Featured Stocks in August's Most Attractive/Most Dangerous Model Portfolios

Recap From July's Picks

Our Most Attractive Stocks (+1.4%) underperformed the S&P 500 (+1.5%) from July 8, 2021 through August 2, 2021 by 0.1%. The best performing large cap stock gained 20% and the best performing small cap stock was up 18%. Overall, 18 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+0.1%) outperformed the S&P 500 (+1.5%) as a short portfolio from July 8, 2021 through August 2, 2021 by 1.4%. The best performing large cap stock fell by 19% and the best performing small cap stock fell by 17%. Overall, 22 out of the 34 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios outperformed as an equal-weighted long/short portfolio by 0.7%.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research. Our proprietary Robo-Analyst Technology[1] scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

Seven new stocks make our Most Attractive list this month, and five new stocks fall onto the Most Dangerous list this month. August's Most Attractive and Most Dangerous stocks were made available to members on August 4, 2021.

Our Most Attractive stocks have high and rising returns on invested capital (ROIC) and low price to economic book value ratios. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

Most Attractive Stocks Feature for August: UBS Group AG (UBS: $17/share)

UBS Group is the featured stock from August's Most Attractive Stocks Model Portfolio.

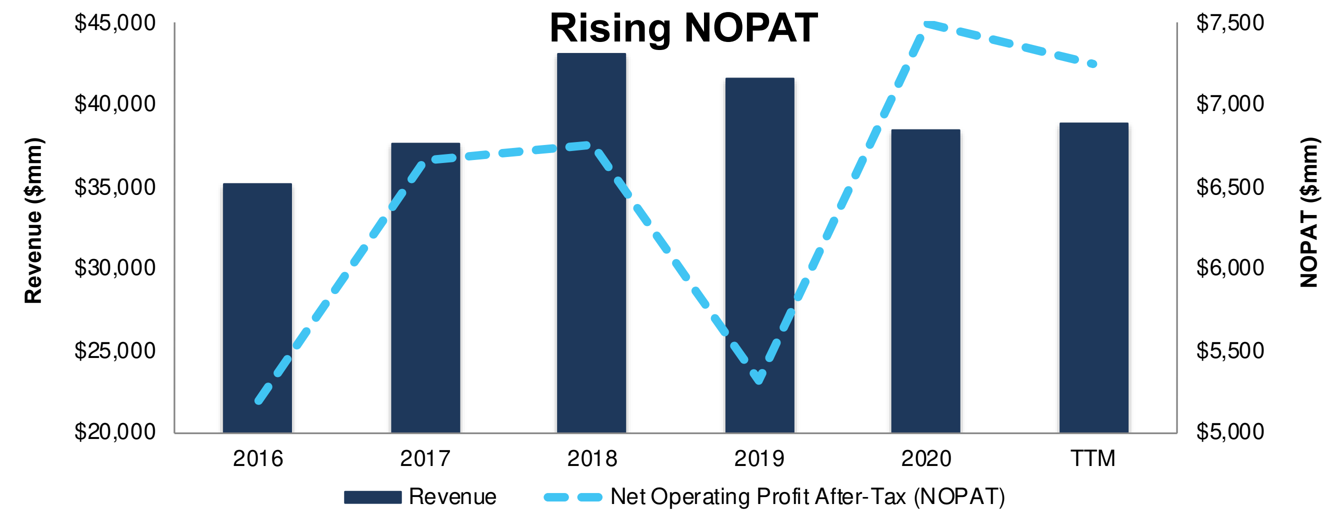
UBS Group has grown revenue by 2% compounded annually and net operating profit after-tax (NOPAT) by 10% compounded annually since 2016.

The firm's NOPAT margin increased from 15% in 2016 to 19% over the trailing twelve months (TTM), while its invested capital turns increased from 0.6 to 0.8 over the same period. Rising margins and invested capital turns drive an improvement in UBS Group's ROIC from 8% in 2016 to 14% TTM.

Over the past five years, UBS Group generated $43.7 billion (72% of market cap) in cumulative free cash flow (FCF). Over the TTM, UBS Group has generated $9.1 billion in FCF.

[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models overcome flaws in Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

Figure 1: Revenue & NOPAT Since 2016



Sources: New Constructs, LLC and company filings

UBS Is Undervalued

At its current price of $17/share, UBS has a price-to-economic book value (PEBV) ratio of 0.5. This ratio means the market expects UBS Group's NOPAT to permanently decline by 50%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 7% compounded annually since 2014.

Even if UBS Group's NOPAT margin falls to 16% (five-year average, compared to 19% TTM) and the firm grows NOPAT by just 1% compounded annually for the next decade, the stock is worth $37/share today – a 117% upside. See the math behind this reverse DCF scenario. Should UBS Group grow profits in line with historical levels, the stock has even more upside.

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

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in UBS Group's 20-F and 6-Ks:

Income Statement: we made $3.3 billion of adjustments, with a net effect of removing $943 million in non-operating expenses (2% of revenue). You can see all the adjustments made to UBS Group's income statement here.

Balance Sheet: we made $23.1 billion in adjustments to calculate invested capital with a net decrease of $10.6 billion. One of the most notable adjustments was $9.2 million in deferred tax assets. This adjustment represented 15% of reported net assets. You can see all the adjustments made to UBS Group's balance sheet here.

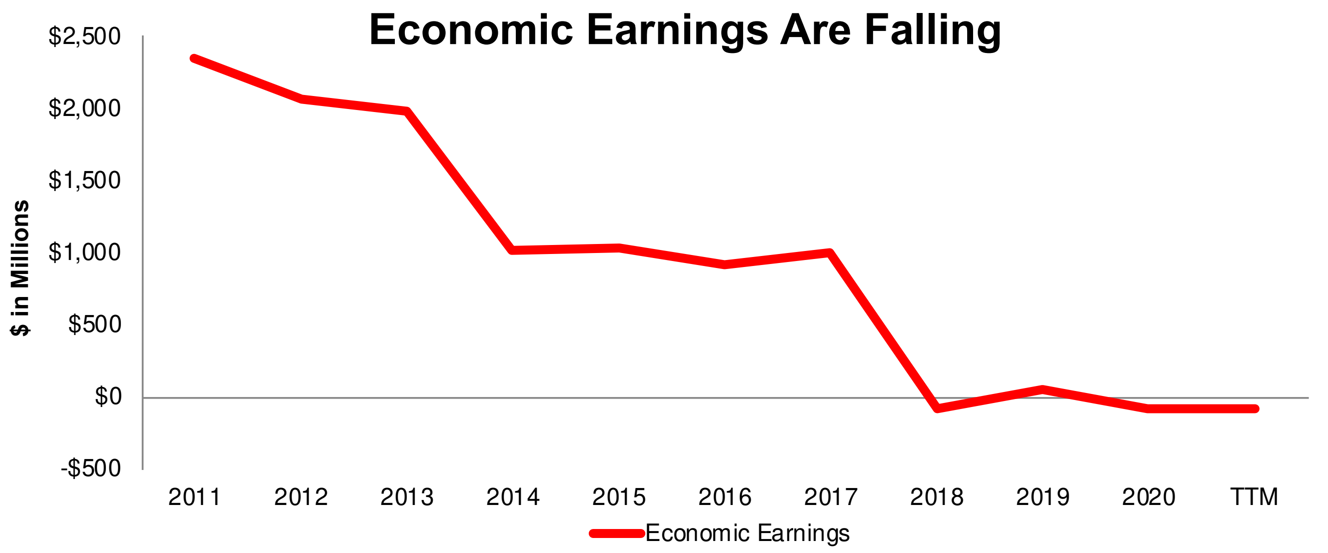
Valuation: we made $865 million of adjustments, all of which decreased shareholder value. One of the most notable adjustments to shareholder value was $558 million in underfunded pensions. This adjustment represents 1% of UBS Group's market cap. See all adjustments to UBS Group's valuation here.

Most Dangerous Stocks Feature: ABB, Ltd. (ABB: $38/share)

ABB, Ltd (ABB) is the featured stock from August's Most Dangerous Stocks Model Portfolio.

ABB's economic earnings, the true cash flows of the business, fell from $2.3 billion in 2011 to -$78 million over the TTM. The firm's NOPAT margin fell from 10% in 2011 to 5% TTM, while invested capital turns fell from 1.6 to 0.9 over the same time. Falling NOPAT margins and invested capital turns drive ABB's ROIC from 16% in 2011 to 4% TTM.

Figure 2: Economic Earnings Since 2011



Sources: New Constructs, LLC and company filings

ABB Provides Poor Risk/Reward

Despite its poor fundamentals, ABB is still priced for significant profit growth and overvalued.

To justify its current price of $38/share, ABB must improve its NOPAT margin to 8% (seven-year high vs. 5% TTM) and grow NOPAT by 13% compounded annually for the next decade. See the math behind this reverse DCF scenario. Given ABB's NOPAT has fallen by 14% compounded annually over the past five years, we think these expectations are overly optimistic.

Even if ABB improves its NOPAT margin to pre-pandemic levels of 6% and grows NOPAT by 6% compounded annually for the next decade, the stock is worth just $21/share today – a 45% downside to the current stock price. See the math behind this reverse DCF scenario. Should ABB's NOPAT grow at a slower rate or, even worse, continue its downward trend, the stock has even more downside.

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

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

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in ABB's 10-K and 10-Qs:

Income Statement: we made $6.8 billion in adjustments, with a net effect of removing $3.9 billion in in non-operating income (15% of revenue). You can see all the adjustments made to ABB's income statement here.

Balance Sheet: we made $16.4 billion in adjustments to calculate invested capital with a net increase of $2.3 billion. One of the largest adjustments was $4.0 billion in other comprehensive income. This adjustment represented 16% of reported net assets. You can see all the adjustments made to ABB's balance sheet here.

Valuation: we made $15.4 billion in adjustments with a net effect of decreasing shareholder value by $3.7 billion. Apart from total debt, the most notable adjustment to shareholder value was $4.1 billion in excess cash. This adjustment represents 5% of ABB's market cap. See all adjustments to ABB's valuation here.

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

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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