New Constructs®
Diligence | Independence | Performance

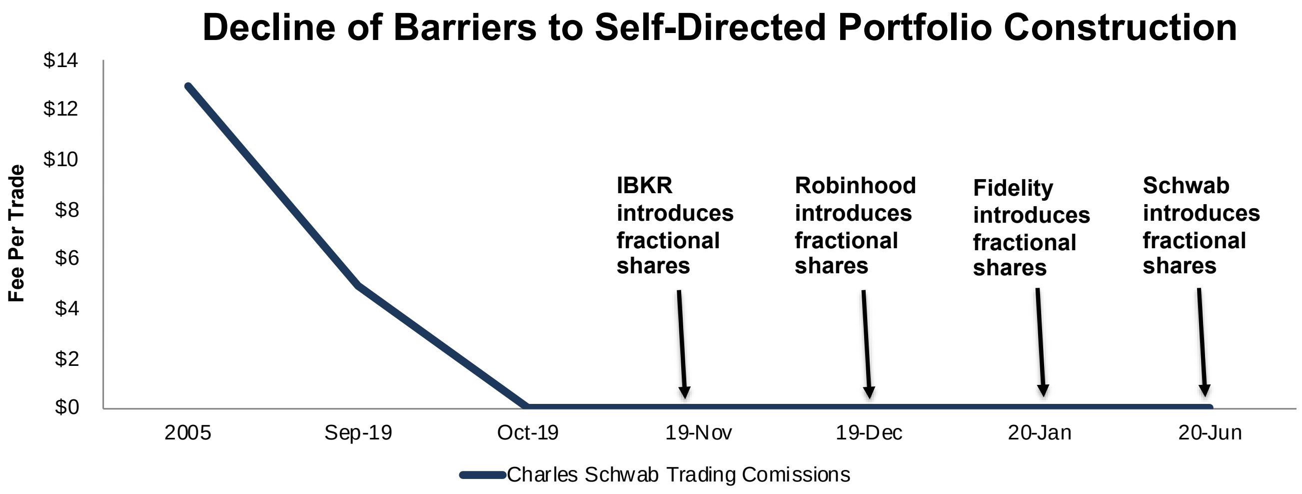
DILIGENCE PAYS 1/25/21

The Paradigm Shift to Self-Directed Portfolio Construction

Now that self-directed investors can trade for free and buy fractional shares, they are no longer dependent on mutual fund managers or ETF providers to construct portfolios for them. Figure 1 shows how quickly trading commissions declined from ~$13/trade in 2005 to $0 today, a trend led by Charles Schwab and followed by nearly every other self-directed trading platform.

At the same time, the old requirement to purchase shares in round lots (quantities of 100) prevented self-directed investors from being able to build and manage portfolios. Almost no one but institutions are investing enough money to be able to buy round lots of shares when they initiate or re-balance positions given that one round lot could be many investors' entire savings. For example, one round lot of shares in Apple (AAPL) equals nearly $14,000. For many self-directed investors, their entire savings might be just $14,000. Figure 1 also shows how the major brokerages recently gave investors the ability to buy fractional shares, soon after commissions went to $0, and removed the barriers to self-directed portfolio construction.

Figure 1: It's Never Been Easier to Construct Your Own Portfolio



Sources: New Constructs, LLC and Bloomberg

Removing trading costs and allowing the purchase of fractional shares means investors are now free to enjoy the benefits of investing in a portfolio of stocks with almost any amount of money.

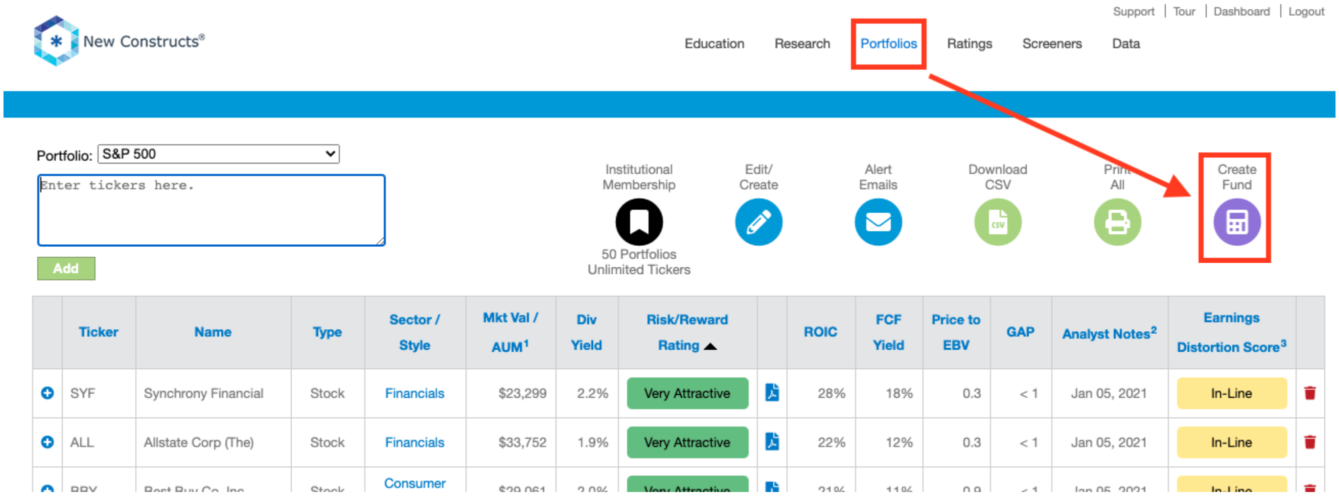
Learn more about the best fundamental research

Why Pay for Something You Can Do for Free

Given that the holdings and weightings of most funds are regularly, if not daily, disclosed to the public, investors have all the information needed to recreate almost any fund on their own. Tools, like our Custom Fund Builder, enable investors to easily upload any list of stocks and position sizes to create an order form for their broker to create the portfolio exactly as disclosed.

For example, investors can download all the holdings and positions sizes for Invesco QQQ here. With that data, investors only need a few seconds to upload that data into our system and produce an order form for their broker to recreate the QQQ in their account without paying any management fees.

Figure 2: Create Your Own Fund Tool



Portfolio: S&P 500

Enter tickers here.

50 Portfolios
Unlimited Tickers

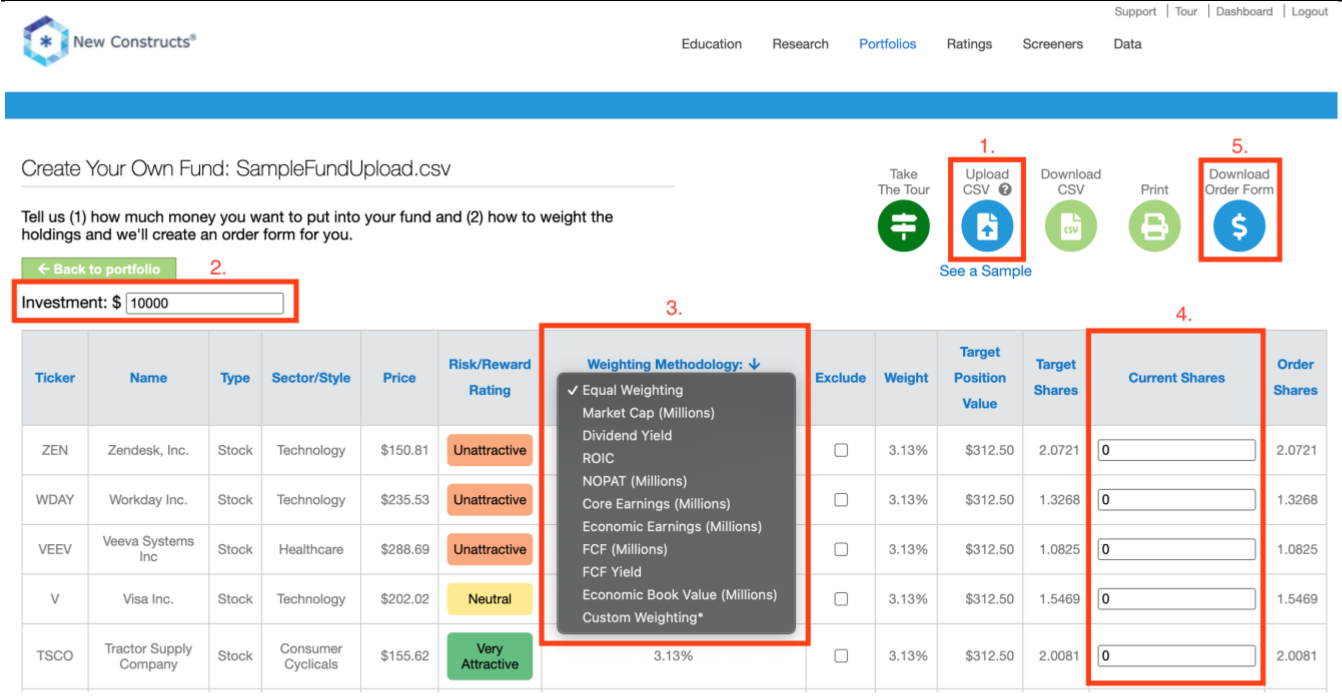
	Ticker	Name	Type	Sector / Style	Mkt Val / AUM[1]	Div Yield	Risk/Reward Rating ▲		ROIC	FCF Yield	Price to EBV	GAP	Analyst Notes[2]	Earnings Distortion Score[3]
⊕	SYF	Synchrony Financial	Stock	Financials	$23,299	2.2%	Very Attractive		28%	18%	0.3	< 1	Jan 05, 2021	In-Line
⊕	ALL	Allstate Corp (The)	Stock	Financials	$33,752	1.9%	Very Attractive		22%	12%	0.3	< 1	Jan 05, 2021	In-Line

Sources: New Constructs, LLC

Goodbye Fund Fees, Hello Better Asset Allocation

It is just as easy to re-balance an existing portfolio by uploading it and updating the allocations or amount of money you want to invest in the portfolio. There's no reason for investors with access to our tools to pay anyone to manage a portfolio of stocks for them. Add the facts that most mutual funds underperform and ETFs are passive, and it's hard to make a straight-faced argument for investors to pay any management fees.

Figure 3: Recreate a Fund without the Fees



Create Your Own Fund: SampleFundUpload.csv

Tell us (1) how much money you want to put into your fund and (2) how to weight the holdings and we'll create an order form for you.

Investment: $ 10000

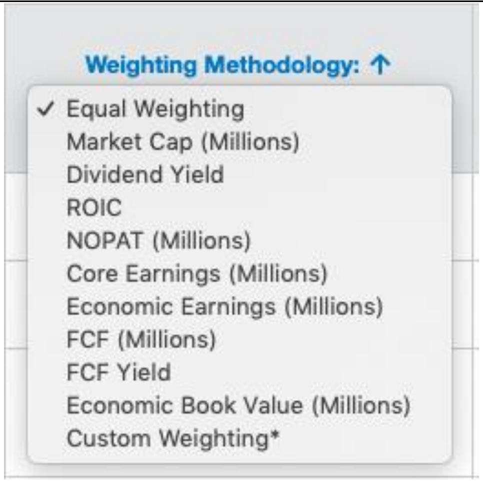
Weighting Methodology:
- ✓ Equal Weighting
- Market Cap (Millions)
- Dividend Yield
- ROIC
- NOPAT (Millions)
- Core Earnings (Millions)
- Economic Earnings (Millions)
- FCF (Millions)
- FCF Yield
- Economic Book Value (Millions)
- Custom Weighting*

Ticker	Name	Type	Sector/Style	Price	Risk/Reward Rating	Weighting Methodology: ↓	Exclude	Weight	Target Position Value	Target Shares	Current Shares	Order Shares
ZEN	Zendesk, Inc.	Stock	Technology	$150.81	Unattractive		☐	3.13%	$312.50	2.0721	0	2.0721
WDAY	Workday Inc.	Stock	Technology	$235.53	Unattractive		☐	3.13%	$312.50	1.3268	0	1.3268
VEEV	Veeva Systems Inc	Stock	Healthcare	$288.69	Unattractive		☐	3.13%	$312.50	1.0825	0	1.0825
V	Visa Inc.	Stock	Technology	$202.02	Neutral		☐	3.13%	$312.50	1.5469	0	1.5469
TSCO	Tractor Supply Company	Stock	Consumer Cyclicals	$155.62	Very Attractive	3.13%	☐	3.13%	$312.50	2.0081	0	2.0081

Sources: New Constructs, LLC

Once the holdings are in our system or others like it, investors can employ more sophisticated weighting methodologies than equal or market cap weighting. For example, our clients can weight holdings based on multiple fundamental metrics: return on invested capital (ROIC), free cash flow (FCF), Core Earnings, etc. See Figure 4 for a list of our unique weighting methodologies. Clients can also screen, rank and select stocks based on these metrics.

Figure 4: Weight Your Portfolio Using Better Metrics



Sources: New Constructs, LLC

While certainly not the first to enable investing in portfolios weighted based on fundamentals, (Research Affiliates has been selling non cap-weighted strategies since 2004), the Create Fund tool puts the power to do so in investors' hands. Plus, all of our metrics are driven by our superior fundamental data[1].

Case Study 1: Creating Your Own Portfolio with Better Weighting Methodologies

Below we provide an example of how investors can not only create their own fund based on an existing fund's holdings but also optimize that fund by allocating more capital to higher-quality stocks.

In this example, we're looking at the State Street SPDR S&P 500 ETF (SPY), a common proxy for "the market". Based on this ETF's market-cap-weighting methodology, it allocates:

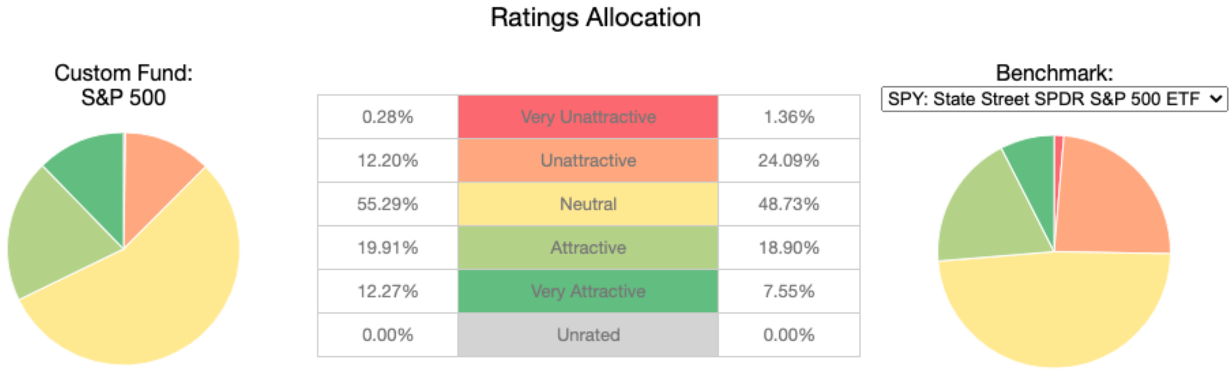
- 26% of assets to Attractive-or-better rated stocks
- 25% of assets to Unattractive-or-worse rated stocks.

If, instead of weighting by market cap, we weight by ROIC, a key driver of shareholder value, our customized fund allocates:

- 32% of assets to Attractive-or-better rated stocks
- 12% of assets to Unattractive-or-worse rated stocks.

Figure 5 compares the quality of stock allocations for our chosen weighting methodology, ROIC, and the chosen benchmark. We enable clients to compare their custom funds to 23 different benchmarks.

Figure 5: Custom Fund Weighting vs. Benchmark Weights



0.28%	Very Unattractive	1.36%
12.20%	Unattractive	24.09%
55.29%	Neutral	48.73%
19.91%	Attractive	18.90%
12.27%	Very Attractive	7.55%
0.00%	Unrated	0.00%

Sources: New Constructs, LLC

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[1] Three independent studies from respected institutions prove the superiority of our data, models, and ratings. Learn more here.

Case Study 2: Stop Buying Stocks Just Based on Size

The ability to create and weight portfolios by more sophisticated metrics means investors can move beyond simple market-cap weighting methodologies and more intelligently allocate capital. Instead of buying a passive ETF, which allocates to companies with low-quality earnings, overvalued stock prices, or both, investors can get exposure to the same basket of stocks but with greater exposure/allocation to the best stocks of the bunch.

Our next case study analyzes State Street Health Care Select Sector SPDR Fund (XLV), which, with over $25 billion in assets under management, is the largest Healthcare ETF in our coverage universe. As we'll show, it's possible to gain exposure to the healthcare sector, but with significantly higher exposure to quality stocks.

Based on its traditional market-cap weighting, XLV allocates:

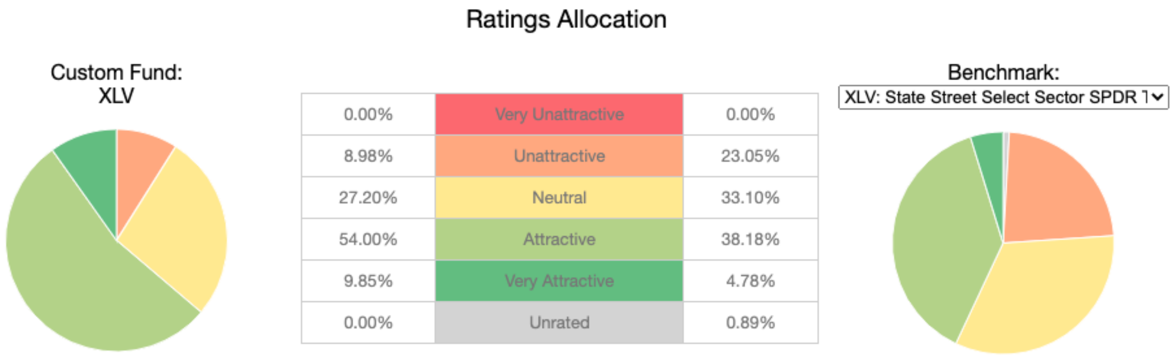
- 43% of assets to Attractive-or-better rated stocks
- 23% of assets to Unattractive-or-worse rated stocks.

If, instead of weighting by market cap, we weight by Core Earnings, our custom fund allocates:

- 64% of assets to Attractive-or-better rated stocks
- 9% of assets to Unattractive-or-worse rated stocks.

Figure 6 shows the comparison between the two weighting methodologies.

Figure 6: Weighting XLV by Core Earnings Provides Higher-Quality Asset Allocation



0.00%	Very Unattractive	0.00%
8.98%	Unattractive	23.05%
27.20%	Neutral	33.10%
54.00%	Attractive	38.18%
9.85%	Very Attractive	4.78%
0.00%	Unrated	0.89%

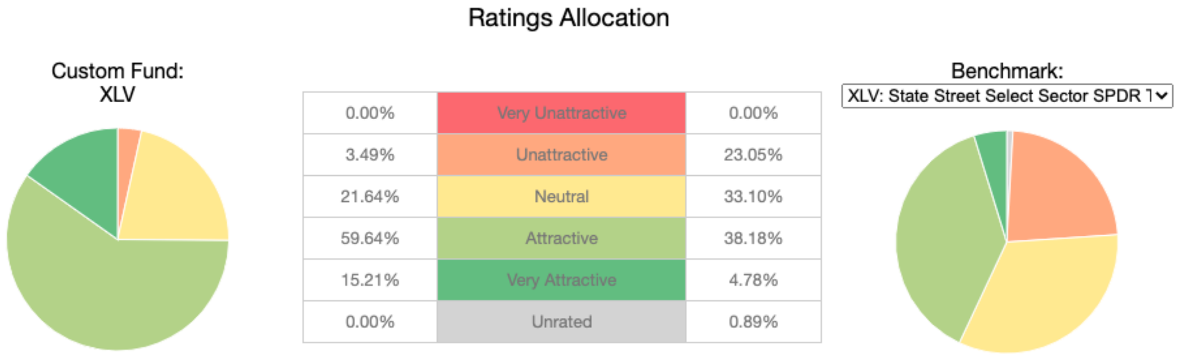
Sources: New Constructs, LLC

If we weight by economic earnings, our custom fund allocates:

- 75% of assets to Attractive-or-better rated stocks
- 3% of assets to Unattractive-or-worse rated stocks.

Figure 7 shows the difference in ratings allocation between weighting XLV's holdings by economic earnings versus weighting its holdings by the standard methodology.

Figure 7: Weighting XLV by Economic Earnings vs. Market-Cap Weighted



0.00%	Very Unattractive	0.00%
3.49%	Unattractive	23.05%
21.64%	Neutral	33.10%
59.64%	Attractive	38.18%
15.21%	Very Attractive	4.78%
0.00%	Unrated	0.89%

Sources: New Constructs, LLC

Cost Savings Can Be In the Thousands of Dollars, Too

Below we provide an example of how large the cost savings can be for investors who build their own fund instead of investing in Dunham Focused Large Cap Growth Fund (DAFGX).

Dunham Focused Large Cap Fund is one of the most expensive Large Cap funds under coverage with total annual costs of 4.03% compared to just 0.21% for the style benchmark, iShares Russell 1000 Growth ETF (IWF).

DAFGX's holdings earn an ROIC on par its benchmark and greater than the stocks in the S&P 500. Given the strong ROIC of holdings, its reasonable that an investor may want to recreate this portfolio but do so without the excessive total annual costs.

If we assume a 10-year holding period, a $10,000 initial investment, and a 10% annual return for the fund, the accumulated total costs of owning DAFGX are:

- $1,351 over 3 years
- $5,091 over 10 years

In other words, creating your own fund that matches DAFGX's holdings could save upwards of $5,000 in fees over 10 years.

This article originally published on January 25, 2021.

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

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Below, we present three different papers from both the public and private sectors that prove the superiority of our proprietary fundamental data, earnings models, investment ratings, and research for stocks, bonds, ETFs, and mutual funds.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves the superiority of our fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *IBSPI Adjustments*, *OIADP Adjustments*, or *OPE Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our NOPAT, Invested Capital, and ROIC research on four mega-cap companies in "Getting ROIC right: how an accurate view of ROIC can drive improved shareholder value".

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [the New Constructs method] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

See the Appendix for direct comparison of our analysis of DOW's 2015 results to Capital IQ and Bloomberg.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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