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Firm Characteristics, Concentrated Portfolio Strategies and Industrial Sector Price Movements in 2014

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Study Objectives

- Determine if stocks in the industrial sector weighted by fundamental characteristics can outperform the market.
- Determine if a concentrated portfolio can outperform the market.

Research Approach

- Determine portfolio weights based on relative value.
- Use the following firm characteristics to determine portfolio weights:
  - Price to Earnings (P/E)
  - Price to Book (P/B)
  - Price to Sales (P/S)
  - Price to Cash Flow (P/CFL)
  - Expected Earnings Growth (EG)
- Use the Top 10 holdings in the industrial sector ETF (XLI) as the concentrated portfolio.
- Original Investment: $5,000,000

Portfolio Weighting Model

1. $r_{ij} = \frac{\sum(P/E_i)}{P/E_i}$
2. $R_{ij} = \sum r_{ij}$
3. $W_{ij} = \frac{R_{ij}}{\sum R_{ij}}$ x 5,000,000
4. $DVI_{lt} = W_{ij} \times 5,000,000$
5. $S_{lt} = DVI_{lt}$
6. $DVI_{lt+1} = S_{lt} \times P_{lt+1}$
7. $PV_{t+1} = \sum_{lt} DVI_{lt+1}$

Findings

- CXLI generates positive alpha.
- CXLI moderately outperforms XLI.
- CXLI significantly outperforms DOW.