Intelligent
Systematic Value Investing

ECM
Ebert Capital Management Inc

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Intelligent Model Portfolio Construction Leading To Strong Returns

The U.S. stock market continues to climb at a high rate, showing above average returns over the last year. Global markets generally have not done as well as the U.S., with many Asian and European countries dealing with market downturns recently. But even with the U.S. stock market at an all-time high, our Value Stock Score model is still outperforming the S&P 500 by a wide margin. And even with many international markets like economic giants China and Russia down significantly this year, our Global Stock Score Model has still continued to outperform global markets significantly as well.

Substantial Results

The Value Stock Score Model has returned 21.30% since inception versus 16.33% for the S&P 500 index over the same period. The Global Stock Score Model has returned 15.25% versus 8.60% for the MSCI EAFE Index, the index most representative of the global stock market.

So why have our stock scoring models done so well versus the U.S. and global markets? We use a purely systematic process to select the stocks, so you can be sure it's not timing, luck or predictive powers.

A stock index, like the Dow Jones, S&P 500, or the MSCI EAFE index is simply a list of stocks, selected based on the systematic application of a few rigid parameters. These indices are updated (rebalanced) by the companies who created the indices when those parameters change. Most indices are constructed by "weighting" companies by their market capitalization. Market capitalization (or market cap) is the total value of a company's shares; it is equal to the share price multiplied by the number of shares outstanding. For most indices, companies with the larger market caps (or total market value) make up a larger proportion of the index.

Systematic Efficiency

The fact that most investment managers don't beat the market indicates that this rigid index or "stock list" design is a good one. Most investors who follow the indexing path get superior results than what active managers can provide. The lower cost and systematic efficiency have historically, in most cases, provided better average performance for investors.

That being said, investment advisers who act as fiduciaries for their clients add enormous value beyond the bare performance by providing financial guidance, financial planning and assistance in understanding and reaching investment goals. But investment advisers who don't act as fiduciaries *or outperform*, actually act as significant obstacles to investors reaching their investment goals.

With the Value Stock Score and Global Stock Score strategies we have simply created a different methodology for creating the "list" of stocks to own. We look at these models as miniature value indices for that reason. Like an index, the stock selection is based off of rigid parameters - but we've designed stock selection rules which

only allow what we consider to be value stocks in the portfolios. These rules score stocks in a way that the top scorers are what we feel to be safe, consistently profitable and very undervalued companies.

Also, because of the self-correcting nature of scoring, rather than screening for stocks - once a stock is no longer one of the best value stocks, according to our definition, its score will drop. Just like an index, once the stock no longer meets the criteria, it is removed from the portfolio

Proven Performance

Years of our testing and re-testing by our analysts and strong performance in our clients' portfolios validate our approach. Looking further into the companies we select for our stock scoring models, versus the list of stocks chosen for index funds requires understanding the selection and weighting methods chosen for both approaches.

For example, the traditional S&P 500 index fund is a market cap weighted index fund. Therefore the companies with the larger market caps (i.e. total market value) make up a larger proportion of the index. As of the writing of this article for example, Apple and Exxon Mobil together make up 7.69% of the entire S&P 500. Often times the higher weighting resulting from higher total market values simply occurs because certain companies are more overvalued than the other stocks in the index. Think of the tech bubble here, when companies with relatively small revenues were valued at enormous levels - causing these companies to make up a larger proportion of the S&P 500 than we feel would have been warranted. Obviously, owning too much of the overvalued companies can lead to substantial losses.

It's this "construction flaw", among others affecting indices and index funds, that we attempt to solve by using the VSS and GSS models. Rather than "over-weighting" companies that have large market values, which can swing wildly on investor sentiment and often have little to do with fundamentals in the short-term - we "equal weight" our portfolios and include only those companies which strictly meet our value stock score criteria. For us and our investors, this ensures a portfolio at all times only contains companies we feel will provide better returns.

In our opinion, the strong returns result from the market at large realizes the companies in the Value Stock Score model are undervalued and raises the fair market values of these companies' stocks over time. On the opposite side, we attempt to avoid companies which are overvalued or unsafe - knowing that eventually the market will realize this overvaluation and reduce the price they'll pay for these stocks - resulting in losses.

Data Sources: CNN Money

Disclosures: We monitor each model portfolio and continually research new ways to deploy current strategies or develop new models. This update is for informational purposes only and should not be taken as instruction or solicitation to buy or sell any security. Investing in securities involves risks that may result in financial losses. Past performance does not guarantee future results.

The returns shown above represent time-weighted, total-return composites of client accounts invested in one or more of our model portfolios. Net performance figures reflect the deduction of investment advisory fees. A full description of investment advisory fees is supplied in our Form ADV Part 2. Performance figures reflect the inclusion and reinvestment of dividends and other earnings.