



## ECONOMIC SITUATION AND STRATEGY

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### "Apple pie" principle: A different way to pick stocks

When analyzing and selecting stocks, one generally looks for companies with positive attributes like low valuation, high earnings growth, balance sheet quality, and an attractive return on equity. And investors do not complain if a stock also exhibits low price volatility and has produced small drawdowns in the past. However, what sounds simple at first turns out to be something of an art, since hardly any stocks rate positive on all these criteria. Stocks with high earnings growth are usually not cheap, and companies with high returns on equity are often comparatively deep in debt and thus do not exhibit high balance sheet quality. This is exactly what in practice forces one to make selection compromises. Two different camps have emerged around this issue. The "growth camp" emphasizes earnings growth and profitability and accepts high valuations, while the "value camp" bets on low valuations and accepts lower earnings growth rates and below-average profitability. There is no right or wrong here. Although one would certainly have done better with a growth strategy in the last ten years, no one can say for certain that the same will be true in the next ten years. The debate is therefore somewhat idle, since there are good and bad, successful and less successful, investors in both camps.

Instead of contributing more to the debate about which investment philosophy might be right, we have come up with a different idea. How would it be if, instead of hunting for attractive attributes and ultimately having to make compromises, we just excluded stocks that obviously exhibit especially poor attributes? Such an approach does not involve scoring, but rather filtering. The point is not to do as well as possible in a scoring system

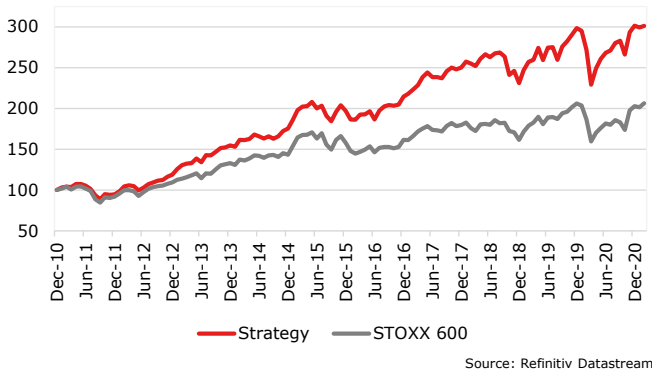
based on attractive attributes, but rather just to clear a comparatively low hurdle. To test such a method based on European stocks, we set the filters as follows. In a first step, we used several criteria to assign to all STOXX 600 stocks a ranking for the following: balance sheet quality, profitability, volatility, valuation, and earnings growth. A stock could then only pass a filter if it was among the best 80% in the STOXX 600. Exactly 480 stocks passed one filter per rebalancing date and criterion, respectively. Given this high number, one might expect that the resulting portfolio would also contain a very large number of stocks. But this expectation was not confirmed. We created a portfolio every six months from 2010 onward with the historical index members and the data that would have been available historically in a real-time application (point-in-time data). The number of stocks in the portfolio ranged from 69 to 119 and came to 100 on average. The reason for this surprisingly low number against the background of the low filter is easy to explain. There are not that many stocks with no weaknesses at all. As in the case of people, it is also true of stocks that none is perfect. But how did the stocks perform that at least exhibited no extreme "damage" and therefore passed our filters one after the other?

The back-calculation (excluding costs) shows performance that turns out significantly better over the years than that of the initial universe. The tracking error that measures deviation from the benchmark here is actually still relatively small (3.8%), and volatility is exactly the same as that of the index. The drawdown attributes are also similar to those of the benchmark, and the infor-

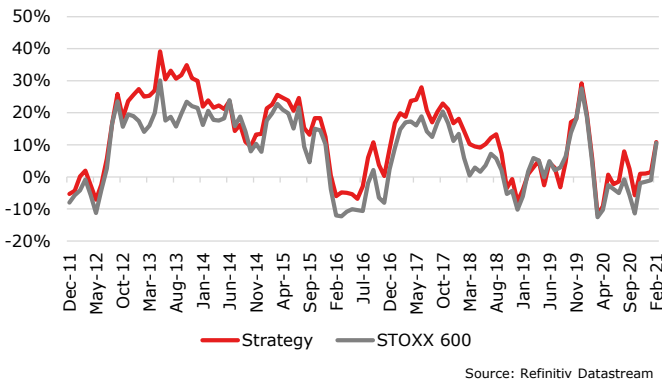
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mation ratio is a highly attractive 1.2. If we analyze the strategy's smoothed annual rate and compare that with the smoothed annual rate of the STOXX 600, we find hardly any periods in which the strategy was systematically and constantly worse than the index.

Strategy backtest and benchmark



Strategy backtest and benchmark y/y



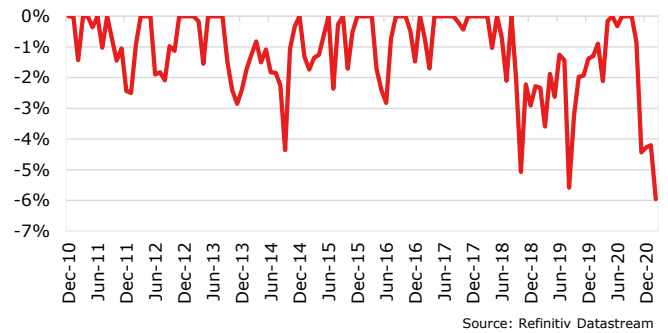
This is also shown by the development of the active return that would have resulted (excluding costs) if one had implemented the strategy on the long side and at the same time had hedged the market by selling a STOXX 600 future.

Performance of the active return of the strategy before costs



Nevertheless, one should not conclude that this strategy would have worked perfectly at all times. The draw-down chart of the active return clearly shows that one would have had to accept at times larger setbacks relative to the benchmark, especially in the last two years. Nevertheless, this realization does not change the fact that this strategy, which was developed entirely without any curve-fitting or optimization, would have worked astonishingly well in sum and over the years.

Drawdown of the active return of the strategy before costs



How can such a simple strategy deliver such good results? Especially when one considers that because the filters are not very restrictive, some stocks turn up in the portfolio that would not have been bought with a conventional selection method? Perhaps it is a little like baking apple pie. We do not intensively check every apple in detail for its taste before using it for the pie. It is actually enough that we ensure that we use no completely rotten apples. Ultimately, investing is a little like baking. The result must taste good, but that need not be true of each and every ingredient.

## Market Data

Stock marketes	As of	Change versus				
	06.04.2021 12:09	30.03.2021 -1 week	05.03.2021 -1 month	05.01.2021 -3 months	03.04.2020 -1 year	31.12.2020 YTD
Dow Jones	33527	1,4%	6,4%	10,3%	59,3%	9,5%
S&P 500	4078	3,0%	6,1%	9,4%	63,9%	8,6%
Nasdaq	13706	5,1%	6,1%	6,9%	85,9%	6,3%
DAX	15259	1,7%	9,6%	11,8%	60,2%	11,2%
MDAX	32386	2,1%	5,4%	4,3%	59,2%	5,2%
TecDAX	3458	2,8%	7,4%	6,3%	35,0%	7,6%
EuroStoxx 50	3974	1,2%	8,3%	12,0%	49,2%	11,9%
Stoxx 50	3358	0,7%	6,2%	7,7%	25,9%	8,0%
SMI (Swiss Market Index)	11181	0,5%	5,4%	4,6%	21,0%	4,5%
Nikkei 225	29697	0,9%	2,9%	9,3%	66,6%	8,2%
Brasilien BOVESPA	117518	0,6%	2,0%	-1,6%	69,0%	-1,3%
Russland RTS	1448	-0,8%	0,1%	1,6%	38,0%	4,4%
Indien BSE 30	49261	-1,7%	-2,3%	1,7%	78,5%	3,2%
China Shanghai Composite	3483	0,8%	-0,5%	-1,3%	26,0%	0,3%
MSCI Welt (in €)	2873	1,8%	6,4%	11,2%	47,6%	10,9%
MSCI Emerging Markets (in €)	1339	0,8%	1,0%	5,3%	46,9%	7,7%
<b>Bond markets</b>						
Bund-Future	171,83	83	-217	-607	-23	-581
Bobl-Future	135,11	11	58	-18	13	-7
Schatz-Future	112,12	3	-7	-20	1	-16
3 Monats Euribor	-0,54	3	2	2	-20	4
3M Euribor Future, Dec 2017	-0,56	-1	-3	0	-18	0
3 Monats \$ Libor	0,20	0	1	-4	-119	-4
Fed Funds Future, Dec 2017	0,08	0	0	0	-3	0
10 year US Treasuries	1,70	-2	15	75	111	79
10 year Bunds	-0,30	2	4	28	14	28
10 year JGB	0,11	3	3	10	13	9
10 year Swiss Government	-0,28	-2	-2	25	6	21
US Treas 10Y Performance	672,66	0,5%	-1,0%	-5,7%	-8,2%	-6,1%
Bund 10Y Performance	670,29	0,4%	0,2%	-2,2%	-0,8%	-2,1%
REX Performance Index	494,40	0,1%	0,1%	-1,1%	-0,4%	-1,0%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,19	-5	-1	17	-94	17
IBOXX BBB, €	0,65	-7	-4	13	-180	9
ML US High Yield	4,85	-3	-11	-14	-505	-13
Convertible Bonds, Exane 25	8232	0,0%	2,4%	-2,2%	17,6%	-1,1%
<b>Commodities</b>						
MG Base Metal Index	391,66	-1,0%	-0,3%	7,5%	62,0%	10,4%
Crude oil Brent	63,64	-1,0%	-8,4%	18,6%	85,9%	22,6%
Gold	1731,60	2,7%	2,1%	-11,0%	7,0%	-8,8%
Silver	24,90	3,1%	-0,2%	-9,4%	73,0%	-5,6%
Aluminium	2203,00	-0,1%	1,2%	8,2%	52,1%	11,6%
Copper	8794,50	0,3%	-1,3%	10,0%	82,3%	13,5%
Iron ore	163,89	-1,9%	-5,3%	-1,3%	98,9%	5,2%
Freight rates Baltic Dry Index	2072	-1,5%	13,3%	46,1%	236,4%	51,7%
<b>Currencies</b>						
EUR/ USD	1,1816	0,6%	-1,0%	-3,7%	9,6%	-3,7%
EUR/ GBP	0,8538	-0,2%	-0,9%	-5,5%	-3,1%	-4,6%
EUR/ JPY	130,52	0,8%	0,9%	3,4%	11,5%	3,2%
EUR/ CHF	1,1076	0,2%	0,1%	2,5%	5,0%	2,5%
USD/ CNY	6,5492	-0,4%	0,8%	1,4%	-7,7%	0,3%
USD/ JPY	110,18	-0,2%	1,7%	7,2%	1,6%	6,7%
USD/ GBP	0,72	-0,9%	-0,1%	-1,8%	-11,4%	-1,2%

Source: Refinitiv Datastream

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