FATI®

SECTOR/GROUP INDEX

and

SELECT FUNDAMENTALS LIST

Methodology Overview

This paper was prepared to assist subscribers/investors with an understanding of the concept and criterion behind the **FATI® Sector/Group Index and the** FATI® Select Fundamentals List.

FATI® SECTOR/GROUP INDEX

Methodology Overview

Key Concepts

Data Dependence

The investment world is more data dependent today than ever before. This applies to both technical or fundamental data. The individual stock universe is comprised of approximately 16,000 stocks, of which 8,000 have quasi-reliable technical and fundamental data available. Even a universe of 8,000 stocks is extremely large and very hard for any investor to manage.

One of the risks with large amounts of data, of any type, is its quality. If you use low quality data, it could create poor data outputs used in your investment decision process. There is an old adage which applies here and most have heard it before: *Garbage In – Garbage Out*. The quality of data and the ability to manage the data is paramount in the investment management process.

Start with the FATI ® Sector/Group Structure

Many of the available Sector/Group Indices have, what is called, 'limited participation'. Some of the industries groups contain only one or two stocks. The FATI® Sector/ Group Index is designed to maximize the number of issues in each industry group. For example, a major index provider has an index with 60 industries and an average of 8.3 stocks per industry. If you look closely you will find over 10% of the industries are comprised of only one or two stocks. Hardly a representative sample. The FATI® Sector/Group Index averages over 44 stocks per industry and usually no less than 6-7 stocks on average in an industry group. This gives investors a more accurate representation of each industry. The index also broadens the number of sectors from the industry average of 10 to 17 sectors. This was done to improve the granularity of the index and make it easy to identify investment opportunities.

Influential Factors on the Markets

It is a well-known fact approximately 90% of the volume in the equity markets come from institutional investors. These investors include mutual funds, pension plans, insurance companies and hedge funds Due to the large size of the portfolios they manage, it may take weeks, if not months; for them to build a position in a stock. Remember, these investors try to buy or sell in a stealth manner to avoid tipping their actions and having the price pushed up or down before they have finished acquiring or disposing a position.

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Since institutional investors have such a significant influence on the market, it only makes sense to focus on the stocks they watch and trade. We conducted a survey to determine if there were a common, and simple, set of criterion which could be used to narrow a list of over 8,000 stocks. At the same time, try to determine what the average investment manager's universe of stocks is comprised of. Institutional analyst's standards are high when it comes data requirements. If those standards are missing from the data of a company, they won't consider the company for investment potential. Remember Data Dependence from above. *'Garbage In – Garbage Out'.*

The Search

The Survey and Results

A survey was conducted from a random list of investment managers. Armed with the data collected from the investment managers a plethora of test screenings were performed. Each screening was reviewed to determine the data available, data completeness and data quality, both fundamental and technical. After exhaustive testing, a final list of criterion was selected. The final screening using the selected criterion was performed and compared to several investment manager's universe of stocks. The results showed, on average, the final screen captured 86% of their universe of stocks. Some higher, some lower.

Below is the final criterion used in the construction of the FATI® Sector/Group Index.

- Average Daily Trading Volume >= 100,000 shares
- Current Price >= $5.00
- Number of Analysts in Average Broker Rating >= 2
- Market Cap Valuation >= $100 million

The index is updated once a month using the criterion listed above. In any given month as many as 20-300 stocks may be added and/or deleted from the index. The number of issues in the index has ranged between 2,500-3,000 stocks. By narrowing the number of stocks in this manner, the fundamental and technical data was more plentiful, more accurate and more complete.

FATI® SELECT FUNDAMENTALS LIST

Screening Overview

Why Fundamentals?

First and foremost, the reason is how institutional investors, who comprise 90% of the activity on the exchanges, determine which stocks they will purchase. Yes, fundamental analysis can be time intensive, but consider this one key fundamental which could immediately boost your portfolio performance.

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Below are the results from a study conducted by a leading investment research firm. The study was done to show the performance impact the percentage change in the current year consensus earnings estimates have on stock prices. The study was conducted over a fifteen-year period cover both bull and bear markets.

The universe of stocks for the study were comprised of companies whose market capitalizations were at least $100 million and had at least one analyst following the company. This came to a total of approximately 3,000 stocks.

The Portfolios

There were three portfolios established based upon the percentage change to the current year consensus earnings estimates.

- **Portfolio A**

  Stocks for which the consensus earnings estimates fell by over 1% during the past month.

- **Portfolio B**

  Stocks for which the consensus earnings estimates did not change during the past month.

- **Portfolio C**

  Stocks for which the consensus earnings estimates rose by over 1% during the past month.

The stocks were sorted into the three portfolios and their performance was measured for the next or following month. This process was repeated every month for a full fifteen years. Transaction costs were not factored in.

The Results

- Portfolio A - had an annualized return over the fifteen years of +0.70%.
- Portfolio B - had an annualized return over the fifteen years of +7.60%.
- Portfolio C - had an annualized return over the fifteen years of **+18.20%.**
- The S&P 500 had an annualized return over the fifteen years of +9.00%.

The Conclusion

Stocks which receive upward revisions to current year consensus earnings estimates outperform over time. That's powerful information to profit from. With FATI® Select Fundamentals **you can have access to an entire list of pre-screened stocks with great fundamentals. The stocks institutional investors are looking at or investing in right now.** Remember now, this was the impact of only one fundamental. *What if you had access to a list of stocks like these?*

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Criterion Used in the FATI Select Fundamental Screen

Below is the criterion used to build the FATI® Select Fundamentals List

- Percentage Change in Current & Next Year's Consensus Estimates over 4 weeks
- P/E Ratio based on the Current Fiscal Year Consensus Estimate
- Number of Analysts in the Consensus Estimates for each year
- Number of Analysts in Average Broker Rating >= 2
- Current & Next Fiscal Year's Consensus Estimates
- Average Daily Trading Volume >= 100,000 shares
- Market Cap Valuation >= $100 million
- Current Price >= $5.00
- Shares Outstanding
- Return on Assets
- Current Ratio
- Cash Flow
- Margins

The Results

Each month you will receive a new list of fundamentally screened stocks (FATISLCT). The list includes stocks from all market capitalization Mega Caps to Nano Caps. The list varies between 30 to 100 stocks depending on market conditions. These are stocks which are attracting the attention of institutional investors. Remember it can take weeks or even months for institutional investors to acquire the positon in any one stock.

Fundamentals Made Simple

There you have it. "***Fundamentals Made Simple***". Just bring up the FATISLCT list and go right into your technical analysis. All the fundamental screening has already been done for you. Each and every month you will receive a new FATI® Select Fundamentals list along with you're the FATI® Sector/Group Index and the entire Fundamental Database of over 4,400 stocks. Powerful.

Putting it All Together

Knowing the key concepts and the criterion used in the construction of the FATI® Sector/Group Index and Select Fundamentals, let's put it all together and answer the question.

"Why Use the FATI® Sector/Group Index and FATI® Select Fundamentals?"

They provide investors and traders with these benefits:

1. a defined list of stocks institutional investors watch and invest in.
2. a higher quality Sector/Group structure for better investment decisions.
3. market capitalizations ranging from Mega Caps to Nano Caps.
4. the elimination of low priced / low quality stocks with poor quality data.
5. no maintenance of the index, fundamental screen or data. ***Download and Use*.**
6. **lower portfolio drawdowns and improved performance over time.**

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One Last Thought

There are two generally accepted approaches to investing. Fundamental and Technical. Which is better is not up for debate here, but instead consider the following;

Fact, the majority of institutional investors purchase companies based upon strong fundamentals and earnings.

Professional Traders focus on technical indicators, patterns and news events to determine when to buy or sell a stock.

Why choose between two methodologies?

Don't, Use Both.

First, use the FATI® Select Fundamentals List to focus on the stocks institutional investors are watching and trading. Next, use technical analysis to determine when to buy or sell the fundamentally screened stocks.

FATI® Sector/Group Index

+

FATI® Select Fundamentals List

+

Technical Analysis

=

MORE PROFIT$

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FATI®

SELECT FUNDAMENTALS

Performance Overview

FATI® SELECT FUNDAMENTALS

Performance Overview

Historical back-testing was performed over 36 four week holding periods.

June 21st, 2013 through April 1st, 2016.

4 WEEK HOLD STATISTICS	FATI® SELECT	S&P 500
Total Compounded Return	60.90%	35.30%
Total Compounded Return $	$16,091	$13,529
Compounded Annual Growth Rate	18.70%	11.50%
Win Ratio	75%	64%
Winning Periods/Total Periods	27 of 36	23 of 36
Avg. # of Stocks Held	27	
Avg. Periodic Turnover	92.8	
Avg. Return per Period	1.4	0.9
Avg. Winning Period	3.5	2.7
Largest Winning Period	10.4	6.8
Avg. Losing Period	-4.6	-2.3
Largest Losing Period	-13.9	-6.1
Max. Drawdown	-14	-7.8
Avg. Winning Stretch (# of Periods)	3.9	2.3
Best Stretch (# of Periods)	11	6
Avg. Losing Stretch (# of Periods)	1.5	1.4
Worst Stretch (# of Periods)	2	3
ANNUALIZED RETURN		
Total Return of Portfolio %	20.40%	
S&P 500 Total Return %	12.20%	
Excess Return of Screen %	8.20%	

** See Performance Disclosure Below*

Performance Disclosure

The performance calculations for the FATI Ultra Fundamentals were produced through back-testing and consist of the total return (price changes + dividends) of an equal weighted portfolio. Returns are calculated on a specified periodic basis (most often one, four or twelve weeks and assume no transaction costs. The portfolio is rebalanced at the start of each new period. Returns are stated as either annualized or compounded returns.

Stock trading/investing involves risk and you can lose some or all of your investment. Hypothetical or back-tested results may not always be duplicated in the real world. Back-testing can at times produce an unintended look-ahead bias. Results can also at times be over or understated due to the exclusion of inactive companies. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading, not the least of which is the ability to withstand losses or to adhere to a particular trading strategy in spite of trading losses. These are material points which can also adversely affect actual trading results. The back-tested results prepared for the FATI Ultra Fundamentals consisted of only active companies.

Potential Limitations in Back-testing

There are four types of biases which may distort back-test results.

1. Look Ahead bias - this occurs when the stocks selected on a rank date use financial information that was not available on that rank date. For example: if a company reports its financials for the quarter ending Mar 2006 on Apr 20, 2006, the rank that is created at the end of the March 2006 quarter should not use the financials for that quarter, since they were not available at the end of the quarter.

2. Restatement bias - this occurs when a company restates its historical financials. For example: if a company reports its 3/16 results and restates its Dec 2015 results; a rank done as of end of Dec 2015 should use the originally reported financials for Dec 2015, not the restated financials for Dec 2015 which were not available until March 2016.

3. Survivor bias - this occurs when stocks that have been delisted or acquired are not included in the back-test results. Depending on your strategy, the impact of survivor bias on the back-test may or may not be significant.

4. Split bias - this can occur if your screen uses price as a qualifier, e.g., Price > $5.00. The database is split adjusted. So, using the example above, if the company had a stock split between the screened date and the date of the back-test, the company may not be included in the back-test results if the split adjustment caused the historical price at the date of the back-test to be below that $5.00 threshold. Typically, stock splits occur at higher prices.