



CANADIAN EQUITY

FACTOR-BASED MODEL PORTFOLIO STRATEGY



2019/04

WHAT



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Summary

Key Points in a Nutshell

1

We are proud to introduce the Factor-Based Canadian Equity Model Portfolio Strategy with institutional level of liquidity and low portfolio turnover.

2

The portfolio gained an annualized return of 16.9% since 2000. It has proven to outperform on a relative basis against the S&P/TSX TR.

3

The portfolio returns are achieved by strategically selecting 25 quality at a reasonable price (QARP) companies generating wealth for its shareholders.



Objectives

Setting a Way to Achieve Success

The portfolio is designed for potential investors with medium risk tolerance seeking exposure to Canadian Equities by following a rigorous bottom-up factor based quantitative approach. The investment objectives of the portfolio are to:

1

Target long term capital appreciation among Canadian Equities.

2

Consistently deliver performance over the S&P/TSX Total Return Index.

3

Maximize tax efficiency by having a low portfolio turnover ratio.

Characteristics

Comparison of Smart Beta Strategies



QARP stands for Quality At Reasonable Price. We are finding companies of quality trading at attractive multiples that consistently generate wealth for its shareholders.

	Market Cap Weighted Index	Factor-Based Canadian Equity
Risk management goals	None	None
Systematic rebalancing	Quarterly	Quarterly
Human input required	No	Supervised
Use of Leverage	None	None
Systematic Risk	Medium	Medium
Portfolio turnover	Low	Low
Investment process	None	Bottom-Up
Investment style	None	QARP
Market behavior	Trend Following	Relative return

Methodology

Quantitative Modeling



HOW IT WORKS

A quantitative model systematically identifies mispriced stocks and attempts to deliver absolute and relative performance. Briefly, a ranking system sorts stocks from a universe based on pre-selected factors and the portfolio periodically buys the best ones and sells the ones in which conditions have deteriorated over time following various rules.

WHY IT WORKS

By rigorously adhering to this stock selection framework based on a thoroughly tested ranking system, we are able to remove the emotional element of the investment process. 80% of portfolio managers cannot beat their benchmark because 1) it is difficult to do so and 2) they unconsciously let fear and greed emotions affect their investment decisions.

A high-contrast, black and white photograph of several interlocking metal gears. The gears are made of a polished metal, likely steel, and their teeth are sharp and well-defined. The lighting creates strong highlights and shadows, emphasizing the mechanical texture and the circular forms of the gears. In the upper left corner, there is a solid blue rectangular area containing the word "HOW" in white, bold, sans-serif capital letters.

HOW

Philosophy

Factor-Based (FB)

1. QARP (Quality At Reasonable Price)

The end goal is to invest in quality companies trading at attractive multiples that consistently generate wealth for their shareholders.

2. Undexing

Our goal is to beat the market over the long run. We believe the best way to do it is to create a portfolio that looks very different from it.

3. Concentration

We are striving to achieve a balance between diversifying to remove specific risk yet not too much to avoid ending up mimicking the index.

4. Low Turnover

Excessive portfolio churning increases trading costs for an investor. It also means a lack of confidence, decisiveness and tax awareness.

Overview

Our Investment Process

6. Monitoring

Monitor the portfolio, rebalance and carry out performance attribution.

5. Portfolio

Build the live portfolio by investing real money in the defined strategy.

4. Simulation

Form a strategy resulting from a mix of set rules and filters applied to the ranking system.



1. Universe

Define the investment environment in which we will pick our companies.

2. Factors

Design factors based on academic literature and innovative concepts.

3. Ranking

Create a composite of factors to rank companies from our defined universe.

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Universe

Our Investment Environment

2.5

\$billion of market cap minimum.

This is what we consider a large cap in Canada although it is usually \$6 billion in the United States.

10

\$million of average daily liquidity for the past month expressed as price x volume.



250

Stocks passing the universe filter. They are all part of the S&P TSX Composite.

25

Stocks in our portfolio, are chosen from the best ranking decile.

Factor

Our Selection Method

We backtested in our universe hundreds of factors individually to find the ones generating the most alpha over the last two investment cycles. We then select the best factors using four criteria shown below:



Ranking

Based on Our Factor Selection

Q_{uality}

(1st part)

Earnings Quality (EPSQ) ↑

This ratio is calculated as the Operating Cash Flow minus Earnings and then divided by Total Assets.

What: Is the company manipulating accruals in its financial statements?

Why: The interpretation of this ratio is that higher is always better.

Debt Reduction (DCHG) ↓

This ratio is the difference between Long-Term Debt to Capital TTM and Long-Term Debt to Capital PTM.

What: Is the company successfully reducing its debt level from last year?

Why: The interpretation of this ratio is that lower is always better.

Free Cash Flow Margin (FCFM) ↑

This ratio measures the percent of the Free Cash Flow TTM compared to Total Revenues TTM.

What: How many dollars of free cash flow gets for each dollar of sales?

Why: The interpretation of this ratio is that higher is always better.

Dividend Yield (DIVY) ↑

This ratio is calculated as the Projected Dividend divided by the current Price, multiplied by 100.

What: How much Dividends are paid by the company relative to its Price?

Why: The interpretation of this ratio is that higher is always better.

Ranking

Based on Our Factor Selection

Quality

(2nd part)

Total Yield (TOTY) ↑

This ratio is calculated as the Buyback Yield added to the Dividend Yield, multiplied by 100.

What: How much is the company giving back to their shareholders?

Why: The interpretation of this ratio is that higher is always better.

Long Term Beta (LVOL) ↓

This ratio measures the systematic risk of a security in comparison to the whole market.

What: How volatile are the shares of a company relative to the market?

Why: The interpretation of this ratio is that lower is always better.

Price / Earnings Ratio (PERA) ↓

This ratio is calculated by dividing the current Price by the sum of the Diluted Earnings Per Share from Continuing Operations Before Extraordinary Items and Accounting Changes over the last four quarters.

What: How much investors are willing to pay per dollar of Earnings?

Why: The interpretation of this ratio is that lower is always better.

Discounted Free Cash Flow / Assets (FCFA) ↑

This ratio is calculated as the output of a Discounted Free Cash Flow model, based on the next five years and using the Mean Long Term Growth as the discount rate, divided by the Assets of the company.

What: How much Discounted Free Cash Flow per unit of Assets is the company making?

Why: The interpretation of this ratio is that higher is always better.

Ranking

Based on Our Factor Selection

V
alue
(2nd part)

Discounted Free Cash Flow / Equity (FCFE) ↑

This ratio is calculated as the output of a Discounted Free Cash Flow model, based on the next five years and using the Mean Long Term Growth as the discount rate, divided by the Equity of the company.

What: How much Discounted Free Cash Flow per unit of Equity is the company making?

Why: The interpretation of this ratio is that higher is always better.

Discounted Free Cash Flow / EV (FCFV) ↑

This ratio is calculated as the output of a Discounted Free Cash Flow model, based on the next five years and using the Mean Long Term Growth as the discount rate, divided by the EV of the company.

What: How much Discounted Free Cash Flow per unit of EV is the company making?

Why: The interpretation of this ratio is that higher is always better.

Operating Income / EV (OPIV) ↑

This ratio is calculated as the Operating Income After Depreciation divided by Enterprise Value (EV).

What: How much Operating Income per unit of EV is the company making?

Why: The interpretation of this ratio is that higher is always better.

Ranking

Based on Our Factor Selection

Momentum

Analyst Revisions 1W (REV1) ↑

This ratio is calculated as a scaled difference between Next Fiscal Year EPS Mean of today vs last week.

What: Was there any weekly EPS revisions and how large were they?

Why: The interpretation of this ratio is that higher is always better.

Analyst Revisions 4W (REV4) ↑

This ratio is calculated as a scaled difference between Next Fiscal Year EPS Mean of today vs 4 weeks ago.

What: Was there any monthly EPS revisions and how large were they?

Why: The interpretation of this ratio is that higher is always better.

Trend (TREN) ↑

This ratio is calculated as 20-Day EMA divided by the 200-Day EMA and measures the price slope.

What: Is the company's price trading in a medium-term uptrend?

Why: The interpretation of this ratio is that higher is always better.

Pullback (PULL) ↑

This ratio is calculated as the 11-Day Exponential Moving Average divided by the Current Price.

What: Has the company's price experienced a short term pullback?

Why: The interpretation of this ratio is that higher is always better.

Simulation

Our Portfolio Rules and Filters

G

General Rules

- The portfolio is long only and without any leverage whatsoever.
- Approximately 25 stocks are held with 30% max weight deviation:
Avg W: 4.0% | Min W: 2.8% | Max W: 5.2%
- Transactions are recorded at the average high | low of trade day.
- Rebalancing frequency is quarterly and sent before market open.
- Variable slippage (average daily \$ traded) is taken into account.

B

Buy Rules

- No penny stocks are allowed. In other words, no stocks below \$1.00 are part of the simulation.
- Stocks with stale financial statements with SEDAR are excluded from the buy list.
- Minimum Daily Total Liquidity of at least \$5M in the last week and a Market Cap > \$2.5B.
- Shareholder's Equity Total must be above zero at inclusion.

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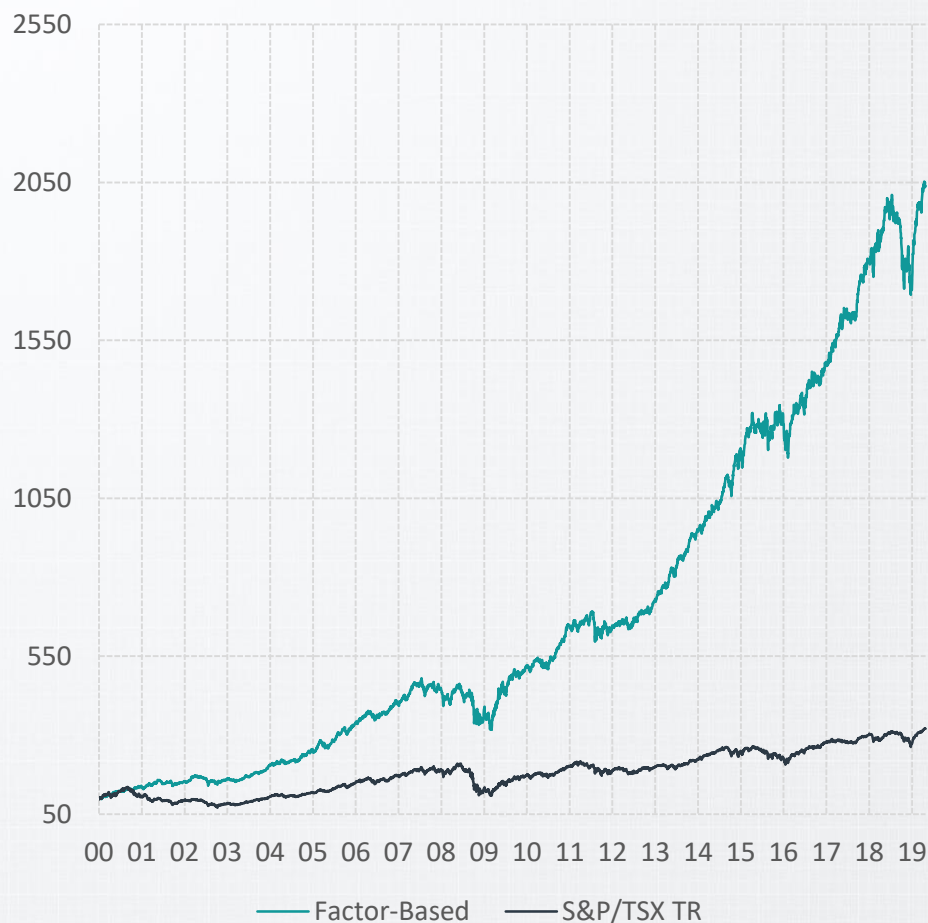
Sell Rules

- Sell stocks when its ranking falls below three deciles.
- Trim stocks weights back to 7.5% and below if their individual weights in the portfolio goes above 7.5%.
- We force positions in the universe even if they are replaced inside our universe.
- Sell stocks with weight below 2.5% and if it's been more than 252 trading days.

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Portfolio

Historical Performance



Key Portfolio Statistics

Annualized Return (%)
(S&P/TSX TR = 6.2) 16.9

Maximum Drawdown (%)
(S&P/TSX TR = -48.5) -34.0

Portfolio Turnover (%)
(S&P/TSX TR = 6.3) 72.4

Index Correlation
(S&P/TSX TR = 1.00) 0.71

Sharpe Ratio
(S&P/TSX TR = 0.36) 1.33

Since Inception (January 1st, 2000)

WHY



Statistics

Calendar Performance

Yearly

Calendar Returns	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Factor-Based	39.7	10.1	3.6	28.0	24.9	31.5	20.8	11.0	-18.1	41.5
S&P/TSX TR	7.4	-12.6	-12.4	26.7	14.5	24.1	17.3	9.8	-33.0	35.1
Difference	32.3	22.7	16.1	1.3	10.4	7.4	3.6	1.1	14.9	6.5

Calendar Returns	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD
Factor-Based	23.9	-0.4	13.1	30.9	26.5	7.7	13.5	22.1	-2.4	16.3
S&P/TSX TR	17.6	-8.7	7.2	13.0	10.6	-8.3	21.1	9.1	-8.9	16.9
Difference	6.3	8.3	5.9	18.0	16.0	16.0	-7.6	13.0	6.5	-0.7

Monthly

Calendar Returns	05-18	06-18	07-18	08-18	09-18	10-18	11-18	12-18	01-19	02-19	03-19	04-19
Factor-Based	3.4	-0.8	0.2	-0.4	-2.5	-7.0	4.3	-4.5	8.3	3.5	1.3	2.4
S&P/TSX TR	3.1	1.7	1.1	-0.8	-0.9	-6.3	1.4	-5.4	8.7	3.1	1.0	3.2
Difference	0.3	-2.5	-1.0	0.4	-1.7	-0.7	3.0	0.9	-0.4	0.4	0.3	-0.8

Statistics

Trailing Performance



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Statistics

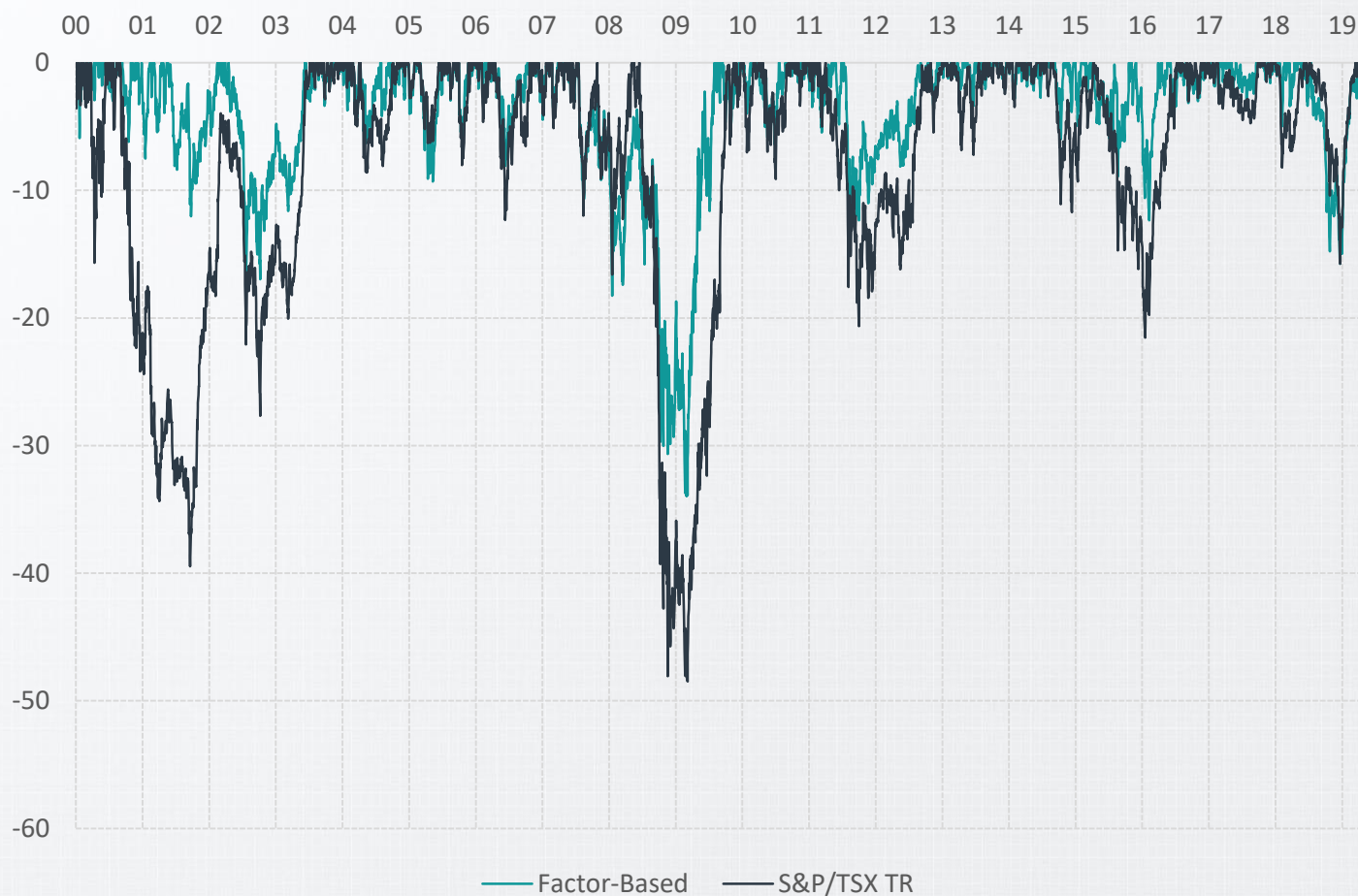
Return & Risk Measurements

Trailing 3 Year	Factor-Based	S&P/TSX TR	Difference
Annualized Return (%)	15.4	9.1	6.3
Standard Deviation (%)	9.5	8.9	0.6
Max Drawdown (%)	-15.7	-15.7	0.0
Portfolio Turnover	72.4	6.3	66.1
Sharpe Ratio	1.37	1.03	0.35
Sortino Ratio	1.74	1.50	0.24
Index Correlation	0.76	1.00	-0.24
R-Squared	0.58	1.00	-0.42
Beta	0.82	1.00	-0.18
Alpha (%) (Annualized)	6.29	0.00	6.29

Since Inception	Factor-Based	S&P/TSX TR	Difference
Annualized Return (%)	16.9	6.2	10.7
Standard Deviation (%)	10.7	13.5	-2.8
Max Drawdown (%)	-34.0	-48.5	14.5
Portfolio Turnover	72.4	6.3	66.1
Sharpe Ratio	1.33	0.36	0.96
Sortino Ratio	1.81	0.47	1.34
Index Correlation	0.71	1.00	-0.29
R-Squared	0.50	1.00	-0.50
Beta	0.56	1.00	-0.44
Alpha (%) (Annualized)	10.67	0.00	10.67

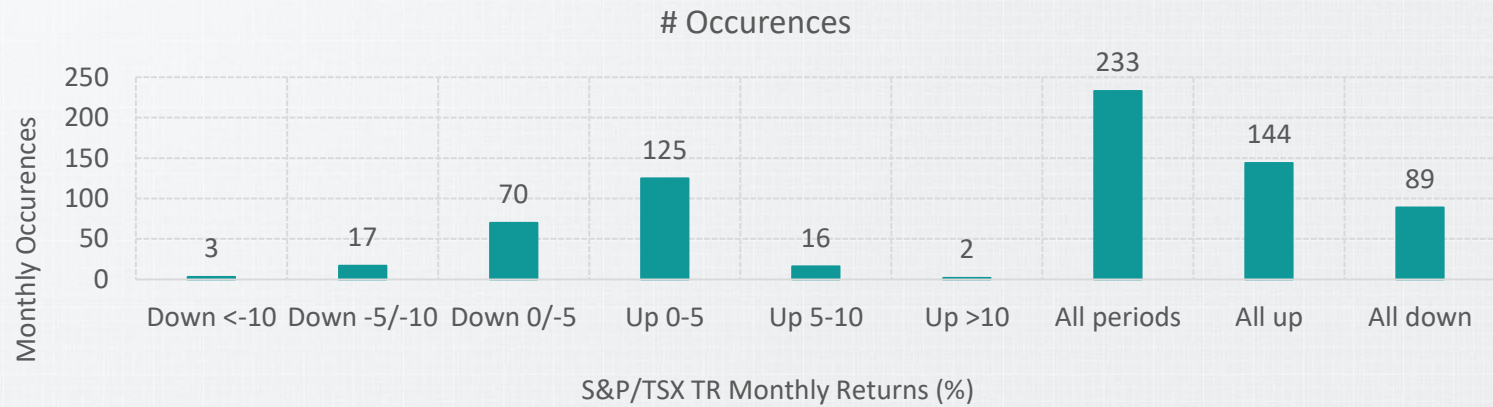
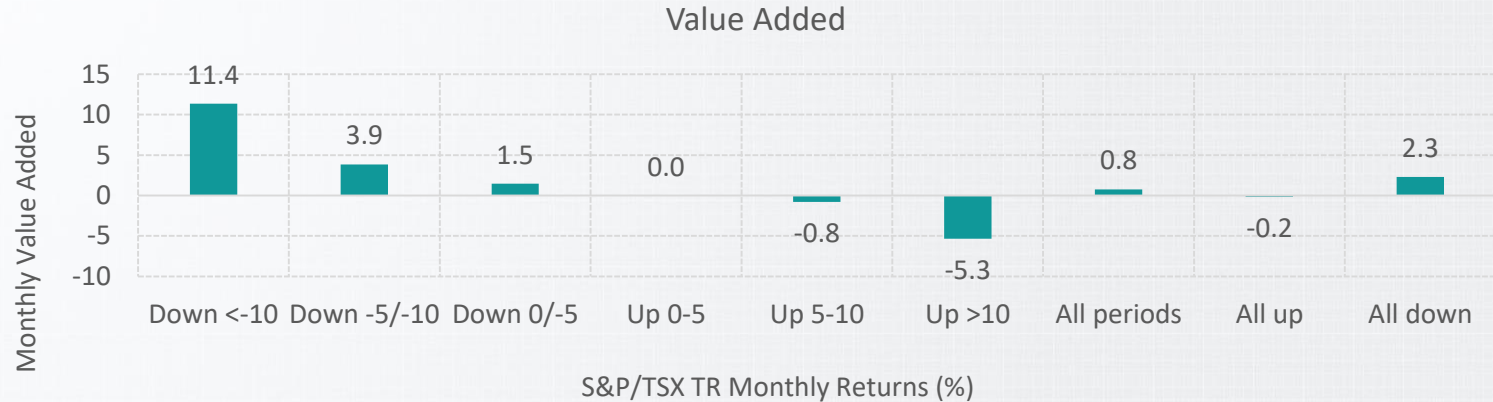
Statistics

Rolling Maximum Drawdown



Statistics

Outperformance in Different Market Conditions



Characteristics

Top Ten Holdings & Fundamentals

Ticker	Weight (%)	Sector
CSU:CN	9.1	Info Tech
AC:CN	5.5	Industrials
L:CN	4.6	Staples
QBR.B:CN	4.5	Telecom
TIH:CN	4.4	Industrials
OTEX:CN	4.3	Info Tech
GIB.A:CN	4.2	Info Tech
BMO:CN	4.1	Financials
MG:CN	4.0	Discretionary
CAE:CN	3.9	Industrials

Median	Factor-Based	S&P/TSX TR
Market Cap (\$B)	26.7	3.4
Price / Earnings	13.0	15.1
Price / Book	2.6	1.8
Price / Sales	1.8	2.0
Price / Cash Flow	9.5	9.9
Return on Equity	17.3	9.0
Dividend Yield	2.1	1.7
5Y EPS Growth	14.1	10.0
Debt / Equity	0.7	0.5
5Y Beta	0.86	1.00

Allocation

Sector Weights & Benchmark Deviations

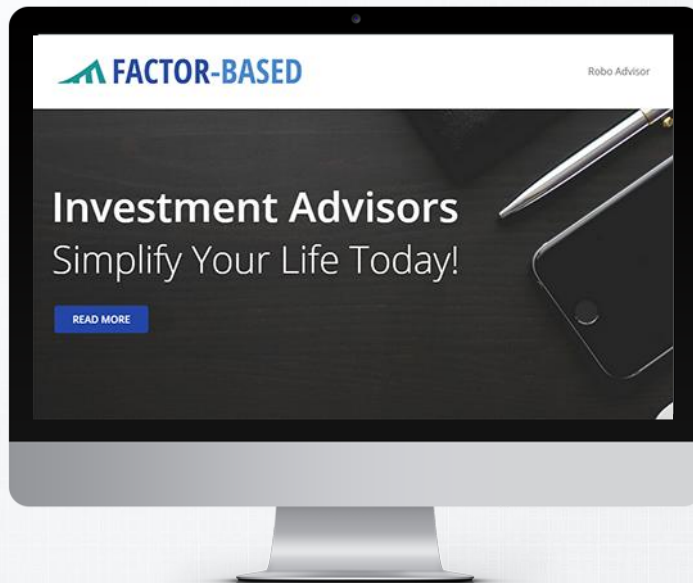
Weights	Factor-Based	S&P/TSX TR	Deviations
Info Tech	17.5	4.6	12.9
Telecom	15.0	5.6	9.4
Industrials	16.7	11.1	5.6
Staples	8.2	3.8	4.4
Discretionary	7.4	4.3	3.2
Materials	9.9	10.2	-0.3
Utilities	3.5	4.1	-0.6
Health Care	0.0	2.2	-2.2
Energy	3.5	18.2	-14.8
Financials	15.0	35.8	-20.9

WHO



Who We Are

Factor-Based (FB)



IN A NUTSHELL...

Factor-Based (FB) is a financial research firm that specializes mostly in equities for private, investment advisors and institutional clients. We are dedicated to produce exceptional risk adjusted returns for our investors by strictly adhering to factor-based investing methods.

Disclosures

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