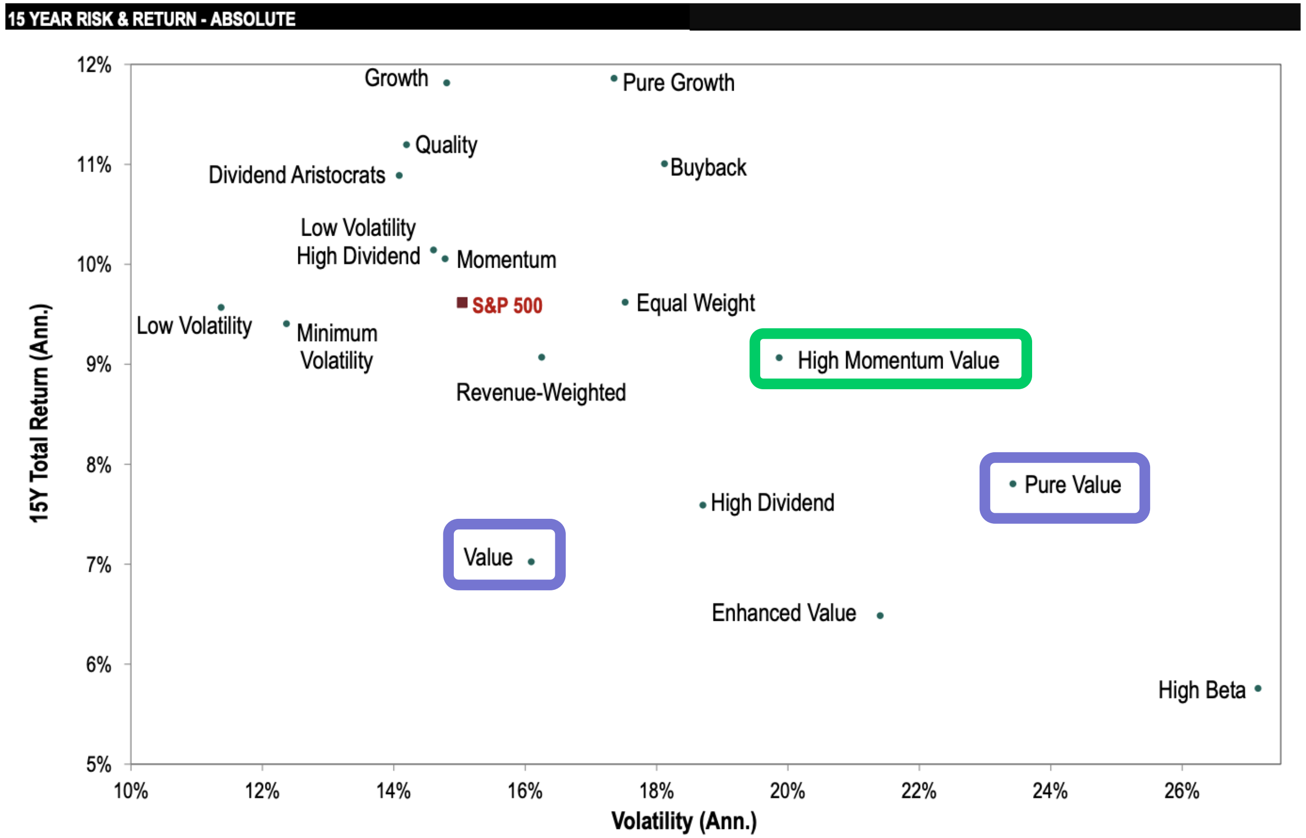
Five Worst Momentum Crashes

Rank	Month	Market Returns 2 Years Prior (%)	Winners vs. Losers (%)	Overall Market (%)
1	Aug 1932	(67.8)	(74.4)	36.5
2	Jul 1932	(74.9)	(61.0)	33.6
3	Jan 2001	10.7	(49.2)	3.7
4	Apr 2009	(40.6)	(45.5)	10.2
5	Sep 1939	(21.5)	(43.8)	17.0

Source: "Momentum Crashes," Kent Daniel and Tobias J. Moskowitz; National Bureau of Economic Research; August 2014.

The combination of a low valuation and good relative price momentum indicates that other investors view the stock as a bargain too.

Momentum Has Helped During Value Drought



Source: "Index Dashboard: S&P 500 Factor-Indices," S&P Dow Jones Indices, January 2021.

Merely looking for low value and strong momentum identifies many stocks.

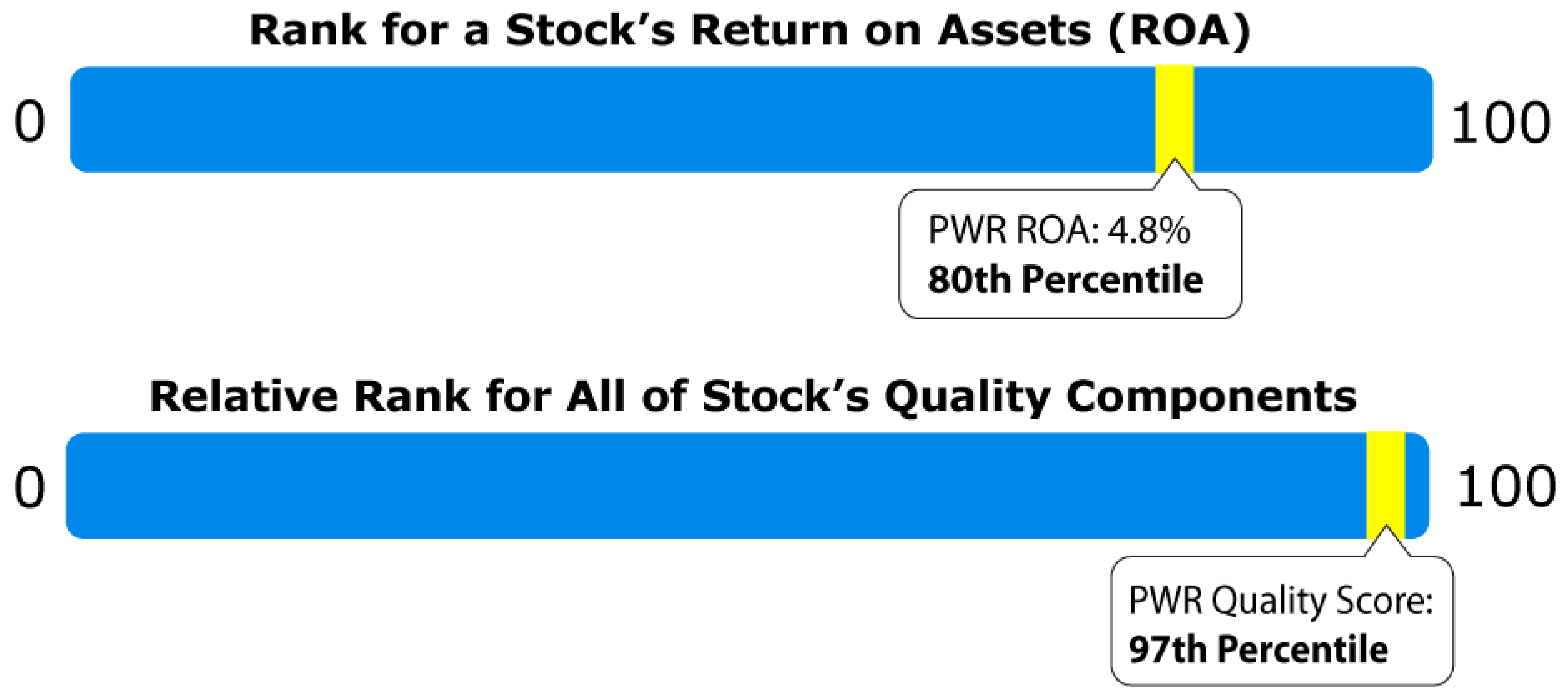
The list can be narrowed down by requiring other attractive traits.

The VMQ Quality Grade uses eight measures to evaluate a company’s underlying fundamental strength.

The Eight Quality Measures

- Return on assets (ROA)
- Return on invested capital (ROIC)
- Gross-profit-to-total-assets ratio
- Buyback yield
- Change in total liabilities relative to total assets
- Accruals-to-total-assets ratio
- Z double prime bankruptcy risk score
- F-Score

Similar Two-Step Process for Quality as for Value



Source: VMQ Stocks; data as of 1/29/21.

VMQ Quality Score

- Must have valid ratio for at least four of the eight measures
- Two-step process:
  - First, the percentage rankings for all valid measures are calculated
  - Second, a stock's average quality rank is compared against the average rank of all other stocks
- Put another way, stocks are ranked based on how their composite quality compares to all other stocks

Additional Restrictions

- Profitable over 12 months and last year, and forecast to stay profitable
- Price at or above $4
- Exchange-listed
- Not China- or Russia-based
- Not an ADR or an ADS
- Not in financial sector or a REIT

Putting It All Together

- Value Grade of A or B (low valuation)
- Momentum Grade of A or B (strong momentum)
- Quality Grade of A or B (good quality)

Sell Rules

- Value Grade worsens to F
- Momentum Grade worsens to F
- Quality Grade worsens to F
- Company stops being profitable on a trailing 12-month basis

VMQ Stocks

Welcome to VMQ Stocks

Commentary:

This Week's Swings in Big Lots, Plus a Good January for the VMQ Model Portfolio

JANUARY 29, 2021

Just when we thought there would be a break from ridiculous things happening, trading in GameStop Corp. (GME) went berserk. Since January 12, shares of GameStop have surged from $19.95 per share to Thursday's intraday high of $483.00. The stock closed today at $325.00.

Contributing to the movement in GameStop is short-selling. Hedge funds and other investment firms that had placed bets on the stock falling in price were forced to cover their positions. This increased the buying pressure, which, in turn, attracted more speculators. Barron's listed the short interest (the number of shares sold short) in GameStop as representing close to 90% of its shares outstanding.

The volatility in GameStop carried over to other stocks. **Big Lots Inc. (BIG)** appears to be one of those stocks. Big Lots' shares jumped by 19.9% on Wednesday before pulling back by 7.6% yesterday. Big Lots' short interest yesterday represented 22% of all shares outstanding, so this may have been the connection.

The short interest ratio does not factor into the VMQ strategy. Market sentiment is captured by the use of momentum, while

Recent Portfolio Alerts

Portfolio Additions

Company (Ticker)	Alert Date	Sector: Industry
Limbach Holdings Inc (LMB)	01/08/2021	Industrials : Construction & Engineering

Portfolio Deletions

Company (Ticker)	Alert Date	Sector: Industry
Cigna Holding Co. (CI)	01/07/2021	Healthcare : Managed Health care

» Click here to see historical alerts

VMQ Model Portfolio Weekly Scoreboard

Green up arrows and red down arrows show the daily change in the Value Grade, Momentum Grade or Quality Score.

Value Grade

Company (Ticker)	New Grade	Date of Change
No Value Grade changes within the last week.		

www.VMQStocks.com

VMQ Portfolio

VMQ Portfolio

+ Add to My Portfolio

Holdings | Performance | Valuation Analysis | Momentum Analysis | Quality Analysis | Characteristics

Green up arrows and red down arrows show the daily change in the Value Grade, Momentum Grade or Quality Grade.

Click on the column headers to change the sort order.

Printer-friendly
Excel

Company Name	Ticker	Portfolio Alert		Current Price	Total Return Since Purchase	Value		Momentum		Quality		Sector: Industry	Portfolio Notes
		Date	Price			Score	Grade	Score	Grade	Score	Grade		
ABM Industries, Inc.	ABM	6/14/2019	$39.76	$36.74	(-5.1%)	11	A	17	F ▼	77	B	Industrials: Business Support Services	approaching momentum floor
Advance Auto Parts, Inc.	AAP	2/23/2018	$116.32	$149.14	37.2%	35	B	20	F ▼	87	A	Consumer Cyclicals: Retailers - Auto Vehicles, Parts & Service	approaching momentum floor
AGCO Corp.	AGCO	3/1/2019	$68.45	$110.90	69.0%	38	B	71	B	91	A	Industrials: Heavy Machinery & Vehicles	qualifying
Arrow Electronics, Inc.	ARW	2/8/2019	$79.24	$97.63	19.9%	8	A	44	C	92	A	Technology: Semiconductors	
AutoNation, Inc.	AN	3/6/2020	$42.19	$71.28	76.7%	12	A	63	B ▲	98	A	Consumer Cyclicals: Retailers - Auto Vehicles, Parts & Service	qualifying
Big Lots, Inc.	BIG	7/10/2020	$40.40	$59.68	34.7%	3	A	61	B	92	A	Consumer Cyclicals: Retailers - Discount Stores	qualifying
BJ's Wholesale Club Holdings Inc.	BJ	3/20/2020	$24.69	$42.07	75.6%	36	B	32	D	91	A	Consumer Cyclicals: Retailers - Discount Stores	

VMQ Stocks portfolio as of 1/31/21.

Types of Stocks Held

- About 40% of all holdings to date have belonged to the S&P 500 or S&P MidCap 400
- Slightly more than 40% have been in the S&P SmallCap 600
- Approximately half of all holdings have paid a dividend

VMQ Ideas

Company Name	Ticker	Current Price	Value		Momentum		Quality		Notes
			Score	Grade	Score	Grade	Score	Grade	
Acadia Healthcare Company Inc	ACHC	$50.68	40	B	71	B	67	B	
AGCO Corporation	AGCO	$110.90	38	B	71	B	91	A	held in the VMQ model portfolio
AMC Networks Inc	AMCX	$49.42	15	A	78	B	96	A	
Apogee Enterprises Inc	APOG	$35.10	9	A	73	B	98	A	
ArcBest Corp	ARCB	$46.35	18	A	71	B	91	A	
Asbury Automotive Group, Inc.	ABG	$142.61	26	B	74	B	82	A	
Atkore International Group Inc	ATKR	$44.36	33	B	70	B	93	A	
AutoNation, Inc.	AN	$71.28	12	A	63	B ▲	98	A	held in the VMQ model portfolio
B&G Foods, Inc.	BGS	$38.08	33	B	70	B	91	A	

VMQ Ideas as of 1/31/21.

Process for Selecting Candidates

- Go through list of VMQ Ideas to identify stocks with the best combination of a low Value Score and a high Momentum Score
- Conduct due diligence to identify any potential red flags (dual class ownership, forthcoming merger, a sizeable drop in future projected earnings, etc.)
- As much as possible, the model is trusted

A Few Final Thoughts

- To beat the market, you have to invest differently than the market; this is what VMQ is designed to do
- Being truly active will lead to a portfolio that is different than the S&P 500; as such, returns will be different too
- Combining factors is a feature, but makes the strategy less intuitive relative to a ”pure” strategy such as deep value

Special Offer for Attendees

https://tinyurl.com/vmqoffer

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The Individual Investor Show: An Update on Shadow Stocks, and Current Trends in Investor Sentiment
Wednesday, February 17, 2021, 7:30 p.m. CST

John Bajkowski on Identifying Promising Companies With AAII.com's Stock Screens
Wednesday, February 24, 2021, 7:30 p.m. CST