

The MarketGrader 100 Index Rebalance Notes

August 2018

MarketGrader's flagship U.S. index, the MarketGrader 100 (MGONE), closed another successful six-month period last Friday, August 17 when it completed its customary semi-annual reconstitution and rebalance. Having recovered smartly from the brief but scary market swoon of early February, MGONE gained 7.0% during the period, well ahead of the U.S. market's 4.9% rise as measured by the Russell 3000 Index. Among the market's size benchmarks MGONE trailed only small caps, which had a phenomenal run during the last six months based on a price return of 9.7% for the Russell 2000 Index. This caps a remarkable one-year stretch for small caps, which gained 24.7% since last August. MGONE, however, wasn't far behind, gaining 22.6% in the last year, well ahead of the Russell 3000 Index's 18.2% and the S&P 500 Index's 17.5% (an outperformance vs. the S&P of 510 basis points), as can be seen in Figure 1. Interestingly, following such strong performance for small caps, MGONE tilted slightly towards larger names during the most recent reconstitution. From a size perspective, the index lost one mid cap name (\$1 billion to \$10 billion) and nine small caps (below \$1 billion); all ten slots were allocated to its large cap segment (above \$10 billion). Thus, the newly reconstituted MGONE now has 40% of its weight in large caps, 56% in mid caps and only four percent in small caps.

Figure 1. MarketGrader 100 Index's One-Year Performance vs. Benchmarks



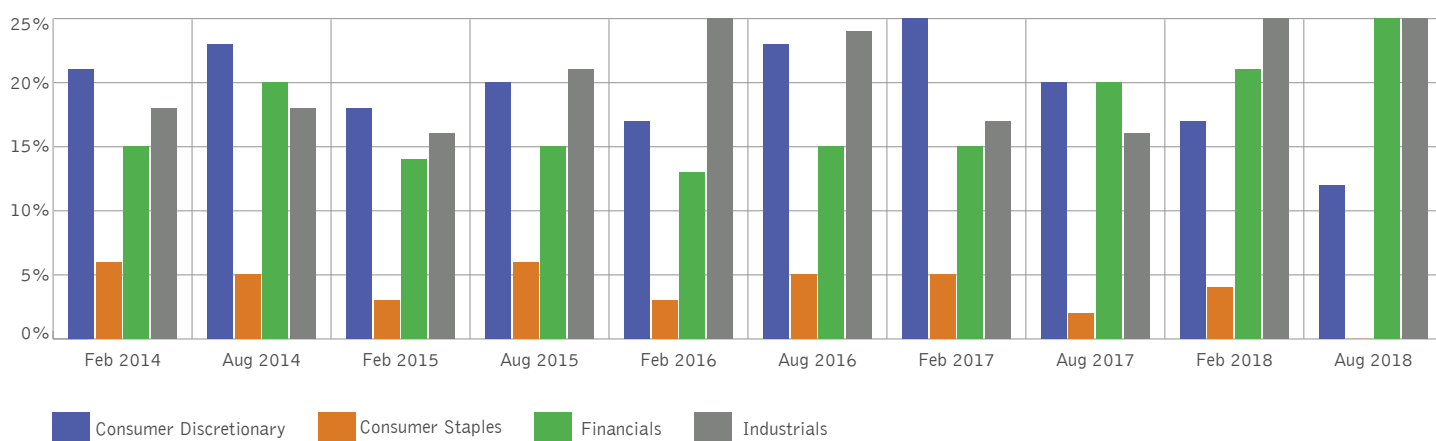
Source: Bloomberg

Among the 100 companies selected to the index in February, 57 contributed positively to its performance, with an average price return of 20.3%, while the remaining 43 generated a drag on performance, with an average return of -10.9%. Among the gainers, five stocks stand out with six-month price returns in excess of 50%. These included Insuperity, Inc. (NSP), which gained 78.5%; Health Insurance Innovations (HIIQ), up 77.2%; Viper Energy Partners (VNOM), up 64.0%; Ligand Pharmaceuticals (LGND), up 57.8%; and Shake Shack (SHAK), which returned 53.2%. All five stocks were subsequently removed from the index during last week's reconstitution, largely as a result of stretched valuations, a good illustration of how MarketGrader's rigorous discipline ensures not only profit taking every six months but also keeps investors from overpaying for growth.

Overall, 77 companies were replaced during the index's latest rebalance, once again above its 63% historical average turnover dating back to MGONE's inception in 2003. This was, however, slightly lower than the prior three rebalance periods. From a sector perspective, the two consumer-driven sectors were the biggest losers in this latest reconstitution, with Consumer Discretionary losing a net five names, down to an overall weight of just 12%, relatively light by the sector's historical standards (it had reached a 25% allocation a year and a half ago, during the February 2017 rebalance). Consumer Staples, meanwhile, shed all four names from the February period and failed to pick up a single one, leaving it completely unrepresented in MGONE, at least for the next six months, the first time this happens in the last five years. These sector fluctuations are a natural part of MarketGrader's grading and index selection process, as the methodology is sector agnostic and simply looks for the best values across all U.S. equities, irrespective of industry or sector.

With both Consumer sectors exhibiting some weakness based on MarketGrader's rigorous fundamental grades, much of the slack was picked up by Industrials, which continues to show remarkable strength in MarketGrader's rating system, with the sector once again maxing out at 25%. This is the second consecutive rebalance period in which Industrials are maxed out in MGONE; in fact, had it not been for the index's methodology sector cap, an additional three Industrial companies would have been selected last week. The other sector that continues to stand out in MarketGrader is Financials, with MGONE's allocation not only climbing from 21 names selected in February to 25 in this most recent rebalance but, also with the sector cap rule preventing an additional eight companies from the sector being selected to the index, which would have given it almost a third of MGONE's overall weight; the majority of these companies, by the way, are Regional Banks. That both of these sectors continue to exhibit such fundamental strength speaks well of the underlying vitality of the U.S. economy, especially encouraging as it suggests that consumption isn't being required to do all the heavy lifting, often typical of the latter stages of expansionary economic cycles. Figure 2 displays the allocation shifts among these four sectors—Consumer Discretionary, Consumer Staples, Financials and Industrials—in the last five years. Among the remaining sectors, the one with the largest representation was Technology, now accounting for 16% of the index, followed by Health Care with eight names and Energy and Materials with seven names apiece.

Figure 2. MGONE Allocations to Consumer Discretionary, Consumer Staples, Financials and Industrial Sectors 2014-2018



Source: MarketGrader

MGONE selected 46 companies for the very first time, including such notable names as Costco Wholesale (COST), PNC Financial Services (PNC), Norfolk Southern (NSC), Aflac (AFL) and TD Ameritrade (AMTD). An additional 13 companies made their reappearance in MGONE after an absence of more than two years, including Valero Energy (VLO), Concho Resources (CXO) and Freeport-McMoRan (FCX) as the recovery in the shares of Energy and Materials stocks continues.

Irrespective of the index's turnover on any given rebalance period we always like to highlight the names among the current crop of constituents that have been regulars in MGONE, even if they miss a semester or two. Notable among the new list are MAXIMUS (MMS), Steven Madden (SHOO), and Freeport-McMoRan (FCX), all of which have been selected to the index nine times since its inception; NVR, Inc. (NVR) with 11 selections; Mastercard (MA) with 12 selections; Booking Holdings (BKNG), formerly Priceline, with 13 selections and Apple (AAPL) with 17 selections. The complete list of MGONE constituents following this latest rebalance is available in Appendix 1.

MGONE and the Bull Market

As stocks continue to grind higher, investors will start seeing this week plenty of references to what is now the longest bull market in history. As followers of MGONE will inevitably wonder how the index has done relative to the market benchmarks, we figured some context might be appropriate.

Since the market bottomed on March 9, 2009, the S&P 500 Index has gained, on a price return basis, an impressive 323%. The overall market, as measured by the much broader Russell 3000 Index, which represents approximately 96% of the U.S. equity market's investable universe, gained 337% during the same period. Small caps, as measured by the Russell 2000 Index, rose a remarkable 400%. Meanwhile, the MarketGrader 100 Index, which is size-agnostic in its selection, gained 426% on a price-only basis between the market bottom in 2009 and Tuesday, August 22, outperforming the overall U.S. market by 89 percentage points.

Appendix 1.

MarketGrader 100 Index Constituents - August 2018 Rebalance

Ticker	Company Name	Overall Grade	Market Cap*
Consumer Discretionary			
BKNG	Booking Holdings Inc.	64.7	88,025.40
CMCSA	Comcast Corporation Class A	72.8	160,551.00
COST	Costco Wholesale Corporation	60.3	96,286.30
IPG	Interpublic Group of Companies	63.7	8,385.70
MTN	Vail Resorts, Inc.	67.3	11,600.70
NTRI	Nutrisystem, Inc.	73.8	1,189.54
NVR	NVR, Inc.	75.0	9,667.66
SHOO	Steven Madden, Ltd.	64.1	3,293.55
SYX	Systemax Inc.	63.8	1,357.88
TSCO	Tractor Supply Company	64.2	9,682.28
WLH	William Lyon Homes Class A	61.0	789.93
YUMC	Yum China Holdings, Inc.	62.8	13,114.70
Energy			
CXO	Concho Resources Inc.	65.5	27,227.90
EGN	Egenen Corporation	63.4	6,956.32
LBRT	Liberty Oilfield Services Inc.	84.2	1,397.76
MTDR	Matador Resources Company	66.1	3,656.19
SHLX	Shell Midstream Partners LP	75.3	5,008.91
TCP	TC PipeLines, LP	66.7	2,330.99
VLO	Valero Energy Corporation	67.1	49,061.00
Financials			
AFL	Aflac Incorporated	64.3	35,549.10
AMTD	TD Ameritrade Holding Corp	61.6	32,804.60
APAM	Artisan Partners Asset Manag	60.7	1,792.07
ASB	Associated Banc-Corp	66.2	4,637.93
BOKF	BOK Financial Corporation	62.0	6,382.92
BXS	BancorpSouth Bank	64.9	3,345.80
CADE	Cadence Bancorporation Class A	63.7	2,331.47
CATY	Cathay General Bancorp	69.2	3,365.62
CMA	Comerica Incorporated	70.5	16,498.90
FII	Federated Investors, Inc. Class B	69.2	2,257.29
GWB	Great Western Bancorp, Inc.	69.6	2,459.58
HBAN	Huntington Bancshares Incop	70.5	17,347.50
HLNE	Hamilton Lane Incorporated	62.5	1,071.80
KEY	KeyCorp	66.9	22,282.20
MA	Mastercard Incorporated Class A	65.2	210,010.00
NBTB	NBT Bancorp Inc.	61.3	1,724.33
NMIH	NMI Holdings, Inc. Class A	60.1	1,410.44
NTB	Bank of N.T. Butterfield & Son Lim	74.5	2,866.19
PBCT	People's United Financial, Inc.	65.7	6,359.14
PNC	PNC Financial Services Group, Inc.	71.0	65,889.10
PNFP	Pinnacle Financial Partners, Inc.	65.4	4,925.78
RNST	Renasant Corporation	65.1	2,239.59
SFBS	ServisFirst Bancshares Inc	72.1	2,246.75
TSC	TriState Capital Holdings, Inc.	66.4	839.52
WSFS	WSFS Financial Corporation	68.3	1,585.42
Health Care			
LH	Laboratory Corporation of Americ	63.9	18,318.60
LMAT	LeMaitre Vascular, Inc.	65.5	710.56
MASI	Masimo Corporation	61.1	5,688.62
NEOG	Neogen Corporation	62.0	4,316.53
NKTR	Nektar Therapeutics	71.3	10,229.10
SUPN	Supernus Pharmaceuticals, Inc.	72.5	2,271.31
TVTY	Tivity Health, Inc.	60.1	1,346.24
ZBH	Zimmer Biomet Holdings, Inc.	63.7	24,916.90

*Market Cap in millions of USD. Source: MarketGrader Research.

Ticker	Company Name	Overall Grade	Market Cap*
Industrials			
AXL	American Axle & Manufacturing	68.9	1,813.78
BAH	Booz Allen Hamilton Holding Cor	60.3	6,974.98
BLD	TopBuild Corp.	68.8	2,587.46
BMCH	BMC Stock Holdings, Inc.	69.9	1,423.73
CC	Chemours Co.	78.1	7,828.93
DLX	Deluxe Corporation	60.2	2,787.79
FAST	Fastenal Company	76.4	16,453.70
FIX	Comfort Systems USA, Inc.	68.2	2,042.89
FWRD	Forward Air Corporation	75.2	1,833.73
GBX	Greenbrier Companies, Inc.	65.9	1,849.37
GNRC	Generac Holdings Inc.	75.0	3,341.48
HEIA	HEICO Corporation Class A	69.1	8,775.83
HII	Huntington Ingalls Industries, Inc.	69.5	10,419.70
HXL	Hexcel Corporation	65.2	6,037.06
IEX	IDEX Corporation	70.4	11,585.60
KAR	KAR Auction Services, Inc.	66.9	8,230.57
MANT	ManTech International Corp	60.2	2,460.25
MMS	MAXIMUS, Inc.	64.7	4,082.97
NSC	Norfolk Southern Corporation	70.1	47,918.70
PATK	Patrick Industries, Inc.	80.0	1,542.31
SNDR	Schneider National, Inc. Class B	70.8	4,693.97
WBC	WABCO Holdings Inc.	72.7	6,356.54
WDFC	WD-40 Company	60.9	2,290.27
WIRE	Encore Wire Corporation	63.7	1,035.15
WM	Waste Management, Inc.	63.3	38,588.80
Materials			
CE	Celanese Corporation Class A	75.2	15,648.80
FCX	Freeport-McMoRan, Inc.	72.5	21,619.10
FMC	FMC Corporation	64.8	11,555.30
IP	International Paper Company	63.5	21,098.10
PKG	Packaging Corporation of America	73.4	10,400.50
SCHN	Schnitzer Steel Industries, Inc.	67.5	778.83
STLD	Steel Dynamics, Inc.	81.7	10,305.60
Technology			
AAPL	Apple Inc.	77.1	1,008,830.00
ADBE	Adobe Systems Incorporated	69.5	124,149.00
ADS	Alliance Data Systems Corporation	66.9	12,492.10
ATHN	athenahealth, Inc.	69.4	6,065.17
CSGP	CoStar Group, Inc.	67.1	15,598.60
EGOV	NIC Inc.	68.0	1,071.62
FTV	Fortive Corp.	65.8	27,691.20
INTU	Intuit Inc.	71.7	53,773.20
JKHY	Jack Henry & Associates, Inc.	66.0	10,950.40
MKSI	MKS Instruments, Inc.	77.0	5,007.90
NVDA	NVIDIA Corporation	79.0	155,465.00
PAYX	Paychex, Inc.	67.4	25,546.40
TSS	Total System Services, Inc.	65.4	17,163.70
TXN	Texas Instruments Incorporated	72.5	106,883.00
VEEV	Veeva Systems Inc Class A	69.7	12,004.30
VSM	Versum Materials, Inc.	65.7	4,008.23

*Market Cap in millions of USD. Source: MarketGrader Research.

Information herein is provided for general informational purposes and not intended to be completely comprehensive regarding the particular subject matter. MarketGrader.com does not represent, guarantee, or provide any warranties (express or implied) regarding the completeness, accuracy, or currency of information or its suitability for any particular purpose. Receipt of information does not create an adviser-client relationship between MarketGrader.com and you. Neither MarketGrader.com nor our advisory affiliates provide tax or legal advice or opinions. You should consult with your own tax or legal adviser for advice about your specific situation.

p | +1.888.529.1767
e | research@marketgrader.com
w | marketgrader.com



MarketGrader
RESEARCH & INDEXES