



## Don't Buy a Fund Based on Its Cover

We've identified a mutual fund whose holdings fail to live up to its stated style and philosophy. Lord Abbett Growth Opportunities Fund (LMGAX) is in the [Danger Zone](#).

[Learn more about the best fundamental research](#)

### Backward-Looking Research Overrates This Fund

Our fund research is forward looking, not backward looking. Our [Predictive Fund Rating](#), which leverages our [more reliable fundamental data](#) proven to generate [novel alpha](#), for LMGAX is Very Unattractive (equivalent to Morningstar's 1 Star).

However, LMGAX, along with nine of its other classes (LMGCX, LGOQX, LGORX, LGOPX, LGOSX, LGOFX, LMGYX, LGOTX, and LGOVX), earns the 3 Star rating from Morningstar, while LOMGX earns the 4 Star rating. See Figure 1.

**Figure 1: Lord Abbett Growth Opportunities Fund Ratings**

Ticker	Morningstar Rating	New Constructs Rating
LMGAX	3 Star	Very Unattractive
LOMGX	4 Star	Unattractive
LMGCX	3 Star	Unattractive
LGOQX	3 Star	Unattractive
LGORX	3 Star	Unattractive
LGOPX	3 Star	Unattractive
LGOSX	3 Star	Unattractive
LGOFX	3 Star	Unattractive
LMGYX	3 Star	Unattractive
LGOTX	3 Star	Unattractive
LGOVX	3 Star	Unattractive

Sources: New Constructs, LLC, company, ETF and mutual fund filings, and [Morningstar](#)

### Long on Words, but Short on Transparency

Lord Abbett Growth Opportunities Fund's [summary prospectus](#) describes its style as,

*"a growth style of investing that seeks to identify companies with strong relative growth prospects that are well positioned to benefit from the anticipated economic environment."*

Similarly vague, Lord Abbett Growth Opportunities Fund's website notes its investment philosophy is,

*"focused on identifying durable franchises that also exhibit a compelling combination of strong growth prospects and seasoned management teams that are mispriced by the market."*

These statements are short on details, rather subjective, and lack attention to any specific metrics to give investors a sense of how managers actually implement their investment strategy. Managers often use subjective or vague language to give them some wiggle room for how they pick stocks. Why wouldn't managers want everyone to [know how much](#) work goes into building a quality portfolio? Why not be more transparent?



Regardless of the level of transparency, without the use of [reliable fundamental data](#) and metrics that accurately reflect profitability and valuation (e.g. [Core Earnings](#)<sup>1</sup>, ROIC, and PEBV), LMGAX routinely invests in stocks with low-quality earnings and expensive valuations.

### Holdings Research Reveals a Low-Quality Portfolio

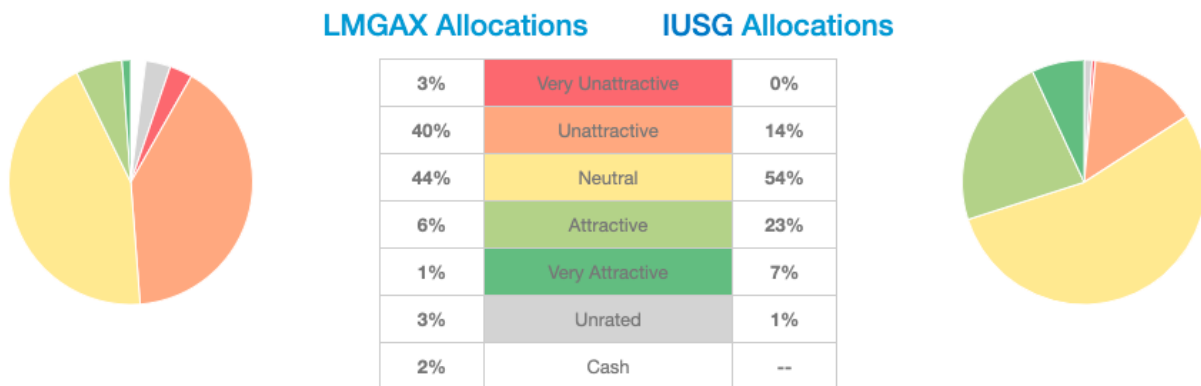
LMGAX’s Very Unattractive rating means that its holdings have low profitability and expensive valuations. Our detailed holdings analysis, made possible by our [Robo-Analyst technology](#)<sup>2</sup>, reveals that LMGAX has a much lower-quality portfolio compared to its benchmark, iShares Core S&P US Growth ETF (IUSG), which earns an Attractive rating.

Per Figure 2, LMGAX allocates 43% of its portfolio to Unattractive-or-worse rated stocks compared to just 14% for IUSG. On the flip side, LMGAX’s exposure to Attractive-or-better rated stocks is much lower, at 7%, versus IUSG at 30%.

Given the unfavorable allocation of Attractive-or-better rated stocks vs. Unattractive-or-worse rated stocks relative to the benchmark, LMGAX appears poorly positioned to generate the outperformance required to justify higher fees.

**Figure 2: LMGAX Allocates Capital to More Low-Quality Holdings**

#### ▼ Stock and Cash Rating Allocations vs Benchmark



Sources: New Constructs, LLC and company, ETF and mutual fund filings

### Expensive Stocks Drive Very Unattractive Risk/Reward Rating

Figure 3 contains our detailed rating for LMGAX, which includes each of the criteria we use to rate all funds under coverage. These criteria are the same for our [Stock Rating Methodology](#), because the performance of a fund’s holdings equals the performance of a fund after fees.

<sup>1</sup> Only Core Earnings enable investors to overcome the flaws in legacy fundamental data and research, as proven in [Core Earnings: New Data & Evidence](#), a paper in [The Journal of Financial Economics](#) written by professors at Harvard Business School (HBS) & MIT Sloan.

<sup>2</sup> Harvard Business School features the powerful impact of our research automation technology in the case study [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).



**Figure 3: Lord Abbett Growth Opportunities Fund Breakdown**

Risk/Reward Rating	Portfolio Management						Total Annual Costs
	Quality of Earnings		Valuation			Asset Allocation	
	Economic vs Reported EPS	ROIC	FCF Yield	Price to EBV	Market-Implied GAP	Cash %	
Very Unattractive	Misleading Trend	Bottom Quintile	<-5%	>3.5 or <-1<0	>50	>20%	>4%
Unattractive	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50	8%<20%	2%<4%
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20	2.5%<8%	1%<2%
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10	1%<2.5%	0.5%<1%
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	0<3	<1%	<0.5%
<b>Actual Values</b>							
<b>LMGAX</b>	<b>Positive EE</b>	<b>12%</b>	<b>0%</b>	<b>4.7</b>	<b>70 yrs</b>	<b>2%</b>	<b>3.5%</b>
<b>Benchmarks</b>							
Style ETF (IUSG)	Rising EE	47%	2%	2.7	30 yrs	-	0.0%
S&P 500 ETF (SPY)	Positive EE	31%	2%	2.5	26 yrs	-	0.1%
Small Cap ETF (IWM)	Positive EE	6%	1%	3.0	38 yrs	-	0.2%

Sources: New Constructs, LLC and company, ETF and mutual fund filings

As Figure 3 shows, LMGAX is inferior to IUSG (click [here](#) for our report on IUSG) in all five criteria that make up our holdings/[Portfolio Management](#) analysis. More specifically:

- LMGAX’s [economic earnings](#) are positive, while IUSG’s economic earnings are positive and rising
- LMGAX’s ROIC is 12% and below the 47% earned by IUSG and 31% earned by SPY holdings
- LMGAX’s free cash flow (FCF) yield of 0% is lower than IUSG’s and SPY’s
- the price-to-economic book value (PEBV) ratio for LMGAX is 4.7, which is greater than the 2.7 for IUSG and 2.5 for SPY
- our [discounted cash flow analysis](#) reveals an average market implied growth appreciation period (GAP) of 70 years for LMGAX’s holdings compared to 30 years for IUSG and 26 years for SPY

In other words, the stocks LMGAX holds generate inferior cash flows and have higher valuations compared to both IUSG and SPY. The market expectations for stocks LMGAX holds imply profit growth (measured by PEBV ratio) that is well above the profit growth expectations embedded in IUSG’s and SPY’s holdings.

Low historical profits and high expectations for future profits are a bad combination.

**Holdings Research Reveals Misleading Fund Style Classification**

Investors that blindly trust fund managers without doing diligence on the fund’s holdings can unknowingly allocate to a different investment style than the fund’s name suggests. Prior [research shows](#) that managers drift into other styles to improve their relative ranking from Morningstar and look more attractive to investors.

Lord Abbett Growth Opportunities Fund may attract investors with its stated goal to (emphasis added), “deliver long-term growth of capital by investing primarily in stocks of **mid-sized** U.S. companies.” Morningstar classifies LMGAX as a Mid Cap Growth fund. Mid Cap is commonly defined as companies with market capitalizations between \$2 and \$10 billion.

Only 17 of LMGAX’s 94 holdings, which make up 12% of assets, have market caps that fall within the standard Mid Cap designation. Its top 10 holdings have market capitalizations ranging from \$31 billion to \$52 billion. Its smallest holding has a market cap of \$1.7 billion. We believe LMGAX should be classified as an All Cap Growth fund to avoid misleading investors.

**LMGAX Holds Danger Zone Stocks: Deep Dive on Lyft**

LMGAX allocates to multiple [Danger Zone](#) stocks such as [Lyft Inc.](#) (LYFT), [Snap Inc.](#) (SNAP), [Zendesk](#) (ZEN), and [Pinterest](#) (PINS), which have expensive valuations despite generating little to no cash flows.



We put Lyft in the Danger Zone in [March 2019](#) before its IPO and reiterated our opinion on the stock in [May 2021](#).

Despite travel and transportation rebounding from COVID-19 lows, Lyft remains highly unprofitable. Its tenuous path to profitability (leveraging scale and autonomous driving to lower costs) isn't looking any more likely either, just as with peers [Uber](#) (UBER) and [Didi Global](#) (DIDI).

When we look at the fundamentals of the business, economic earnings, which account for [hidden and reported](#) unusual gains and losses, have never been positive and declined from -\$908 million in 2017 to -\$1.7 billion over the trailing twelve months (TTM). Lyft has burned through \$5.4 billion (30% of market cap) in FCF over the past three years, and FCF sits at -\$575 million over the TTM period.

**Current Price Implies 90% of 2030 Global Total Addressable Market (TAM):** Given a continued lack of profitability and recent rulings classifying drivers as employees (which will increase labor costs), we think Lyft shares remain priced beyond perfection. Below, we use our [reverse discounted cash flow \(DCF\) model](#) to analyze the future cash flow expectations baked into Lyft's stock price and provide clear mathematical evidence that the current valuation implies Lyft will take 90% of the global TAM.

To justify its current price of \$52/share, Lyft must immediately:

- improve its pre-tax margin to 4% (compared to -63% TTM), which is similar to airlines prior to consolidation, from 2021 through 2030 and
- grow revenue by 38% compounded annually for the next 10 years.

In this [scenario](#), Lyft would earn \$59 billion in revenue in 2030, which is 24x its TTM revenue and over 16x its 2019, or pre-COVID revenue. If we assume a take rate<sup>3</sup> of 19%, this scenario equates to nearly \$309 billion spent on Lyft's platform in 2030.

In other words, to justify its current stock price, Lyft must capture 90% of the [projected global TAM](#) for ridesharing in 2030. For reference, Second Measure [estimates](#) Lyft's U.S. market share is 32% as of August 2021.

**There's 63%+ Downside If Consensus Is Right:** If we instead assume:

- pre-tax margin immediately improves to 4% from 2021 through 2030 and
- revenue grows by consensus estimates from 2021-2023
- revenue grows 22% (continuation of 2023 consensus estimate) a year from 2024-2030 then

the stock is worth just \$19/share today – a 63% downside to the current price. [See the math behind this reverse DCF scenario](#). Should Lyft fail to achieve such high pre-tax margins, or miss consensus revenue growth estimates, the downside is even larger.

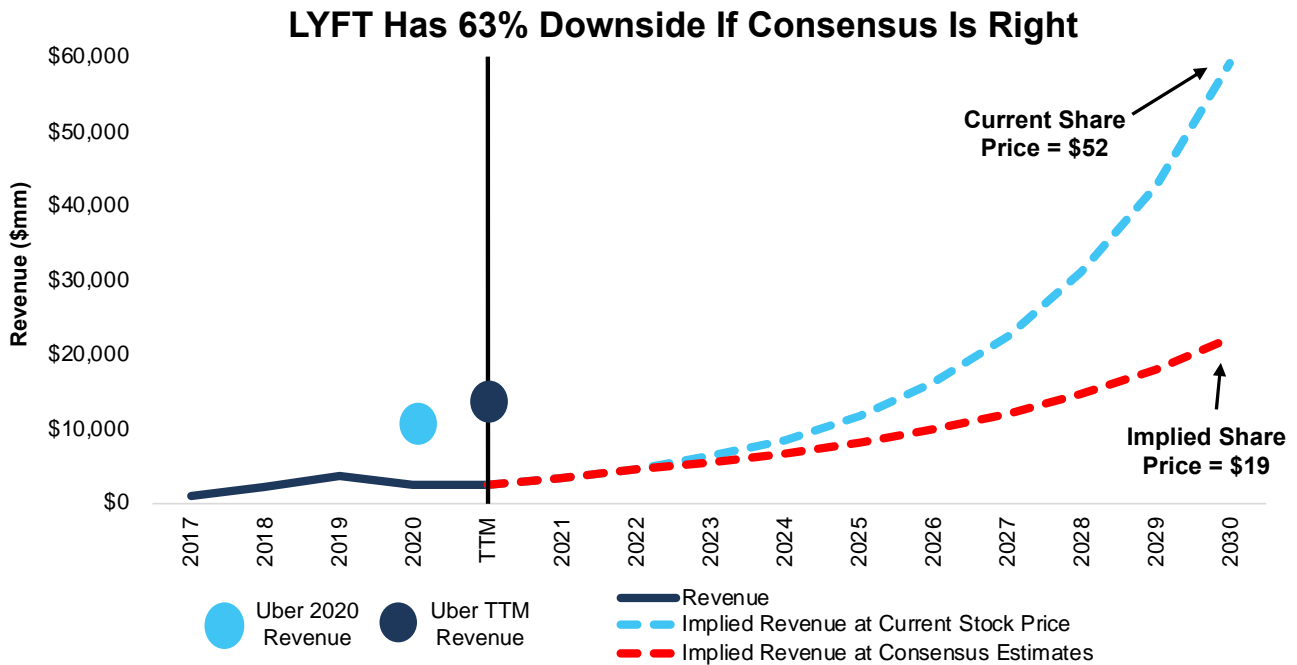
Figure 4 charts Lyft's historical and implied revenue in each of the above scenarios, along with Uber's 2020 and TTM revenue for reference.

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<sup>3</sup> Lyft doesn't report its take rate, or the amount of each ride Lyft collects as revenue. For this scenario, we assume a similar take rate as Uber in 2020.



**Figure 4: Lyft's Historical and Implied Revenue: DCF Valuation Scenarios**



Sources: New Constructs, LLC and company filings.

Each of the above scenarios also assumes Lyft is able to grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is highly unlikely but allows us to create best-case scenarios that demonstrate how high the expectations embedded in the current valuation are.

**Overpriced and Overhyped**

At 3.50%, LMGAX's total annual costs (TAC) are higher than 93% of the 461 All Cap Growth mutual funds under coverage. For comparison, the average TAC of all the All Cap Growth mutual funds under coverage is 1.66%, the asset-weighted average is 1.42%, and the benchmark ETF (IUSG) has total annual costs of just 0.04%.

Our TAC metric accounts for more than just the expense ratio. We consider the impact of front-end loads, back-end loads, redemption fees, and transaction costs. For example, LMGAX's annual turnover ratio of 50% adds 0.11% to its total annual costs – which isn't captured by the expense ratio. Figure 5 shows our breakdown of LMGAX's total annual costs, which we provide for all of the ~6,000 mutual funds and 800+ ETFs under coverage.



**Figure 5: Lord Abbett Growth Opportunities Fund's Total Annual Costs Breakdown**

Total Annual Costs Breakdown		
All Cost Types	LMGAX	IUSG
Front-End Load	2.19%	--
Expense Ratio	1.20%	0.04%
Back-End Load	0.00%	--
Redemption Fee	0.00%	--
Transaction Costs	0.11%	--
<b>Total Annual Costs</b>	<b>3.50%</b>	<b>0.04%</b>

\*All values represented are Annualized Values.

Sources: New Constructs, LLC and company, ETF and mutual fund filings

To justify its higher fees, LMGAX must outperform its benchmark by 3.46% annually over three years, the average holding period for all funds.

However, LMGAX's load-adjusted three-year [quarter-end average annual total return](#) has underperformed IUSG by 128 basis points. Its load adjusted five-, and ten-year quarter-end average annual total returns have also underperformed IUSG by 320 and 263 basis points respectively.

Given that 43% of assets are allocated to stocks with Unattractive-or-worse ratings, and 87% are allocated to stocks with Neutral-or-worse ratings, LMGAX looks likely to continue to underperform.

Get a copy of our standard mutual fund [report](#) on LMGAX.

**Free copy of our LMGAX report**

**Easily Make Any Fund, Even LMGAX, Better**

As we showed in [The Paradigm Shift to Self-Directed Portfolio Construction](#), new technologies enable investors to create their own funds without any fees while also offering access to better, more sophisticated weighting methodologies. If for instance, investors wanted exposure to LMGAX's holdings, but weighted by [Core Earnings](#), the risk/reward of this [customized version](#) of the fund improves dramatically:

- 21% of assets to Attractive-or-better rated stocks (compared to 7% for LMGAX)
- 16% of assets to Unattractive-or-worse rated stocks (compared to 43% for LMGAX).

Compare the quality of stock allocation in our customized fund vs. LMGAX [here](#). For research on smart beta strategies based on [Earnings Distortion](#), click [here](#).

**Get an Edge from Holdings-Based Fund Analysis Based on Superior Stock Research**

Smart fund (or ETF) investing means analyzing the holdings of each mutual fund. Failure to do so is a failure to perform proper due diligence. Simply buying a mutual fund or ETF based on past performance [does not necessarily lead](#) to outperformance. Only through holdings-based analysis can one determine if a fund's methodology leads managers to pick high-quality or low-quality stocks.



Most investors don't realize they can access sophisticated fundamental research<sup>4</sup> that enables them to [overcome](#) inaccuracies, omissions, and biases in legacy fundamental datasets. Our [Robo-Analyst technology](#) analyzes the holdings of all 487 ETFs and mutual funds in the All Cap Growth style and ~6,800 ETFs and mutual funds under coverage to avoid "[the danger within](#)." Our diligence on holdings allows us to [cut through the noise](#) and identify potentially dangerous funds that traditional, backward-looking fund research may overlook, such as LMGAX.

### **Better Rated All Cap Growth Funds**

Below we present five All Cap Growth ETFs or mutual funds that earn an Attractive-or-better rating, have more than \$100 million in assets under management, and have below average TAC.

1. Marshfield Concentrated Opportunity Fund (MRFOX) – Very Attractive rating and 1.17% TAC
2. TrimTabs U.S. Free Cash Flow Quality ETF (TTAC) – Very Attractive rating and 0.65% TAC
3. Fidelity Nasdaq Composite Index ETF (ONEQ) – Attractive rating and 0.23% TAC
4. Fidelity Momentum Factor ETF (FDMO) – Attractive rating and 0.32% TAC
5. American Century STOXX U.S. Quality Growth ETF (QGRO) – Attractive rating and 0.32% TAC

Check out this week's [Danger Zone interview](#) with Chuck Jaffe of [Money Life](#).

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

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<sup>4</sup> See how our models overcome flaws in Bloomberg and Capital IQ's (SPGI) analytics in the [detailed appendix of this paper](#).





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

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Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our “novel database” enables investors to overcome these flaws and apply [reliable](#) fundamental data in their research.
3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

### **Best Fundamental Data in the World**

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior [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 S&P Global’s (SPGI) *Adjustments* individually.” – pp. 14, 1<sup>st</sup> 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, 2<sup>nd</sup> para.

### **Superior Models**

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

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 [ as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5<sup>th</sup> 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, 2<sup>nd</sup> para.

### **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, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> 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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