It's Getting Ugly Out There

Before we get started: Yesterday, I held a live webinar explaining the hottest sectors, key stocks to avoid and the proprietary research we have at New Constructs. It's a limited time presentation and offer. Here's the replay.

Markets move fast. They can turn on a dime. If you're investing based on a narrative without understanding fundamentals, you're playing a very dangerous game. And, I'm going to share a stock that is a perfect example of just how damaging narrative-based investing can be.

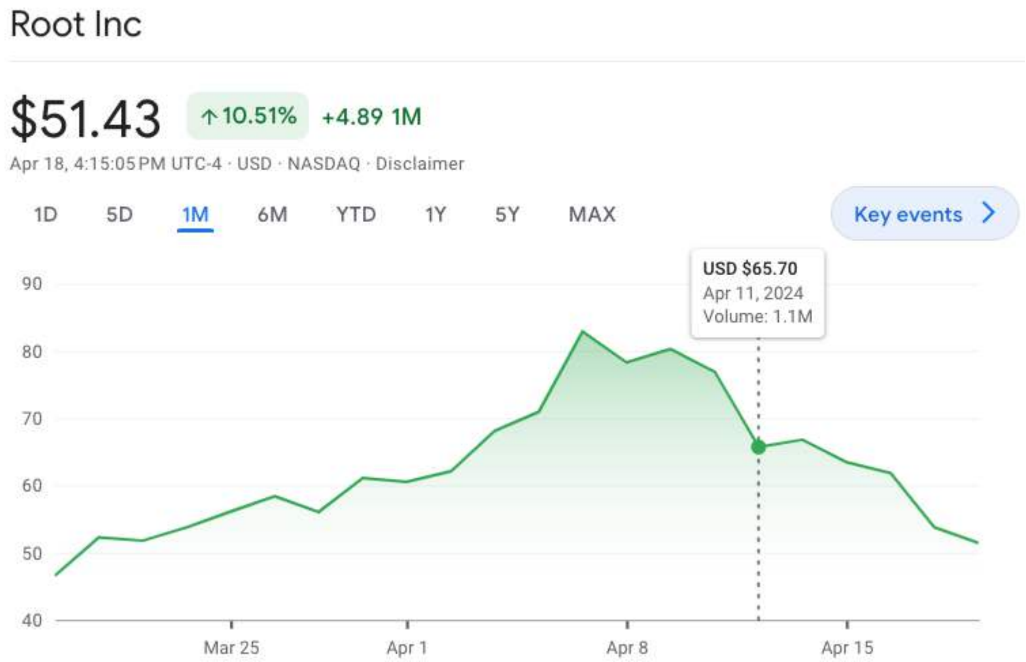
I'm not saying your investing process should be 100% fundamentals-based, but I am saying it should NOT BE 0% fundamentals-based. People can say fundamentals don't matter, and they might be right for a short time, **but, in the end, fundamentals always matter**. It's a law of nature: businesses that do not make money cannot survive forever.

Ignoring fundamentals is like playing chicken with a freight train. You'll be fine if you jump off the track in time, but if you wait too long…splat. If you jump too soon and others HODL longer, you miss out on big gains. You have to wait until the last second, time the market and sell near the peak. Easier said than done. Just ask all the investors who lost a fortune in 2022.

Or, you can use fundamentals to get your cake and eat it too. I mean: use fundamentals *AND* technicals. Use fundamentals to help you gauge just how far away a stock's valuation is from its fundamentals so you have a better sense of when to jump off the track. Just a suggestion.

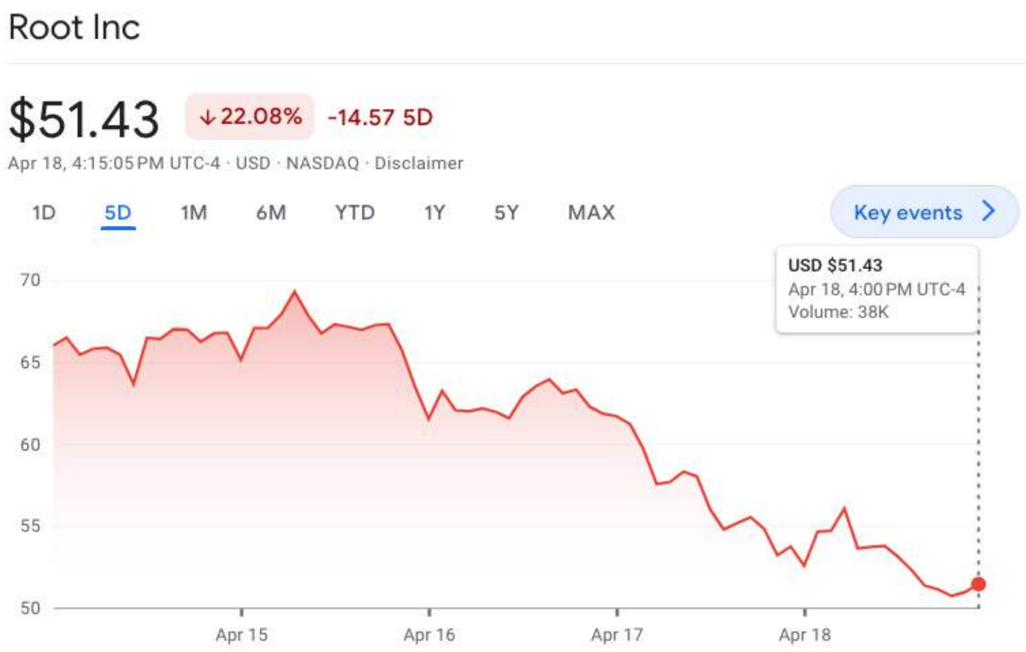
Ok, here's the perfect example of a Wall Street pump-and-dump stock scheme that was designed to take advantage of unsuspecting investors. This one is so obviously exploitative that it makes me angry to write about it. Having seen so many of these tricks over the years, I honestly get frustrated knowing that these ruses still work. Then, I realize that I've been inside Wall Street firms, and I have seen things, terrible things that opened my eyes to the realities of how devious these firms are. And, most people have never had anything like those experiences. So, it is part of my duty to support the integrity of the capital markets to explain what is going on. The bottom line is that most people simply do not realize how sneaky Wall Street analysts can be. So, here's a perfect example, on April 11th, Wells Fargo analyst Elyse Greenspan raised her price target on Root (ROOT) from $12 to $64, or 500%, while not changing her "Equalweight Rating". That's not a typo. [Thanks to Giulio Helmsdorff for bringing that to our attention in a recent post he made in our Society of Intelligent Investors: "Sell Side Analysts Never Fail to Entertain".]

This "upgrade" happened after the stock nearly doubled. See chart below. My guess is that institutional investors needed more time to get out of the stock before it cratered, so Ms. Greenspan stepped up, baited the hook, and the rest is history**.**



Source: Google Finance

Guess what happened next. That's right, the stock is down over 20%. Interesting time for a price target upgrade, don't ya think?



Source: Google Finance

Add to the fact that options activity skyrocketed in ROOT last week, and I can tell you what's going on. This is a pump and dump scheme. ROOT is trading like a meme stock, going up for no reason while Wall Street insiders use order flow to trade ahead of the market with plans to sell the stock to unsuspecting retail investors. I hope none of our readers took the bait.

Curious about what New Constructs says about $ROOT. I typed in the ticker and pulled up our Rating on April 11th, and voila. See below. It's not pretty. Do you wonder how a Wall Street analyst could have such a different opinion? The answer, as I have mentioned before, is that Wall Street analysts' interests are not always aligned with yours. Oftentimes, Wall Street sees individual investors as “more sheep to lead to slaughter” - that’s a real line that an institutional investor actually said to me a couple years ago. It’s hard to see the $ROOT situation, and not think that’s exactly what's going on.

Root Inc. (ROOT)

Closing Price: $65.70 (Apr 11, 2024)
Market Value: $959 Million
Sector: Financials
Latest Filing: 10-K for period ending Dec 31, 2023
Next Expected Filing: 10-Q on May 21, 2024

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	Quality of Earnings		Valuation		
Risk/Reward Rating	Economic vs Reported EPS	ROIC	FCF Yield	Price to EBV	Market-Implied GAP
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3
Actual Values					
ROOT	-$15.64 vs. -$10.24	-23%	-6%	-0.8	> 100 yrs
Benchmarks					
Sector ETF (XLF)	Positive EE	16%	3%	2.2	29 yrs
S&P 500 ETF (SPY)	Positive EE	26%	2%	4.6	69 yrs
Small Cap ETF (IWM)	Positive EE	6%	1%	4.2	53 yrs

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I’m not here just to complain and wave red flags. I have solutions too. I hosted a special webinar last week: **The Hottest Sectors In The Market Right Now**. Replay here. In this webinar, I shared specific sectors that are good investments in this environment along with specific stocks and sectors that are not. With one of the most important earnings seasons upon us, I highly recommend you watch. You’ll see that not only do I provide specific recommendations on stocks to avoid and stocks to buy, but I also make a very special offer on some of our top products so you can, very cost effectively, de-risk your portfolio from the Most Dangerous Stocks and add the Most Attractive Stocks.

And, for those that didn’t know, we do a free live Podcast every month. The next one is on May 10th at 12pmET. Register here. Email us at support@newconstructs.com to make requests for stocks to review. Or, join (use this form to sign up for free) our Society of Intelligent Investors and ask questions and make requests anytime!

In the meantime, buckle your seat belt and get ready for a rocky earnings season. It’s gonna be exciting. Lots of opportunities for those who have our research.

Diligence matters,

David

This article was originally published on April 19, 2024.

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

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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:

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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.

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