Changing Markets: Does Anything Still Work?

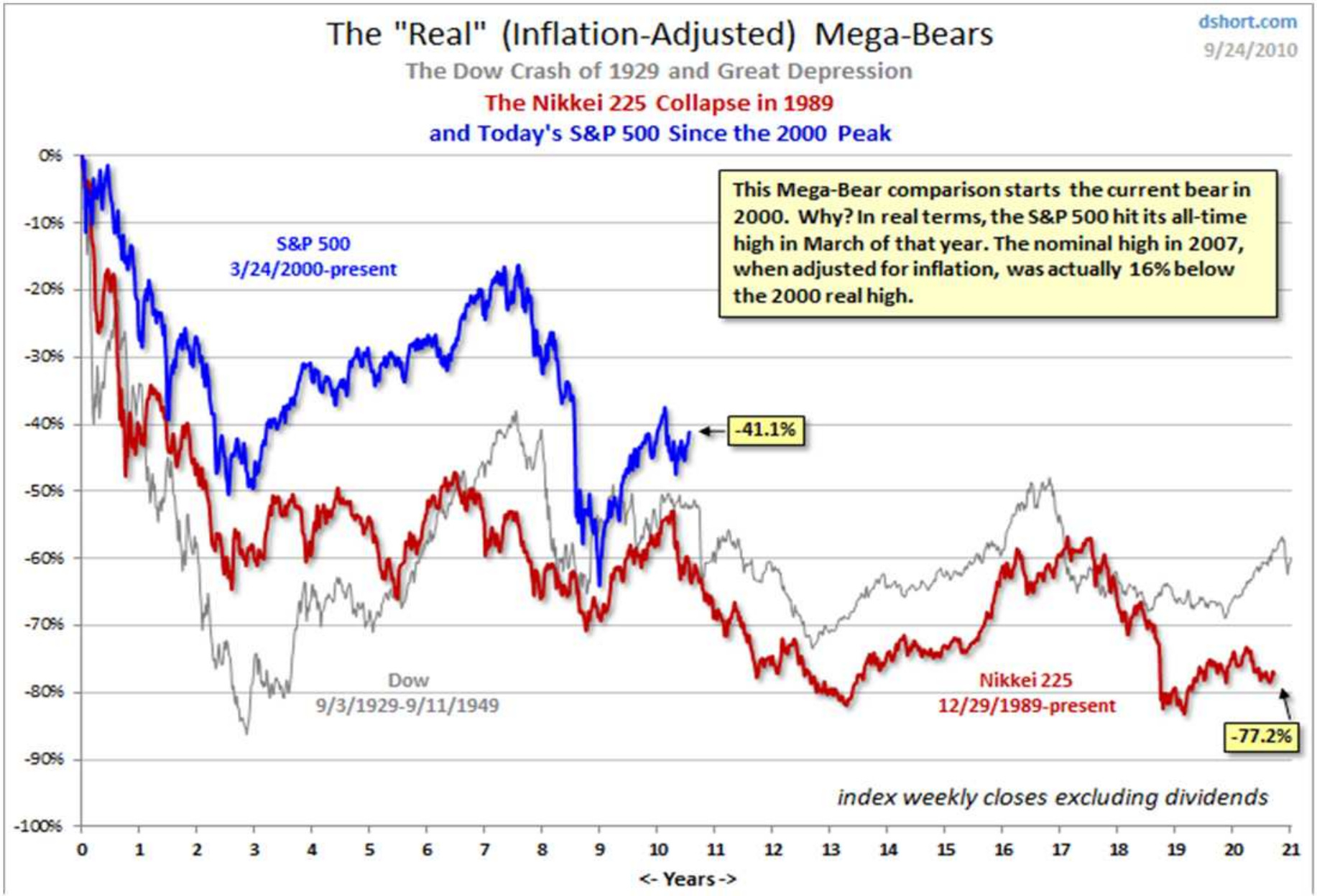
- The Challenges We Face Today
  - An Investing “New World Order”?
- Does Anything Still Work?
  - Asset Allocation Schemes
- Does Anything Still Work?
  - Stock Screen Examples
- Summary
- Q&A
- References

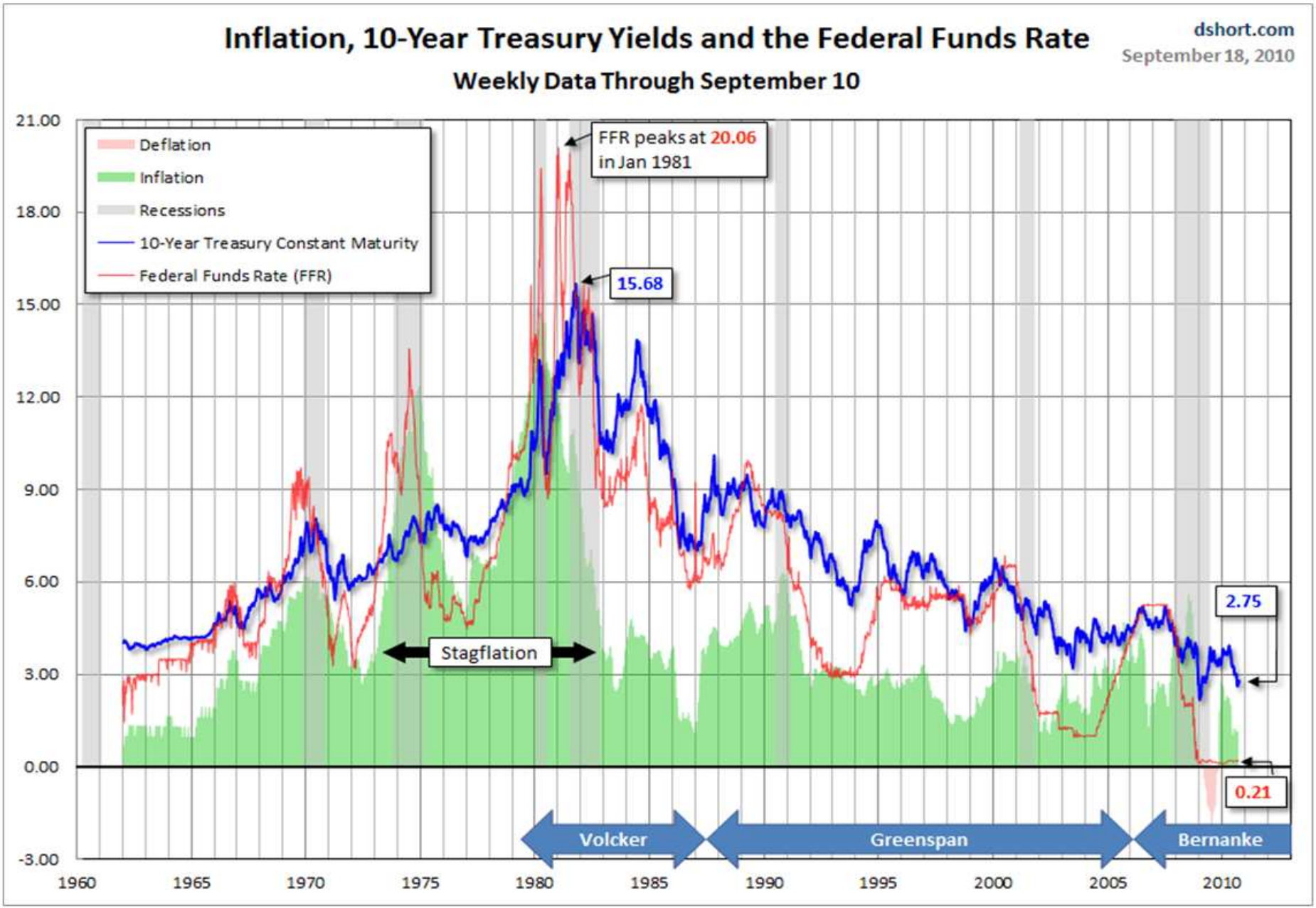
The Challenges We Face Today:

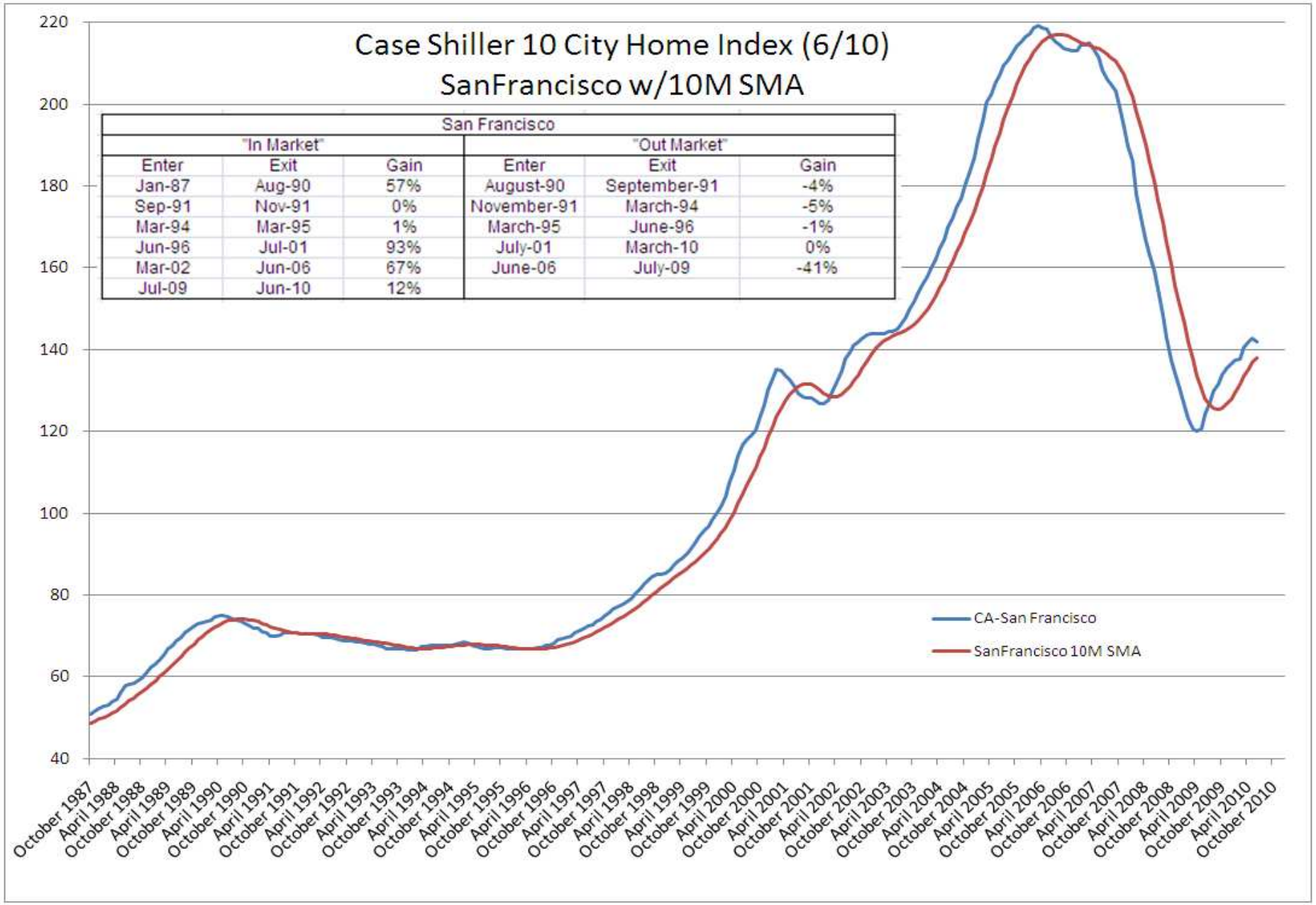
An Investing “New World Order”?

(Some of)The Challenges We Face Today

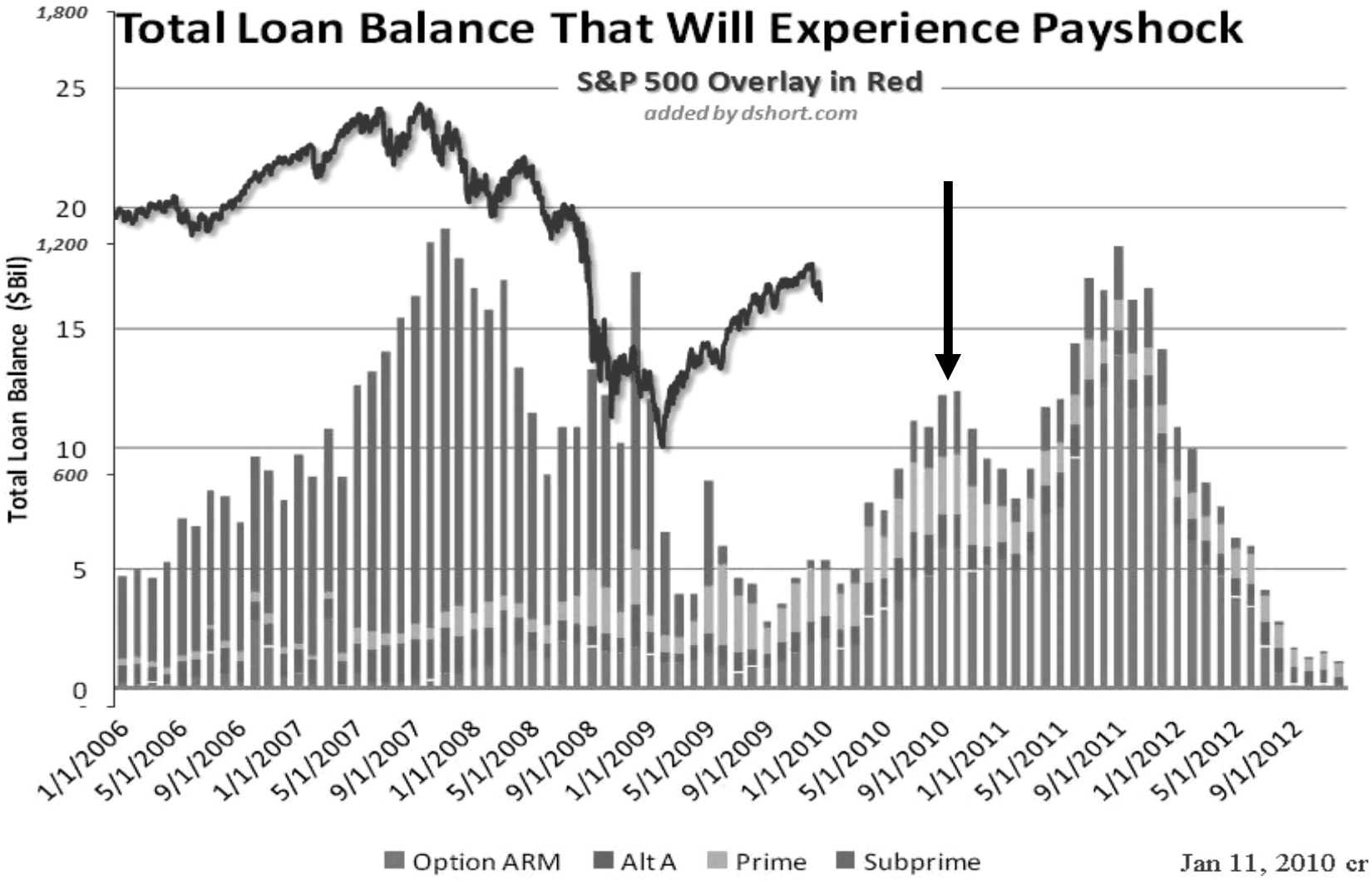
- Secular bear market
- Interest rates – 1% or 10%?
- Imploding home prices
- A “Shadow Inventory” of unsold homes
- Unemployment rates at level not seen for a generation
- Option Arm resets coming due
- Sovereign debt crisis
- Quantitative Easing (printing money) by “Helicopter Ben”
- $1T in stimulus (and debt)
- Capacity utilization at recession levels – after the recession
- $20T US debt by 2015
- Consumer sentiment at recession levels
- Consumer savings rates are up – and consumption down
- Competitive currency devaluations
- The rise of China – and the US as #2 (at best)
- Anti-Austerity protests across Europe
- The creation of a 1T euro bailout fund
- US states in deep fiscal trouble
- The US middle class is disappearing - incomes flat at best for 20 years
- Gold is skyrocketing as currencies are debased
- And many others….


The "Real" (Inflation-Adjusted) Mega-Bears
The Dow Crash of 1929 and Great Depression
The Nikkei 225 Collapse in 1989
and Today's S&P 500 Since the 2000 Peak
dshort.com
9/24/2010
This Mega-Bear comparison starts the current bear in 2000. Why? In real terms, the S&P 500 hit its all-time high in March of that year. The nominal high in 2007, when adjusted for inflation, was actually 16% below the 2000 real high.
S&P 500
3/24/2000-present
-41.1%
Dow
9/3/1929-9/11/1949
Nikkei 225
12/29/1989-present
-77.2%
index weekly closes excluding dividends
0%
-10%
-20%
-30%
-40%
-50%
-60%
-70%
-80%
-90%
-100%
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21
<- Years ->


Inflation, 10-Year Treasury Yields and the Federal Funds Rate
Weekly Data Through September 10
dshort.com
September 18, 2010
Deflation
Inflation
Recessions
10-Year Treasury Constant Maturity
Federal Funds Rate (FFR)
FFR peaks at 20.06 in Jan 1981
15.68
2.75
0.21
Stagflation
Volcker
Greenspan
Bernanke
21.00
18.00
15.00
12.00
9.00
6.00
3.00
0.00
-3.00
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

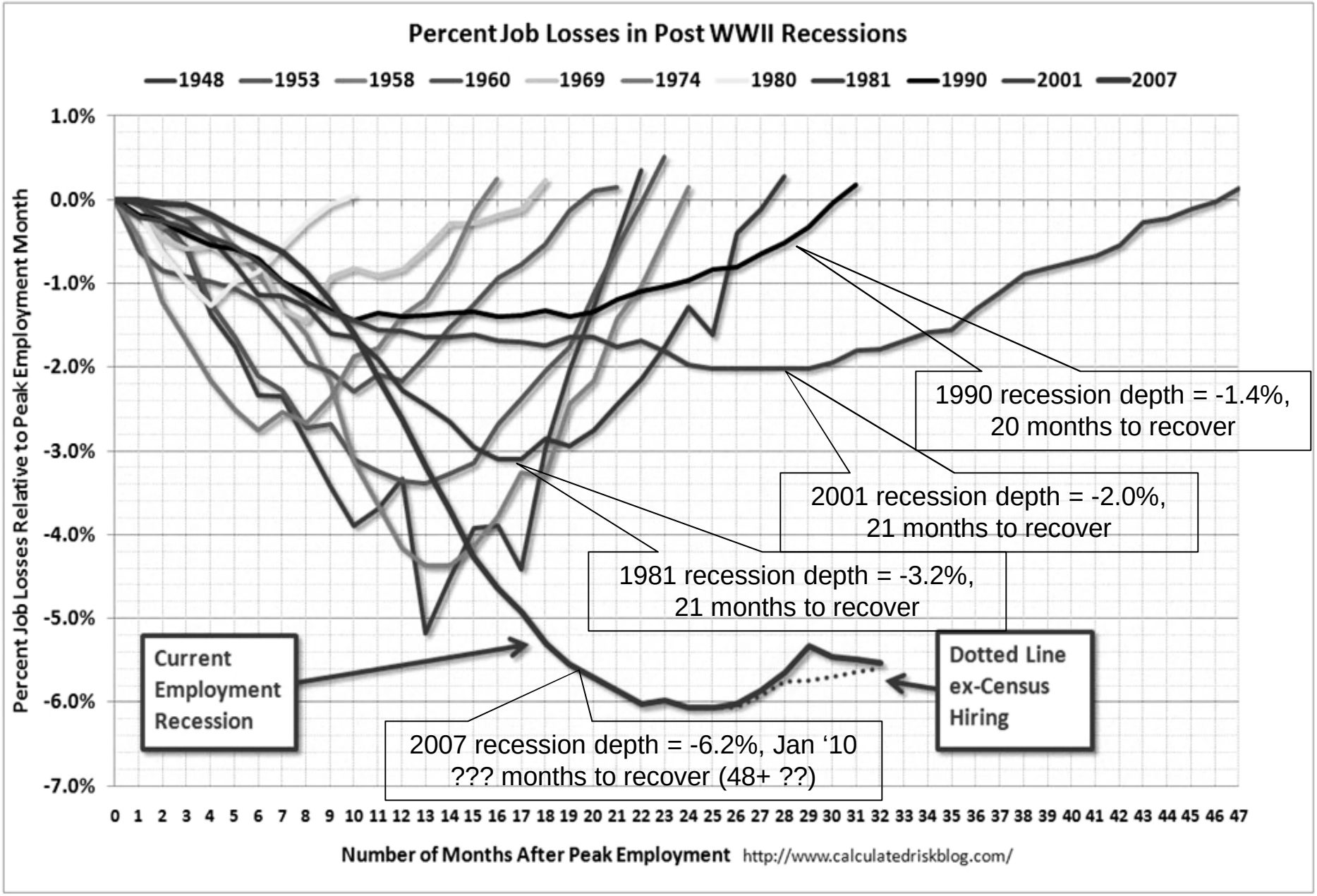


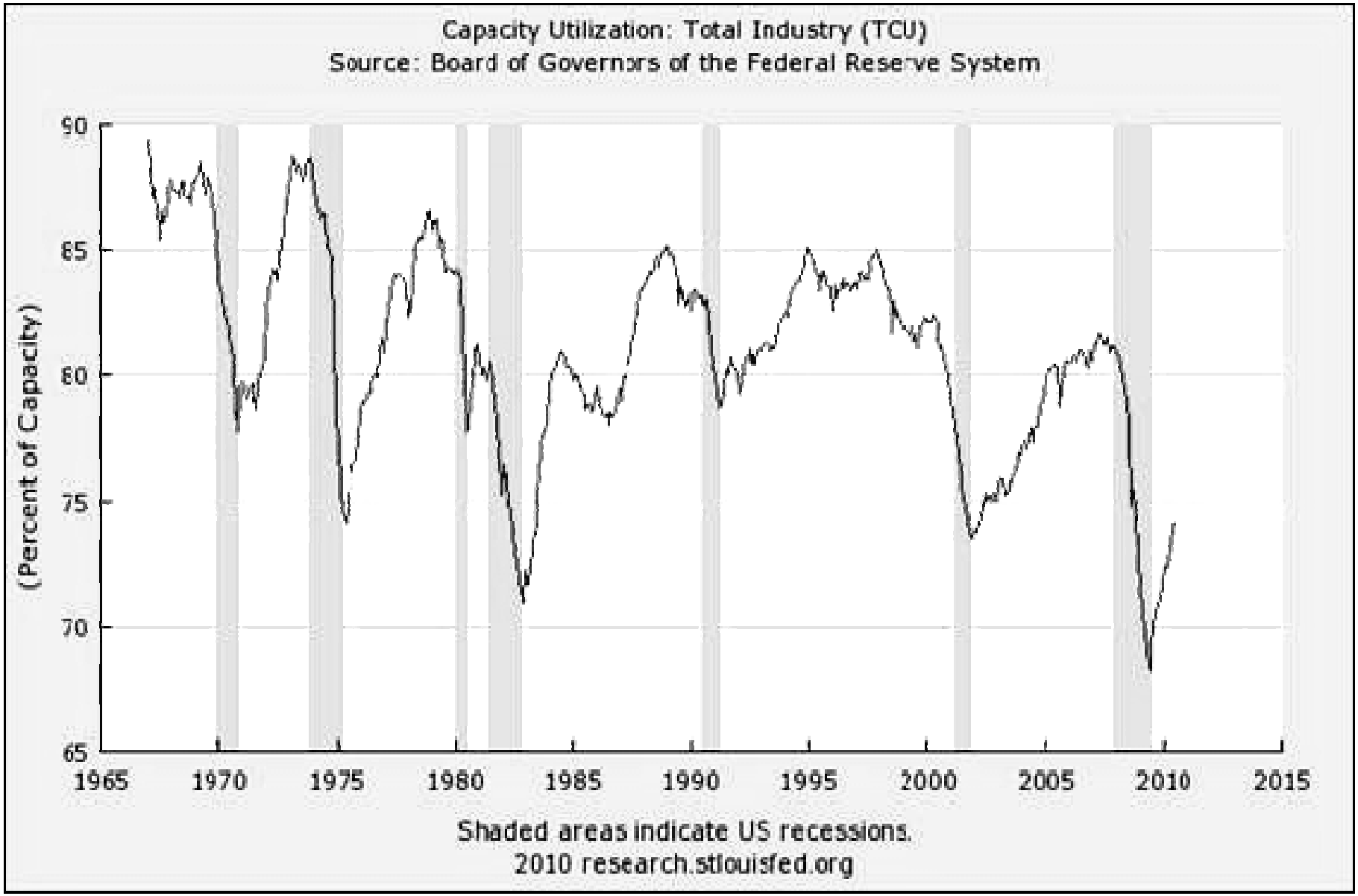
San Francisco					
"In Market"			"Out Market"		
Enter	Exit	Gain	Enter	Exit	Gain
Jan-87	Aug-90	57%	August-90	September-91	-4%
Sep-91	Nov-91	0%	November-91	March-94	-5%
Mar-94	Mar-95	1%	March-95	June-96	-1%
Jun-96	Jul-01	93%	July-01	March-10	0%
Mar-02	Jun-06	67%	June-06	July-09	-41%
Jul-09	Jun-10	12%			



Source: Loan Performance, Amherst Securities

Amherst Securities Group LP

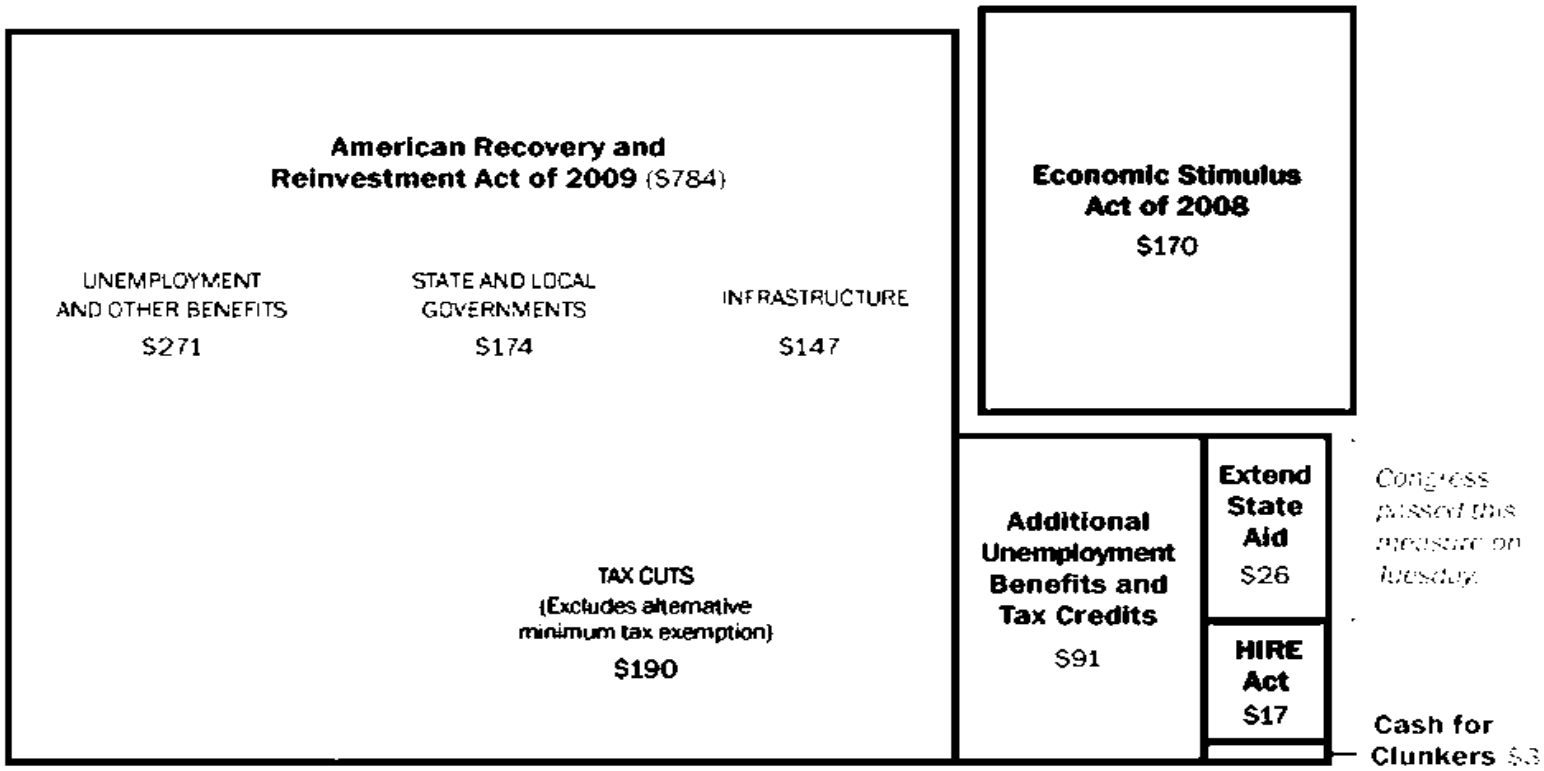

Percent Job Losses in Post WWII Recessions
1948
1953
1958
1960
1969
1974
1980
1981
1990
2001
2007
Percent Job Losses Relative to Peak Employment Month
1.0%
0.0%
-1.0%
-2.0%
-3.0%
-4.0%
-5.0%
-6.0%
-7.0%
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47
Number of Months After Peak Employment
http://www.calculatedriskblog.com/
1990 recession depth = -1.4%, 20 months to recover
2001 recession depth = -2.0%, 21 months to recover
1981 recession depth = -3.2%, 21 months to recover
Current Employment Recession
Dotted Line ex-Census Hiring
2007 recession depth = -6.2%, Jan '10
??? months to recover (48+ ??)


Capacity Utilization: Total Industry (TCU)
Source: Board of Governors of the Federal Reserve System
(Percent of Capacity)
90
85
80
75
70
65
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate US recessions.
2010 research.stlouisfed.org

Have We Had Enough Stimulus? $1.09T (7.9% GDP)

Total fiscal stimulus *(in billions)*

Spending increases Tax cuts

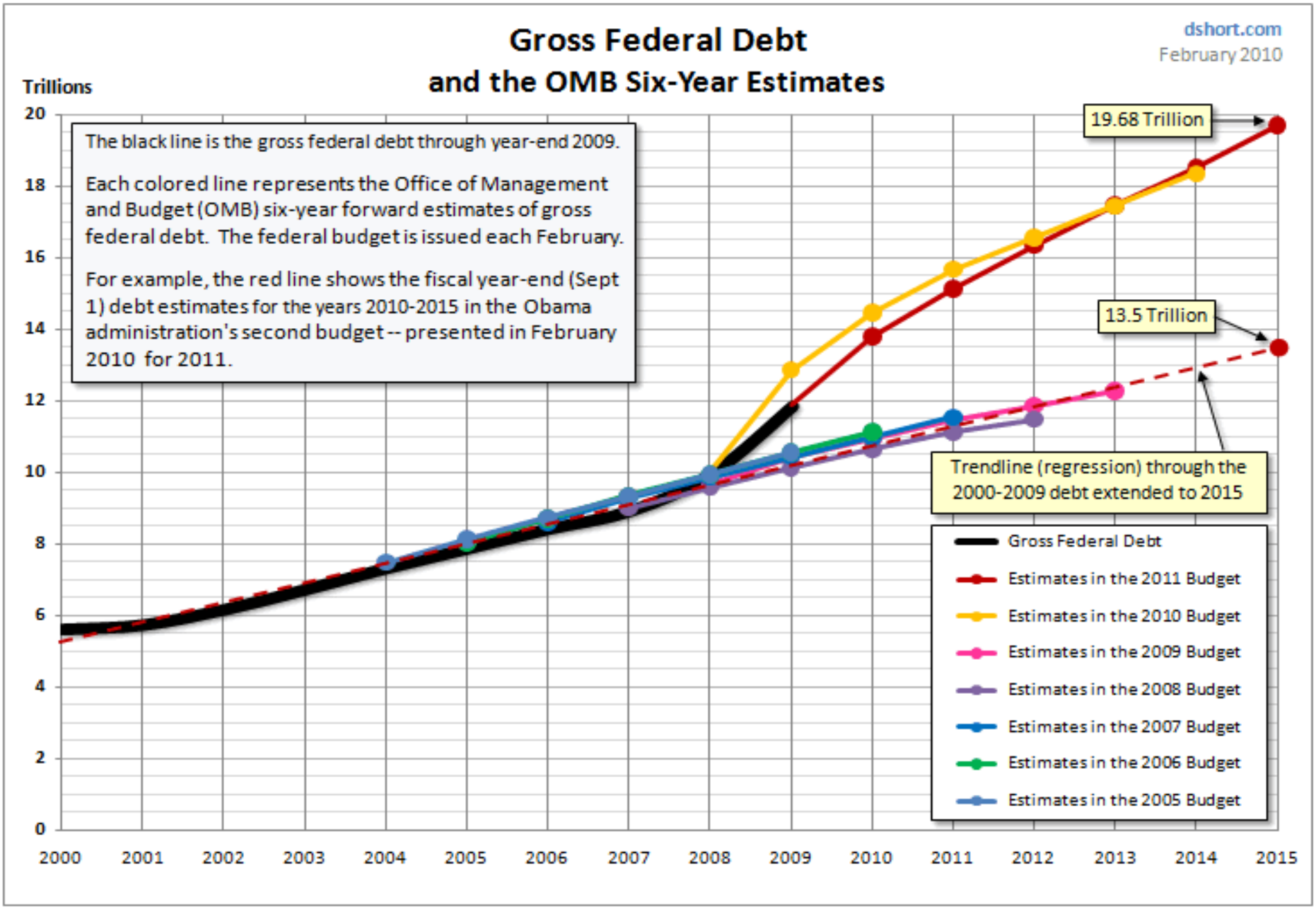


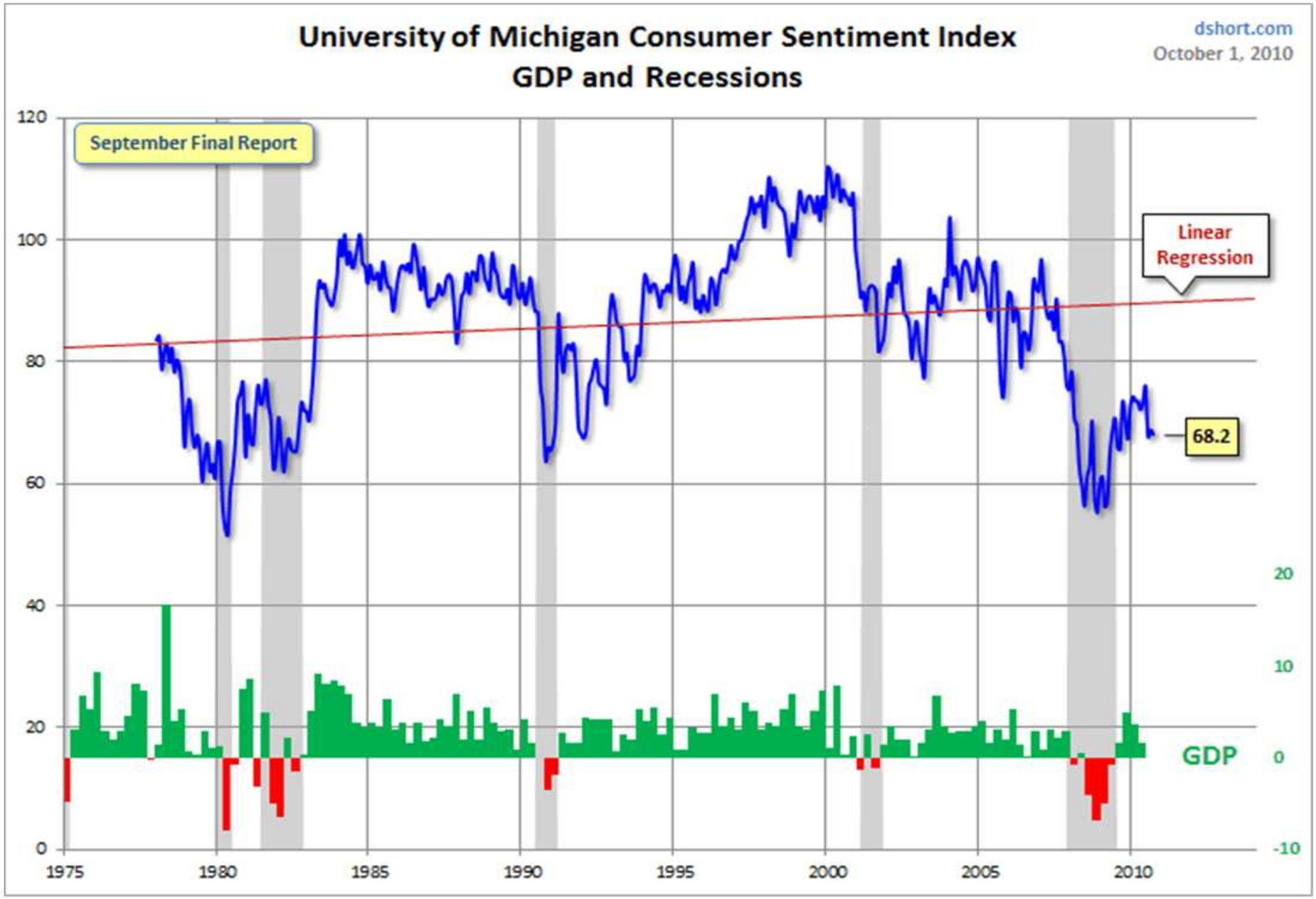
Economy Half Full? A Tale of the Tape

Difference in the U.S. economy without stimulus and market intervention by the government.

	With Intervention	Without Intervention	Difference
Inflation Rate	2%	-1%	3%
Highest Unemployment	10%	16%	37.5% lower
GDP in 2011	$13.80 trillion	$12 trillion	15% higher

Source: Alan S. Blinder, Mark Zandi


Gross Federal Debt
and the OMB Six-Year Estimates
dshort.com
February 2010
Trillions
20
18
16
14
12
10
8
6
4
2
0
The black line is the gross federal debt through year-end 2009.
Each colored line represents the Office of Management and Budget (OMB) six-year forward estimates of gross federal debt. The federal budget is issued each February.
For example, the red line shows the fiscal year-end (Sept 1) debt estimates for the years 2010-2015 in the Obama administration's second budget -- presented in February 2010 for 2011.
19.68 Trillion
13.5 Trillion
Trendline (regression) through the 2000-2009 debt extended to 2015
Gross Federal Debt
Estimates in the 2011 Budget
Estimates in the 2010 Budget
Estimates in the 2009 Budget
Estimates in the 2008 Budget
Estimates in the 2007 Budget
Estimates in the 2006 Budget
Estimates in the 2005 Budget
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015


University of Michigan Consumer Sentiment Index
GDP and Recessions
dshort.com
October 1, 2010
September Final Report
Linear Regression
68.2
GDP
120
100
80
60
40
20
0
20
10
0
-10
1975
1980
1985
1990
1995
2000
2005
2010

Does Anything Still Work? Asset Allocation Examples

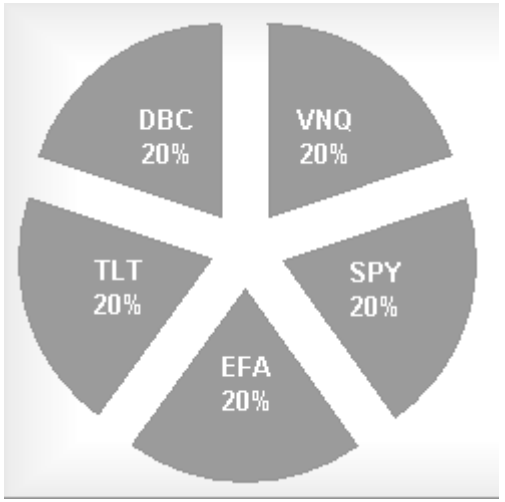
Or

Did Anything I Talked About in the Last Two Seminars Matter?

QTAA: A Quick Review

(from '09 seminar)

There are three parts to this scheme:

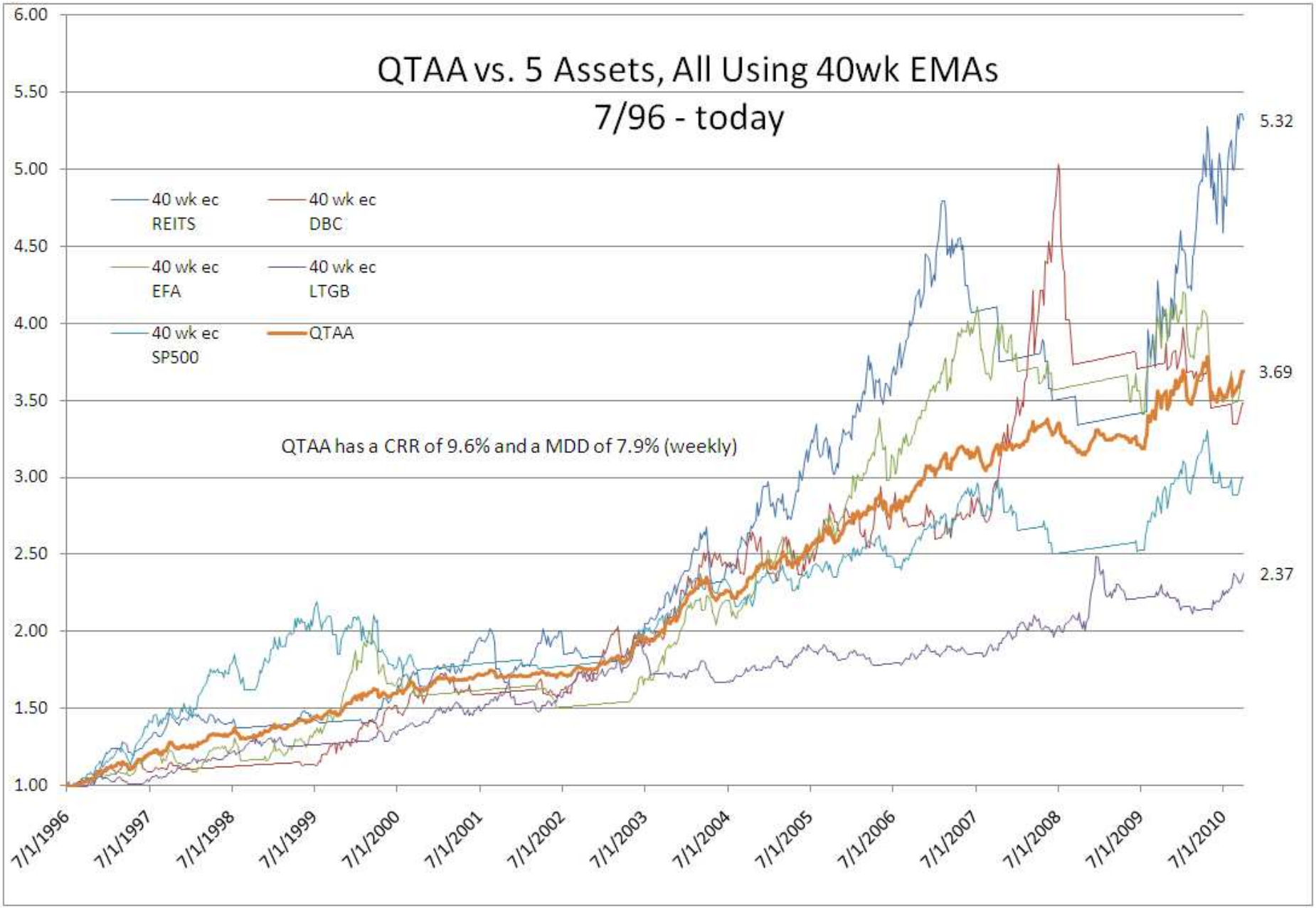


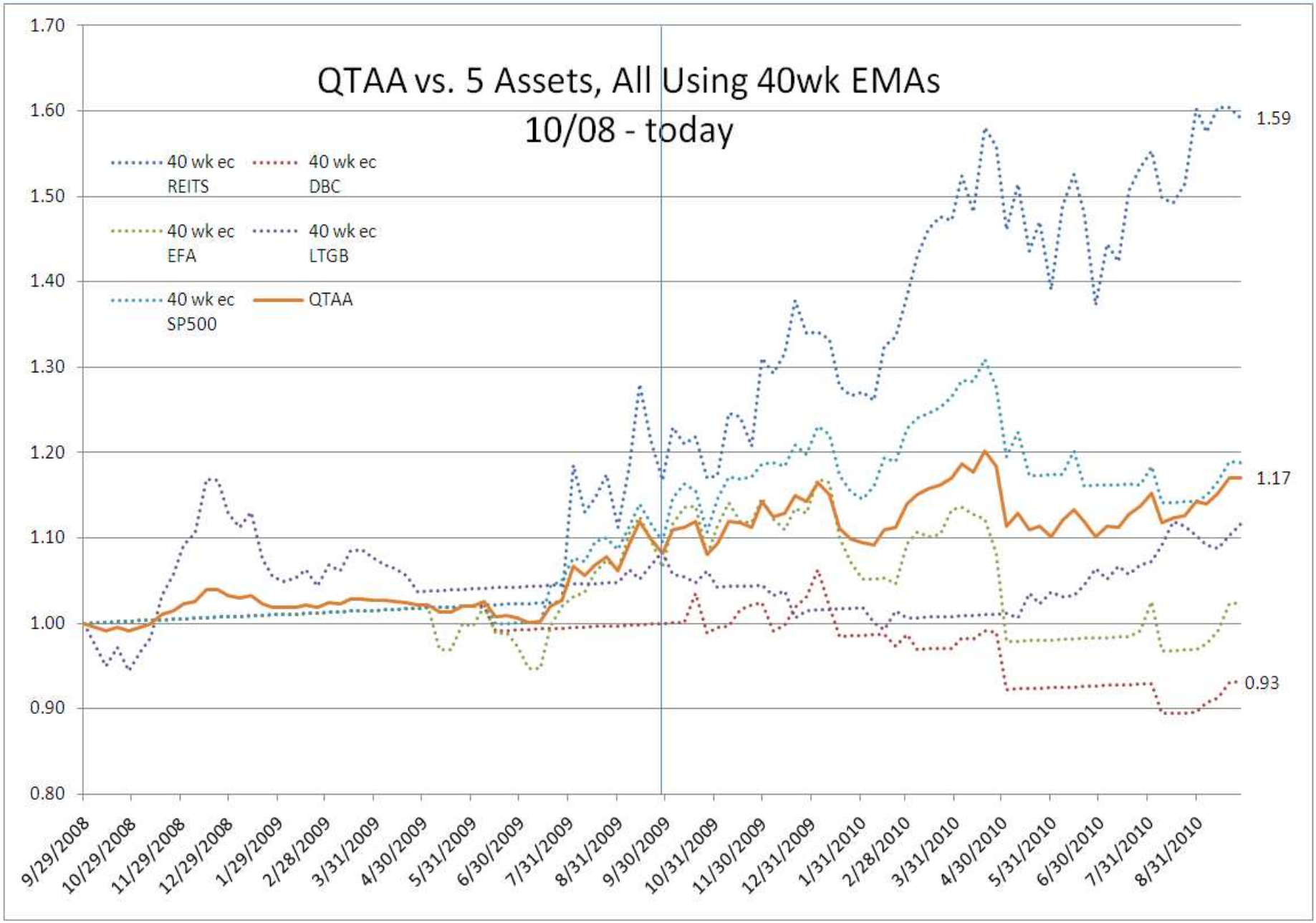
- Allocate assets with equal weight to:
  - Large Cap US Stocks (SPY, VTI)
  - Foreign-EAFE Stocks (EFA, VEU)
  - Long Term Government Bonds (TLT, BND)
  - Real Estate Investment Trusts (VNQ, IYR)
  - Commodity Index (DBC, GCC)

- Market timing (once/month)
  - Go long when an asset's index is above its 10 month simple moving average (SMA)
  - Go to cash when index drops below its 10 month SMA

- Cash: Commercial paper return

with permission, Michael Begley, informal notes


QTAA vs. 5 Assets, All Using 40wk EMAs
7/96 - today
40 wk ec REITS
40 wk ec DBC
40 wk ec EFA
40 wk ec LTGB
40 wk ec SP500
QTAA
QTAA has a CRR of 9.6% and a MDD of 7.9% (weekly)
5.32
3.69
2.37
6.00
5.50
5.00
4.50
4.00
3.50
3.00
2.50
2.00
1.50
1.00
7/1/1996
7/1/1997
7/1/1998
7/1/1999
7/1/2000
7/1/2001
7/1/2002
7/1/2003
7/1/2004
7/1/2005
7/1/2006
7/1/2007
7/1/2008
7/1/2009
7/1/2010


QTAA vs. 5 Assets, All Using 40wk EMAs
10/08 - today
40 wk ec REITS
40 wk ec DBC
40 wk ec EFA
40 wk ec LTGB
40 wk ec SP500
QTAA
1.70
1.60
1.50
1.40
1.30
1.20
1.10
1.00
0.90
0.80
1.59
1.17
0.93
9/29/2008
10/29/2008
11/29/2008
12/29/2008
1/29/2009
2/28/2009
3/31/2009
4/30/2009
5/31/2009
6/30/2009
7/31/2009
8/31/2009
9/30/2009
10/31/2009
11/30/2009
12/31/2009
1/31/2010
2/28/2010
3/31/2010
4/30/2010
5/31/2010
6/30/2010
7/31/2010
8/31/2010

QTAA: Asset Class Rotation

(from '08 seminar)

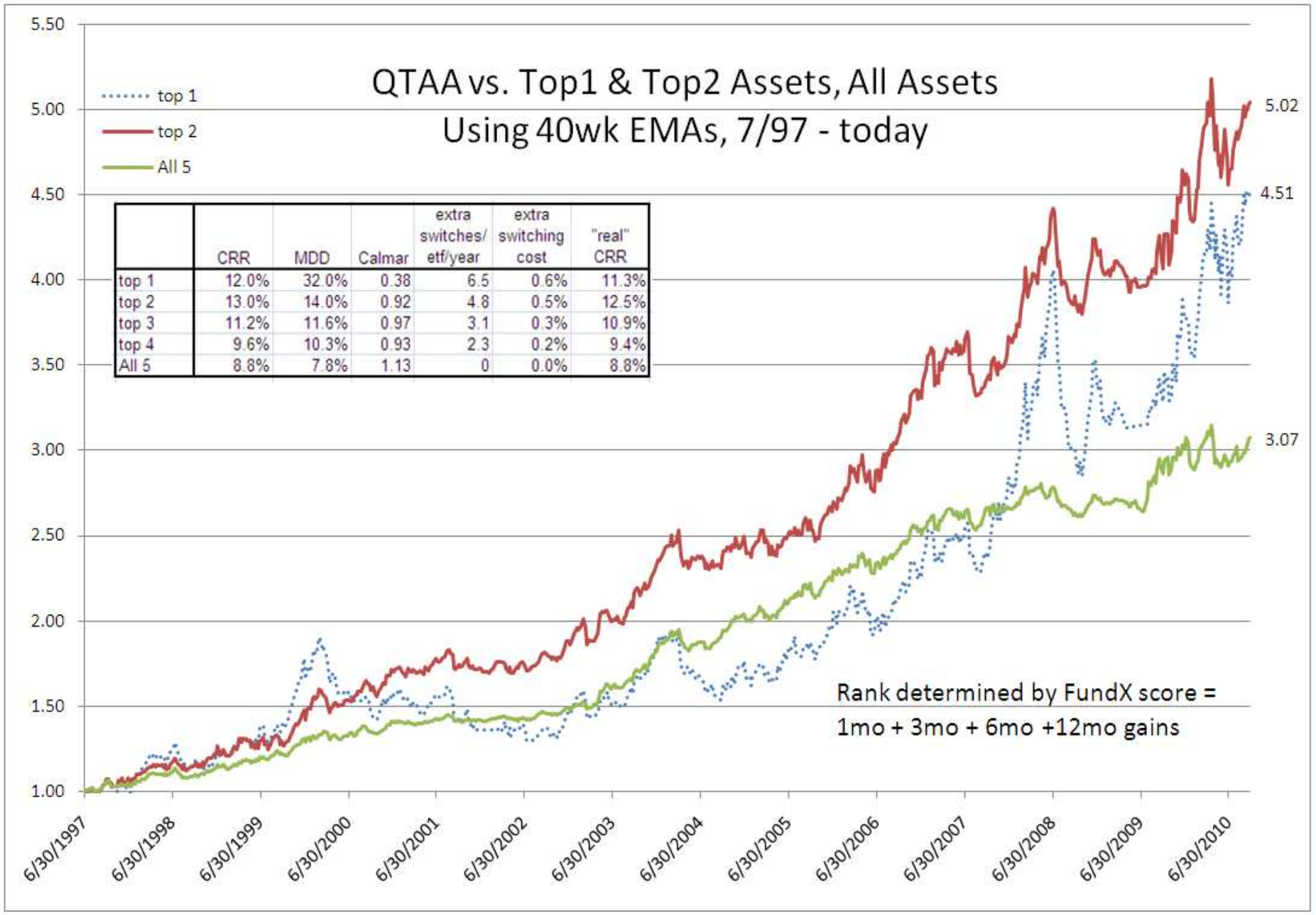
The system uses the same five asset classes as before - US Stocks, Foreign Stocks, US Bonds, REITs, and Commodities.

Each month, the 3, 6, and 12 month total returns are recorded for each asset class (and then averaged for the combo). The actual time frame selected does not matter much as the 3, 6, and 12 month time frames all produce similar results. I prefer using all three (combo) because it picks the asset classes that are outperforming in numerous time frames.

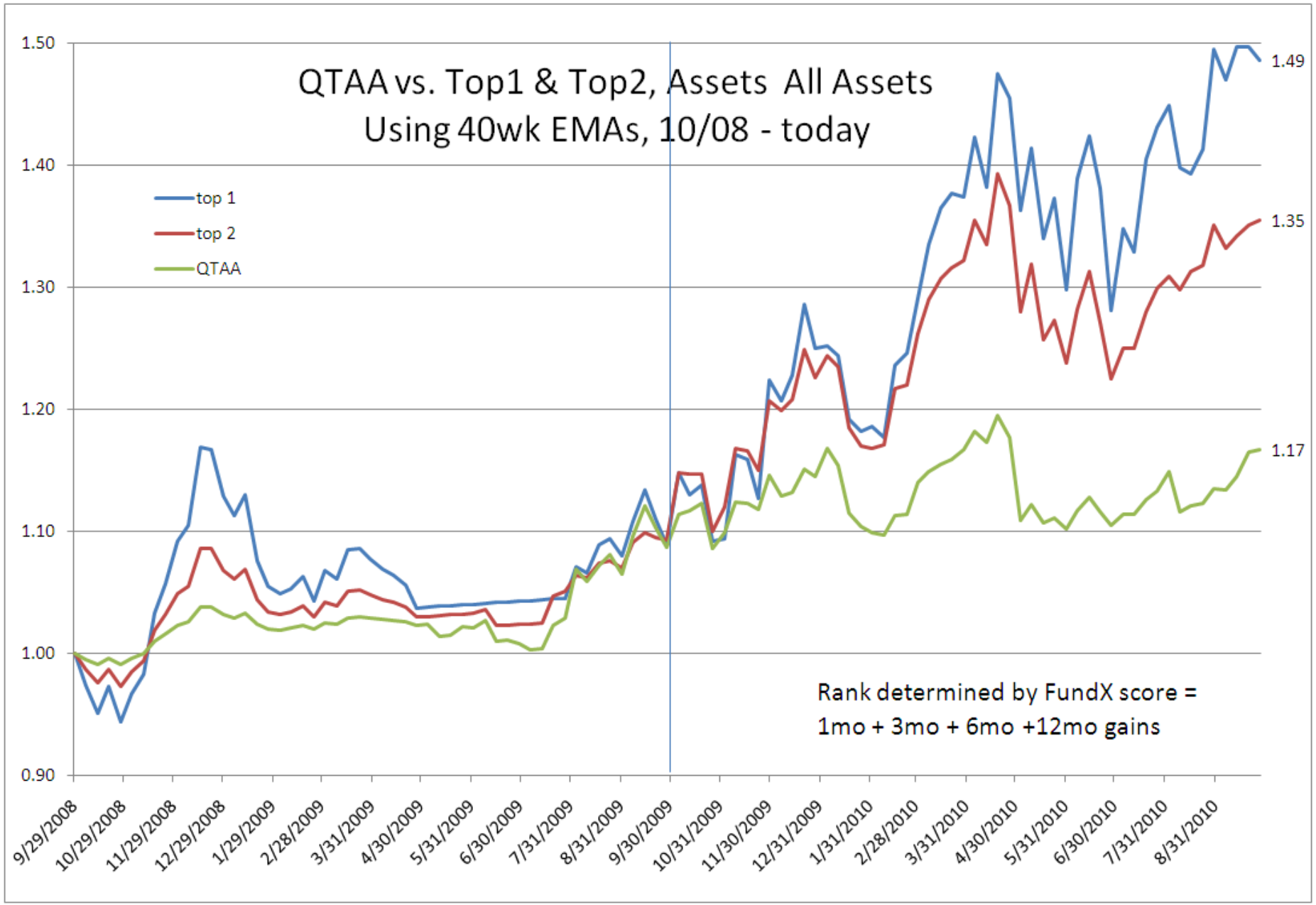
The investor then simply invests in the top X asset classes for the following month. For example, at the end of 2007 the order of returns from best to worst was Commodities, Foreign Stocks, Bonds, US Stocks, and Real Estate. The portfolio for the next month (January) in 2008 would be in that same order.

Below we show the results of taking the top one, two, and three asset classes, updated monthly, based on the rolling 3,6, and 12-month total returns. (Top 1 means you just take the top asset class each month. Top 2 means you select the top two asset classes each month and put 50% of the portfolio in each, Top 3 is the top three assets with 33% in each, etc).

	B&H	3month			6month			12month			Combo		
1973-2007		Top1	Top2	Top3	top1	top2	top3	top1	top2	top3	top1	top2	top3
CAGR	11.20%	14.65%	13.83%	14.06%	14.58%	17.09%	13.96%	16.90%	16.14%	14.59%	17.61%	17.23%	15.27%
VOL	8.93%	18.05%	12.29%	10.04%	18.08%	11.85%	9.96%	18.06%	12.24%	10.19%	18.27%	12.02%	10.17%
TBILLS	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%	6.57%
Sharpe	0.52	0.45	0.59	0.75	0.44	0.89	0.74	0.57	0.78	0.79	0.60	0.89	0.85
Max DD	-19.62%	-27.03%	-20.16%	-18.34%	-39.91%	-15.18%	-14.80%	-45.62%	-26.78%	-14.50%	-33.90%	-19.31%	-13.16%



	CRR	MDD	Calmar	extra switches/ etf/year	extra switching cost	"real" CRR
top 1	12.0%	32.0%	0.38	6.5	0.6%	11.3%
top 2	13.0%	14.0%	0.92	4.8	0.5%	12.5%
top 3	11.2%	11.6%	0.97	3.1	0.3%	10.9%
top 4	9.6%	10.3%	0.93	2.3	0.2%	9.4%
All 5	8.8%	7.8%	1.13	0	0.0%	8.8%


QTAA vs. Top1 & Top2, Assets All Assets
Using 40wk EMAs, 10/08 - today
top 1
top 2
QTAA
1.50
1.40
1.30
1.20
1.10
1.00
0.90
1.49
1.35
1.17
Rank determined by FundX score =
1mo + 3mo + 6mo +12mo gains
9/29/2008
10/29/2008
11/29/2008
12/29/2008
1/29/2009
2/28/2009
3/31/2009
4/30/2009
5/31/2009
6/30/2009
7/31/2009
8/31/2009
9/30/2009
10/31/2009
11/30/2009
12/31/2009
1/31/2010
2/28/2010
3/31/2010
4/30/2010
5/31/2010
6/30/2010
7/31/2010
8/31/2010

Foreign Stocks: Buying Country Indices

(from '09 seminar)

- This algorithm chooses various country indices/ETFs based on: a) their being above their 10 month SMA, and b) their recent momentum
- The algorithm:
  - Determine if each countries stock index ETF is above its 10 month SMA
  - For those above their 10 month SMA, calculate their FundX score
    - FundX score = 1 Month + 3 Month + 6 Month + 12 month gains
  - Rank countries based on resulting score; Choose top 3-6 countries
- Designed with ETFs in mind, but could substitute equivalent MFs
  - Watch for switching penalties on MFs
- Risks:
  - Possibly higher correlation between the Foreign stock and US stock portions of your portfolio than you would expect
  - May have high correlation between countries chosen

Country ETF Scoring

(from '09 seminar)

To reduce trading costs I've added 3 zones (green = buy/hold, Yellow = sell)

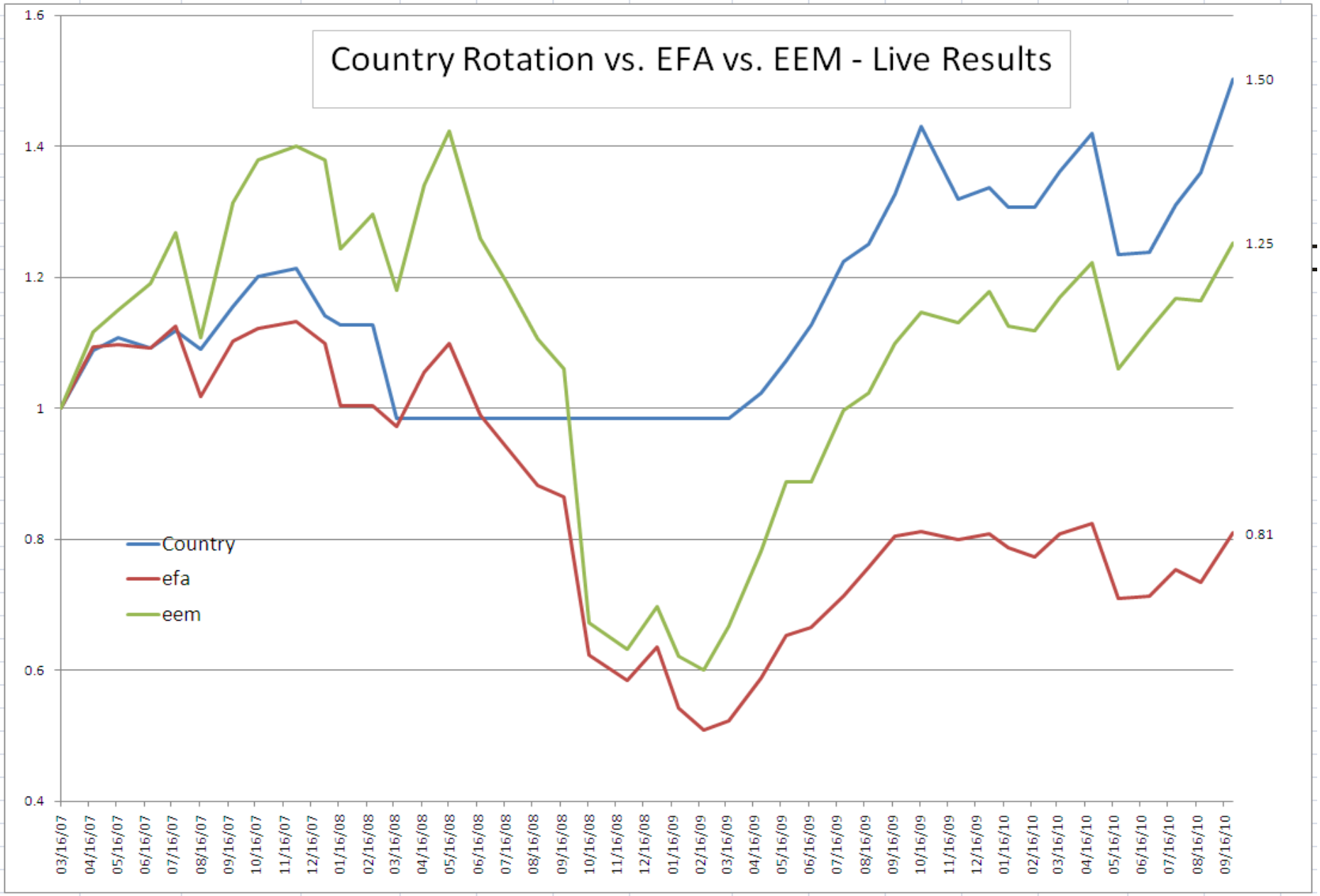
	etf	> 10M SMA ?	fx	country	region
1	ech	1	121.3%	chile	Americas
2	THD	1	110.9%	THAILAND	ASIA
3	gxg	1	103.9%	colombia	americas
4	IDX	1	98.8%	indonesia	asia
5	brf	1	93.7%	brazil small cap	americas
6	epu	1	92.6%	peru	americas
7	TUR	1	91.6%	TURKEY	EMEA
8	ewd	1	85.9%	sweden	emea
9	ewm	1	80.9%	malysia	asia
10	DGS	1	74.3%	em mkts small cap	various
11	HAO	1	73.5%	small cap china	asia
12	epi	1	71.4%	india	asia
13	eza	1	68.8%	s. africa	emea
14	ewh	1	65.6%	hong kong	asia
15	epp	1	53.0%	pacific ex-japan	asia
16	GML	1	49.2%	emrgng latin am	americas
17	ewa	1	48.6%	australia	asia
18	ewt	1	47.4%	taiwan	asia
19	eem	1	47.4%	emerging markets	various
20	ewy	1	45.6%	s. Korea	asia
21	ewu	1	45.1%	uk	emea
22	ilf	1	44.8%	latin am	americas
23	eww	1	44.2%	mexico	americas
24	ewz	1	41.7%	brazil.	americas
25	VGK	1	40.8%	europe	emea
26	GUR	1	39.0%	emrgng europe	emea
27	ewk	1	38.0%	belgium	emea
28	ewn	1	34.7%	netherlands	emea
29	ewg	1	31.9%	germany	emea
30	efa	1	31.1%	dev mkt	various
31	ewq	1	29.6%	france	emea
32	rsx	1	28.9%	russia	emea
33	ewl	1	28.1%	switzerland	emea
34	ewc	1	28.0%	canada	americas
35	fxi	1	28.0%	china	asia
36	ewp	1	25.1%	spain	emea
37	bwx	1	21.5%	world LT treasury	various
38	wip	1	10.1%	world tip	various
39	ewi	1	8.9%	italy	emea
40	ewj	1	7.2%	japan	asia
41	bwz		-7.1%	world ST treasury	various
42	ewo		-9.3%	austria	emea
43	vnm		-12.8%	vietnam	asia
44	eev		-114.2%	emrging mkts	various

Calculation done 9/24/10. Emerging countries continue to dominate the rankings

40 country, regional ETFs plus 3 world bond ETFs and 1 inverse fund are available

If all fall below 10M SMA, go to cash

International bonds kept in the mix as possible purchases when appropriate


Country Rotation vs. EFA vs. EEM - Live Results
1.6
1.4
1.2
1
0.8
0.6
0.4
1.50
1.25
0.81
Country
efa
eem
03/16/07
04/16/07
05/16/07
06/16/07
07/16/07
08/16/07
09/16/07
10/16/07
11/16/07
12/16/07
01/16/08
02/16/08
03/16/08
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07/16/09
08/16/09
09/16/09
10/16/09
11/16/09
12/16/09
01/16/10
02/16/10
03/16/10
04/16/10
05/16/10
06/16/10
07/16/10
08/16/10
09/16/10

Real Estate & Infrastructure Rotation w/ETFs

- This algorithm chooses various Real Estate and Infrastructure indices/ETFs based on: a) their being above their 10 month SMA, and b) their recent momentum
- The algorithm:
  - Determine if each RE/Infrastructure ETF is above its 10 month SMA
  - For those above their 10 month SMA, calculate their FundX score
    - FundX score = 1 Month + 3 Month + 6 Month + 12 month gains
  - Rank ETFs based on resulting score; Choose top 3-6 ETFs
- Designed with ETFs in mind, but could substitute equivalent MFs
  - Watch for switching penalties on MFs
- Risks:
  - May have high correlation between ETFs chosen (e.g., RWX & TAO)

Real Estate & Infrastructure ETF Scoring

etf	> 10M SMA ?	fx	country	sector
rnp	1	92.5%	us	CEMF REIT
rez	1	72.9%	us	residential
vnq	1	62.9%	us	US reits
pxr	1	61.1%	emrgng	infrastrcuture
tao	1	56.5%	china	china reits
rwx	1	56.1%	intl	Intl reits
ifgl	1	48.2%	intl	reits
IGF	1	31.2%	intl	Infrastructure
tlt	1	25.4%	us	US LT Treas
bwx	1	21.5%	intl	Wrld LT Treas
tip	1	17.3%	us	Inflation proof
bwz	1	17.1%	intl	World ST Treas
wip	1	10.1%	intl	wrld tip
mbb	1	8.6%	us	mortgage bonds
itb		1.0%	us	home constr
		red=	bonds	
		black =	equities/reits	

Calculation done 9/24/10.

9 RE ETFs and 6 fixed income ETFs. Covers both US and RoW.

More ETFs in (and coming) in this space (e.g., BRXX)

Bonds kept in the mix as possible purchases when appropriate

Does Anything Still Work?

American Customer Satisfaction Index Stocks

Or

Do Happy Customers = Good Stocks?

Customer Satisfaction and Stock Prices: High Returns, Low Risk

Do investments in customer satisfaction lead to excess returns? If so, are these returns associated with higher stock market risk? The empirical evidence presented in this article suggests that the answer to the first question is yes, but equally remarkable, the answer to the second question is no, suggesting that satisfied customers are economic assets with high returns/low risk. Although these results demonstrate stock market imperfections with respect to the time it takes for share prices to adjust, they are consistent with previous studies in marketing in that a firm's satisfied customers are likely to improve both the level and the stability of net cash flows. The implication, implausible as it may seem in other contexts, is high return/low risk. Specifically, the authors find that customer satisfaction, as measured by the American Customer Satisfaction Index (ACSI), is significantly related to market value of equity. Yet news about ACSI results does not move share prices. This apparent inconsistency is the catalyst for examining whether excess stock returns might be generated as a result. The authors present two stock portfolios: The first is a paper portfolio that is back tested, and the second is an actual case. At low systematic risk, both outperform the market by considerable margins. In other words, it is possible to beat the market consistently by investing in firms that do well on the ACSI.

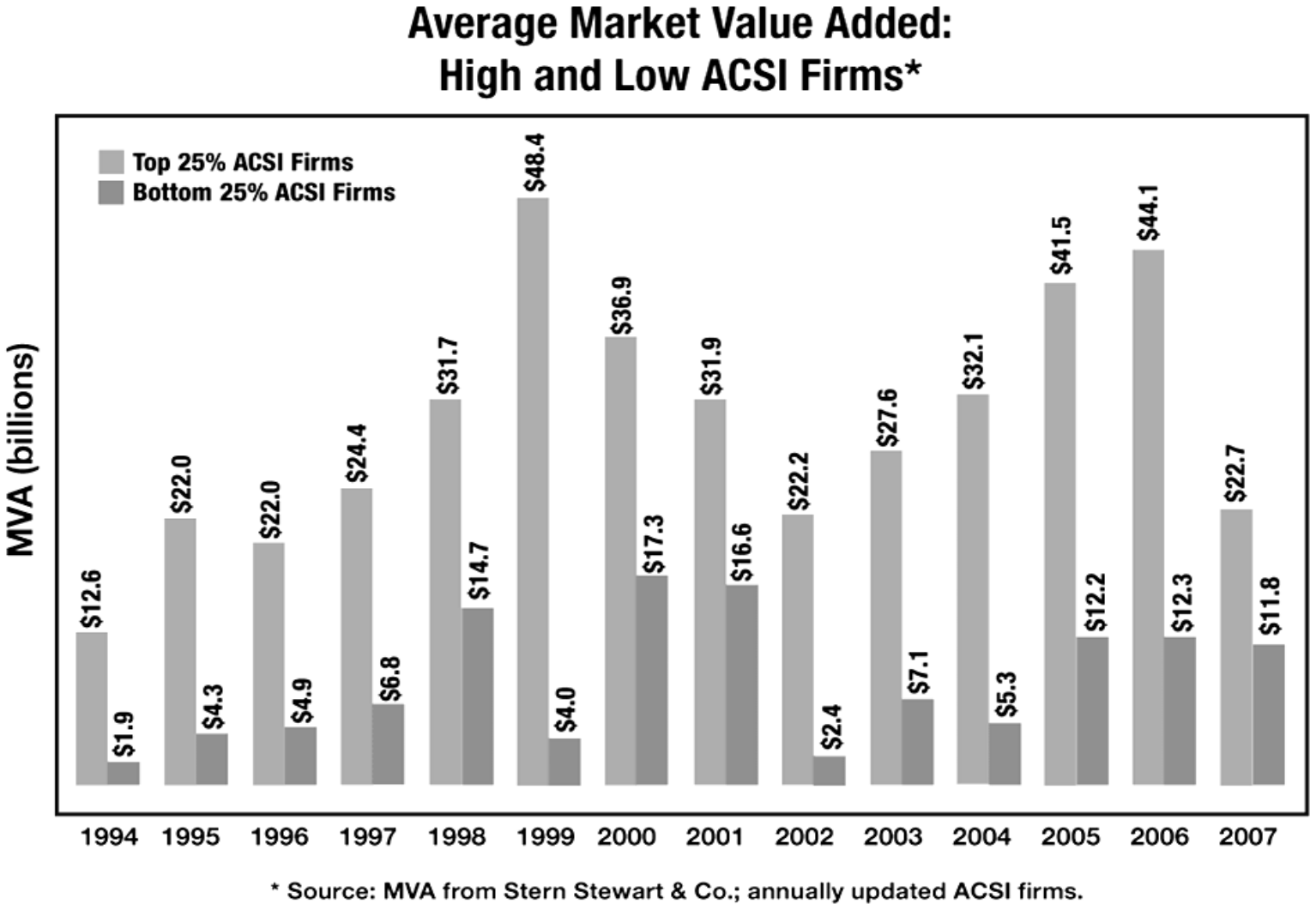
How are the measured companies selected? Do they change over time?

ACSI measures customer satisfaction with the products and services of approximately 200 companies in 43 household consumer industries and nearly 100 major customer segments of federal agencies. Within each industry companies are selected on the basis of total sales and the measured companies represent a significant proportion of the overall market share of the industry. Individual companies are added or deleted from ACSI as their market position changes or as a result of mergers and acquisitions. Industries are added as new types of consumer products or services emerge and grow over time like Internet retailers or wireless telephone service carriers. (back)

How are ACSI data collected?

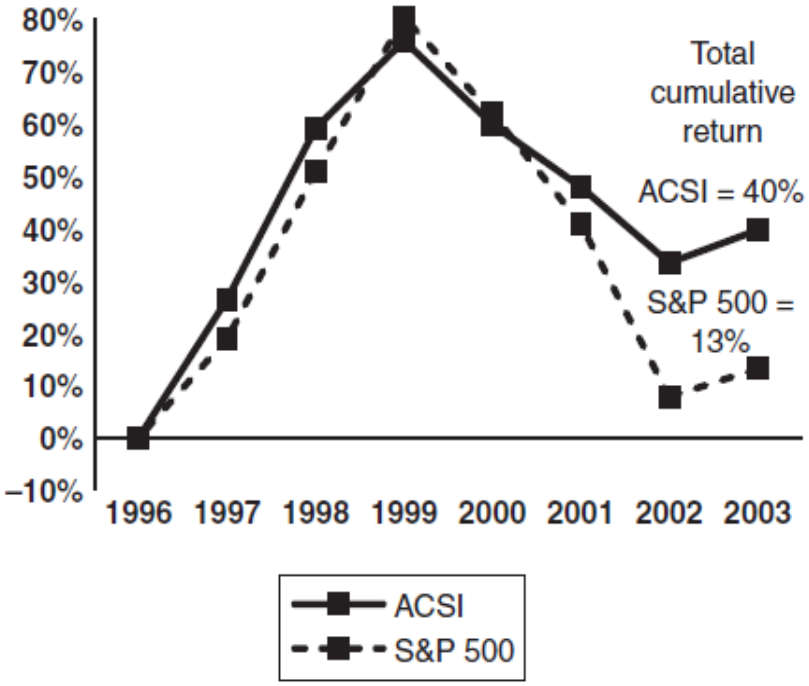
Customers of all companies (and some federal agency customer segments) are selected from national and regional probability samples by screening a randomly chosen adult (age 18 to 84 for private sector companies) in each telephone household. The respondent is asked questions about the purchase and use of specific products and services purchased within specified, recent time periods (these periods vary according to the product or service). Those who qualify as respondents are then asked from which company or which brand they have purchased and responses to the ACSI survey questions are coded as a customer interview for that company. The ACSI for each company is based on a sample of 250 customer interviews with more than 65,000 interviews conducted annually.

Customer Satisfaction and Stock Prices



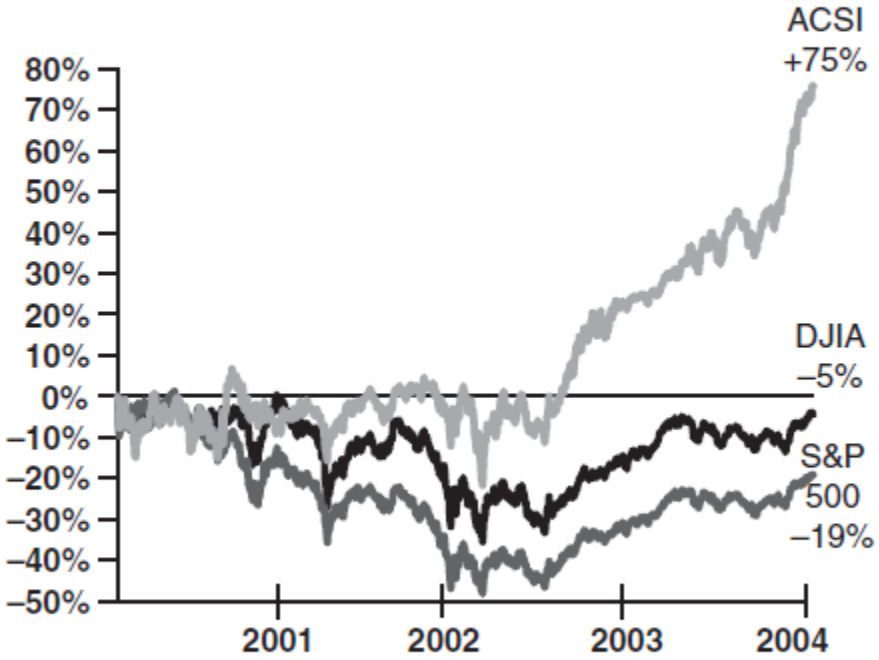
Customer Satisfaction and Stock Prices

FIGURE 2
Cumulative Returns: ACSI Top 20% Versus S&P 500 (1997–2003)[a]



[a]February 18, 1997, through May 21, 2003.

FIGURE 5
ACSI Portfolio Versus DJIA and S&P 500 (2000–2004)[a]



[a]April 11, 2000, through December 31, 2004.

I love it when I find a stock selection methodology that has nothing to do with normal market parameters – price, EPS, CFS, SPS, etc.

ACSI Scores: Top 12 Chosen Stocks 00-09

Company	ticker	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Iams	(PG)					85						
Amazon.com	amzn		84	84	88	88	84	87	87	88	86	86
barnesandnoble	bks				87	86	87	87	88			
ConAgra Foods	cag					84		86				
Hill's Pet Nutrition	cl	86		84	84	85				85		
Colgate-Palmolive	cl			85							87	
Clorox	clx	84	85	85	85	86	88	88	86	87	87	88
Mercedes(Daimler)	dai	86	87	86	83							
Dr Pepper Snapple	dps	85	86	85	86	89	84		86	86	87	86
Lincoln Mercury	f		85		84		86			86		88
FedEx	fdx	83							86			
General Electric	ge			83								
Pillsbury	gis	84	84									
Google	goog										86	86
Honda	hmc	83					85	86	86	84	86	88
H.J. Heinz	hnz	85	90	89	88	90	88	91	87	90	89	89
Hershey	hsy	86	85	86	87	85	87	86	86	87	85	87
Kellogg	K			83								
Kraft Foods	kft	83						84	86			
Coca-Cola	ko	84	86		85			84				
Kohl's	kss				84							
Netflix	nflx									84		87
Quaker (PepsiCo)	pep	83	86	86	87	86	86	88	85	86	87	87
PepsiCo	pep		85	84	86				86			
Procter & Gamble	pg		84			85	86			85	85	
Sara Lee	sle				84		84		85			
Toyota (Toyota)	TM	83				85	84	87	87	84	86	86
Lexus (Toyota)	Tmo								86	87	87	89
Unilever	ul		85	83		85	85	85	85	86	87	87
VF	vfc			84		84						
Maytag	whr	84	87	83	83							
Whirlpool	whr	84	86	83								

Selected Stock
Repeat Ticker
No Ticker

ACSI Stocks: It Can't Be That Simple…

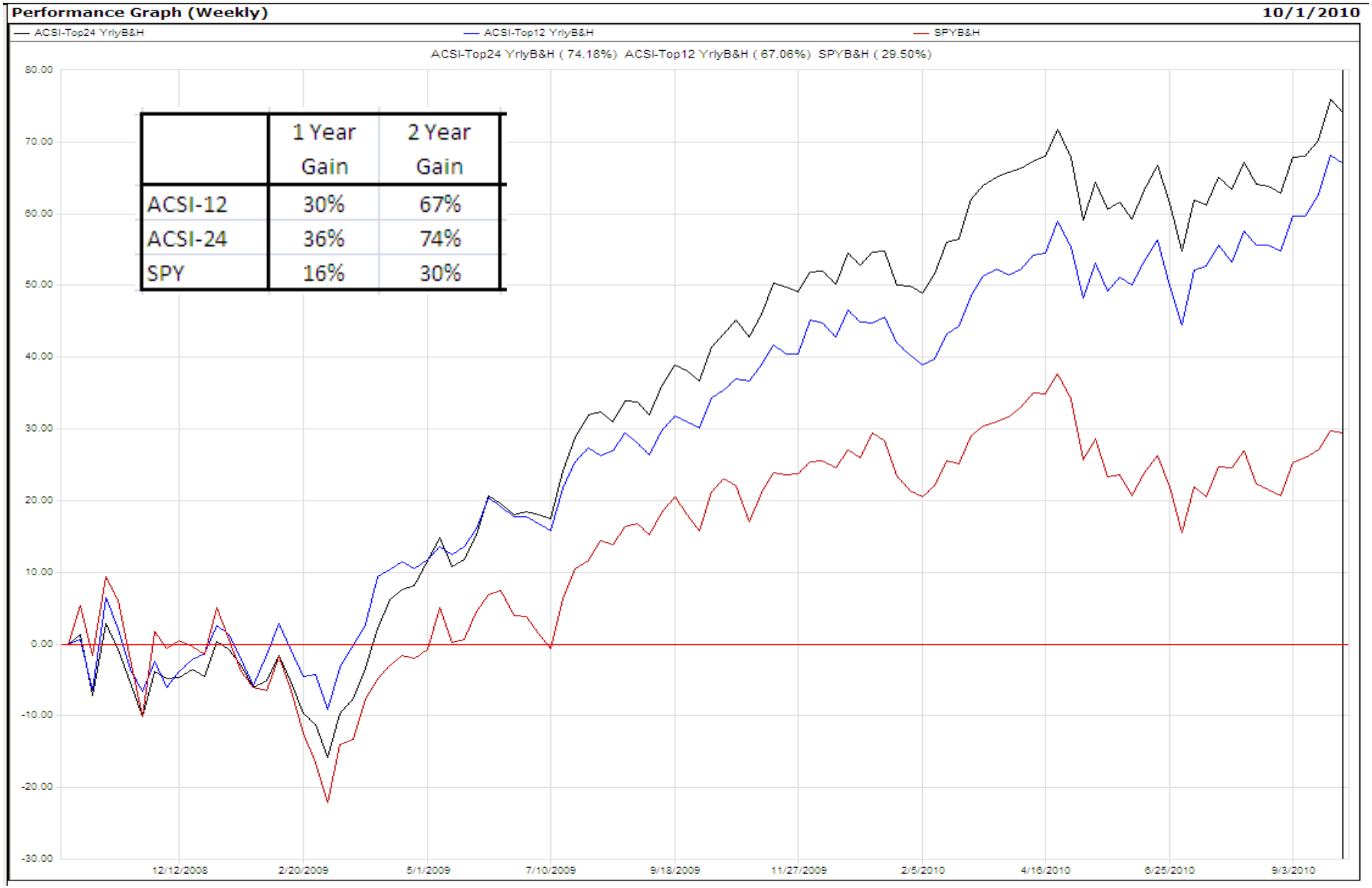
- This looks very attractive, but it seems way too easy
  - Luckily this is easy (actually darn near perfect) to back-test

- To verify this I did the following:
  - Developed yearly watch lists of "Top 12" & "Top 24" stocks for '99 – '09
    - I assumed these would be available on 3/31 of the next year – e.g., 2000's ACSI winner list ready on 3/31/2001
  - Simulated an "Always Long" Portfolio
    - Equal weight in each stock; Rotate top 12/24 stocks each quarter
    - Compare to S&P B&H for risk & reward
  - Simulated an "Best 12 of 24" portfolio – where "Best" is based on EPS Growth Rate
    - Why EPS GRT? Avoid any (relative) losers, pick a few (relative) winners, overcome a value bias (my perception)
    - Compared to S&P B&H, Top12 for risk and reward

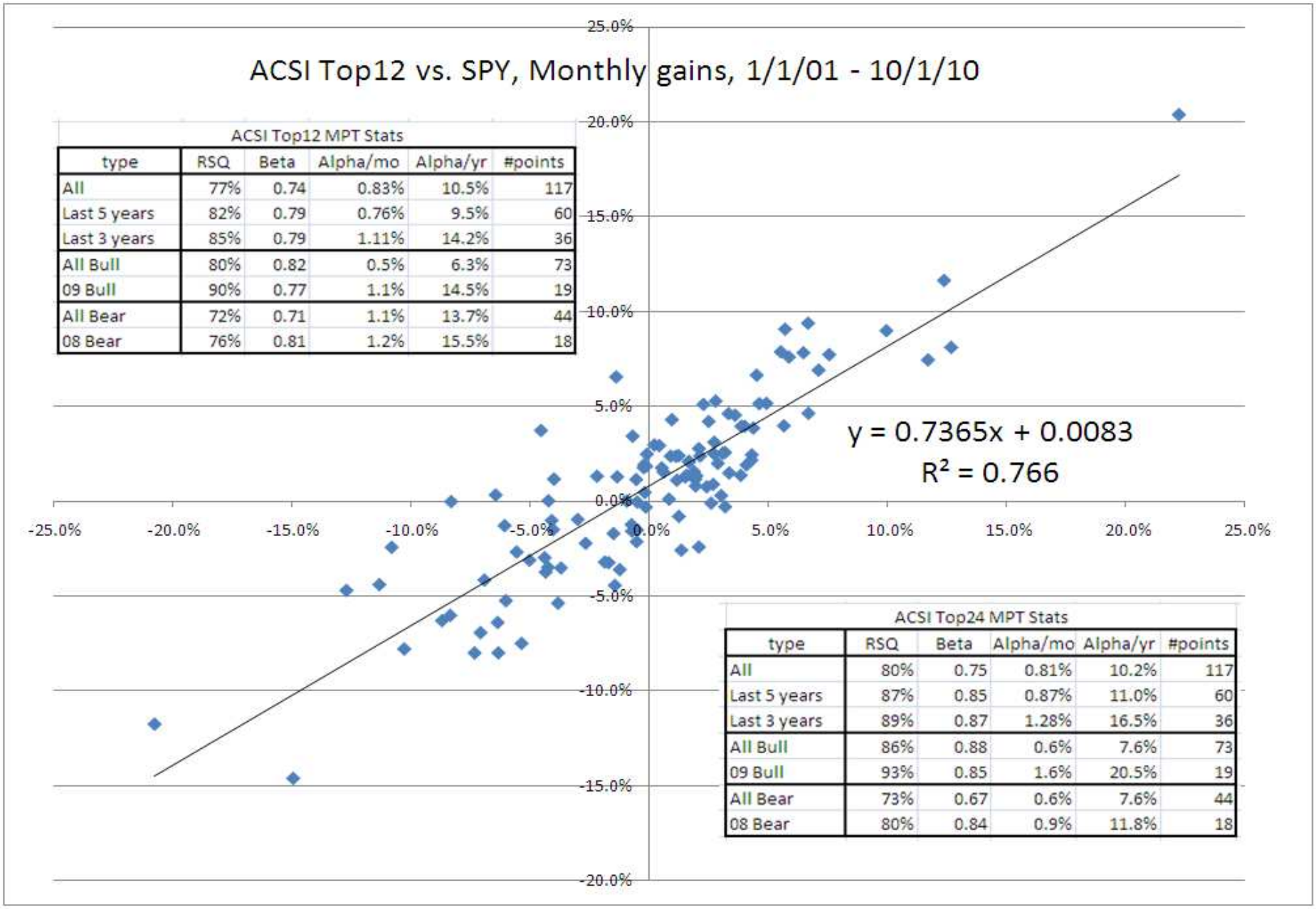
ACSI Top12 & Top24 "Always Long" vs. SPY B&H – Since 1/1/01

	CRR	MDD	Calmar	Switches per year
ACSI-12	9.3%	36%	0.26	4
ACSI-24	9.0%	42%	0.21	4
SPY	-1.4%	56%	-0.03	0

ACSI Top12 & Top24 "Always Long" vs. SPY B&H – Last 2 Years



	1 Year Gain	2 Year Gain
ACSI-12	30%	67%
ACSI-24	36%	74%
SPY	16%	30%



ACSI Top12 MPT Stats

type	RSQ	Beta	Alpha/mo	Alpha/yr	#points
All	77%	0.74	0.83%	10.5%	117
Last 5 years	82%	0.79	0.76%	9.5%	60
Last 3 years	85%	0.79	1.11%	14.2%	36
All Bull	80%	0.82	0.5%	6.3%	73
09 Bull	90%	0.77	1.1%	14.5%	19
All Bear	72%	0.71	1.1%	13.7%	44
08 Bear	76%	0.81	1.2%	15.5%	18

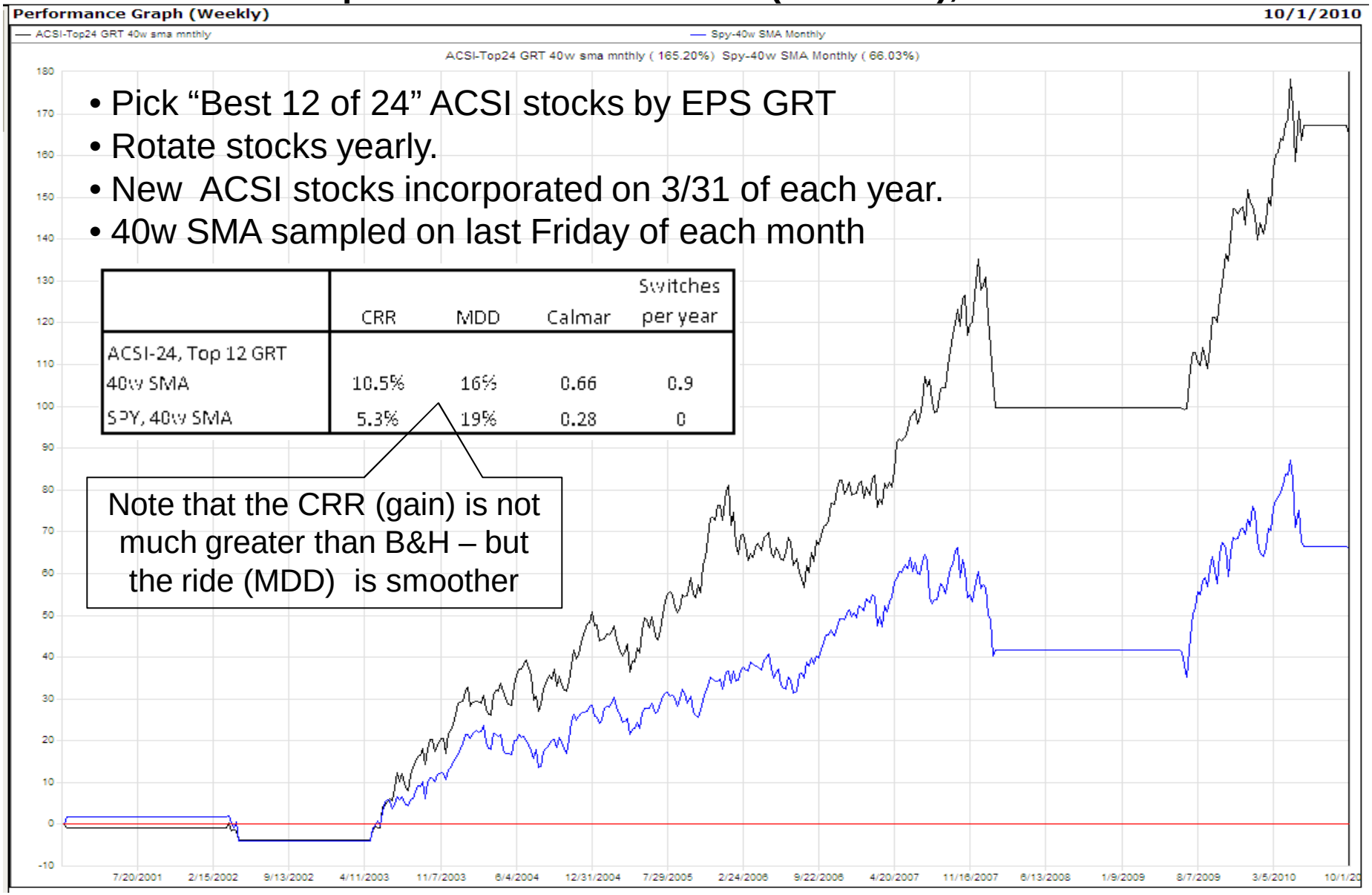
ACSI Top24 MPT Stats

type	RSQ	Beta	Alpha/mo	Alpha/yr	#points
All	80%	0.75	0.81%	10.2%	117
Last 5 years	87%	0.85	0.87%	11.0%	60
Last 3 years	89%	0.87	1.28%	16.5%	36
All Bull	86%	0.88	0.6%	7.6%	73
09 Bull	93%	0.85	1.6%	20.5%	19
All Bear	73%	0.67	0.6%	7.6%	44
08 Bear	80%	0.84	0.9%	11.8%	18

ACSI Top12 vs. ACSI Top12/24 GRT Sort

	CRR	MDD	Calmar	Switches per year
ACSI-12	9.3%	36%	0.26	4
ACSI-24 Top 12 GRT	10.3%	39%	0.26	4
SPY	-1.4%	56%	-0.03	0

ACSI Top12/24 EPS GRT vs. SPY (40w SMA), 1/1/01 – 10/1/10

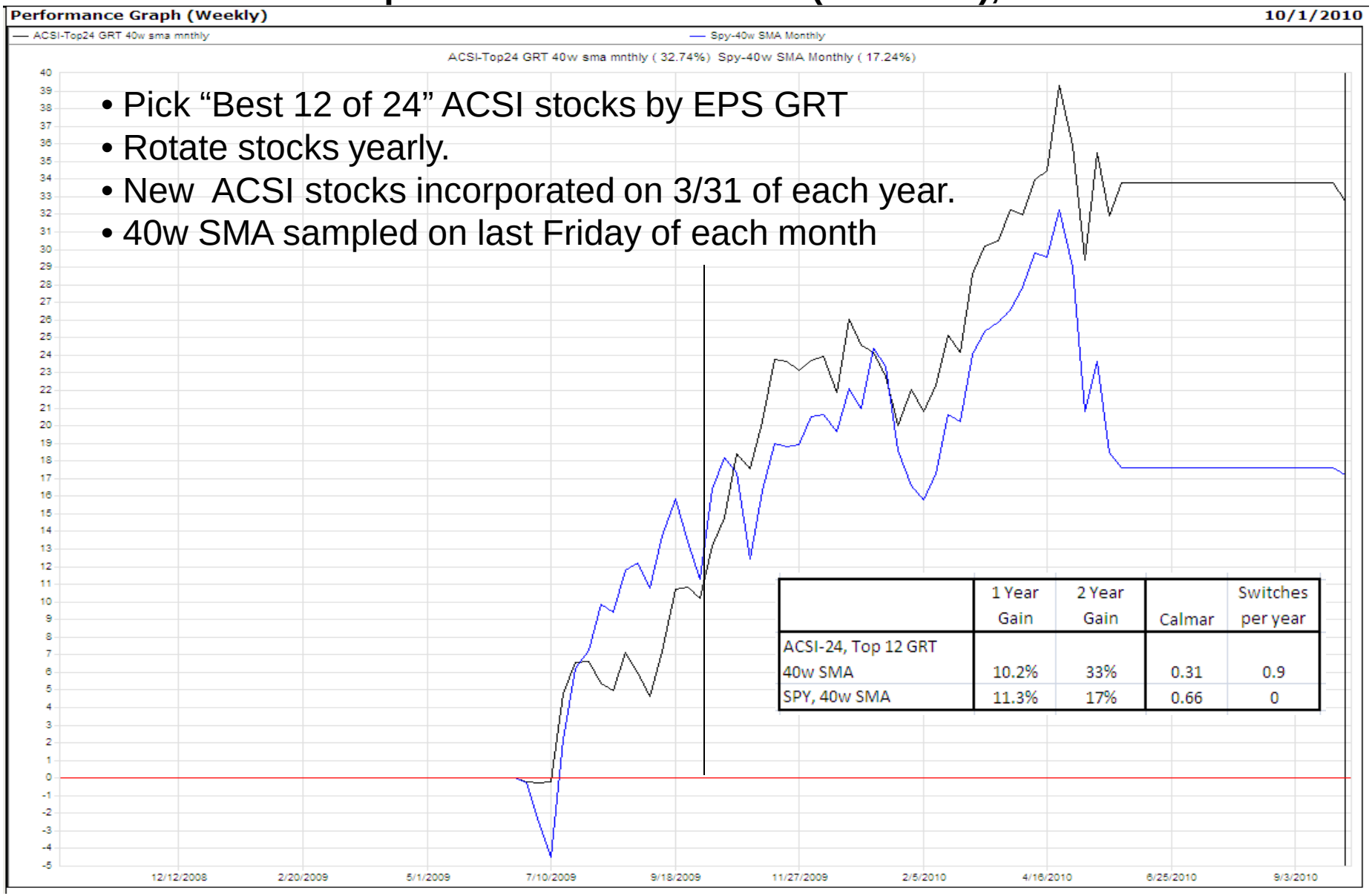


- Pick “Best 12 of 24” ACSI stocks by EPS GRT
- Rotate stocks yearly.
- New ACSI stocks incorporated on 3/31 of each year.
- 40w SMA sampled on last Friday of each month

	CRR	MDD	Calmar	Switches per year
ACSI-24, Top 12 GRT 40w SMA	10.5%	16%	0.66	0.9
SPY, 40w SMA	5.3%	19%	0.28	0

Note that the CRR (gain) is not much greater than B&H – but the ride (MDD) is smoother

ACSI Top12/24 EPS GRT vs. SPY (40w SMA), Last 2 Years



	1 Year Gain	2 Year Gain	Calmar	Switches per year
ACSI-24, Top 12 GRT 40w SMA	10.2%	33%	0.31	0.9
SPY, 40w SMA	11.3%	17%	0.66	0

ACSI Stocks: So What Does All This Mean?

- Amazingly enough - this works! (Is the market this inefficient??)
  - Screen is orthogonal to normal financial metrics (EPS, etc.) - a plus
- Consider using wherever you use SPY – it is a "Better SPY"
  - Bid/ask spread should be competitive with SPY, commission costs ??
  - ACS Top12 better than many 130/30 Long Only funds I've seen
  - Among the better "fire and forget" screens I've seen
  - Low beta portfolio that still provides alpha
- B&H since 1/1/01 beats SPY, MDY and IWM handily
- May be able to add value by selecting the best 12 of 24 top stocks
  - Growth related sorts seem to pick the winners
- Works well with 40 week SMA timing
  - Makes sense most all of the ACSI stocks are large cap "SP500" type stocks
- Holding stocks for 1 year each has little impact on performance
  - Overall, the stock universe does not change that much either

Does Anything Still Work?

“Buy the Biggest” w/GARP

Or

Does Jack Welch Give (Good) Investment Advice?

Buy the Biggest w/GARP

- Welch's public philosophy was that a company should be either #1 or #2 in a particular industry, or else leave it completely. ***Is this useful investment advice?***
  - Theory: A large, dominant company in its industry should be a good investment
  - Depending on the database you use, there are 100-200 industries (e.g., Stock Investor Pro has some 100+)

- Growth At a Reasonable Price (GARP)
  - AAII categorizes these screens as “Growth & Value” – e.g., Value on the Move
  - Uses the PE to Growth ratio (PEG) to find reasonably priced growth stocks
    - “Deep value” PEGs are ~ 0.5, Levels to 1.0 are typically considered “OK”

- Combining the two concepts:
  - Construct a universe of stocks (a watch list) that has the #1 stock by sales revenue for each industry. (Could expand this list to include the #2 stock)
  - Select the Top X stocks from the watch list based on lowest PEG ratios

Buy the Biggest: ‘02 Industry Watch List in ‘10

Date: 12/31/2009 Return: 1000 Return All Refresh

Edit Sorted by: Sales DESC

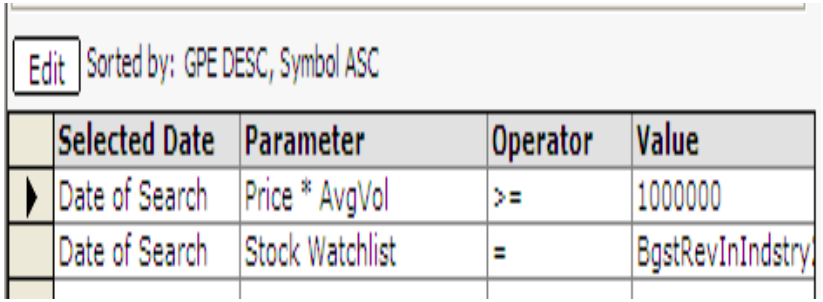
Buys: 54 (29.3%) Sells: 13 (7.1%) Holds: 117 (63.6%) Total: 184

My WatchLists

Company	Symbol	Industry	Mkt Cap($M)	Price	Price * AvgVol	EY	GRT	P/S	Sales GRT	GPE	P/E	EPS	Sales(M)	DY	DIV
Wal-Mart Strs	**WMT**	**Retail (Major Chains)**	**203653.59**	**53.45**	**759296600.00**	**6.75**	**1**	**0.50**	**1**	**0.07**	**14.81**	**3.61**	**404543.00**	**2.04**	**1.09**
Exxon Mobil	XOM	Petroleum (Intl Integrted)	366998.59	68.19	661507000.00	8.51	-7	1.37	-41	-0.59	11.76	5.80	268353.00	2.46	1.68
Gen'l Electrc	GE	Diversified Companies	161096.68	15.13	111437000.00	6.21	-9	1.00	-20	-0.55	16.10	0.94	161558.00	2.64	0.40
Motors Lqdtn	MTLQQ	Auto & Truck (Mfg)	287.55	0.471	1671876.00	-99.00	20	0.00	-47	403.39	-0.05	-9.50	129027.00	0.00	0.00
Hewlett-Packard	HPQ	Computer (Makers)	121778.39	51.51	720334300.00	8.44	6	1.06	-8	0.51	11.84	4.35	114552.00	0.62	0.32
Nippon T&T ADR	NTT	Utility (Telephone)	52243.29	19.74	9743249.00	10.08	-7	0.46	-3	-0.70	9.92	1.99	112394.60	0.00	0.00
Verizon Comm	VZ	Telecomm (Services)	94110.73	33.13	549695700.00	7.55	-5	0.89	10	-0.37	13.25	2.50	105362.00	5.73	1.90
Cardinal Hlth	CAH	Drug (Wholesale\Distrb)	11693.45	32.24	115870100.00	6.27	-7	0.12	6	-0.43	15.96	2.02	100856.00	2.17	0.70
A X A ADS	AXAHY	Insurance (General)	48808.74	23.68	14150510.00	11.57	-6	0.49	40	-0.69	8.64	2.74	99849.99	8.70	2.06
Int'l BusMach	IBM	Computer (Services)	171950.23	130.90	783769200.00	8.33	13	1.80	-7	1.09	12.01	10.90	95533.00	1.68	2.20
Procter & Gmbl	PG	Personal (Cosmetics)	177144.49	60.63	674049300.00	6.84	-2	2.28	-6	-0.13	14.61	4.15	77853.00	2.90	1.76
Sony Corp.	SNE	Home (Audio\Video Prods)	29102.08	29.00	24319460.00	-3.17	-13	0.38	-20	-0.42	-31.52	-0.92	76097.47	0.00	0.00
Champion Entrp	CHBQ	Building (Mobile\Mfg\RV)	3.41	0.044	109826.00	-99.00	-12	0.01	-55	839.19	-0.01	-3.08	682.08	0.00	0.00
Aqua America	WTR	Utility (Water Supply)	2386.09	17.51	25314940.00	5.14	8	3.60	2	0.42	19.46	0.90	662.49	3.31	0.58
Unifi Inc	UFI	Home (Textiles)	240.79	3.88	649919.40	-20.88	-9	0.46	-15	-1.88	-4.79	-0.81	527.51	0.00	0.00
Carmike Cin A	CKEC	Media (Movies)	97.22	7.56	689169.60	8.47	33	0.20	0	2.80	11.81	0.64	495.99	0.00	0.00
Primedia Inc	PRM	Media (Periodicals)	159.38	3.61	217968.20	11.08	-6	0.59	-18	-0.66	9.03	0.40	270.09	7.76	0.28
Hurco Cos	HURC	Machinery (Automation)	95.31	14.80	370207.20	0.07	-12	1.05	-51	0.00	999.99	0.01	91.02	0.00	0.00
Zions Bancorp	ZION	Bank (West\Swst)	1750.01	12.83	78227150.00	-17.30	-13	50.53	-92	-2.25	-5.78	-2.22	34.63	0.31	0.04
Torch EnrgyRoy	TRU	Petroleum (U S Royalty)	40.85	4.75	137146.80	8.00	2	6.37	-1	0.17	12.50	0.38	6.41	8.63	0.41
Synovus Fin'l	SNV	Bank (Southeast)	984.80	2.05	42460770.00	-51.71	-9	0.00	-100	-4.66	-1.93	-1.06	0.00	1.95	0.04
Fannie Mae	FNMA	Financial (Mortgage Svcs)	1309.79	1.18	42794580.00	-99.00	-6	0.00	0	-35.09	-0.17	-6.90	0.00	0.00	0.00
iStar Fin'l	SFI	REIT (Mortgage)	249.47	2.56	2529262.00	-99.00	-11	0.00	0	-17.45	-0.63	-4.06	0.00	0.00	0.00

Caution - Can still get some thinly traded stocks

Buy the Biggest: Screen, Current Stocks



Edit | Sorted by: GPE DESC, Symbol ASC

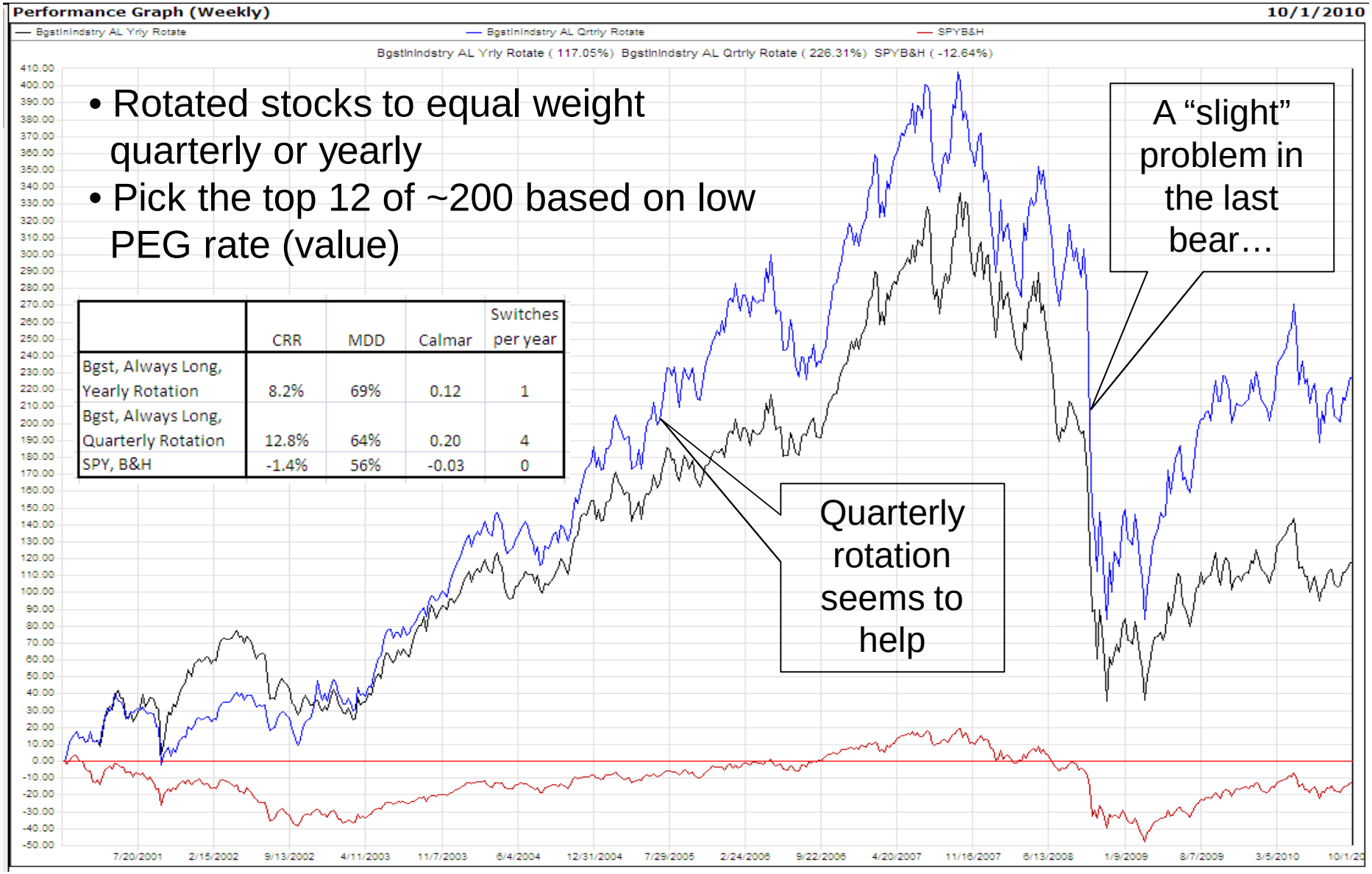
	Selected Date	Parameter	Operator	Value
▶	Date of Search	Price * AvgVol	>=	1000000
	Date of Search	Stock Watchlist	=	BgstRevInIndstry

GPE is inverse of PEG, EY is inverse of PE

- GPE range 3.0-5.8; (PEG range: 0.17-0.33)
- EPS GRT range: 26 – 42;
- EY range: 8.4 – 19.3; (PE range: 5.2 – 12)
- Sales range: $1.6B – $51.5B
- Mkt. Cap. range: $700M – $108B

Company	Symbol	Industry	Price	EY	EPS	GRT	P/S	GPE	Sales(M)	Mkt Cap($M)
DeutscheBk ADR	**DB**	**Financial (Brokers)**	**55.12**	**19.30**	**10.64**	**30**	**0.91**	**5.80**	**37696.17**	**34135.81**
Avnet	AVT	Electronic (Parts Distrib)	26.84	12.59	3.38	36	0.21	4.54	19160.17	4075.65
Amer Greetgs	AM	Personal (Consumer Prods)	19.06	13.48	2.57	33	0.46	4.45	1635.86	753.44
Ingram MicroA	IM	Retail (Computers)	17.08	12.00	2.05	35	0.08	4.20	32444.05	2676.27
Capital OneFnl	COF	Financial (Consumer Loans)	39.30	11.37	4.47	34	0.92	3.87	19511.08	17951.06
Dow Chemical	DOW	Chemical (Basic)	27.88	8.43	2.35	42	0.63	3.55	51547.00	32336.90
Donnelley RR	RRD	Business Svc (Printing)	16.99	10.01	1.70	35	0.36	3.51	9869.90	3510.13
Goodyear Tire	GT	Auto & Truck (Tires\Misc)	10.85	13.00	1.41	26	0.15	3.38	17620.00	2635.79
Intel	INTC	Electronic (Semicndtr Mfg)	19.32	9.73	1.88	33	2.62	3.22	41022.00	107554.44
Whirlpool Cp	WHR	Home (Appliances)	80.20	11.38	9.13	27	0.34	3.08	18167.00	6096.00
Applied Mat	AMAT	Electronic (Semicndtr Eqp)	11.71	9.65	1.13	31	1.91	3.00	8188.63	15645.38
Int'l Paper	IP	Paper	22.36	10.20	2.28	29	0.41	2.96	23824.00	9771.77

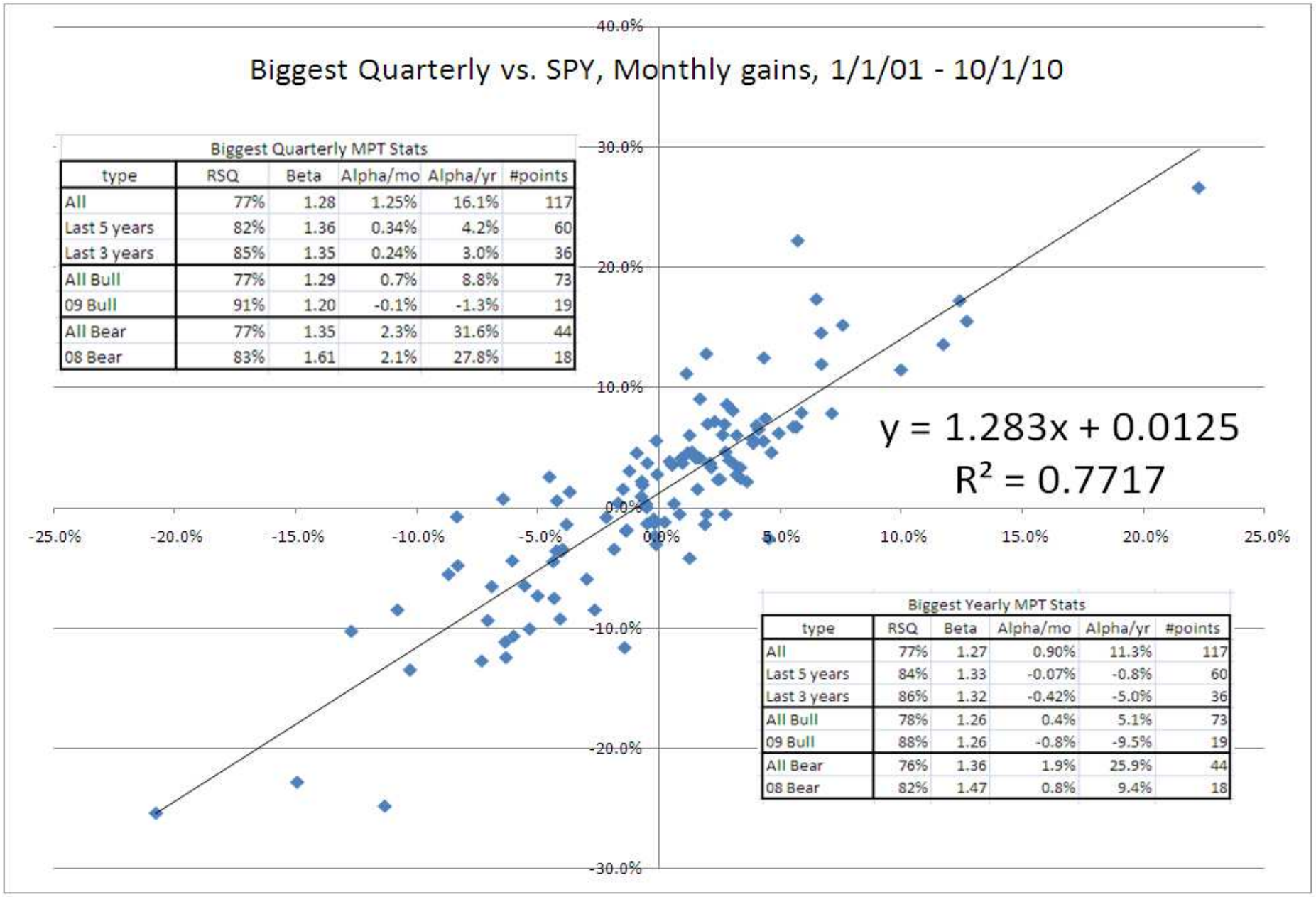
BTB w/GARP: "Always Long" vs. SPY B&H – Since 1/1/01



	CRR	MDD	Calmar	Switches per year
Bgst, Always Long, Yearly Rotation	8.2%	69%	0.12	1
Bgst, Always Long, Quarterly Rotation	12.8%	64%	0.20	4
SPY, B&H	-1.4%	56%	-0.03	0

BTB w/GARP: "Always Long" vs. SPY B&H – Last 2 Years

	1 Year Gain	2 Year Gain
Bgst, Always Long, Yearly Rotation	8.3%	15.0%
Bgst, Always Long, Quarterly Rotation	26.9%	32.4%
SPY, B&H	15.8%	30.0%



Biggest Quarterly MPT Stats

type	RSQ	Beta	Alpha/mo	Alpha/yr	#points
All	77%	1.28	1.25%	16.1%	117
Last 5 years	82%	1.36	0.34%	4.2%	60
Last 3 years	85%	1.35	0.24%	3.0%	36
All Bull	77%	1.29	0.7%	8.8%	73
09 Bull	91%	1.20	-0.1%	-1.3%	19
All Bear	77%	1.35	2.3%	31.6%	44
08 Bear	83%	1.61	2.1%	27.8%	18

Biggest Yearly MPT Stats

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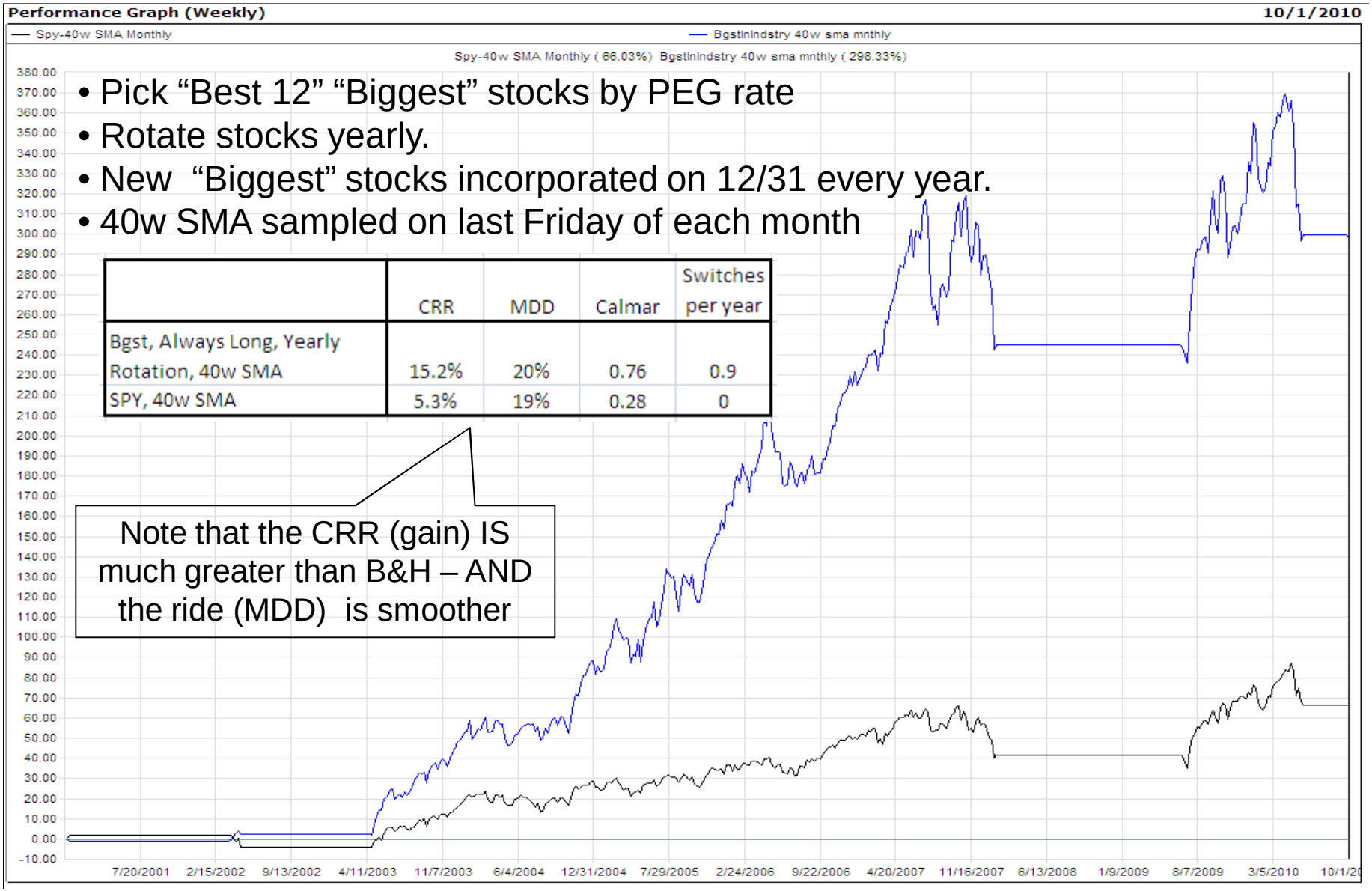
BTB w/GARP vs. SPY B&H(40w SMA), 1/1/01 – 10/1/10



- Pick “Best 12” “Biggest” stocks by PEG rate
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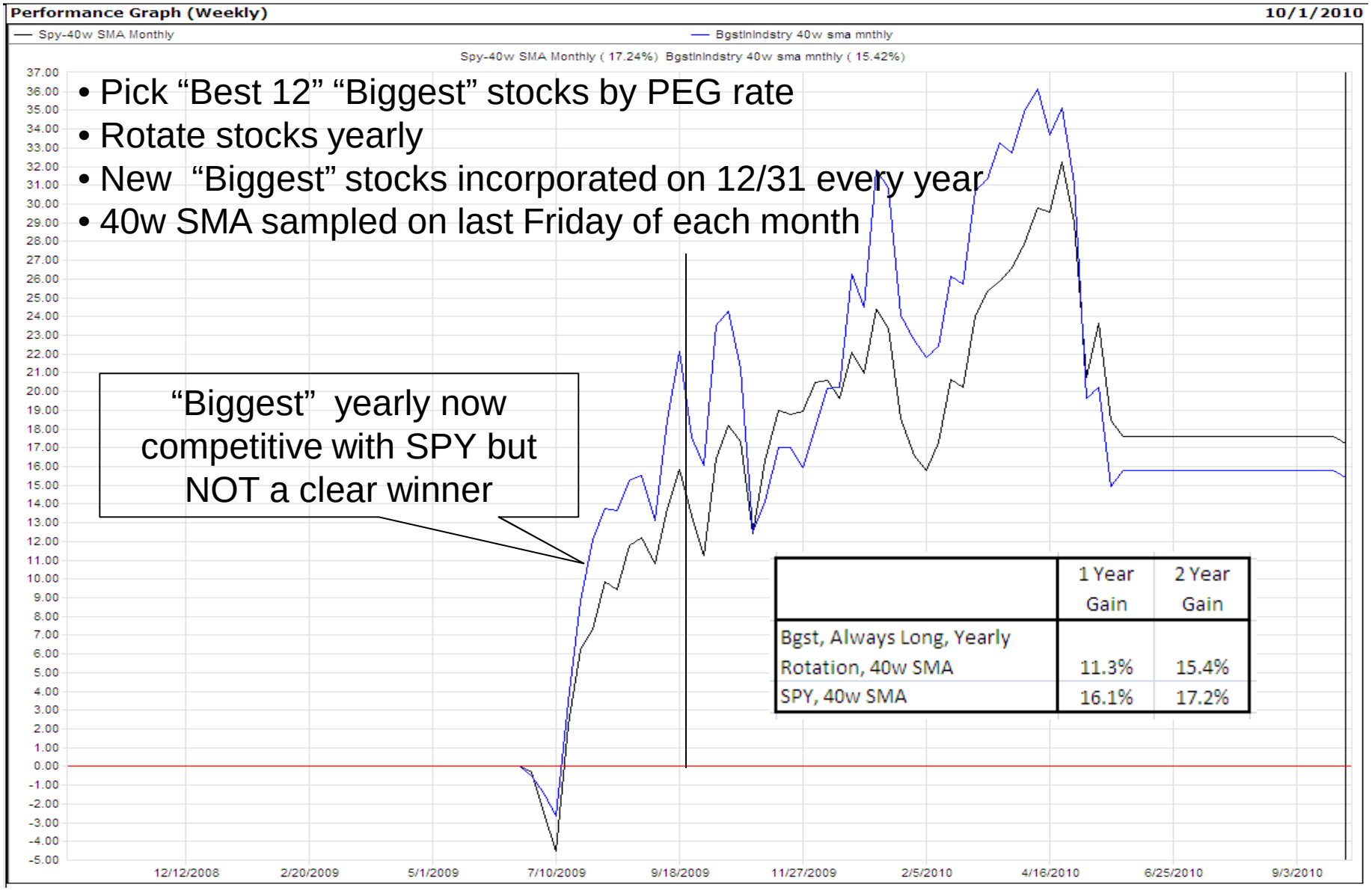
- 40w SMA sampled on last Friday of each month

	CRR	MDD	Calmar	Switches per year
Bgst, Always Long, Yearly Rotation, 40w SMA	15.2%	20%	0.76	0.9
SPY, 40w SMA	5.3%	19%	0.28	0

Note that the CRR (gain) IS much greater than B&H – AND the ride (MDD) is smoother

BTB w/GARP vs. SPY B&H(40w SMA), Last 2 Years



BTB w/GARP: So What Does All This Mean?

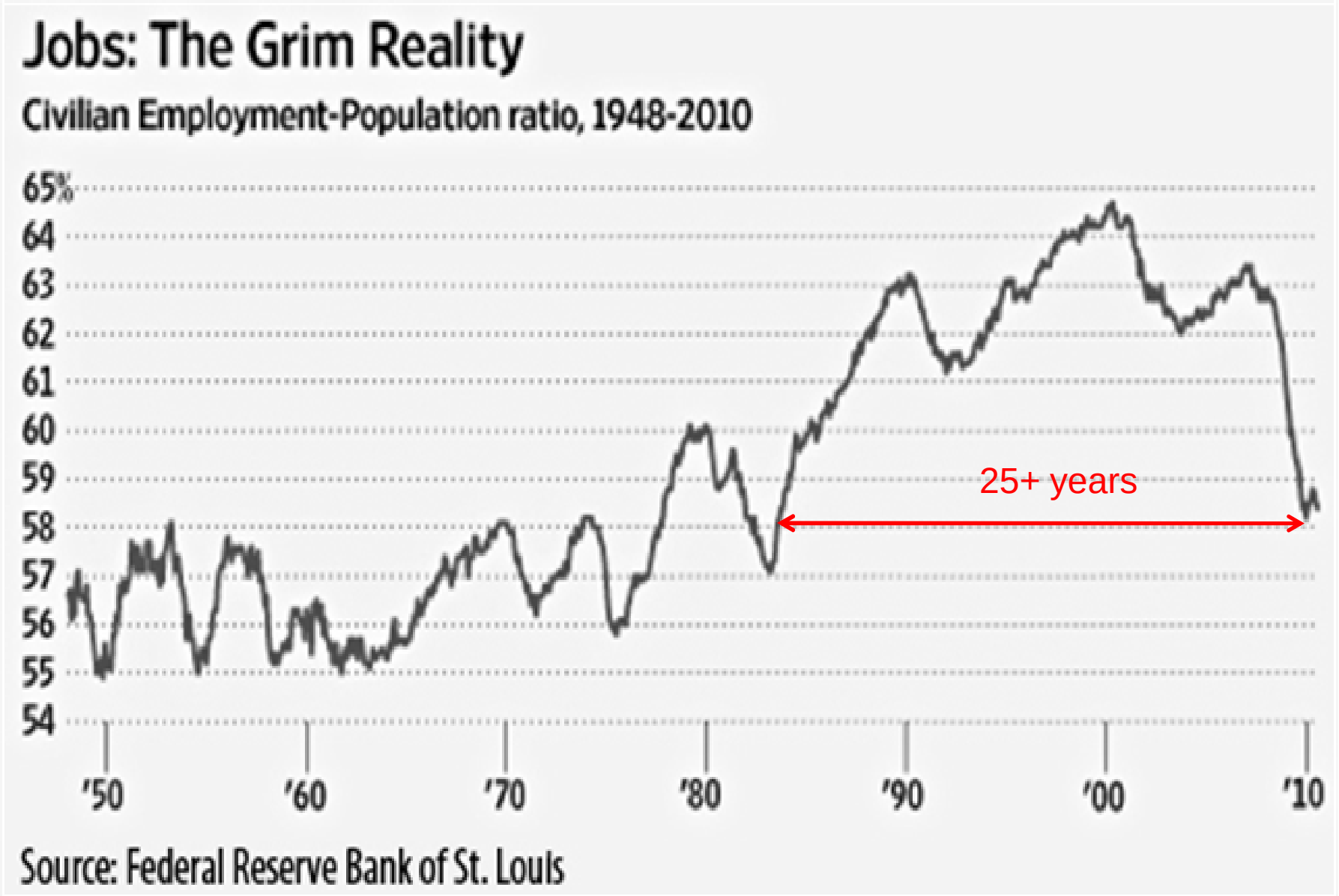
- A higher risk/reward situation than the ACSI approach
  - Have a ”High Beta” portfolio – with the beta getting higher in bears! Also has negative alpha in recent past
- B&H since 1/1/01 beats SPY, MDY and IWM handily – but few could stomach the draw-downs
- GARP adds value (no surprise there)
- Works “well” with 40 week SMA timing
  - Makes sense most all of the “Biggest” stocks are large cap “SP500” type stocks
- Bigger universe (100-200 stocks) allows more stocks in a portfolio if you so choose

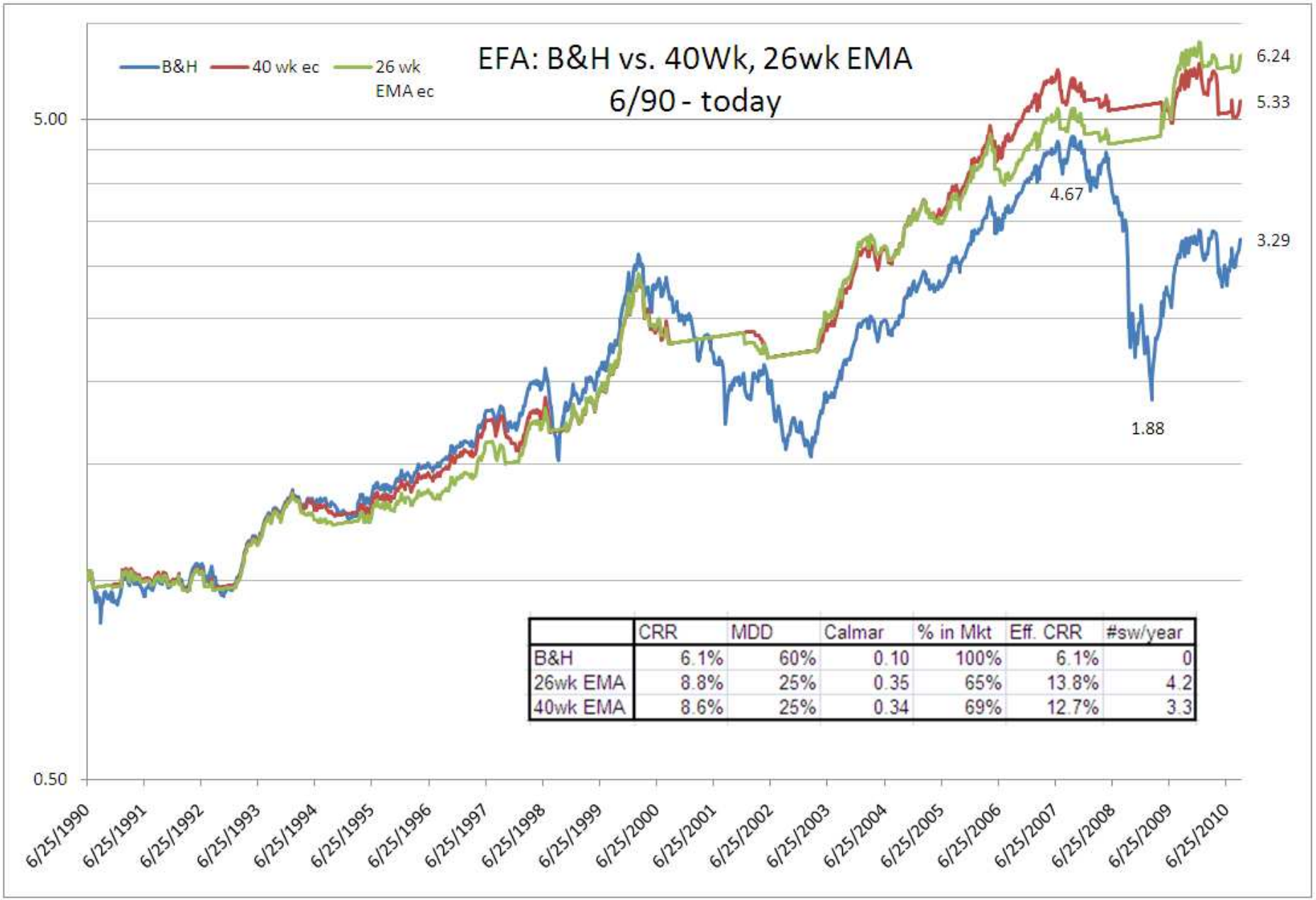
Changing Markets: Does Anything Still Work?

- Individual investors do face a challenging “New World Order”
  - Take your pick of the challenges we discussed earlier – or add your own
  - It’s not the 80’s and 90’s anymore (or even the early ‘00s)
  - You still have to invest (stuffing it in a mattress doesn’t count)
  - Don’t Despair!
- Does Anything Still Work?
  - Investing in multiple uncorrelated asset classes still works
  - You now have a few approaches to boost return via ETFs/MFs and stock selection
  - Be careful out there!

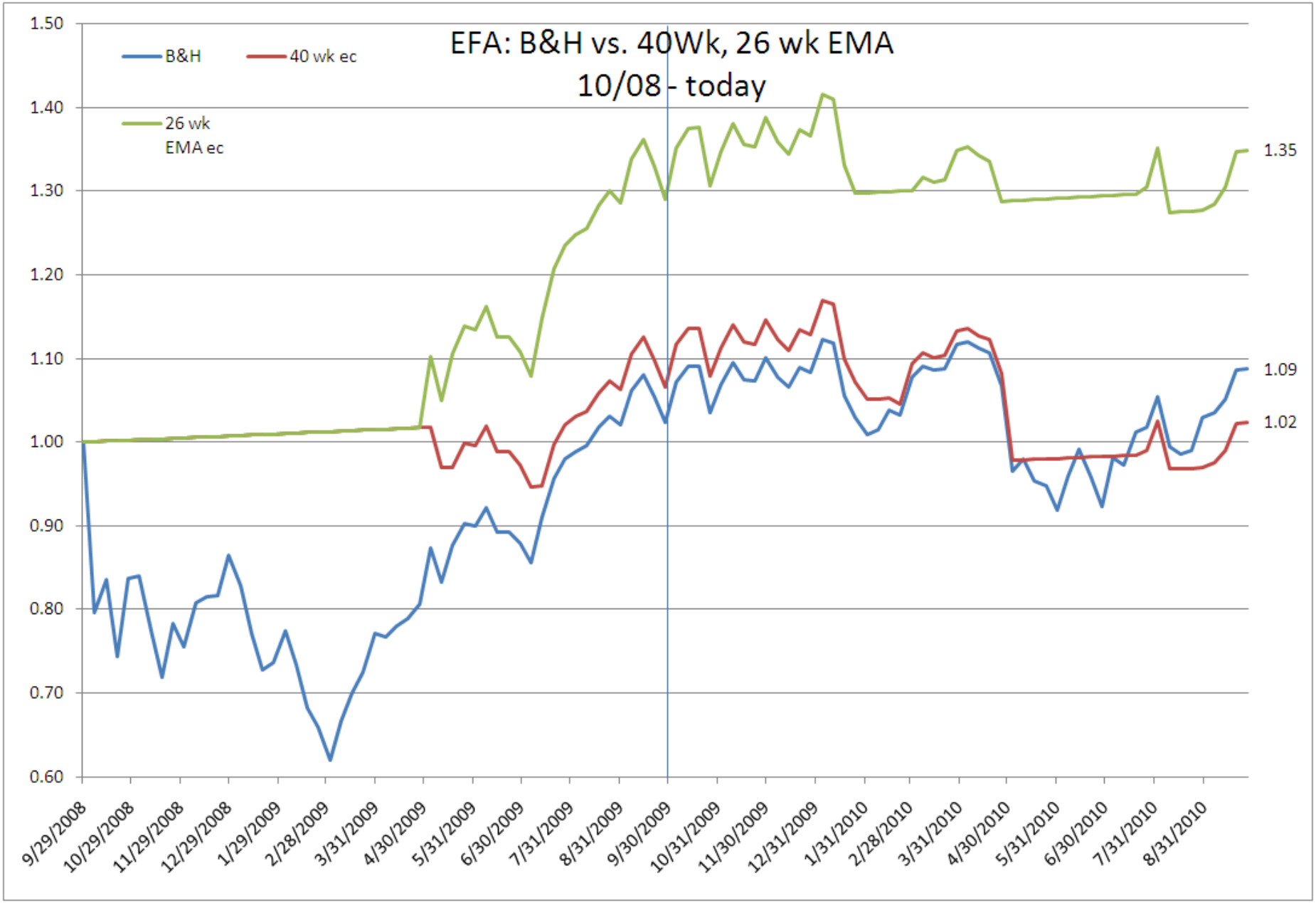
Q & A

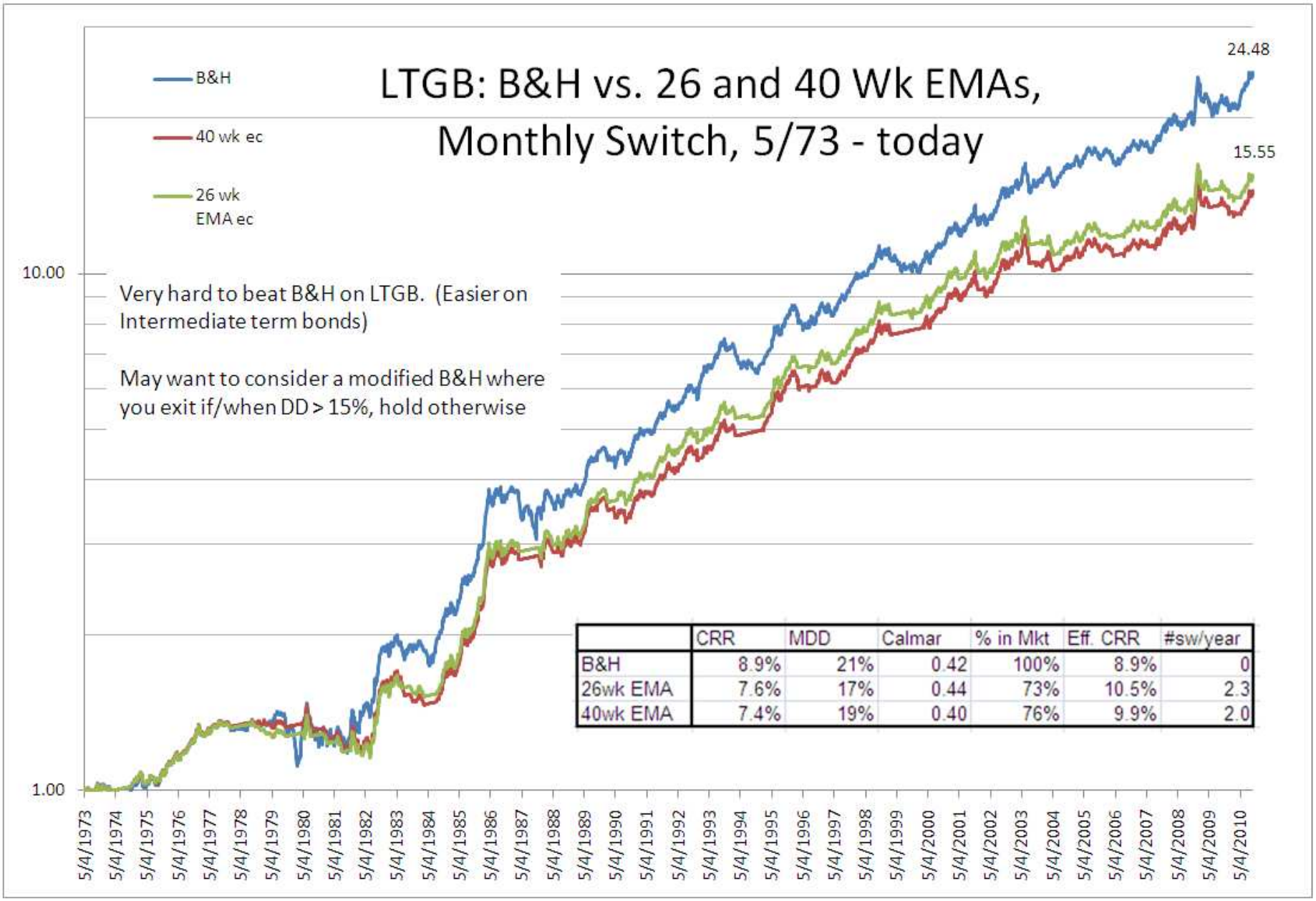
Appendices:
Asset Classes: B&H and Timed
References,
Performance Metrics


Jobs: The Grim Reality
Civilian Employment-Population ratio, 1948-2010
65%
64
63
62
61
60
59
58
57
56
55
54
25+ years
'50
'60
'70
'80
'90
'00
'10
Source: Federal Reserve Bank of St. Louis

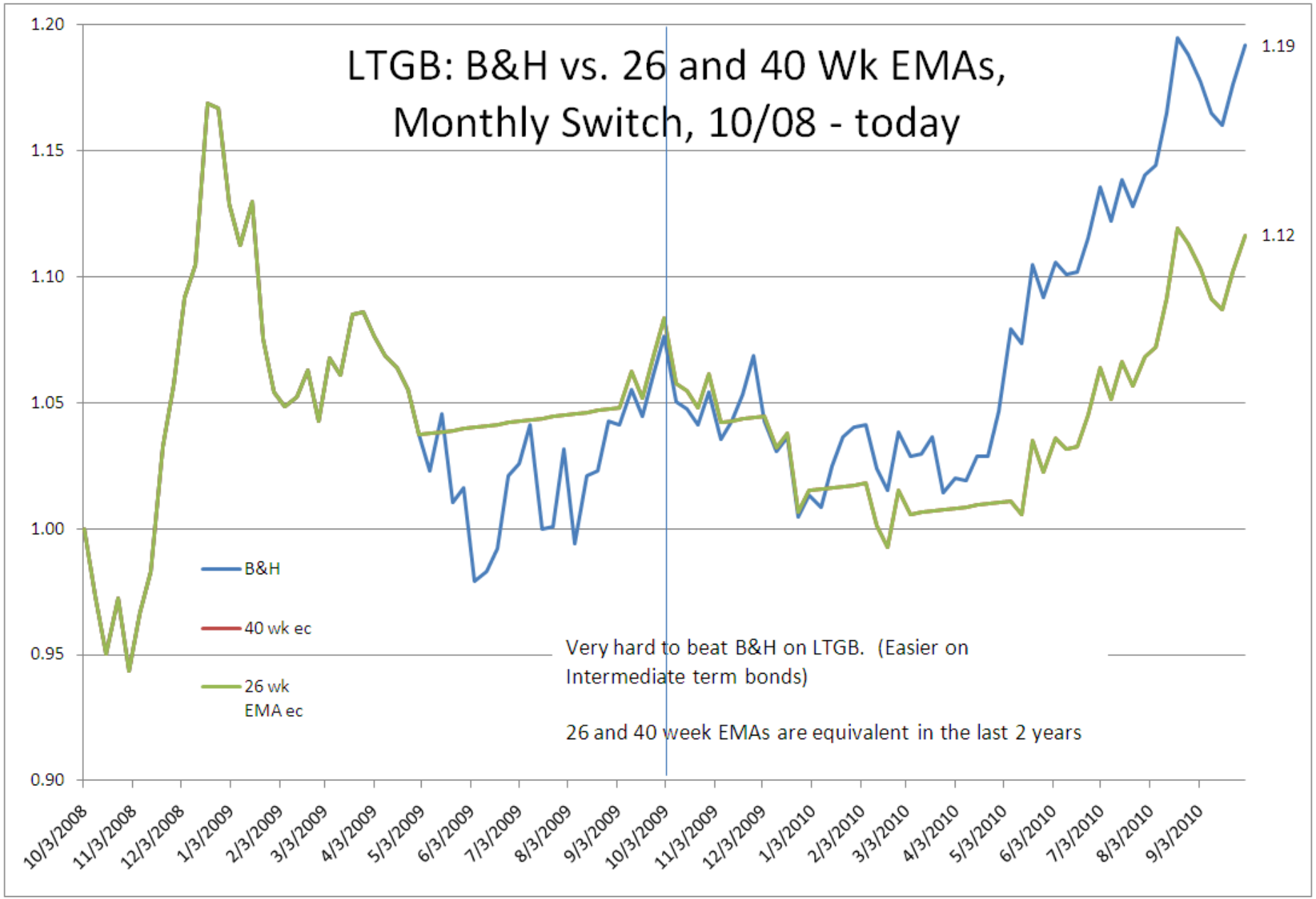


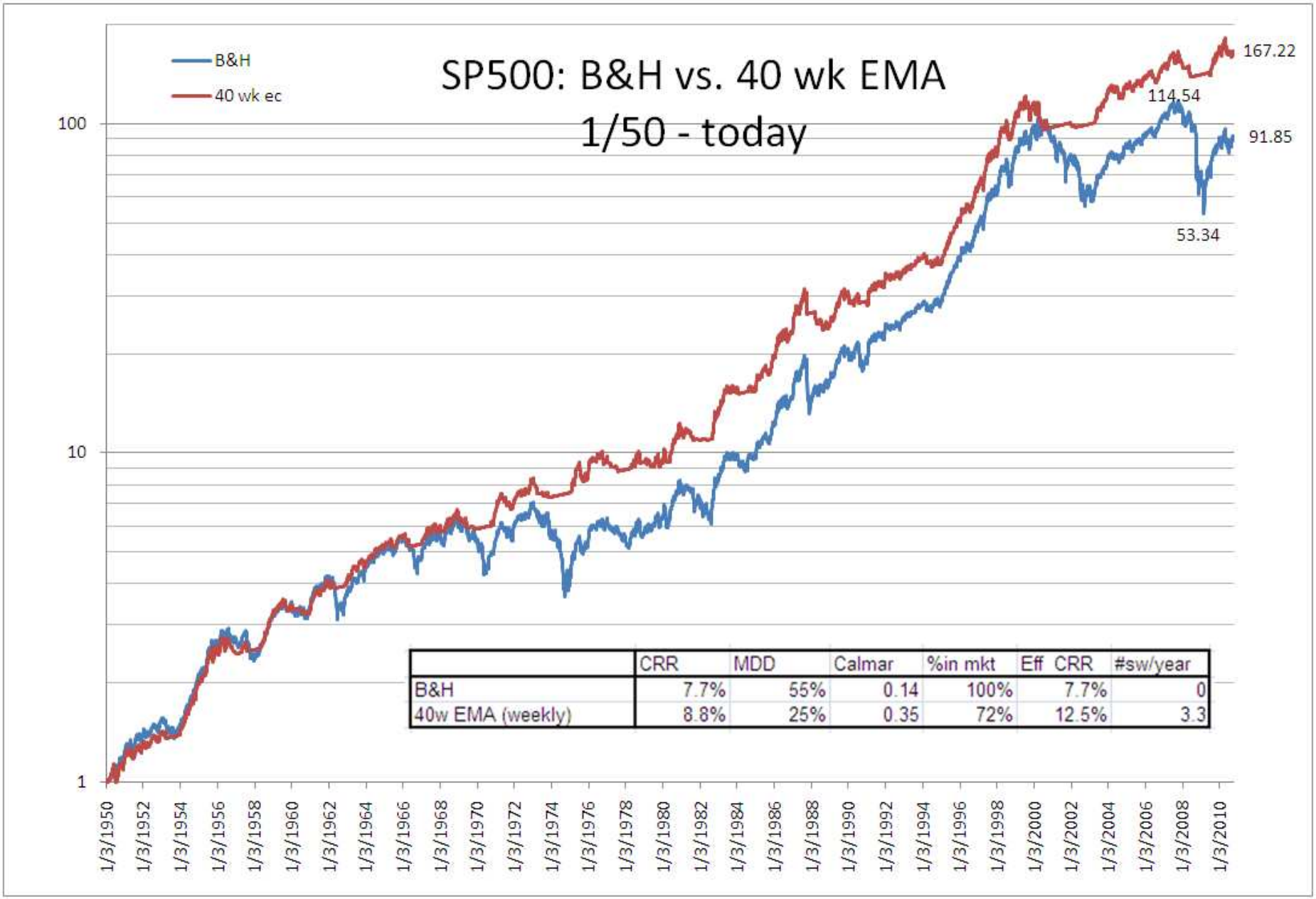
	CRR	MDD	Calmar	% in Mkt	Eff. CRR	#sw/year
B&H	6.1%	60%	0.10	100%	6.1%	0
26wk EMA	8.8%	25%	0.35	65%	13.8%	4.2
40wk EMA	8.6%	25%	0.34	69%	12.7%	3.3


EFA: B&H vs. 40Wk, 26 wk EMA
10/08 - today
B&H
40 wk ec
26 wk EMA ec
1.50
1.40
1.30
1.20
1.10
1.00
0.90
0.80
0.70
0.60
1.35
1.09
1.02
9/29/2008
10/29/2008
11/29/2008
12/29/2008
1/29/2009
2/28/2009
3/31/2009
4/30/2009
5/31/2009
6/30/2009
7/31/2009
8/31/2009
9/30/2009
10/31/2009
11/30/2009
12/31/2009
1/31/2010
2/28/2010
3/31/2010
4/30/2010
5/31/2010
6/30/2010
7/31/2010
8/31/2010

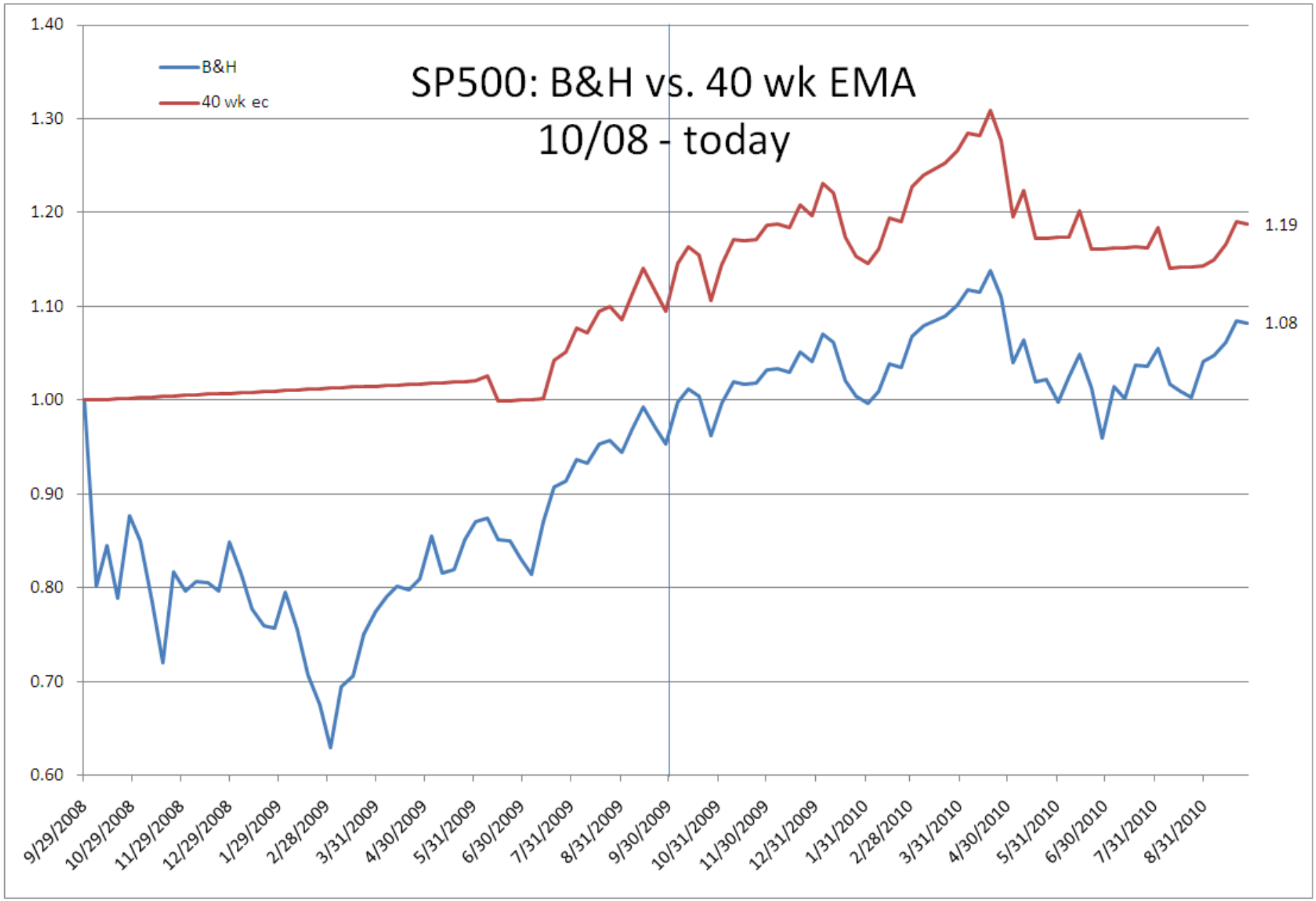


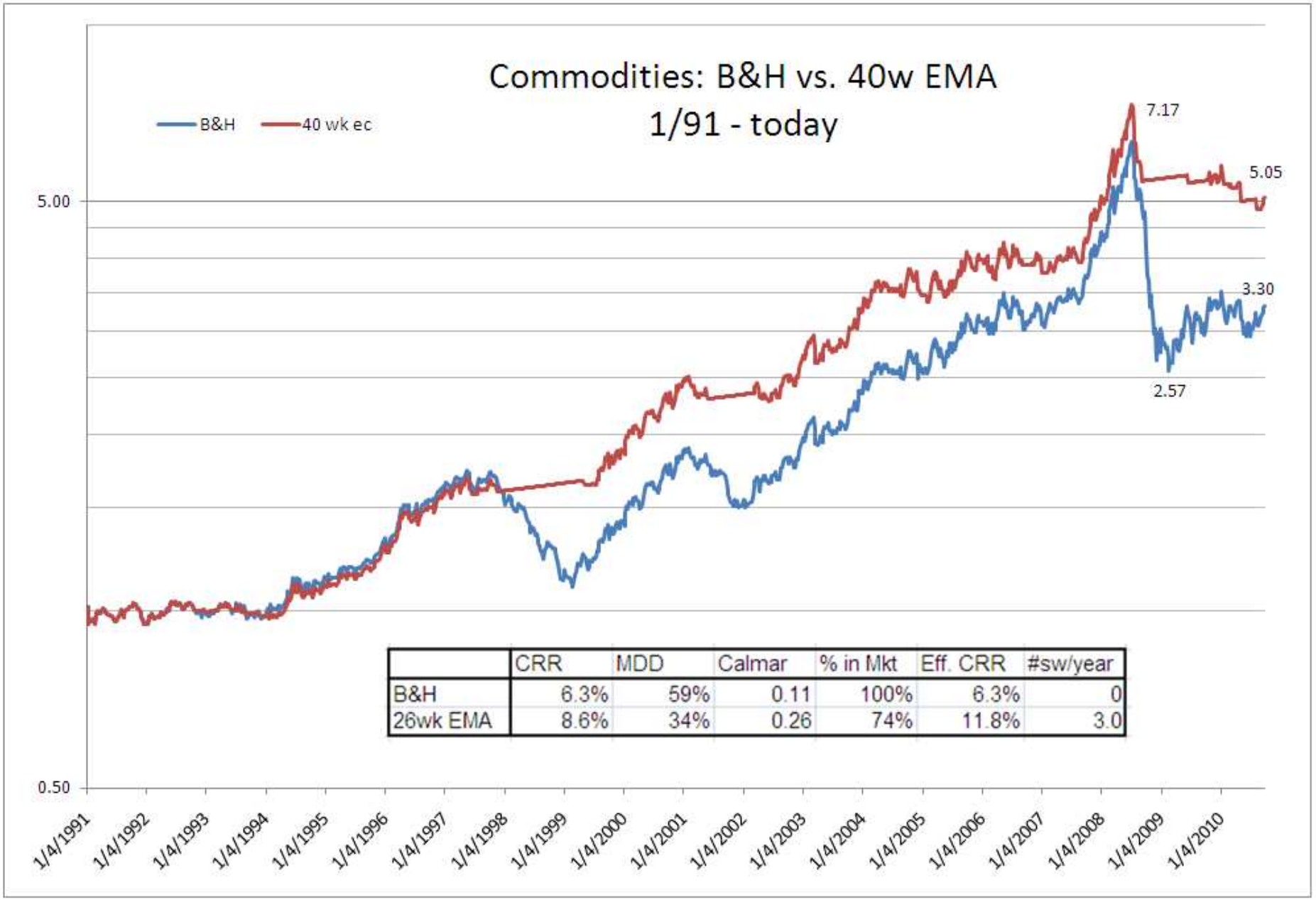
	CRR	MDD	Calmar	% in Mkt	Eff. CRR	#sw/year
B&H	8.9%	21%	0.42	100%	8.9%	0
26wk EMA	7.6%	17%	0.44	73%	10.5%	2.3
40wk EMA	7.4%	19%	0.40	76%	9.9%	2.0


LTGB: B&H vs. 26 and 40 Wk EMAs,
Monthly Switch, 10/08 - today
1.20
1.15
1.10
1.05
1.00
0.95
0.90
1.19
1.12
B&H
40 wk ec
26 wk
EMA ec
Very hard to beat B&H on LTGB. (Easier on Intermediate term bonds)
26 and 40 week EMAs are equivalent in the last 2 years
10/3/2008
11/3/2008
12/3/2008
1/3/2009
2/3/2009
3/3/2009
4/3/2009
5/3/2009
6/3/2009
7/3/2009
8/3/2009
9/3/2009
10/3/2009
11/3/2009
12/3/2009
1/3/2010
2/3/2010
3/3/2010
4/3/2010
5/3/2010
6/3/2010
7/3/2010
8/3/2010
9/3/2010

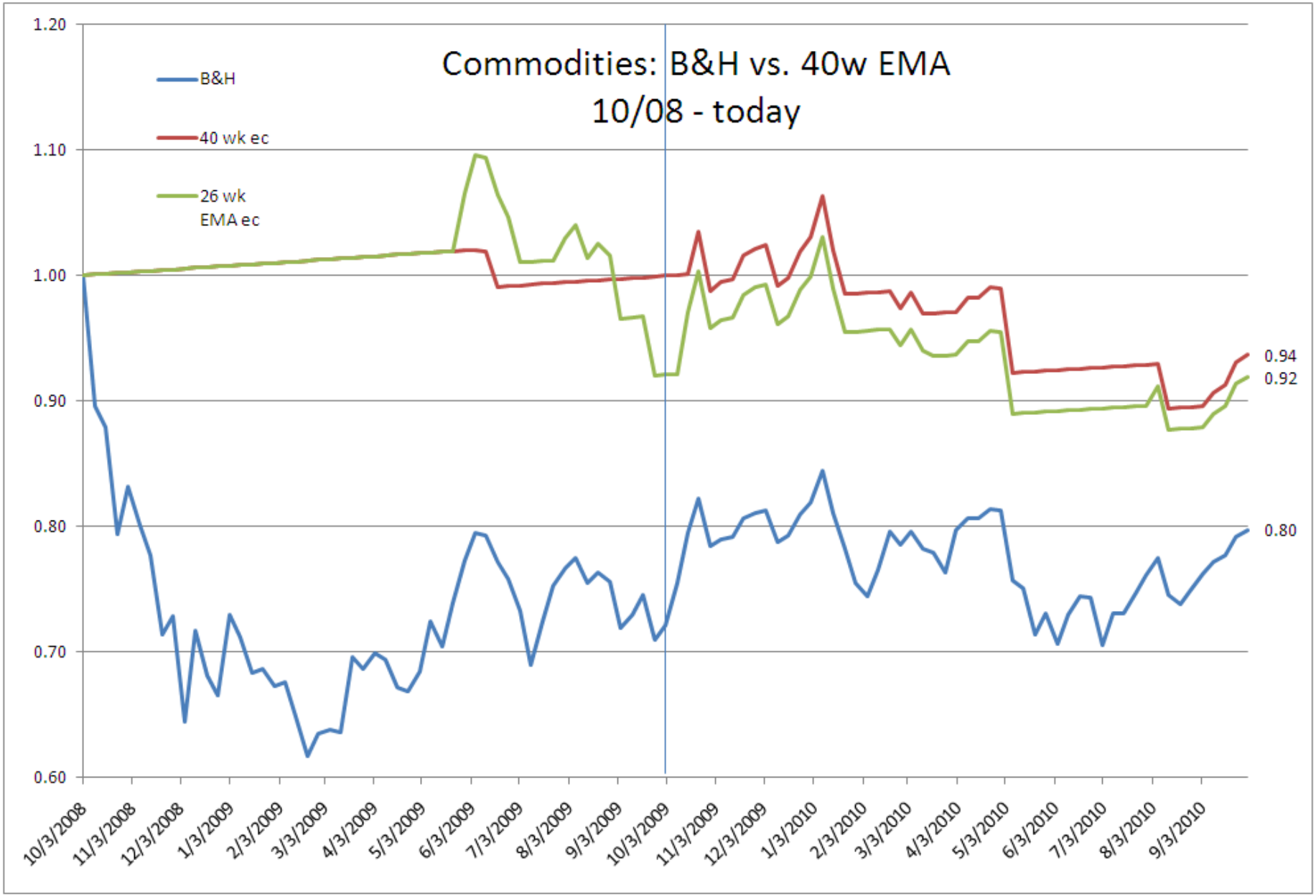


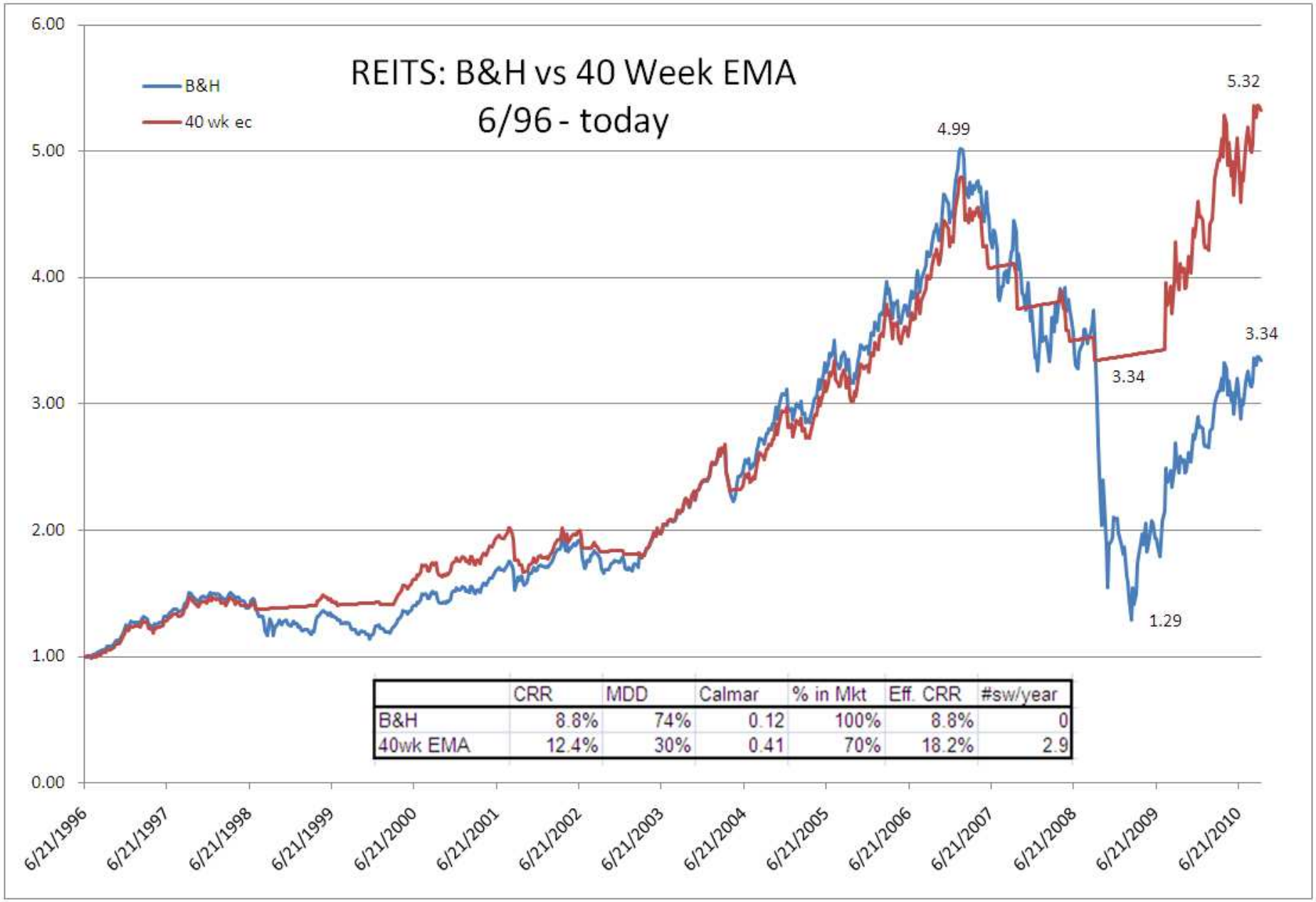
	CRR	MDD	Calmar	%in mkt	Eff CRR	#sw/year
B&H	7.7%	55%	0.14	100%	7.7%	0
40w EMA (weekly)	8.8%	25%	0.35	72%	12.5%	3.3


SP500: B&H vs. 40 wk EMA
10/08 - today
B&H
40 wk ec
1.40
1.30
1.20
1.10
1.00
0.90
0.80
0.70
0.60
1.19
1.08
9/29/2008
10/29/2008
11/29/2008
12/29/2008
1/29/2009
2/28/2009
3/31/2009
4/30/2009
5/31/2009
6/30/2009
7/31/2009
8/31/2009
9/30/2009
10/31/2009
11/30/2009
12/31/2009
1/31/2010
2/28/2010
3/31/2010
4/30/2010
5/31/2010
6/30/2010
7/31/2010
8/31/2010

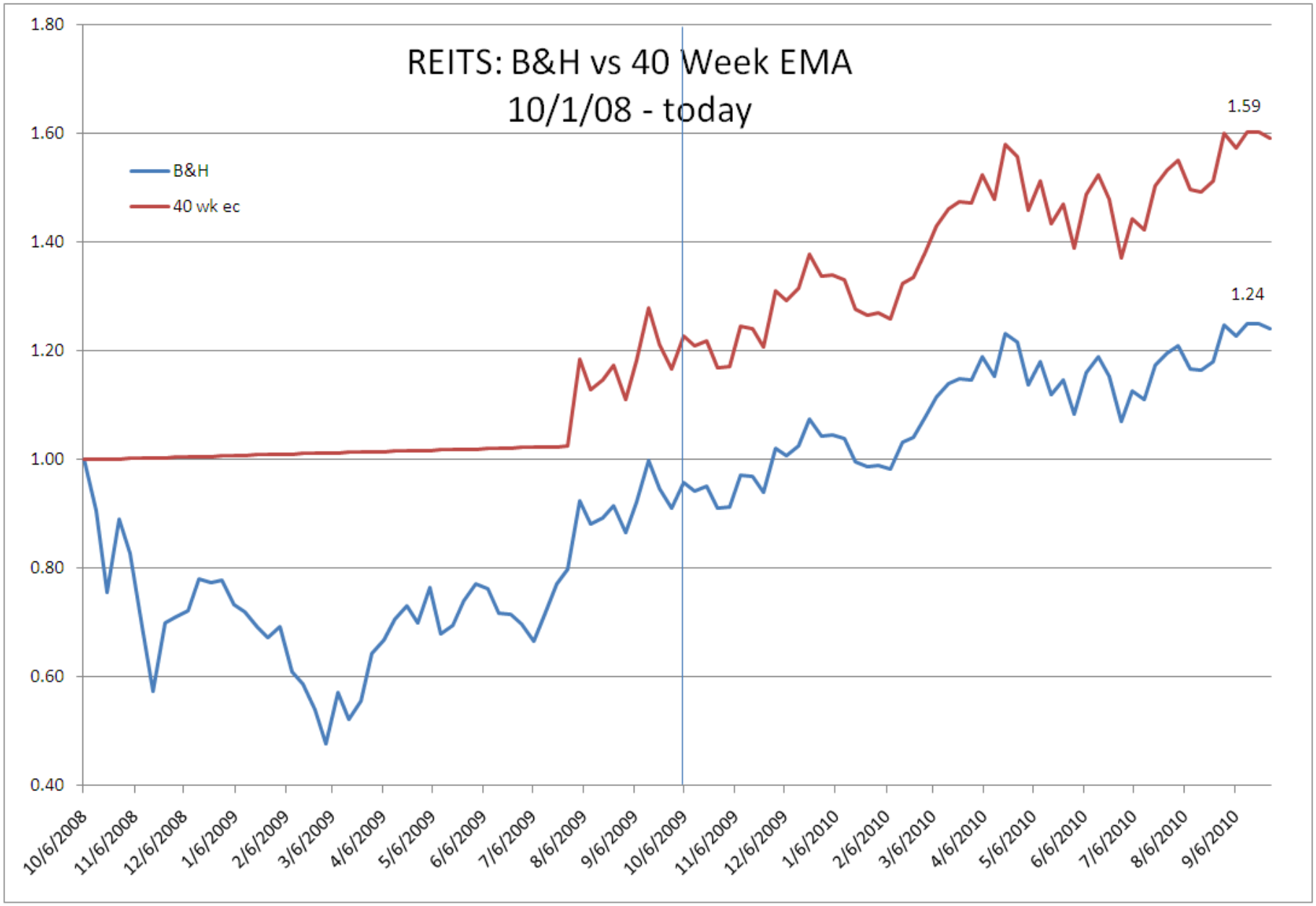


	CRR	MDD	Calmar	% in Mkt	Eff. CRR	#sw/year
B&H	6.3%	59%	0.11	100%	6.3%	0
26wk EMA	8.6%	34%	0.26	74%	11.8%	3.0


Commodities: B&H vs. 40w EMA
10/08 - today
B&H
40 wk ec
26 wk EMA ec
1.20
1.10
1.00
0.90
0.80
0.70
0.60
0.94
0.92
0.80
10/3/2008
11/3/2008
12/3/2008
1/3/2009
2/3/2009
3/3/2009
4/3/2009
5/3/2009
6/3/2009
7/3/2009
8/3/2009
9/3/2009
10/3/2009
11/3/2009
12/3/2009
1/3/2010
2/3/2010
3/3/2010
4/3/2010
5/3/2010
6/3/2010
7/3/2010
8/3/2010
9/3/2010



	CRR	MDD	Calmar	% in Mkt	Eff. CRR	#sw/year
B&H	8.8%	74%	0.12	100%	8.8%	0
40wk EMA	12.4%	30%	0.41	70%	18.2%	2.9


REITS: B&H vs 40 Week EMA
10/1/08 - today
B&H
40 wk ec
1.59
1.24
1.80
1.60
1.40
1.20
1.00
0.80
0.60
0.40
10/6/2008
11/6/2008
12/6/2008
1/6/2009
2/6/2009
3/6/2009
4/6/2009
5/6/2009
6/6/2009
7/6/2009
8/6/2009
9/6/2009
10/6/2009
11/6/2009
12/6/2009
1/6/2010
2/6/2010
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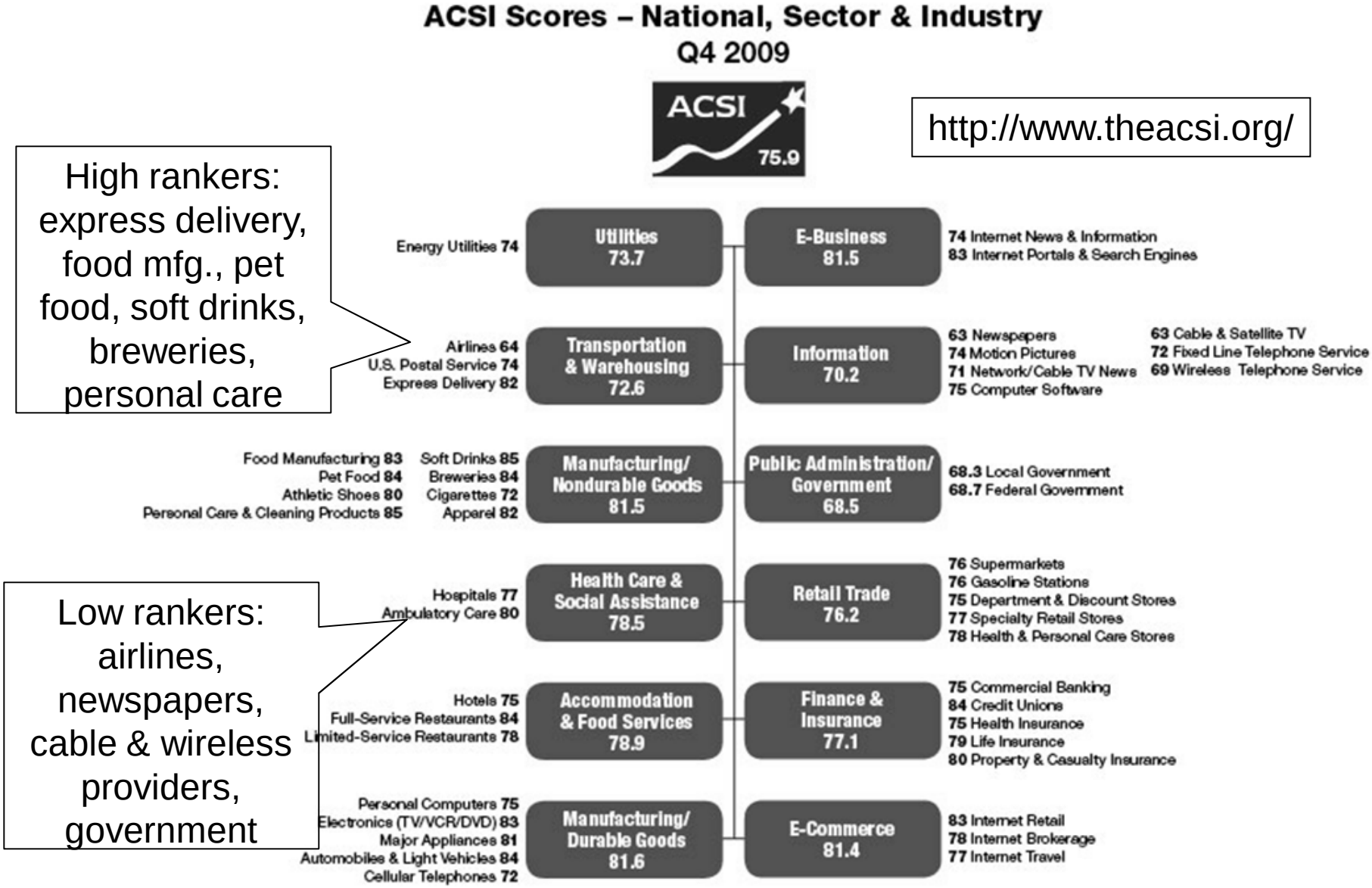
6/6/2010
7/6/2010
8/6/2010
9/6/2010

Customer Satisfaction and Stock Prices



ACSI Scores: Stocks *Not Chosen* 00-09

Company	ticker	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	comment
Cadillac (GM)		85	86	88	86	87		86		86	85	89	defunct - survivorship issue
Buick (GM)		86	86	86	86	84		84	86	86	85	88	defunct - survivorship issue
BMW		86		86	86	85	84	86	85	86	87	87	no US ticker
Mars		84		86			85		86	86	86	87	private company
Newegg										87	88	86	private company
Dial			85	84	84	85	85			86	85		No US Ticker (Henkel)
Kenmore		85	85	86		84	85						no ticker 00, 01 - survivorship issue
Ralston Purina			85	83									nestle division - no US ticker
Nestle		84	84	83									no US ticker

Appendix: References - Books

- Rogoff & Reinhart's **This Time Is Different: Eight Centuries of Financial Folly** is an excellent book on financial & debt crises (and may cause you some sleepless nights)
- Mebane Faber's **The Ivy Portfolio** is the basis for the QTAA approach
- James P. O'Shaugnessy's **What Works on Wall Street** can form the basis of many passive screening portfolios
- Bill Matson's **Data Driven Investing** performs studies similar to O'Shaugnessy's
- Tom Stridsman's **Trading Systems that Work** is an excellent trading system development text covering a number of topics
- Ralph Vince's **The Mathematics of Money Management: Risk Analysis Techniques for Traders** is a good general text on money management techniques

Appendix: References – Web Sites/URLs

URLs specific to the Faber/QTAA scheme:

- URL for Faber's blog: http://www.mebanefaber.com/
- URL for Faber Asset Allocation paper
  - http://trendfollowing.com/whitepaper/CMT-Simple.pdf

ACSI URL: http://www.theacsi.org/

Good sites for general information, tools. As always, take discussions on general bulleting boards with caution!

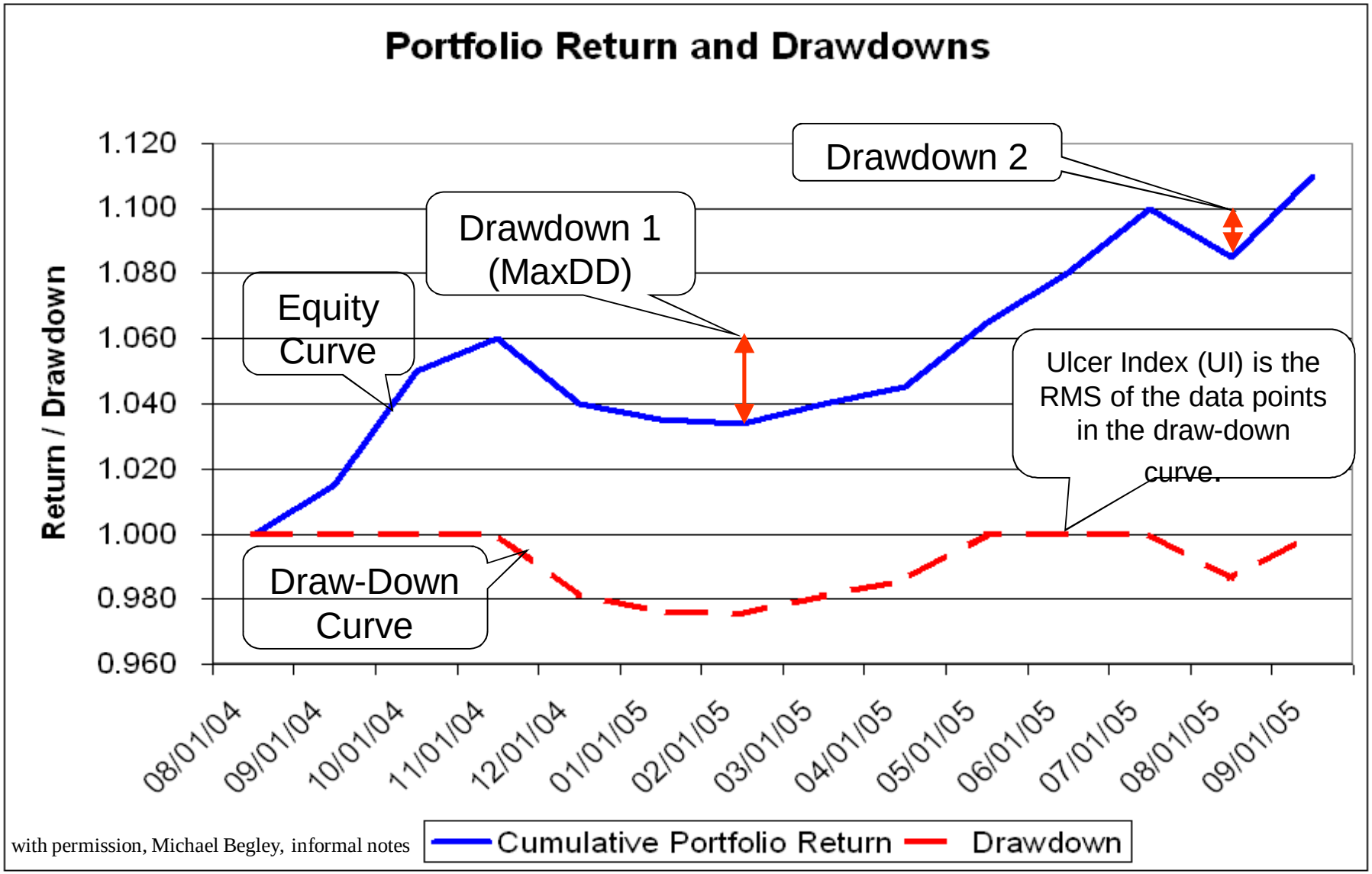
- URL for SIPro information: http://www.aaii.com/stockinvestor/
- URL for Keelix back testing tool: http://keelix.com/
- URL for Vector Vest (a back testing tool): http://www.vectorvest.com/
- URL for portfolio123 (another back testing tool/advisory firm): http://www.portfolio123.com/
- URL for Foliofn (an inexpensive way to buy large baskets of stocks): http://www.foliofn.com/index.jsp
- URL for Motley Fool Mechanical Investing board http://boards.fool.com/Messages.asp?bid=100093
- URL for No Load FundX site: http://www.noloadfundx.com/

Performance Metrics

EC	Equity Curve	Portfolio Value plotted against time
CRR	Compound Rate of Return	Reward Measurement -- Annualized compound, or geometric, rate of return
DD	Drawdown	Percentage difference in portfolio value on a given date from the maximum portfolio value on all prior dates
MDD	Maximum Drawdown	Risk Measurement - Maximum observed DD over all portfolio valuation dates
UI	Ulcer Index	Risk Measurement - Root Mean Square of the DD measurements for all portfolio evaluation dates. For each date, measure DD and square it. Then take the square root of the average of all the DD^2 measurements. The result is the Ulcer Index where a high number means the portfolio has large drawdowns that take a long time to recover to a new portfolio high value.
UPI	Ulcer Performance Index	Reward to Risk Measure -- CRR / UI
CR	Calmar Ratio	Reward to Risk Measure -- CRR / MDD This measure is inferior to the UPI because a single large DD will result in a low Calmar Ratio forever

with permission, Michael Begley, informal notes

Performance Metrics: Examples



with permission, Michael Begley, informal notes