

How A Multifactor Strategy Thinks About Stocks

While looking at **top holdings of a factor-based equity strategy** can be deceptive, investors still need some way to grasp how quantitative managers construct their portfolios. One way to give a sense of how systematic factor investing works is to take a few example firms and walk through the stock selection model's "thought process."

Here we share two recent top long and top short investments in terms of an "investment pitch" that illustrates how our model weighs different company characteristics. Before we begin, readers must understand a crucial aspect of our factor investment process: A very widely diversified portfolio of long and short positions has the best chance of earning positive returns associated with factors. The long and short examples here are two of more than many hundred positions our **Counterpoint Tactical Equity Fund (CPIEX)** might take on either the long or short side.

Long Position: Delek US Holdings



Our quantitative model recently ranked Delek Holdings* (NYSE:DK) as one of the most attractive long opportunities in our investment universe. Delek is a petroleum refiner founded in 2001. Its businesses include refining, logistics, renewables, and convenience stores. Refinery operations are primarily in Texas, Arkansas, and Louisiana.

Although Counterpoint Tactical Equity's model does not factor in qualitative assessments, it's worth noting that management's recent comments seem consistent with expectations of a persistent positive trend. During the

May 3, 2022, earnings announcement, Delek management said the oil refining environment has provided business tailwinds, and that the firm was looking for additional ways to return cash to shareholders this year:

- ▲ **Momentum:** As of our model's evaluation the stock had been beating the market over the recent 6-month period – up double digits while the market was falling. Academic research indicates companies with strong recent stock performance see their shares continue to rise, on average.
- ▲ **Asset Growth:** Historically, companies that grow assets aggressively on average underperform companies that don't. The capital discipline reflected in the earnings announcement was consistent with our model's evaluation of the firm as a moderate asset grower.
- ▲ **Value:** On a valuation basis, the stock earned high marks due to its extremely high sales-to-price ratio (97th percentile). Although the company had been challenged in terms of profitability, when weighing the two valuation factors together.

The model's evaluation of Delek shows how multiple variables like value and momentum can combine to create favorable conditions – on average. It's also a good example for why using multiple valuation measurements (such as sales-to-price together with price-to-earnings) can create a more robust picture of a stock's relative cheapness.

* As of July 21st, 2022, the fund does not hold any position in Delek Holdings but is subject to change in the future.

There is no guarantee that any investment strategy will achieve its objectives, generate profits or avoid losses. Holdings and/or Examples are subject to change and do not constitute a recommendation or solicitation to buy or sell a particular security.

Short Position: Aterian



Aterian** (NASDAQ:ATER), calls itself the “world’s most efficient consumer products platform.” According to the company, it synthesizes aggregated online data to identify gaps in the consumer product marketplace and then uses an agile supply chain to bring those solutions to market. The stock ramped aggressively from November 2020 to February 2021 in keeping with that era’s trend for **tech-oriented, unprofitable highfliers to rocket higher on investor enthusiasm**.

Counterpoint’s quantitative model recently rated it as an attractive short due to a somewhat steep valuation, downward trending shares, a money-losing history, and a track record of shareholder dilution:

- ▼ **Sales-To-Price:** On a sales-to-price basis, Aterian ranks in the bottom third of US traded stocks. The stock has been heading lower on the 6- and 12-month time frames.
- ▼ **Profitability & Short-Interest:** Aterian rates poorly on profitability (6th percentile) according to our model, a finding that’s consistent with three straight years of negative net profits from 2019 to 2021. The stock is heavily shorted, suggesting a set of sophisticated investors capable of shorting may have taken a negative view of the company.
- ▼ **Asset Growth:** The company stands out for a lack of balance sheet discipline, ranking in the 90th percentile on asset growth.

The model’s evaluation of Aterian indicates our model’s tendency to poorly rate stocks whose fundamentals don’t seem to justify investor enthusiasm. In this case, a hard fall from investors’ good graces to our model appears set to continue.

Conclusion

The purpose of this exercise was to show how quantitative strategies can express the same insights many bottom-up fundamental stock analysts try to produce. The positive and negative ratings shown here can give investors an intuitive sense for how the **Counterpoint Tactical Equity Fund (CPIEX)** approaches global stock markets. However, the differences between our quantitative approach and that of discretionary analysts are crucial:

- **Machine Learning:** The model uses machine learning analysis to help balance variables that are in conflict with one another to create a synthesized viewpoint. Cheap stocks are often weakly profitable or have poor momentum. Our method seeks to weigh all those factors appropriately.
- **Systematic Investment Methodology:** The model is insulated from human failings like confirmation bias and ego. When a stock’s metrics change, the model’s rating of the stock changes accordingly. Human beings are often slower to update their views based on new information – or they may suffer from “style drift” if the market goes against their convictions forcefully enough.

** As of July 21st, 2022, the fund does not hold any position in Aterian but this is subject to change.

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- **Factor Analysis:** By applying factor analysis across many stocks, the model provides the opportunity for broad diversification – reducing the potential impact of a few stocks going against the strategy’s positioning.

Investors who are looking for ways to diversify their stock market exposure and potentially benefit from uncorrelated sources of return may want to consider a security selection model that systematically and dispassionately invests in apparently attractive opportunities and bets against companies with relatively weak fundamentals.

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 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.

As of July 21, 2022, the fund does not hold any position in the securities listed above but this is subject to change.

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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