

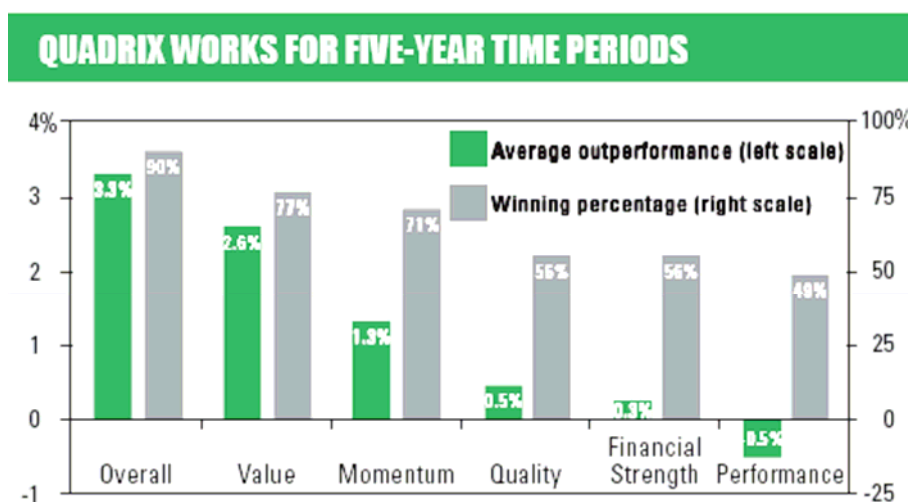
## Quadrix for buy-and-holders

By now, regular readers know that the Quadrix® stock-rating system is effective at finding stocks likely to outperform over time periods of up to one year. But not everyone has an investment horizon that short.

Many investors would rather not make buys and sells with the frequency necessary to stay in stocks with top near-term potential. Such investors prefer to buy quality companies and hold them for the long haul. So, how well does Quadrix work for buy-and-holders? The answer: Better than we expected.

Most of our research involving Quadrix focuses on stock returns for periods of three, six, and 12 months. Quadrix Overall scores — and most of the up to 100 variables used to compute Overall scores — generally deliver higher annualized returns with shorter holding periods and more frequent rebalancing. But, partly because we are skeptical of variables that require frequent rebalancing, our weighting system is designed for 12-month performance. While this meshes nicely with the year-ahead orientation of our Focus List and Buy List, Quadrix also has a good record of picking five-year winners.

For example: Based on a back-test of five-year returns for stocks in the S&P 500 Index starting in 1990, the top one-fifth of Overall scorers outperformed the average stock by



Based on a back-test of five-year stock returns, S&P 500 Index stocks in the top one-fifth as measured by Quadrix Overall score outperformed the average S&P 500 stock by an average of 3.3%, annualized. Top Overall scorers had a winning percentage of 90%, meaning they outperformed the average stock in 90% of the 145 rolling five-year periods tested.

an annualized 3.3%. The top quintile of Overall scorers outperformed the average stock in 90% of the 145 rolling five-year periods tested. Our study excludes companies that were acquired, removed from the index, or did not have data available for the entire five-year period. On average, each basket contained 416 stocks.

Quadrix Value and Momentum scores also worked, though the Overall score was most effective. The top one-fifth of Value and Momentum scorers both outperformed the average stock in at least 70% of the tested five-year periods.

**Investing for the long haul**

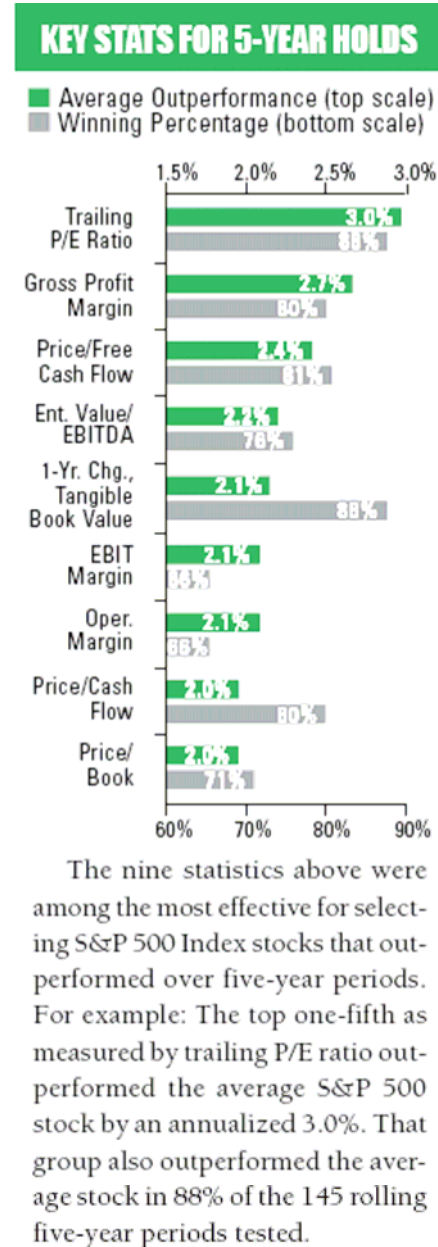
While investors may be able to earn better returns by seeking 12-month gains and tolerating a fair amount of portfolio turnover, long-term investment strategies make sense for many investors. Here are two arguments for buying and holding:

**Less decision-making:** Investors who hold stocks for long periods are less likely to make buy and sell decisions based on the news of the day.

Fewer knee-jerk decisions probably leads to fewer errors made. Returns over three-month periods may be largely driven by a single quarterly report, while five-year returns probably reflect the quality of a company’s business model and its ability to consistently generate strong profit growth. In our back-test of 145 rolling five-year periods, 76% of the S&P 500 stocks generated positive returns, illustrating the benefits of a buy-and-hold strategy. The 90% winning percentage for the top one-fifth of Quadrix Overall scorers illustrates the value Quadrix can add to that buy-and-hold strategy.

**Transaction costs:** With the growth of cheap online trading, commission costs are not the drag on returns they once were. But trading costs still affect investment results, and buy-and-holders tend to trade infrequently, paying less in such costs.

**Tax efficiency:** The less often you trade, the more your money can compound without facing a tax bite. Long-term investing comes with its own type of risk. Investors who buy with a five-year holding period in mind may feel comfortable not keeping a close eye on their investments.



However, not every stock will do well, and even buy-and-holders should monitor the companies they purchase. Buy-and-hold investors should not react instinctively, panicking in the face of bad news. But sometimes a stock's breakdown reflects poor operating conditions or company-specific problems that could take several years to overcome. In such cases, investors must be willing to bail out.

**Finding buy-and-hold stocks**

Because the Quadrix Overall score works well for five-year holding periods, investors putting together a buy-and-hold portfolio should consider stocks with high Overall ranks.

Quadrix considers up to 100 statistics in deriving the Overall score, and the table at right lists nine of those statistics key to identifying strong buy-and-hold candidates.

Our back-tests show that the top one-fifth of stocks in the S&P 500 as measured by each statistic outperformed the average stock in the index by an annualized 1.9% or better. In addition, top scorers have a winning percentage of at least 65%, meaning they outperformed the average stock at least 65% of the time.