Equity Solutions for Financial Markets

New Forward Looking Value UIT Launched

July 1, 2019: The 7th Sabrient Forward Looking Value Portfolio (FNOWLX) was launched by First Trust Portfolios on July 1, 2019. This portfolio seeks companies that are positioned to perform well in the near future by "looking forward" at anticipated earnings over the next few years. The stocks in the portfolio are selected by applying a comprehensive investment strategy developed by Sabrient. The portfolio will terminate on October 7, 2020. For a prospectus or fact sheet, please visit First Trust Portfolios.

June 2019 Baker's Dozen UIT Portfolio Launched

June 20, 2019: Sabrient Baker's Dozen UIT Portfolio for June 2019 (FJNGOX) was launched by First Trust Portfolios on June 20, 2019. This portfolio, like all Baker's Dozen portfolios, comprises 13 top-ranked stocks from a cross-section of market caps and industries based on our GARP approach, i.e., growth at a reasonable price. Sabrient believes each of these stocks is positioned to perform well for the next 13 months. The portfolio will terminate on July 20, 2020. For a fact sheet or prospectus, please visit FirstTrustPortfolios.com.

01 Jul 2019

Buybacks: More Nuanced Than the Media Narrative Suggests

by **Ryan Frederick**
Equity Analyst, Gradient Analytics LLC (a Sabrient Systems company)

Stock buybacks (or share repurchases – we will use the terms interchangeably) have garnered significant attention as publicly-traded companies have repurchased shares at record levels (in terms of dollars spent). In 2018, companies in the S&P 500 spent $806 billion on buybacks (about 3.8% of public float), shattering the previous record of $590 billion spent in 2007 (about 5.3% of public float) by 36.6%. Few topics provoke as intense of a response from those in the world of finance as to what role buybacks should play – whether in a given company's cash management strategy or for the broader market as a whole. There are various viewpoints on the subject, but there's a good chance you've primarily heard buybacks described in *pejorative* terms. The negative framing ranges from management using buybacks to *manipulate* EPS growth and share prices (with no underlying change in the company's financial condition), to shortchanging long-term investments and employees, to cannibalization, to mis-spending tax cuts, to outright calls for the practice to be outlawed.

Indeed, it is easy to frame buyback programs in a negative light, and some of the connotations may be deserved. To be sure, corporate executives often focus so much on EPS performance that they might choose to engage in short-sighted and/or self-centered activities. (Whether they can get away with it is another matter.) However, the truth about buybacks is much more complicated than typically presented as there is a confluence of many factors and questions that must be considered, such as: What timeframe was used to analyze the effects? Was it the right timeframe? What are a company's alternative investment opportunities before, during, and after a buyback program? Can an outsider refute with certainty what is/isn't a good use of cash? What is the cost of capital and opportunity cost? What are the macroeconomic conditions, e.g., interest rates, fiscal policy, trade wars?

Moreover, do buybacks actually lift a given company's share price and the value of an index that holds it? Is this practice such an epidemic and scourge on society that the federal government should step in to regulate what a private company (or by extension, its shareholders) can or cannot do with its cash? Should a buyback intended to reduce public float be made illegal once again (as it was until 1982)? We believe the answers to these questions are more nuanced than the media presents, so we will attempt to offer some additional insight. *Read on….*

Author: *gradient* / Tag: *stock buybacks, forensic accounting, share repurchases, earnings quality, GAAP, EPS, ASC 606, DAL, HD*
/ *0* Comments

10 Jun 2019

Sector Detector: Stocks regain their footing after trade negotiations stumble

by **Scott Martindale**
President, Sabrient Systems LLC

In my prior commentary in early May, I wrote that investors were aggressively bidding up stocks and appeared to have "stopped looking over their shoulders with fear and anxiety and are instead focused on the opportunities ahead." The S&P 500 was retrenching after a breakout to new highs in preparation for a major upside move driven by a risk-on rotation – which I expected would bode quite well for Sabrient's Baker's Dozen portfolios that have been predominantly composed of stocks from growth-oriented cyclical sectors and small-mid caps. After all, recession fears had subsided, US and Chinese economic data were improving, Q1 corporate profits were coming in better than expected, the Fed had professed that it had our backs, and of course, a resolution to the US/China trade impasse was imminent. Or so it seemed. Instead, the month of May gave stocks a wild ride.

It was exactly one year ago that President Trump escalated the trade war with China from simple threats of tariffs to actual numbers and dates, which ignited a risk-off rotation and a starkly bifurcated market, as the S&P 500 large-cap index continued to rise on the backs of defensive sectors and mega-caps while risk-on cyclical sectors and small-mid caps sold off. The big oversold risk-on recovery following Christmas Eve began to peter out in late-April as the S&P 500 challenged its all-time high, but then the breakdown in negotiations in last month created another risk-off market reaction reminiscent of last summer. In other words, stocks and investor sentiment have been jerked around by Trump's tweetstorms.

I talk a lot more about China and the trade war in today's commentary, but the upshot is that this problem has been festering for a long time, and to his credit, President Trump decided he wasn't going to continue the practice of kicking the can down the road to a future administration. China clearly (and dangerously) is intent on challenging the US for global dominance – economically, technologically, and militarily – with its powerful brand of state-sponsored capitalism. I support the cause against China's unfair practices, given the enormous importance for our nation's future – even though the resulting lengthy period of risk-off sentiment (essentially 9 of the past 12 months) has been challenging for Sabrient's growth-and-valuation-driven portfolios (which are dominated by the neglected cyclical sectors and smaller caps), as the negative news stream creates a disconnect between analyst consensus earnings estimates and investor preferences. Fund flows instead suggest strong demand for low-volatility and momentum strategies as well as fixed income (tilted to shorter maturities and higher credit quality), and the 10-year TIPS breakeven inflation rate has fallen to 1.73% (as worries of *deflation* have set in).

In response to the recession fears and rampant defensive sentiment, the FOMC felt compelled last week to issue a highly accommodative statement that essentially said, *we got your back*, which turned around the fading stock market. Fed chairman Jay Powell asserted that the trade war is on the list of the committee's concerns and that the central bank would "act as appropriate to sustain the expansion," i.e., cut interest rates if necessary. This explicitly reestablished the proverbial "Fed put" as a market backstop, and investors liked it. We already are seeing a somewhat weaker dollar, which could be a further boost to US equities (especially those that sell internationally).

My view is that the May pullback was another buy-the-dip opportunity, particularly in risk-on market segments, as the pervasive worries about imminent global recession and a bear market caused by escalating trade wars have little basis in reality. The latest defensive rotation, including shunning of cyclical sectors, relative weakness in small caps, and global capital flight into Treasuries causing plunging yields (and a 3-mo/10-yr yield curve inversion), has been driven by uncertainty rather than hard data. Every piece of worsening economic data can be offset with encouraging data, in my view. Yes, the economic expansion (consecutive positive GDP prints) has been going on for a longer-than-average period of time, but there is no time limit on expansions, i.e., they don't die of old age but rather from excesses and inflation that must be reined in (but there is nary of whiff of inflation anywhere in the developed world). I still expect that a resolution to the trade war will send stocks in general, and risk-on market segments in particular, into orbit … but until then, it is hard to predict when investor sentiment will again align with the still-solid fundamentals.

In this periodic update, I provide a market commentary, offer my technical analysis of the S&P 500, review Sabrient's latest fundamentals based SectorCast rankings of the ten US business sectors, and serve up some actionable ETF trading ideas. In summary, our sector rankings have turned neutral, while the sector rotation model retains its bullish posture. *Read on…*

Author: *smartindale* / Tag: *ETF, sectors, iShares, volatility, inflation, S&P 500, SectorCast, technology, Financial, healthcare, energy, Consumer, Industrial, telecom, utilities, materials, SPY, VIX, IYF, iyw, IYJ, IYZ, IYC, IYK, IYH, IDU, IYM, IYE, IWM, SLX, XLU, XLRE, RWCD, RWDC, XTL, IGN, FXR, KRE, PPH, JETS, FTXO, ZMLP, IBB, MLPA, IYG, AMLP, KCE, AIRR, QVM, F, FDX, GOOGL, QCOM, INTC* / *0* Comments

02 May 2019

Sector Detector: Anticipation builds for US/China trade agreement amid encouraging earnings beats

by **Scott Martindale**
President, Sabrient Systems LLC

The S&P 500 and Nasdaq Composite indexes both hit new all-time highs this week on strong breadth, and all the major indexes appear to be consolidating recent gains before attempting an upside breakout. P/E multiples are expanding, particularly among large caps, as stocks rise despite a temporary slowdown in earnings growth. Why are investors bidding up stocks so aggressively? They have stopped looking over their shoulders with fear and anxiety and are instead focused on the opportunities ahead. And on that horizon, recession fears are falling, optimism regarding a US-China trade resolution is rising, US and Chinese economic data are improving, corporate profits are better than expected, and the Fed has agreed to step out of the way. All of this reduces uncertainty that typically holds back business investment. Stocks valuations are forward looking and a leading economic indicator, so they already seem to be pricing in expectations for stronger economic growth in the Q3, Q4, and 2020.

I said in my commentary last month that I thought we may see upside surprises in Q1 and Q2 earnings announcements, given the low bar that had been reset, and indeed we are seeing higher-than-average earnings beats – including big names like Apple (AAPL) and Facebook (FB), among many others – as half of the S&P 500 companies have reported. Moreover, the recent legal settlement between Apple and Qualcomm (QCOM) was a big positive news story that should now free up both companies to focus on 5G products, including step-function upgrades to smartphones, tablets, and computers, as the critical race with China for 5G dominance kicks into high gear.

Looking ahead, there are plenty of mixed signals for the economy and stocks – and no doubt the pessimists could fill a dossier with plenty of doom and gloom. But I think the pessimism has been a positive in keeping stocks from surging too exuberantly, given all the positive data that the optimists can cite. And on balance, the path of least resistance for both the economy and stocks appears to be upward. I think bond yields will continue to gradually firm up as capital rotates from bonds to equities in an improving growth and inflation environment, stabilizing the dollar (from advancing much further), while reducing the odds of a Fed rate cut in 2019. A healthy economy helps corporate earnings, while a dovish Fed keeps rates low and supports equity valuations. And as the trade war with China comes to resolution, I expect corporations will ramp up capital spending and guidance, enticing idle cash into the market and further fueling bullish conviction.

Rather than an impending recession, we may be returning to the type of growth and inflation we enjoyed just prior to the tax reform bill, which would provide a predictable environment for corporate planning and steady (but not exuberant or inflationary) corporate earnings growth.

This should bode well not only for Sabrient's *Baker's Dozen* portfolios, but also for our other growth and dividend-oriented portfolios, like Sabrient Dividend and Dividend Opportunity, each of which comprises 50 growth-at-a-reasonable-price (aka GARP) stocks paying an aggregate yield in excess of 4% in what is essentially a growth-and-income strategy, and perhaps our 50-stock Small Cap Growth portfolios. As a reminder, I am always happy to make time for conversations with advisors about market conditions and our portfolios. We are known for our model-driven growth-at-a-reasonable-price (GARP) approach, and our model is directing us to smaller caps, as many of the high-quality large caps that are expected to generate solid earnings growth already have been "bid up" relative to small caps.

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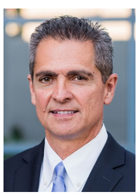
02 Apr 2019

Sector Detector: Stellar Q1 performance confronts a brief yield curve inversion



by **Scott Martindale**
President, Sabrient Systems LLC

You might not have realized it given the technical consolidation in March, but Q1 2019 ended up giving the S&P 500 its best Q1 performance of the new millennium, and the best quarterly performance (of any quarter) since Q3 2009. Investors could be forgiven for thinking the powerful rally from Christmas Eve through February was nothing more than a proverbial "dead cat bounce," given all the negative news about a global economic slowdown, the still-unresolved trade skirmish with China, a worsening Brexit, reductions to US corporate earnings estimates, and the Fed's sudden about-face on rate hikes. But instead, stocks finished Q1 with a flourish and now appear to be poised to take another run at all-time highs. The S&P 500, for example, entered Q2 less than 4% below its all-time high.

Overall, we still enjoy low unemployment, rising wages, and strong consumer sentiment, as well as a supportive Fed ("Don't fight the Fed!") keeping rates "lower for longer" (and by extension, debt servicing expenses and discount rates for equity valuation) and maintaining $1.5 trillion in excess reserves in the financial system. Likewise, the ECB extended its pledge to keep rates at record lows, and China has returned to fiscal and monetary stimulus to revive its flagging growth stemming from the trade war. Meanwhile, Corporate America has been quietly posting record levels of dividends and share buybacks, as well as boosting its capital expenditures – which is likely to accelerate once a trade deal with China is signed (which just became more likely with the apparently-benign findings of the Mueller investigation). In addition, the bellwether semiconductor industry is presenting a more upbeat tone and an upturn from a cyclical bottom (due to temporary oversupply), while crude oil has broken out above overhead resistance at $60.

On the other hand, there is some understandable concern that US corporate earnings forecasts have been revised downward to flat or negative for the first couple of quarters of 2019. Of course, it would be preferable to see a continuation of the solid earnings growth and profitability of last year, but the good news is that revenue growth is projected to remain solid (at least 4.5% for all quarters), and then earnings is expected to return to a growth track in 2H2019. Moreover, the concurrent reduction in the discount rate (due to lower interest rates) is an offsetting factor for stock valuations.

All of this leads me to believe that economic conditions remain generally favorable for stocks. In addition, I think we may see upside surprises in Q1 and Q2 earnings announcements, especially given the low bar that has been reset. But it also may mean that investors will become more selective, with some stocks doing quite well even if the broad market indexes show only modest growth this year.

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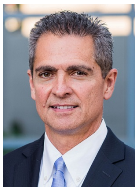
Author: *smartindale* / Tag: *ETF, sectors, iShares, volatility, inflation, S&P 500, SectorCast, technology, Financial, healthcare, energy, Consumer, Industrial, telecom, utilities, materials, SPY, VIX, IYF, iyw, IYJ, IYZ, IYC, IYK, IYH, IDU, IYM, IYE, qqq, SLY, MDY, SLX, XPH, LTL, TDIV, IBB, KIE, BBH, BIZD, FLAG, NLR, WBIB, SCHD, DVP, YMLP, XME, QVM, SHE, ALFA* / *0* Comments

04 Mar 2019

Sector Detector: Fundamentals suggest impressive risk-on recovery will continue



by **Scott Martindale**
President, Sabrient Systems LLC

The first two months of 2019 have treated Sabrient's portfolios quite well. After a disconcerting 3Q2018, in which small-cap and cyclicals-heavy portfolios badly trailed the broad market amid a fear-driven defensive rotation, followed by a dismal Q4 for all stocks, the dramatic V-bottom recovery has been led by those same forsaken small-mid caps and cyclical sectors. All of our 12 monthly all-cap *Baker's Dozen* portfolios from 2018 have handily outperformed the S&P 500 benchmark since then, as fundamentals seem to matter once again to investors. Indeed, although valuations can become disconnected from fundamentals for a given stretch of time (whether too exuberant or too pessimistic), share prices *eventually* do reflect fundamentals. Indeed, it appears that institutional fund managers and corporate insiders alike have been scooping up shares of attractive-but-neglected companies from cyclical sectors and small-mid caps in what they evidently saw as a buying opportunity.

And why wouldn't they? It seems clear that Q4 was unnecessarily weak, with the ugliest December since the Great Depression, selling off to valuations that seem more reflective of an imminent global recession and Treasury yields of 5%. But when you combine earnings beats and stable forward guidance with price declines – and supported by a de-escalation in the trade war with China and a more "patient and flexible" Federal Reserve – it appears that the worst might be behind us, as investors recognize the opportunity before them and pay less attention to the provocative news headlines and fearmongering commentators. Moreover, I expect to see a renewed appreciation for the art of active selection (rather than passive pure-beta vehicles). However, we must remain cognizant of 2018's lesson that volatility is not dead, so let's not be alarmed if and when we encounter bouts of it over the course of the year.

Looking ahead, economic conditions appear favorable for stocks, with low unemployment, rising wages, strong consumer sentiment, and solid GDP growth. Moreover, Q4 corporate earnings are still strong overall, with rising dividends, share buybacks at record levels, and rejuvenated capital investment. So, with the Fed on the sidelines and China desperately needing an end to the trade war, I would expect that any positive announcement in the trade negotiations will recharge the economy *in supply-side fashion*, as US companies further ramp up capital spending and restate guidance higher, enticing risk capital back into stocks (but again, not without bouts of volatility). This should then encourage investors to redouble their current risk-on rotation into high-quality stocks from cyclical sectors and small-mid caps that typically flourish in a growing economy – which bodes well for Sabrient's growth-at-a-reasonable-price (GARP) portfolios.

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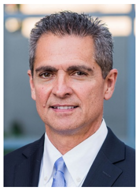
05 Feb 2019

Sector Detector: Recovery in stocks continues as the Fed and China become more cooperative



by **Scott Martindale**
President, Sabrient Systems LLC

There is a stock market adage that says, “as goes January, so goes the year.” Well, if that comes true this year, we are in for some robust gains, as stocks just enjoyed the strongest January since 1987 (when it rose +13.2%). For the full month of January, the S&P 500 gained +8.0% (and S&P mid and small caps were even stronger at around +10.5%). Meanwhile, after a dismal 2H2018 in which Sabrient’s cyclicals-heavy portfolios trailed the broad market in the wake of a fear-driven defensive rotation that began in June, our 12 monthly all-cap *Baker’s Dozen* portfolios from 2018 handily outperformed by gaining an average of +11.8% for the full-month of January (and +19.7% since the low on Christmas Eve through 1/31, versus +15.2% for the SPY), and our actively-managed SMA portfolio (which holds 30 GARP stocks) gained +13.2%. Fundamentals seem to matter again, and institutional fund managers and corporate insiders have been suddenly scooping up shares of attractive-but-neglected companies in what they evidently see as a welcome buying opportunity.

On the other hand, it’s pretty clear to me that 4Q2018 was unnecessarily weak, with the ugliest December since the Great Depression, selling off to valuations that seem more reflective of an imminent global recession and Treasury yields of 5%. So, some might argue that January’s big rally was just a temporary bounce from massively oversold conditions – a case of “righting the ship” back to more appropriate valuations – and as such is giving us little indication about the balance of the year.

My view is more on the bullish side. When you combine earnings beats and stable or rising forward guidance with price declines, it sure seems to me that the worst is behind us, as investors recognize the opportunities before them and pay less attention to the gloomy news headlines and fearmongering commentators. Moreover, I expect to see a renewed appreciation for active management and a return to a more selective stock-picker’s market, with a rising stock market fueled by a de-escalation (or preliminary resolution) to the trade war with China and a more patient and accommodative Fed. In fact, as I said at the start of the year, I think the S&P 500 will finish the year with a gain in the 20-25% range – but savvy stock selection could produce even better returns. However, please be cognizant of 2018’s lesson that volatility is not dead, so try not to be alarmed when we encounter bouts of it over the course of the year.

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