MILL STREET RESEARCH

MAER Stock Ranking Model

The MAER Stock Ranking Model uses six factors to rank stocks within any universe and forecast returns over a 3-6 month horizon. The underlying drivers of the model are well established in both academic and practitioner literature, but our proprietary implementation helps make the results more effective, robust, and institutionally investable than most other similar models. The six drivers of the model are:

SIX FACTORS

1 EARNINGS ESTIMATE REVISIONS BREADTH

The key underlying driver of MAER is the idea that the direction of analyst estimate revisions is a significant driver of relative returns. We use the net proportion of analysts raising versus lowering estimates for each stock as the most important input to the model.

2 EARNINGS ESTIMATE REVISIONS MAGNITUDE

Alongside the revisions breadth, we gauge the conviction of analyst activity by using a scaled measurement of monthly percent changes in consensus analyst estimates for each stock.

3 ALPHA MOMENTUM

Our proprietary measure of risk-adjusted six-month returns for each stock. This helps gauge each stock's return momentum after accounting for market and style effects.

4 SHORT-TERM MEAN REVERSION

We use a scaled measurement of each stock's prior month return to capture well-known short-term mean reversion effects in prices.

5 FORWARD EARNINGS YIELD

We use forward valuation multiples to help identify stocks for which the trends in revisions (fundamentals) may not be priced in.

6 RELATIVE FORWARD EARNINGS YIELD

In addition to the absolute level of valuation for each stock, we use a relative measure that accounts for each stock's historical valuation range and thus avoids structural biases toward particular sectors or styles based on valuation.

MARKETING AFFILIATE: BlueFox ADVISORS ▪ TELEPHONE: (212)452-3115 ▪ EMAIL: INFO@MILLSTREETRESEARCH.COM

MILL STREET RESEARCH, LLC ▪ www.millstreetresearch.com ▪ P.O. Box 282 ▪ Sherborn, MA 01770

Why MAER Matters

MAER is designed for institutional investors with an intermediate-term time horizon.

Unlike models that require very high turnover and/or trading in small and illiquid stocks to produce results, the MAER rankings are only applied to institutionally investable stocks, do not require frequent trading, and can be used effectively to build portfolios with 3-6 month typical holding periods.

This is due to the constraints we place on the universe of covered stocks and the focus on persistent underlying trends in company fundamentals and analyst sentiment. To be included in the MAER universe, stocks must have minimum market capitalizations of $200 million for US stocks and $500 million for non-US stocks, along with at least 3 analysts reporting estimates and $2 million/day in average daily trading value.

MAER is global and consistent.

The MAER Ranking Model currently covers approximately 6000 stocks globally, and is applied in the same way for all stocks. This means that any universe of stocks can be ranked and used to build portfolios in a consistent and flexible way.

MAER's construction helps avoid focusing too heavily on the most volatile stocks.

The scaling and normalization methods used in the model help avoid a key limitation of many models that use similar inputs: top-ranked stocks would often be more volatile than average and thus increase the risk of portfolios built from them. MAER allows less volatile stocks an equal chance of being highly ranked and thus helps control risk in portfolios.

Historical testing shows MAER is effective and robust.

Our historical tests (available on request) show that the MAER ranking yields favorable results even in the presence of transactions costs when applied to a wide variety of stock universes (regions, sectors), using various trading strategies, and in most time frames since 2003.

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