Weed Out the Weak With VMQ Stocks

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What is a truly active approach?

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

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

ETF Evaluator: Vanguard S&P 500 ETF (VOO) Follow This ETF

Overview | Insights

Equity Global Asset Class	$412.520 Last Trade (as of Feb 04)	$441.260 - $341.920 52-Wk High-Low Range
U.S. Equity Fund Group	$845,932 Mil Assets	0.03% A Expense Ratio
Large Blend Category	1.3% TTM Yield	4% Portfolio Turnover

BEST PERFORMING IN LARGE BLEND OVER THE LAST YEAR

No etfs meet the criteria for consistent category performer.

Data as of 1/31/2022

1-Mo Return	3-Mo Return	YTD Return	1-Yr Return	3-Yr Return	5-Yr Return	Category Risk Index	Total Risk Index
-5.2% B (NAV)	-1.6% B (NAV)	-5.2% B (NAV)	23.2% B (NAV)	20.7% B (NAV)	16.7% B (NAV)	0.97 B	1.17
-5.2% B (Price)	-1.7% B (Price)	-5.2% B (Price)	23.3% B (Price)	20.7% B (Price)	16.7% B (Price)		

Source: AAII.com

The median R-squared for no-load, actively managed large-cap stock funds is 90%.

In other words, 90% of their return can be explained by movement in the S&P 500 index as opposed to their strategy.

The Money Manager's Dilemma

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

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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

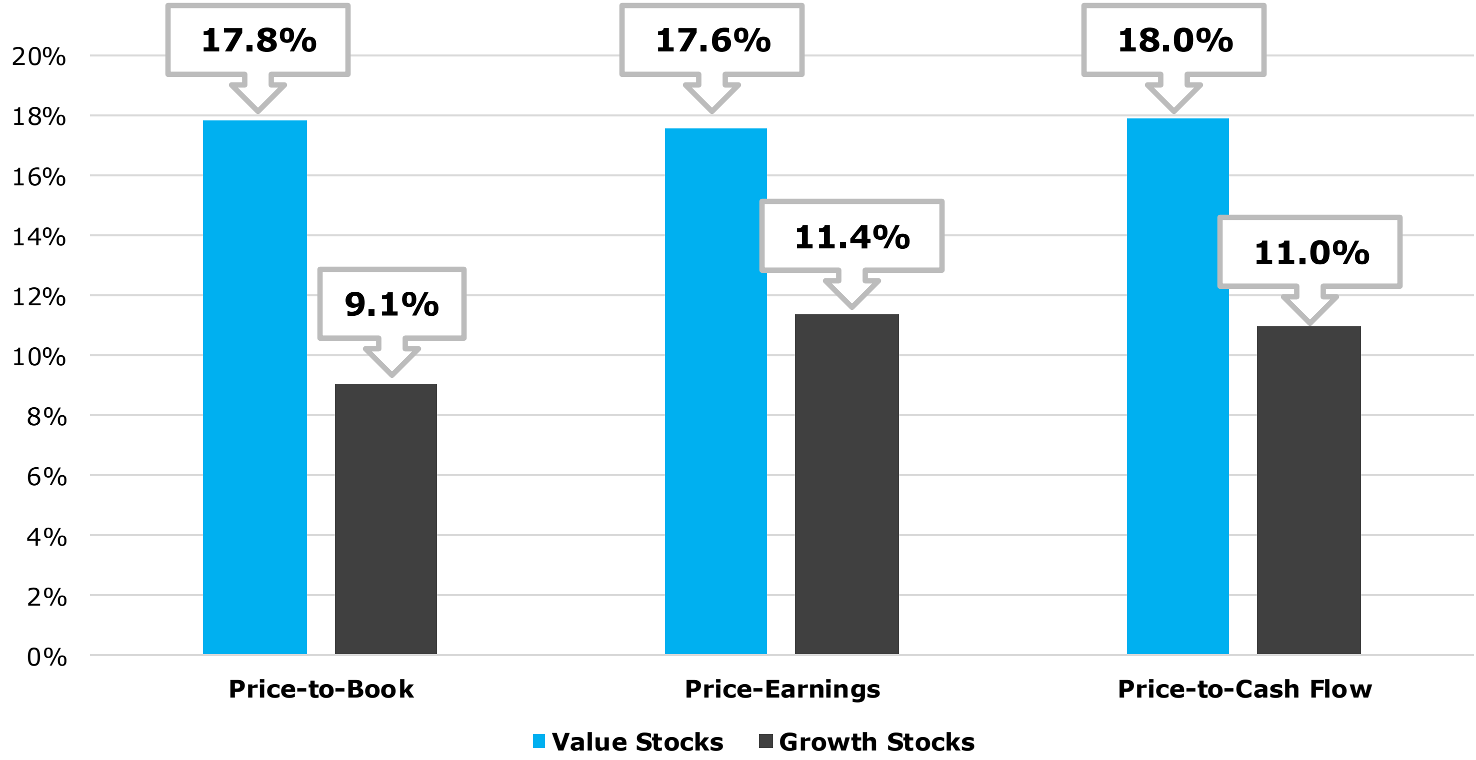
Risk-Adjusted Expected Return

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 2021.

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

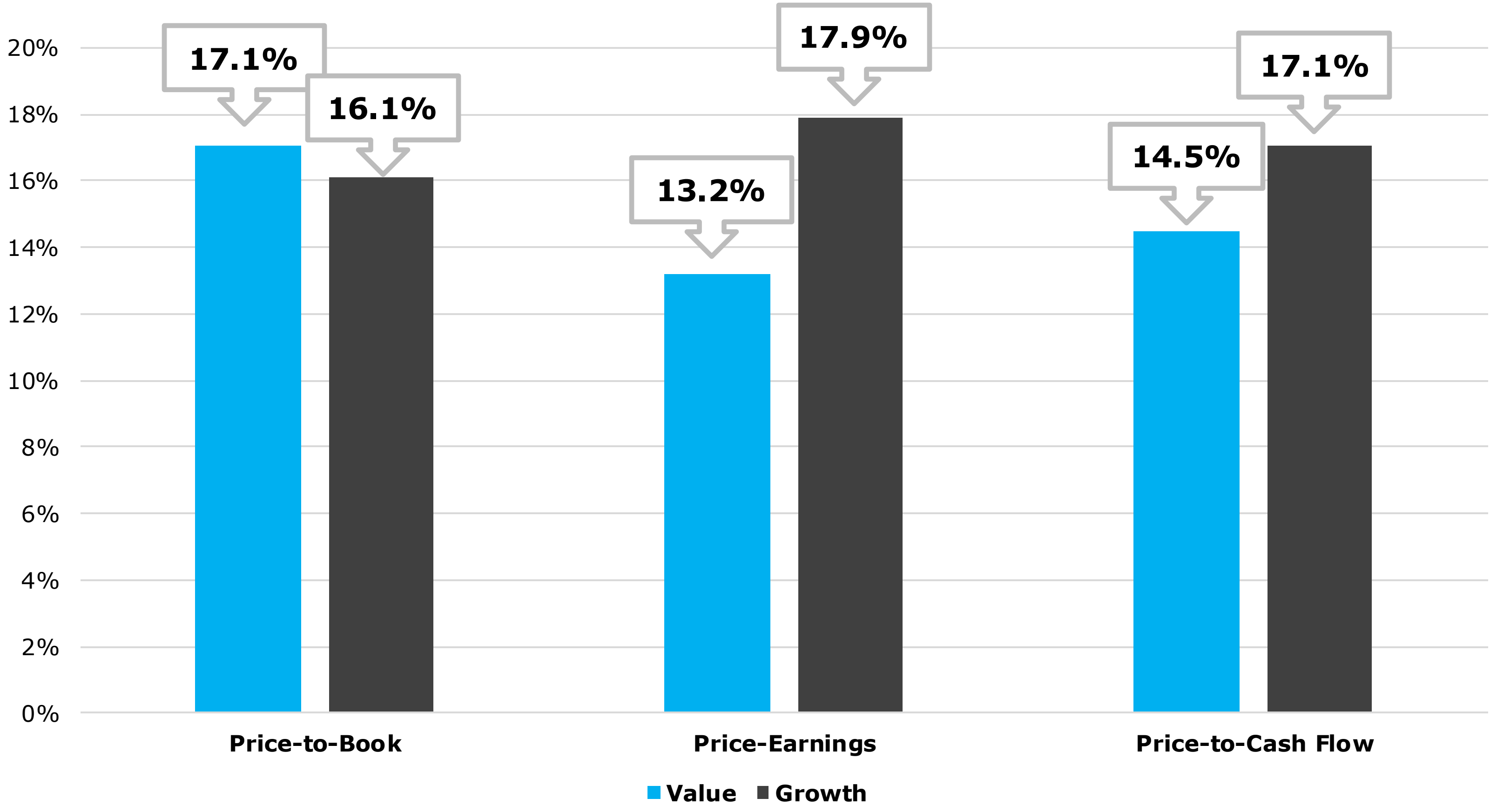
VMQ Value Score
Two-Step Process

Source: VMQ Stocks. Data as of 2/4/22.

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, value (cheapest 30%) and growth (most expensive 30%) 12-month price returns for equal-weight portfolios, data for 2018 through 2021.

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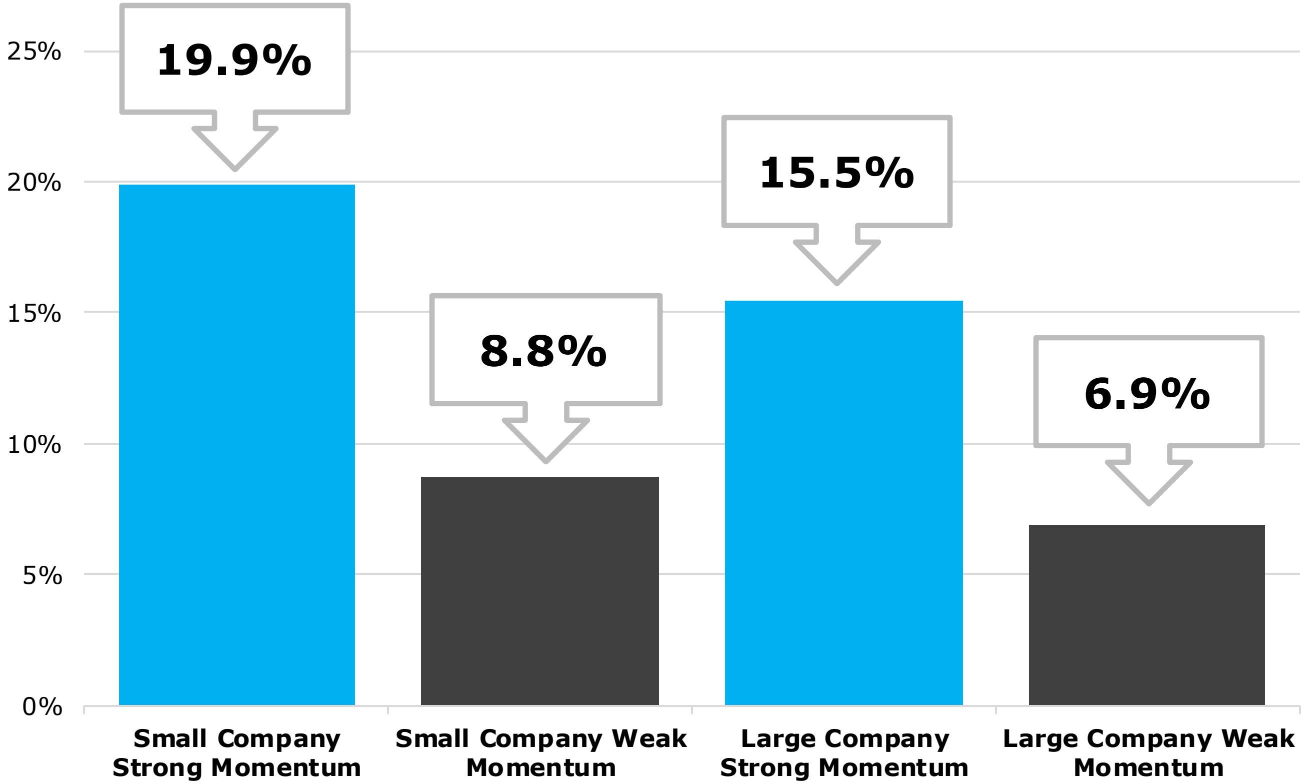
The fear of incurring periods of underperformance is one of the reasons factor premiums, including the excess long-term return from favoring value, continue to exist.

Momentum: Investors Prefer Winners

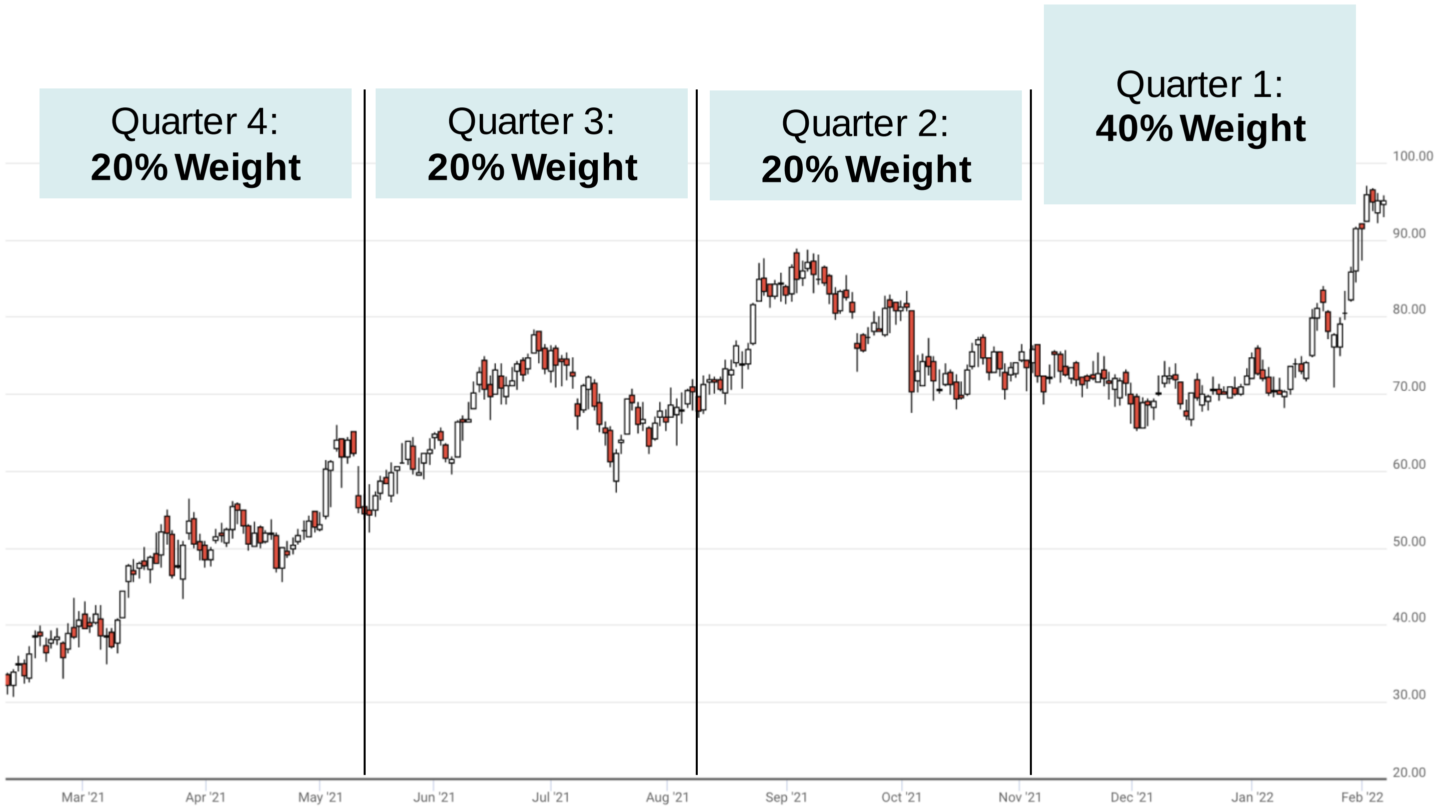


Source: Kenneth French Data Library, strongest (highest 30%) and weakest (lowest 30%) 12-month price momentum for equal-weight portfolios, data from 1952 to 2021.

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: AAII.com and QuoteMedia, Quanta Services Inc. (PWR), data as of 2/4/2022; annotations from AAII.

Weighted Four-Quarter Relative Strength Rank

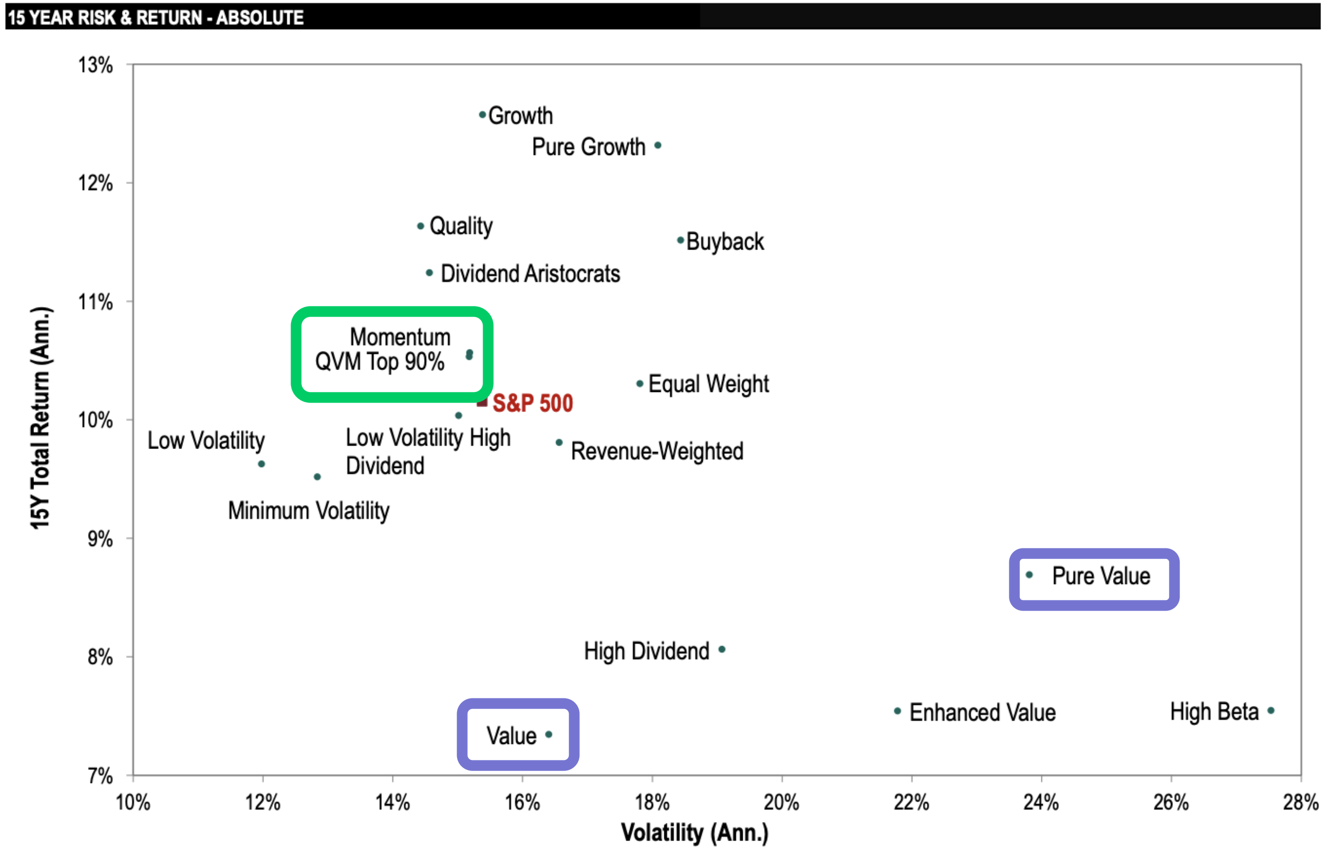
- 40% weight to most recent quarterly relative strength rank
- 20% weight to relative strength rank of each of the previous three quarters
- Fared better than other momentum indicators, including 26-week and 50/50 26-week/52-week relative strength ranks

The momentum factor can "crash," most often after the stock market has fallen by a significant amount.

For example, the stocks that held up the best during the financial crisis went on to underperform in March through May 2009.

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 2022.

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

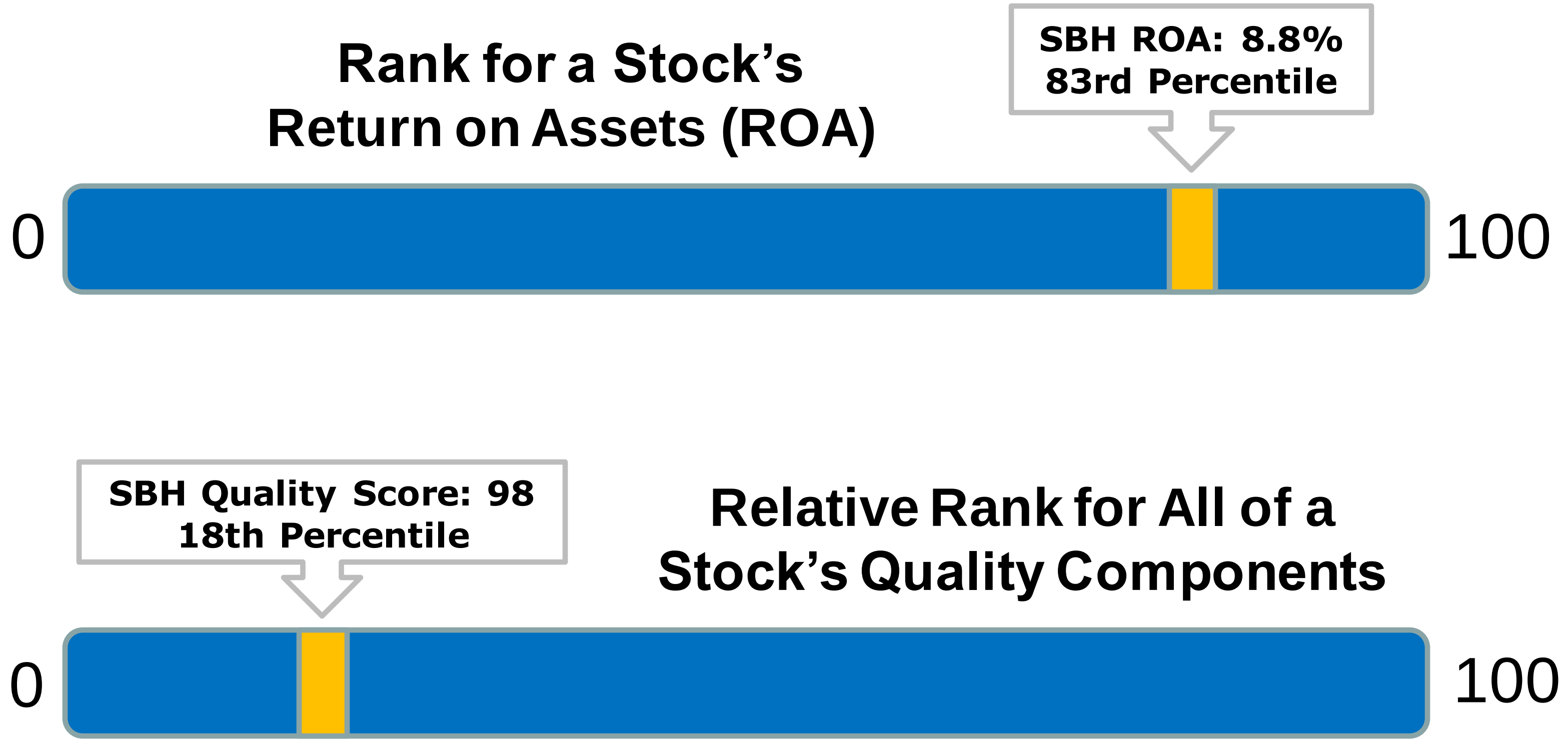
The list can be narrowed down by requiring other attractive traits.

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 2/4/22.

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

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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 American depositary receipt (ADR) or an American depositary share (ADS)
- Not in financial sector or a real estate investment trust (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:

Let's Talk About What January's Decline Means for the Full Year

FEBRUARY 4, 2022

Many investors would request a do-over if they had the chance to turn back the clock by one month. The S&P 500 index endured its worst January performance since January 2009, falling by 5.3%. The Nasdaq composite shed 8.9% of its value, its worst monthly return since March 2020.

As goes January, so goes the year, according to the Stock Trader's Almanac. Positive returns in January lead to positive full-year returns. Down Januarys … well the record is more mixed. Nine of out of the last 10 times January was down, the S&P 500 rose. Its median February–December gain was 16.0% according to LPL Research.

Keep in mind that the S&P 500, and other major indexes, could have positive February–December returns and still realize a loss for all of 2022. Since 1945 when the stock market was up between Christmas and New Year's (the Santa Claus Rally), but down during the first five days of January and down for January overall, the S&P 500 has only posted a full-year gain 13% of the time according to Sam Stovall at CFRA Research.

Recent Portfolio Alerts

Portfolio Additions

Company (Ticker)	Alert Date	Sector: Industry
There are no recent portfolio Additions.		

Portfolio Deletions

Company (Ticker)	Alert Date	Sector: Industry
There are no recent portfolio Deletions.		

» 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
Rent-A-Center Inc (RCII)	B ▲	02/04/2022
United Rentals, Inc. (URI)	B ▲	02/04/2022

https://vmq.aaii.com

VMQ Portfolio

VMQ 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	$40.42	6.2%	33	B	52	C	60	C	Industrials: Business Support Services	
AGCO Corp.	AGCO	3/1/2019	$68.45	$114.51	80.2%	44	C	53	C	74	B	Industrials: Heavy Machinery & Vehicles	
Arrow Electronics, Inc.	ARW	2/8/2019	$79.24	$126.23	55.0%	8	A	78	B ▼	78	B	Technology: Semiconductors	qualifying
AutoNation, Inc.	AN	3/6/2020	$42.19	$104.05	157.9%	6	A	73	B	99	A	Consumer Cyclicals: Retailers - Auto Vehicles, Parts & Service	qualifying
BJ's Wholesale Club Holdings Inc.	BJ	3/20/2020	$24.69	$59.85	149.8%	46	C	82	A	93	A	Consumer Cyclicals: Retailers - Discount Stores	

VMQ Stocks portfolio as of 2/4/22.

Types of Stocks Held

- Almost 40% of all holdings to date have belonged to the S&P 500 or S&P MidCap 400 index
- Slightly more than 41% have been in the S&P SmallCap 600 index
- More than half of all holdings have paid a dividend

VMQ Ideas

VMQ Ideas

These companies qualify for initial consideration under the VMQ Stocks approach.

Overview | Valuation Analysis | Momentum Analysis | Quality Analysis | Characteristics

Qualifying as of 2/4/2022

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

Excel

Click on the column headers to change the sort order.

Company Name	Ticker	Current Price	Value		Momentum		Quality		Notes
			Score	Grade	Score	Grade	Score	Grade	
Abercrombie & Fitch Co.	ANF	$38.03	7	A	86	A	98	A	
Academy Sports and Outdoors Inc	ASO	$36.76	17	A	84	A	88	A	
AdvanSix Inc	ASIX	$40.55	11	A	87	A	89	A	
AerCap Holdings N.V.	AER	$62.58	12	A	84	A	63	B	
Albertsons Companies Inc	ACI	$28.10	23	B	88	A	85	A	
Alliance Resource Partners, L.P.	ARLP	$13.46	12	A	96	A	94	A	
Allison Transmission Holdings Inc	ALSN	$38.58	27	B	60	C ▼	92	A	
Alpha and Omega Semiconductor Ltd	AOSL	$46.25	40	B	90	A	75	B	

VMQ Ideas as of 2/4/22.

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Process for Selecting Candidates

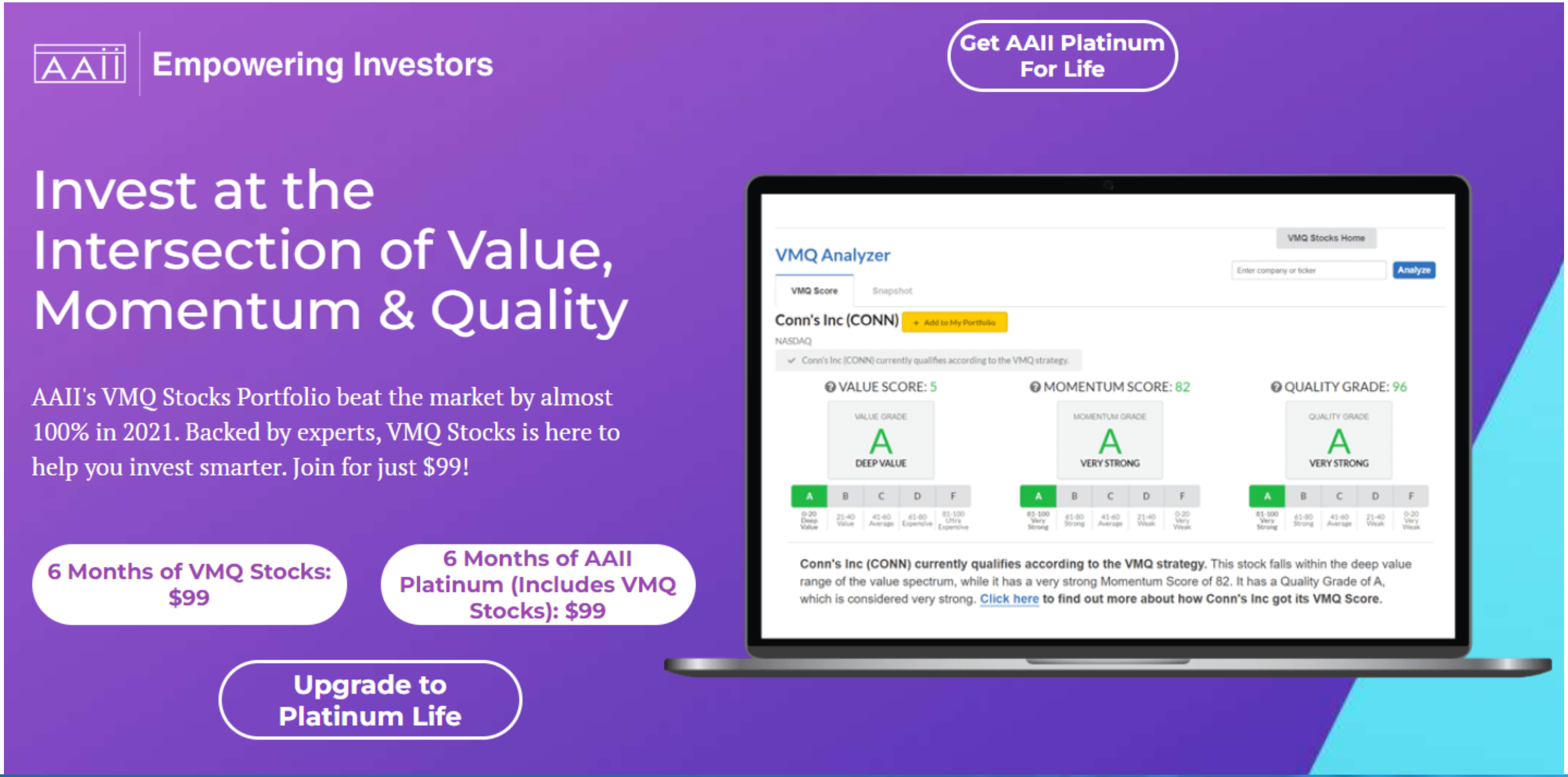
- Go through list of VMQ Ideas to identify stocks with the best combination of a low Value Score and a high Momentum Score
- Conduct due diligence to identify any potential red flags (dual class ownership, forthcoming merger, a sizeable drop in future projected earnings, etc.)
- As much as possible,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



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Thursday, February 17, 2022, 7:30 PM Central

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Presented by
Charles Rotblut & Jenna Brashear, AAII

LIVE: Using Your Personal Preferences to Find the Right Investment
Thursday, February 17, 2022, 7:30 p.m. CST

Watch the Next Episode
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