

## What Are Your Top 10 Holdings?

Top holdings within a portfolio are often shorthand for how a manager thinks about stocks. If the ten holdings are cheap, we're probably dealing with a value manager. If they're tilted toward healthcare, maybe there's some specialization going on. These rules of thumb can be crucial to an investor's diligence process, especially in concentrated long-only strategies.

In the case of **systematic factor strategies**, though, rules of thumb can be misleading.

Factor strategies are often called "multifactor" strategies because they consider many features of a potential investment simultaneously – a stock's valuation, momentum, volatility, etc. This approach tends to create portfolios with a variety of different stocks. A sample of only 10 "top picks" may not fully capture what's "under the hood" in a multifactor strategy.

To illustrate the point, here is a modified version of the security selection model Counterpoint Mutual Funds uses for its **Tactical Equity Fund** as of May 20<sup>th</sup>, 2022. It lists 10 of the top global companies (min. market cap \$200 million) based on their aggregate factor exposures that leverages a machine learning model to pull together various factors into one score between 0-100 (where 0=low and 100=high.)

### Recent Top-Ranked Stocks in Counterpoint's Multifactor Selection Model

| Ticker   | Company Name                              | Value | Profitability | Momentum | Volatility | Industry  |
|----------|---|-------|---------------|----------|------------|-----------|
| ESI*     | Ensign Energy Services Inc.               | 77    | 49            | 100      | 66         | Energy    |
| DK       | Delek US Holdings, Inc.                   | 97    | 32            | 97       | 78         | Energy    |
| GENL     | Genel Energy plc                          | 49    | 91            | 96       | 59         | Energy    |
| 1733 HK* | E-Commodities Holdings Limited            | 98    | 97            | 99       | 84         | Materials |
| NGL      | NGL Energy Partners LP                    | 100   | 50            | 75       | 53         | Energy    |
| CLMT     | Calumet Specialty Products Partners, L.P. | 92    | 12            | 51       | 69         | Energy    |
| WHC      | Whitehaven Coal Limited                   | 42    | 41            | 99       | 56         | Energy    |
| OKEA     | OKEA ASA                                  | 69    | 90            | 96       | 68         | Energy    |
| GPOR     | Gulfport Energy Corporation               | 61    | 98            | 85       | 53         | Energy    |
| GTE      | Gran Tierra Energy Inc.                   | 65    | 92            | 100      | 87         | Energy    |
| Average  |   | 75.0  | 65.2          | 89.8     | 67.3       |           |

Source: Counterpoint Funds Research. For illustrative purposes only. These are not investment recommendations. The Top Ten Holdings may not be representative of the Fund's current or future investments. Portfolio holdings are subject to change at any time and should not be considered investment advice. \*The Counterpoint Tactical Equity Fund is long ESI and 1733 HK, which makes up 0.28% and 0.27% of the long basket respectively.

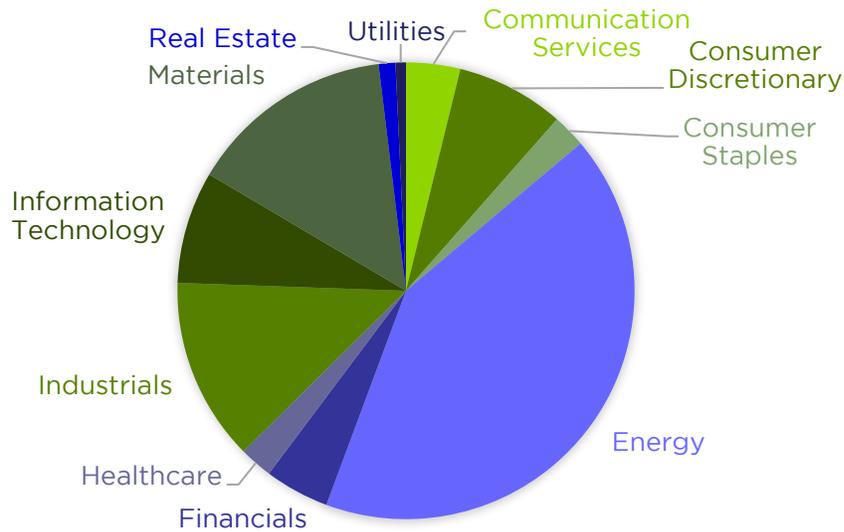
An investor might reach several conclusions by looking at this list. These stocks are:

- All energy and materials stocks
- Very cheap
- Somewhat, but not amazingly, profitable
- Rallying strongly as of the last 6 months
- Not overly volatile

Is the Counterpoint Tactical Equity Fund’s selection process built around finding deep-value, reasonable quality stocks in the energy sector? Actually, the answer is “No” and here’s why.

First, the actual fund’s long positions at the time of selection are among top 10-20% of ranked stocks (depending on optimization) in a universe of ~7000, which can include upwards of ~500 top long positions or more. Again, looking at the top-ranked stocks with market cap of \$200 million or more, the top selections look like this:

### Top-10 Global Stocks by Industry, >\$200M Market Cap as of 05/20/2022



Source: Counterpoint Funds Research. For illustrative purposes only. These are not investment recommendations. No level of diversification or non-correlation can ensure profits or guarantee against losses. The security holdings are presented to illustrate examples of the securities that the fund has bought and the diversity of areas in which the funds may invest and may not be representative of the fund’s current or future investments. Portfolio holdings are subject to change and should not be considered to be investment advice.

The model’s long book is somewhat concentrated in energy, but overall, much more diversified than the top holdings would indicate. The strong tilt toward value and momentum we saw in the top 10 moderates somewhat, and profitability improves when we look at the bigger picture.

| Selection         | Value | Profitability | Momentum | Volatility |
|-------------------|-------|---------------|----------|------------|
| Top 10 Stocks     | 75.0  | 65.2          | 89.8     | 67.3       |
| Top 10% of Stocks | 62.2  | 68.4          | 80.8     | 54.4       |

Source: Counterpoint Funds Research. For illustrative purposes only. These are not investment recommendations.

Let’s also keep in mind: **Counterpoint Tactical Equity’s** portfolio optimization process neutralizes out sector and currency exposures. For every energy stock the model likes, there’s a corresponding short position within the same sector, so there is never net positive exposure within a specific sector.

These differences between our stock selection model’s top 10 holdings and the top 715 reveals some key aspects of Counterpoint’s approach to factor investing. A solid multifactor strategy should invest in hundreds of global stocks on both the long and short side. It should diversify across sectors and geographies – then neutralize those risks altogether by shorting companies in those same sectors and geographies that have unfavorable characteristics.

There is no guarantee that any investment strategy will achieve its objectives, generate profits, or avoid losses.

## Conclusion

While the top holdings of other equity strategies may give a great sense for how a manager approaches stocks, that's not the case for long-short factor strategies. These strategies instead seek to invest in stocks with great prospects as measured by an aggregate score by multiple factors (e.g. value, momentum, profitability) and short stocks with poor prospects as measured by those same factors. Factor strategies also seek strong diversification across hundreds of names, so a snapshot of a few top picks can be misleading.

When considering factor driven strategies, the main concerns ought to be:

- How well does the strategy get exposure to factors that have historically been associated with excess stock market returns?
- How diversified is the manager?
- Has the manager been effective in neutralizing out other sources of return – broad market risk, geographic risk, currency risk, industry risk?

And finally:

- How well has the manager stuck to the process even in difficult environments for factor strategies?

In the long run, managers who can answer “yes” to these questions deserve consideration within a factor-tilted sleeve of an investor’s portfolio. Answering these questions should tell an investor a lot more about a long-short factor manager’s capabilities than the top 10 holdings will.

**There is no guarantee that any investment strategy will achieve its objectives, generate profits or avoid losses. Important information about the funds are available in their prospectuses, which can be obtained at [counterpointfunds.com](https://counterpointfunds.com) or by calling 844-273-8637. The prospectuses should be read carefully before investing. Investors should carefully consider the investment objectives, risks, charges, and expenses of the funds managed by Counterpoint Mutual Funds. The Counterpoint Mutual Funds fund family is distributed by Northern Lights Distributors, LLC member FINRA/SIPC. Counterpoint Mutual Funds, LLC is not affiliated with Northern Lights Distributors, LLC member [FINRA/SIPC](#).**

## Important Risk Information

The Counterpoint Tactical Equity Fund seeks to provide capital appreciation while managing downside risk. The Fund invests in individual stocks that have exposure to multiple market anomalies, while using a tactical model to dynamically adjust portfolio risk. There is no guarantee that any investment strategy will achieve its objectives, generate profits, or avoid losses. Portfolio holdings are subject to change, vary over time and should not be considered a recommendation to buy any individual security.

Mutual Funds involve risk including the possible loss of principal. The use of leverage by the Fund or an Underlying Fund, such as borrowing money to purchase securities or the use of derivatives, will indirectly cause the Fund to incur additional expenses and magnify the Fund’s gains or losses. Derivative instruments involve risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments. There is a risk that issuers and counterparties will not make payments on securities and other investments held by the Fund, resulting in losses to the Fund. Past performance is no guarantee of future results. There is no assurance the Funds will meet their stated objectives.

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