Featured Stock in November's Dividend Growth Model Portfolio

Nine new stocks make our Dividend Growth Stocks Model Portfolio this month, which was made available to members on November 26, 2019.

Recap from October's Picks

Our Dividend Growth Stocks Model Portfolio underperformed the S&P 500 from October 30, 2019 through November 22, 2019. The Model Portfolio rose 1.7% on a price return basis and 1.8% on a total return basis. The S&P 500 rose 2.2% on a price return and total return basis. The portfolio's best performing stock was up 24%. Overall, 13 out of the 30 Dividend Growth Stocks outperformed the S&P from October 30, 2019 through November 22, 2019, and 20 had positive returns.

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "Core Earnings: New Data and Evidence." The long-term success of our model portfolio strategies highlights the value of our Robo-Analyst technology[1], which scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2].

The methodology for this model portfolio mimics an All-Cap Blend style with a focus on dividend growth. Selected stocks earn an Attractive or Very Attractive rating, generate positive free cash flow (FCF) and economic earnings, offer a current dividend yield >1%, and have a 5+ year track record of consecutive dividend growth. This model portfolio is designed for investors who are more focused on long-term capital appreciation than current income, but still appreciate the power of dividends, especially growing dividends.

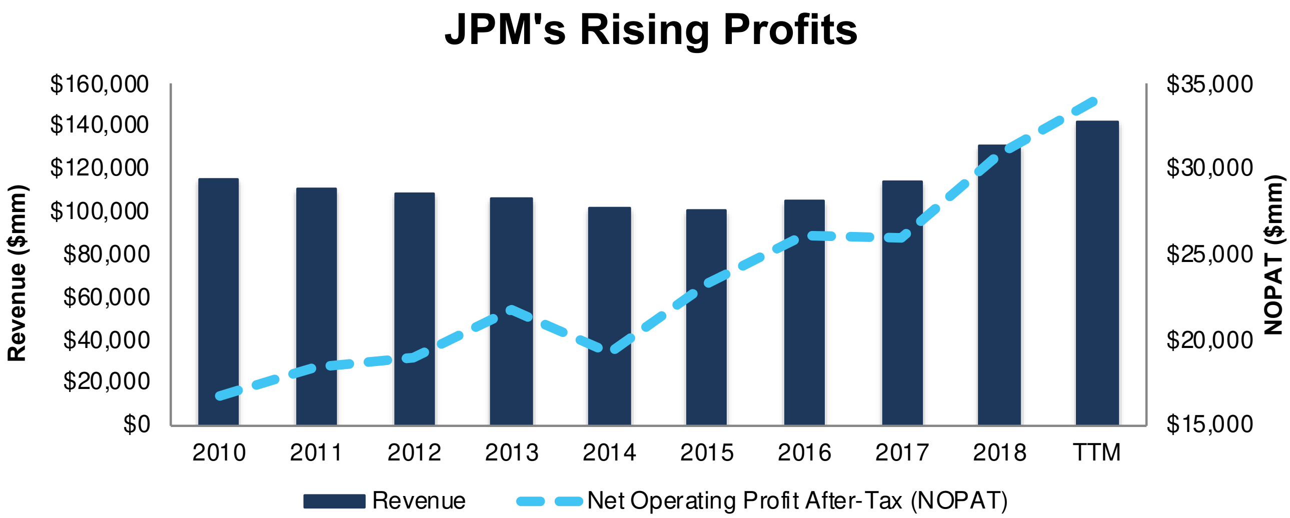
Featured Stock from November: JPMorgan Chase & Company (JPM: $131/share)

JPMorgan Chase & Company (JPM) is the featured stock from November's Dividend Growth Stocks Model Portfolio.

Since 2010, JPM has grown revenue by 2% compounded annually and after-tax profit (NOPAT) by 8% compounded annually. The company earned $34.2 billion in NOPAT over the trailing twelve months, which is up 15% over the prior TTM period. JPM's NOPAT margin is up from 15% in 2010 to 24% TTM while its return on invested capital (ROIC) improved from 7% to 11% over the same time.

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Figure 1: JPM's Revenue & NOPAT Since 2010



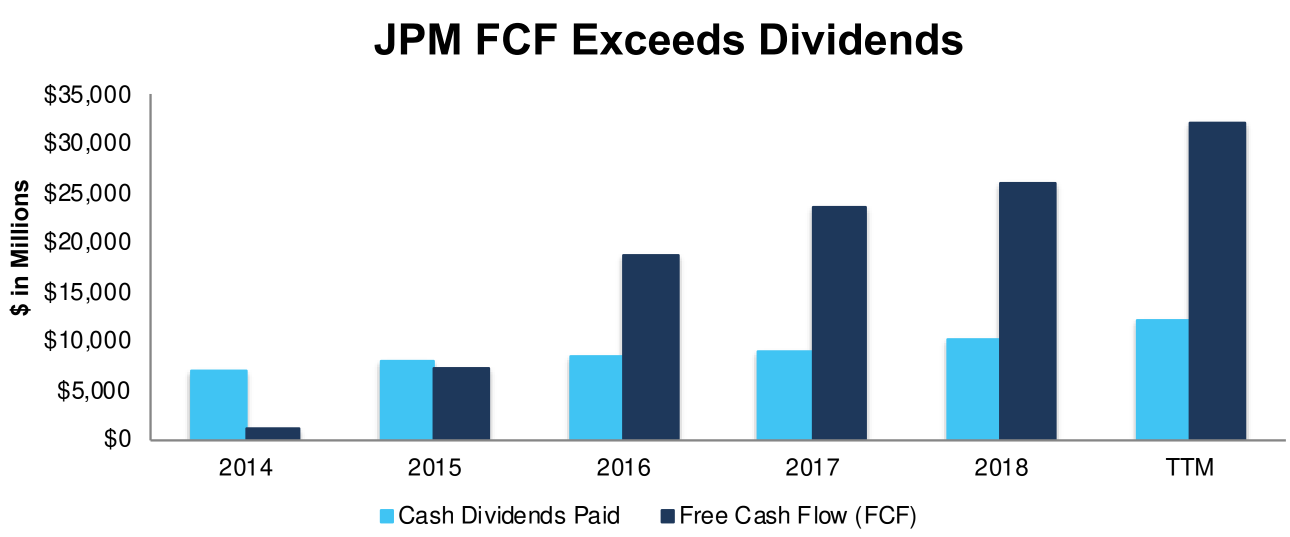
Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

JPM has increased its annual dividend each of the past nine years. The company increased its annualized dividend from $1.58/share in 2014 to $2.72/share in 2018, a 14% compound annual growth rate. Its current quarterly dividend, $0.90/share, equates to $3.60/share annually. Most importantly, JPM easily generates the cash flow needed to continue paying and growing its dividend. Over the past five years, JPM has generated a cumulative $76.9 billion in FCF (19% of market cap) while paying $42.4 billion in dividends.

Companies with FCF well in excess of dividend payments provide higher quality dividend growth opportunities because we know the firm generates the cash to support a higher dividend. On the other hand, the dividend of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or even maintain its dividend because of inadequate free cash flow.

Figure 2: Free Cash Flow (FCF) vs. Regular Dividend Payments



Sources: New Constructs, LLC and company filings

JPM Is Undervalued

At its current price of $131/share, JPM has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects JPM's NOPAT to permanently decline by 10%. This expectation seems rather pessimistic for a firm that has grown NOPAT by 8% compounded annually since 2010 and 11% compounded annually over the past two decades.

If JPM can maintain TTM (24%) and grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $158/share today – a 21% upside. See the math behind this reverse DCF scenario. Add in JPM's 2.7% dividend yield and history of dividend growth, and it's clear why this stock is in November's Dividend Growth Stocks Model Portfolio.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings as shown in the Harvard Business School and MIT Sloan paper, "Core Earnings: New Data and Evidence".

Below are specifics on the adjustments we make based on Robo-Analyst findings in JPMorgan Chase & Company's 2018 10-K:

Income Statement: we made $6 billion of adjustments with a net effect of removing $218 million in non-operating expense (<1% of revenue). See all adjustments made to JPM's income statement here.

Balance Sheet: we made $56.4 billion of adjustments to calculate invested capital with a net increase of $38.9 billion. The most notable adjustment was $16.1 billion (6% of reported net assets) related to goodwill. See all adjustments to JPM's balance sheet here.

Valuation: we made $48 billion of adjustments with a net effect of decreasing shareholder value by $38.9 billion. The largest adjustment to shareholder value was $28.4 billion in preferred stock. This adjustment represents 7% of JPM's market value. See all adjustments to JPM's valuation here.

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Disclosure: David Trainer, Kyle Guske II, and Sam McBride receive no compensation to write about any specific stock, style, or theme.

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Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

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- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
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Combining human expertise with NLP/ML/AI technologies (featured by Harvard Business School), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Learn more.

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

"…the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications." – page 20

Pick better stocks:

"Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year." – Abstract

Avoid losses from using other firms' data:

"…many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat…" – page 14

Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

"An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A." – page 33-34

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