

NDRG GUIDE TO

# Equity Rating and Report



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# EQUITY FOCUS RANKS

Each week, the NDRG Equity Focus Ranks product sorts a U.S. multi-cap universe by fundamental and technical metrics. Over time we believe that this **quantitative model relative ranking system** will assist in finding profitable, undervalued companies with strong technicals. This system is intended to assist investors with a two-to-three month time horizon.

## UNIVERSE

The NDRG Broad Market Equity Series source universe consists of companies with one or more stocks on the NYSE, NASDAQ, and AMEX stock exchanges. Only companies incorporated in the United States or its territories are considered (ADRs and GDRs are ineligible). Furthermore, stocks must also meet additional selection criteria in the total source universe: top 99% of market capitalization and top 95% of liquidity based on NDRG's dollar volume factor. The NDRG Broad Market Equity Series Universe is re-selected semi-annually (March and September).

The NDRG Broad Market Equity Series Multi-Cap universe includes all of the NDRG Broad Market Equity Series Large-Cap and Mid-Cap segments and the top portion of the Small-Cap segment, representing the top 97% of capitalization in the source universe. On average, the Multi-Cap universe consists of approximately 1,600 stocks.

## RATING A STOCK BASED ON THE NDR EQUITY FOCUS RANK

The NDRG Equity Rating classifies stocks as Buy, Neutral, or Sell based on the Equity Focus Ranks. After combining the Fundamental and Technical components (page 2), we rank the stocks from 0 (worst) to 100 (best). Stocks with a rank greater than 90 receive a Buy rating, while stocks with a rank of less than 10 receive a Sell rating. All other stocks in the universe get a Neutral rating.

## CONSTRUCTION

The NDRG Equity Focus Ranks consists of half Fundamentals, half Technicals. This fusion approach combines stock potential (Fundamentals) with stock behavior (Technicals).

### 50% Fundamental Component

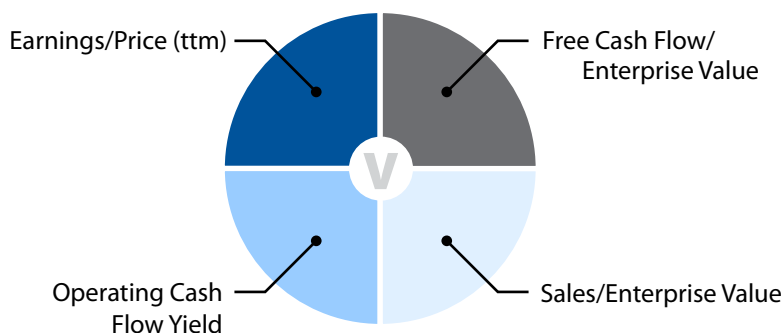
To select the fundamental factors, we backtested a pool of approximately 70 characteristics. The fundamental rank component uses lowly correlated factors with positive risk/return (magnitude and consistency) profiles. We classify the chosen factors as profitability or valuation metrics and equally weight the two groups.

### 50% Technical Component

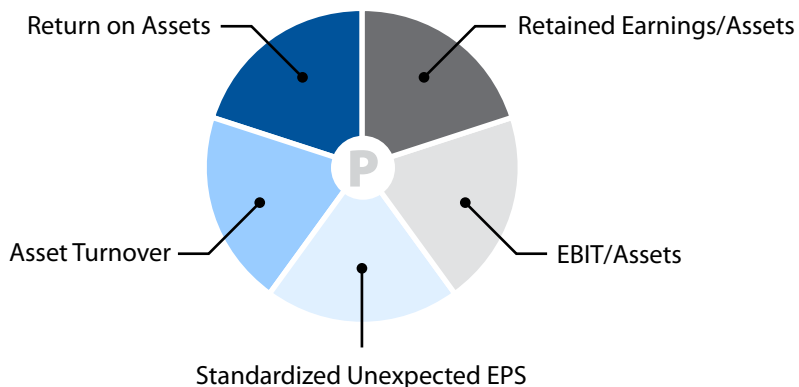
The Technical Component Rank applies a technical regime flag to the NDRG U.S. Momentum Rank to determine whether to use the momentum ranks as is or to invert them (mean-reverting).

The Momentum Rank consists of: 40% sub-industry price momentum, 30% sector price momentum, and 30% stock price momentum.

## VALUATION



## PROFITABILITY



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## **BENEFITS OF PRICE MOMENTUM**

Price is a unique variable. Unlike valuation variables and economic fundamentals, which all have the potential to diverge from the market's primary trend, price is unique in that it cannot diverge from itself. As a result, the price momentum-based ranks attempt to "lock" onto major leadership trends, allowing profits to run, and losses to be cut short.

## **DRAWBACKS OF PRICE MOMENTUM**

Highly Concentrated Portfolios & Event Risk — A key property of momentum-based ranking systems is their tendency to produce highly concentrated portfolios. As a result, when a surprise event occurs such as an unanticipated rate hike, a whiff of inflation, an unexpected political outcome, etc., these ranking systems will tend to produce temporary drawdowns until they can adjust to the new leadership.

## **SHIFTING BETWEEN MOMENTUM AND MEAN REVERSION**

In order to mitigate the large drawdowns suffered by momentum systems around market turning points, we have developed a momentum-reversion regime flag. When the Momentum Rank long top decile, short bottom decile performance equity line declines by 10%, we categorize the environment as mean-reverting. The environment retains the reverting classification until the equity line rises by 5%. During the mean-reverting environment, we invert the momentum-based ranks to make them mean-reverting. Our studies have found that the momentum-reversion regime flag helps reduce the momentum strategy's drawdowns.

# EQUITY REPORT DEFINITIONS (PRODUCT ORDERING)

The NDRG Equity report provides information regarding a stock's NDRG rating, share information, classifications, earnings estimates, fundamentals, and technicals.

## (1) Market Capitalization

The price of a stock multiplied by the number of shares outstanding.

## (2) Dividend Yield

The annual indicated dividend divided by the price.

## (3) Price-to-earnings (P/E) Ratio

The price of the stock divided by earnings (ttm). Also known as Price Multiple.

## (4) ttm

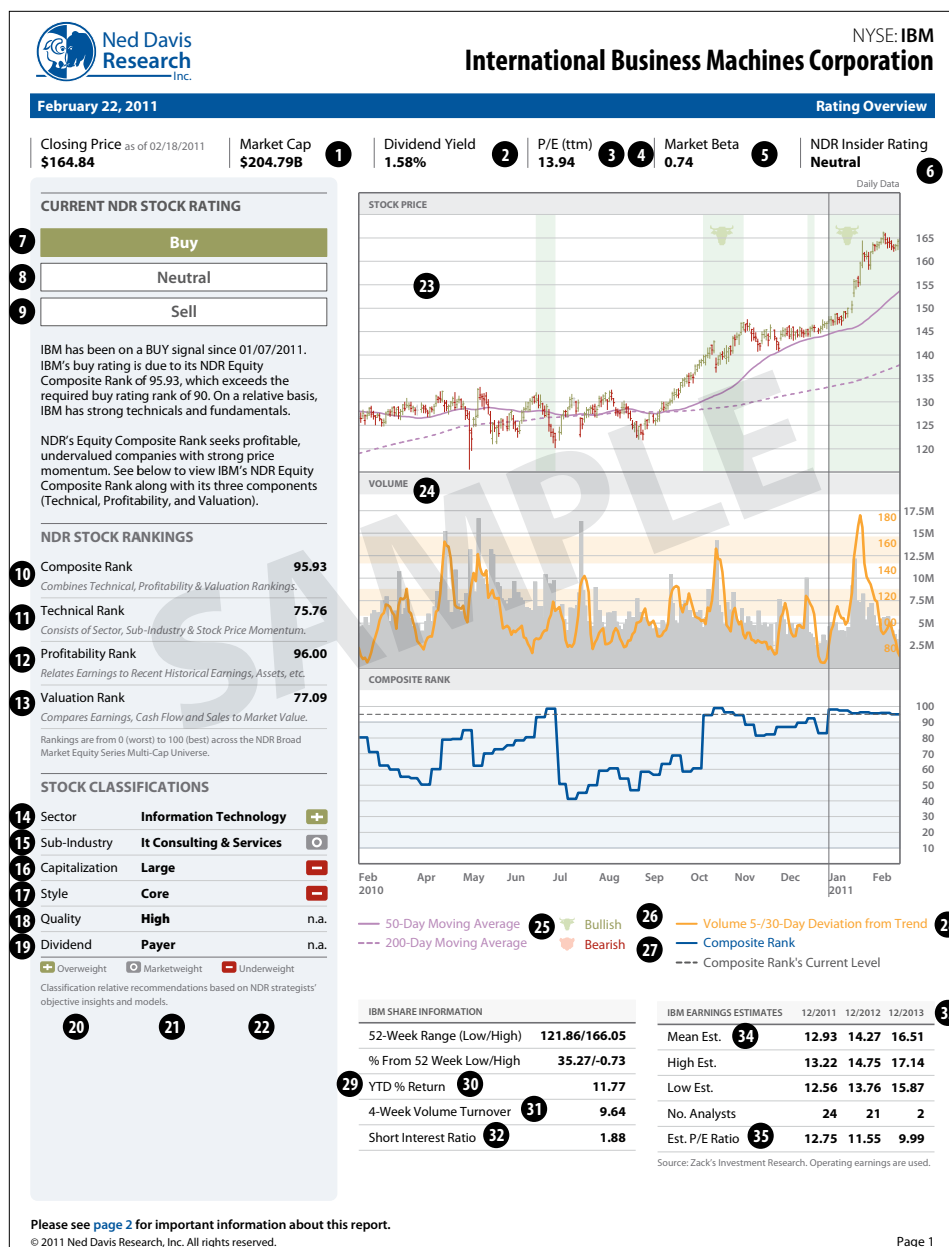
An accumulation over the trailing twelve months.

## (5) Market Beta

The relative measure of an asset's risk against the market portfolio. A beta greater than one means the asset is riskier than the market, a beta of one means equally risky, and a beta less than one means less risky than the market.

## (6) NDRG Insider Rating

Stock classification of corporate insider activity. The NDRG Insider Rating consists of the following categories: Heavy Selling, Light Selling, Neutral, Light Buying, and Heavy Buying.



## (7) Buy Rating

A recommendation to buy a stock due to a NDRG Equity Focus Rank greater than 90. Stocks on a buy rating are expected to rise over the life of the signal.

## (8) Neutral Rating

Neither a positive or negative outlook. No expectation regarding a stock's price trend.

## (9) Sell Rating

A recommendation to sell a stock due to a NDRG Equity Focus Rank less than 10. Stocks on a sell rating are expected to decline over the life of the signal.

## (10) Equity Focus Rank (EFR)

A 0-100 score constructed using static (constant) weights on the EFR Technical, Profitability, and Valuation ranks. A higher rank is better.

### (11) EFR Technical Rank

A component of the NDRG Equity Focus Rank that consists of sector, sub-industry, and firm-specific statically (constant) weighted variables. This 0-100 rank typically favors a trend-following approach, but inverts when mean reversion outpaces momentum. A higher rank is better.

### (12) EFR Profitability Rank

A component of the NDRG Equity Focus Rank that combines return on assets, asset turnover, ebit/assets, retained earnings/assets, and standardized unexpected earnings. This 0-100 rank uses a static (constant) weighting scheme on the individual profitability metrics. A higher rank is better.

### (13) EFR Valuation Rank

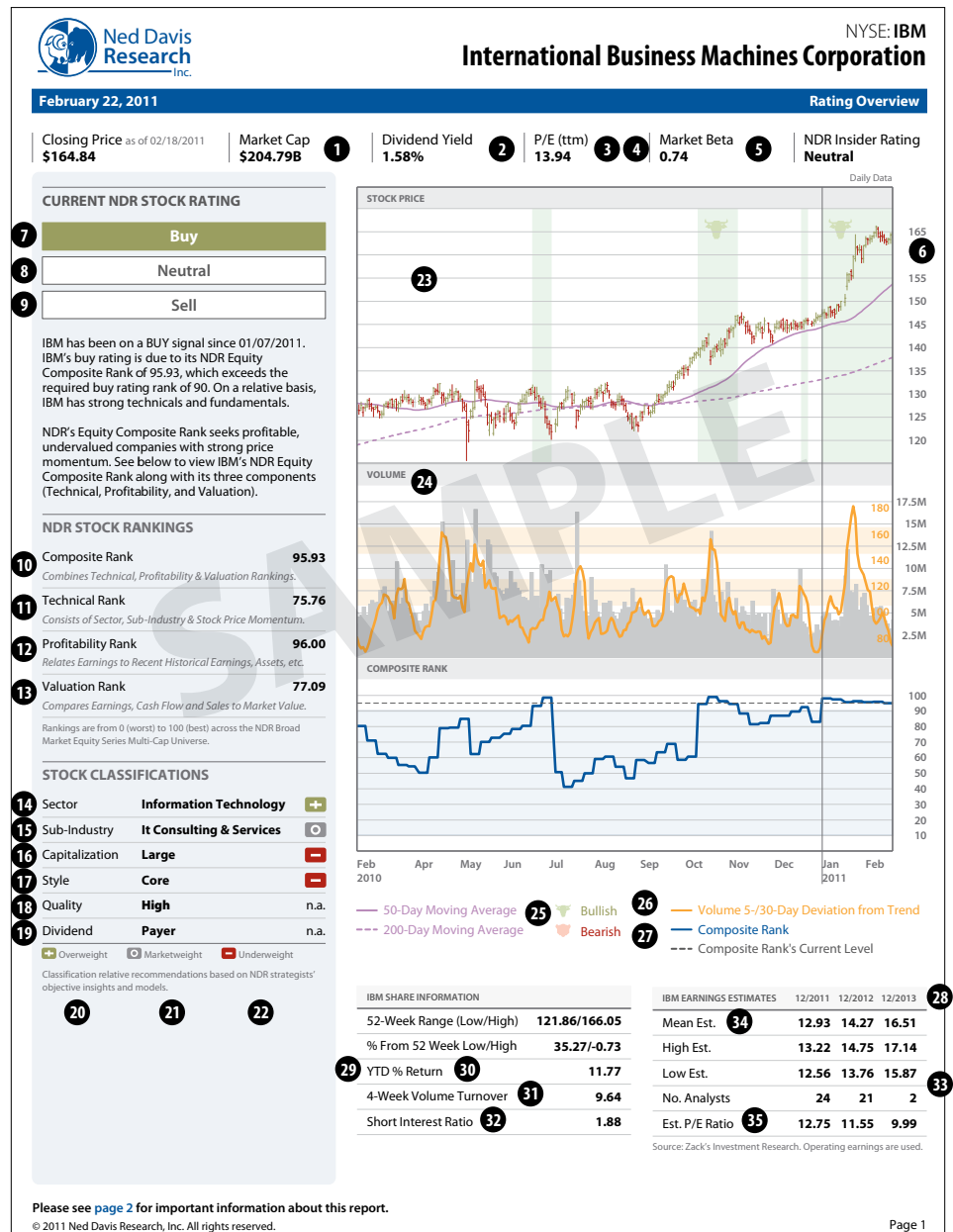
A component of the NDRG Equity Focus Rank that compares earnings, sales, free cash flow, and operating cash flow to market value. This 0-100 rank uses a static (constant) weighting scheme on the individual valuation metrics. A higher rank is better.

### (14) NDRG Sector Coverage

Sectors constructed based upon S&P/ MSCI Global Industry Classification Standard (GICS) within the NDRG Multi-Cap universe.

### (15) NDRG Sub-Industry Coverage

Sub-Industry constructed based upon the S&P/MSCI Global Industry Classification Standard (GICS) within the NDRG Multi-Cap universe.



### (16) Capitalization Classification

NDRG size classification (Large-, Mid-, Small-Cap) where the top 80% of capitalization falls in the Large-Cap universe and the bottom 10% of capitalization resides in the Small-Cap universe.

### (17) Style Classification

NDRG Growth, Value, or Core classification determined by a unique process using widely accepted valuation measures with four distinct factors (each for value and growth).

## (18) Quality Classification

A stock's inclusion in the NDRG High Quality Index requires an S&P Quality Rating of B+ and above, while inclusion in the NDRG Low Quality Index requires a S&P Quality Rating of B and below.

## (19) Dividend Classification

NDRG classification based on whether the company pays a dividend.

## (20) Overweight

Hold more than the benchmark weight allocation for the asset.

## (21) Marketweight

Maintain the benchmark weight allocation for the asset.

## (22) Underweight

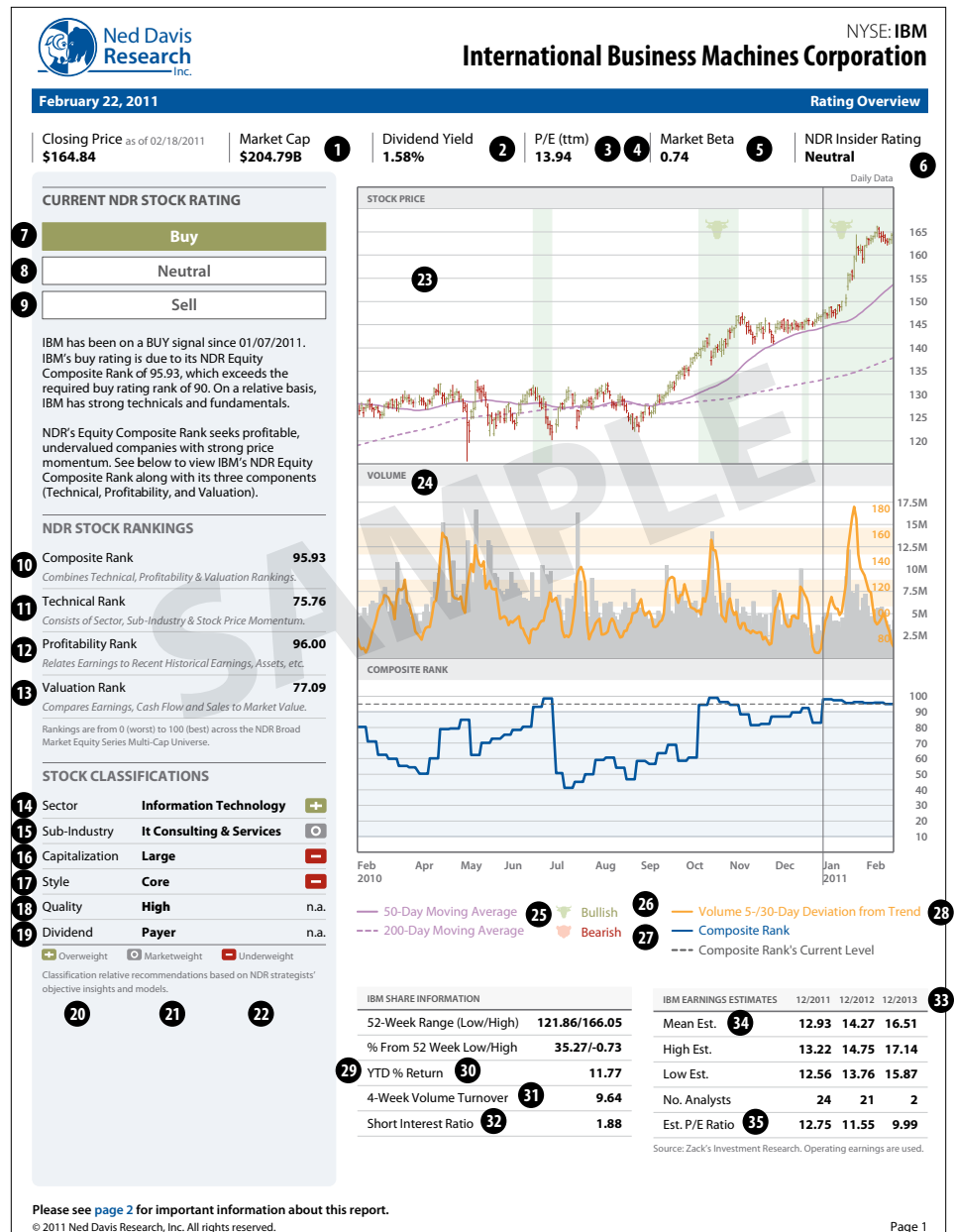
Hold less than the benchmark weight allocation for the asset.

## (23) Candlestick Chart

A time series plot of a stock's open, high, low, and close prices. For a period where the stock's close is greater (smaller) than its open, the bar shows green (red). The chart's light green and red background shading corresponds to NDRG Buy and Sell ratings.

## (24) Volume

The number of shares traded in a period. Higher volume during a price change indicates more significant movement than lower volume.



## (25) Moving Average

The average price of a security over a period of time. Moving averages are used to smooth out price and volume fluctuations (noise) in order to view trends.

## (26) Bullish

A positive outlook or an expected upward price trend.

## (27) Bearish

A negative outlook or an expected downward price trend.

## (28) Deviation From Trend

A ratio comparing a shorter-term moving average to a longer-term moving average. The ratio shows potential divergences from longer-term trends.



### (29) YTD

Year-to-date. A calculation from the beginning of the year to the current date.

### (30) Percent Return

A value represented as the percentage of an earlier value.

### (31) Volume Turnover

Total volume divided by common shares outstanding.

### (32) Short Interest Ratio

Short interest divided by average daily volume. Short Interest is the number of shares borrowed from brokerage firms and sold (which the sellers expect to buy back at lower prices). The ratio indicates the number of days, on average, for short sellers to cover their positions.

### (33) Earnings Estimates Table

The current fiscal year's and the next two fiscal year's average, high, low, and number of analyst earnings estimates.

### (34) Mean

Average. Sum of the values in the data set divided by the number of values in the data set.

### (35) Forward Price/Earnings

Price divided by the perpetual 12-months forward mean earnings estimate. The perpetual 12-months forward calculation uses both the FY1 and FY2 estimates, blended together with a weight applied to each based upon the number of weeks remaining until FY1.

**Ned Davis Research Inc.** NYSE: IBM  
**International Business Machines Corporation**

February 22, 2011 Rating Overview

Closing Price as of 02/18/2011: **\$164.84** | Market Cap: **\$204.79B** | Dividend Yield: **1.58%** | P/E (ttm): **13.94** | Market Beta: **0.74** | NDR Insider Rating: **Neutral**

**CURRENT NDR STOCK RATING**

Buy  
Neutral  
Sell

IBM has been on a BUY signal since 01/07/2011. IBM's buy rating is due to its NDR Equity Composite Rank of 95.93, which exceeds the required buy rating rank of 90. On a relative basis, IBM has strong technicals and fundamentals.

NDR's Equity Composite Rank seeks profitable, undervalued companies with strong price momentum. See below to view IBM's NDR Equity Composite Rank along with its three components (Technical, Profitability, and Valuation).

**NDR STOCK RANKINGS**

10 Composite Rank: **95.93**  
 Combines Technical, Profitability & Valuation Rankings.

11 Technical Rank: **75.76**  
 Consists of Sector, Sub-Industry & Stock Price Momentum.

12 Profitability Rank: **96.00**  
 Relates Earnings to Recent Historical Earnings, Assets, etc.

13 Valuation Rank: **77.09**  
 Compares Earnings, Cash Flow and Sales to Market Value.

Rankings are from 0 (worst) to 100 (best) across the NDR Broad Market Equity Series Multi-Cap Universe.

**STOCK CLASSIFICATIONS**

14 Sector: **Information Technology** (+)  
 15 Sub-Industry: **It Consulting & Services** (O)  
 16 Capitalization: **Large** (-)  
 17 Style: **Core** (-)  
 18 Quality: **High** (n.a.)  
 19 Dividend: **Payer** (n.a.)

Overweight Marketweight Underweight

Classification relative recommendations based on NDR strategists' objective insights and models.

**STOCK PRICE** (Daily Data)

23 STOCK PRICE: Line chart showing price from Feb 2010 to Feb 2011. Includes 50-Day Moving Average (25), 200-Day Moving Average (26), and Composite Rank (27). Legend includes Bullish (26) and Bearish (27).

24 VOLUME: Bar chart showing volume from Feb 2010 to Feb 2011. Includes Volume 5-/30-Day Deviation from Trend (28).

20 52-Week Range (Low/High): **121.86/166.05**

21 % From 52 Week Low/High: **35.27/-0.73**

22 YTD % Return: **11.77**

29 4-Week Volume Turnover: **9.64**

30 Short Interest Ratio: **1.88**

**IBM EARNINGS ESTIMATES**

	12/2011	12/2012	12/2013
Mean Est.	12.93	14.27	16.51
High Est.	13.22	14.75	17.14
Low Est.	12.56	13.76	15.87
No. Analysts	24	21	2
Est. P/E Ratio	12.75	11.55	9.99

Source: Zack's Investment Research. Operating earnings are used.

Please see page 2 for important information about this report.  
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### (36) Historical Growth Rates Of Per Share Values (%) Chart

Shows the full history, five-year, 12-month, and previous quarter per share growth rates for earnings, sales, book value, cash flow, and dividends.

### (37) Seasonal Cycle Chart

Shows the current year's price (rescaled to start at 100), the historical cycle pattern (scaled to start at 100), the percentage of time for each month in which the stock outperformed the S&P 500 Index, and the average magnitude of the excess gain.



February 22, 2011

Supplemental Information

#### HISTORICAL GROWTH RATES OF PER SHARE VALUES (%)

	EARNINGS	SALES	BOOK VALUE	CASH FLOW	DIVIDEND
Full History Growth Rate	8.42	9.80	5.50	7.76	6.29
Last Five Years Growth Rate	19.29	7.27	-7.51	12.66	29.54
Change Over Last 12 Months	13.85	10.15	3.69	-2.42	24.33
Last Quarter Non-Annualized Growth	4.94	3.28	9.60	-1.83	0.00

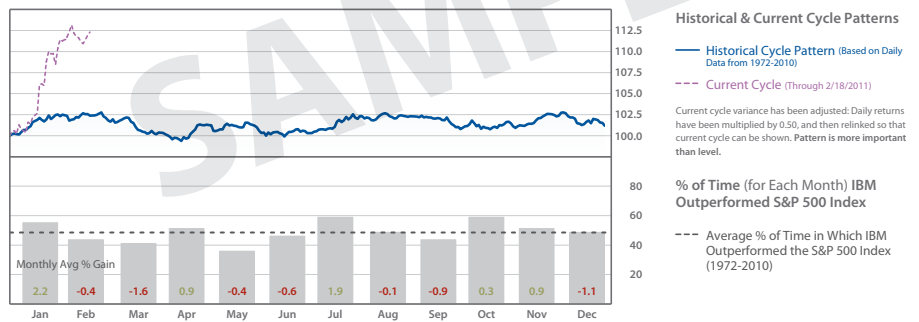
Growth rates capped at +/-100%

#### FUNDAMENTAL COMMENTARY

- IBM's per share growth rates show neither a positive or negative outlook.
- IBM appears overvalued based on its Price/Book of 8.82, which is greater than the Information Technology sector's top quintile value of 1.62.
- IBM appears undervalued based on its Price/Earnings (TTM) of 13.94, which is less than the Information Technology sector's bottom quintile value of 14.62.

#### SEASONAL CYCLE (vs S&P 500 Index)

Daily Data



#### TECHNICAL COMMENTARY

- IBM underperforms the S&P 500 Index 43.59% of the time in February, with an average excess return of -0.45%.
- IBM/S&P 500 Index currently lies 2.40% above its 50-day moving average and 3.30% above its 200-day moving average.
- IBM/Information Technology sector currently lies 2.27% above its 50-day moving average and 1.87% above its 200-day moving average.

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# EQUITY REPORT DEFINITIONS (ALPHABETICAL LISTING)

## B

### **Bearish**

A negative outlook or an expected downward price trend.

### **Bullish**

A positive outlook or an expected upward price trend.

### **Buy Rating**

A recommendation to buy a stock due to a NDRG Equity Focus Rank greater than 90. Stocks on a buy rating are expected to rise over the life of the signal.

## C

### **Candlestick Chart**

A time series plot of a stock's open, high, low, and close prices. For a period where the stock's close is greater (smaller) than its open, the bar shows green (red). The chart's light green and red background shading corresponds to NDRG Buy and Sell ratings.

### **Capitalization Classification**

NDRG size classification (Large-, Mid-, Small-Cap) where the top 80% of capitalization falls in the Large-Cap universe and the bottom 10% of capitalization resides in the Small-Cap universe.

## D

### **Deviation From Trend**

A ratio comparing a shorter-term moving average to a longer-term moving average. The ratio shows potential divergences from longer-term trends.

### **Dividend Classification**

NDRG classification based on whether the company pays a dividend.

### **Dividend Yield**

The annual indicated dividend divided by the price.

## E

### **Earnings Estimates Table**

The current fiscal year's and the next two fiscal year's average, high, low, and number of analyst earnings estimates.

### **Equity Focus Rank (EFR)**

A 0-100 score constructed using static (constant) weights on the EFR Technical, Profitability, and Valuation ranks. A higher rank is better.

## F

### **Forward Price/Earnings**

Price divided by the perpetual 12-months forward mean earnings estimate. The perpetual 12-months forward calculation uses both the FY1 and FY2 estimates, blended together with a weight applied to each based upon the number of weeks remaining until FY1.

## G

### **GICS Industry**

Assignment according to the S&P/MSCI Global Industry Classification Standard (GICS).

### **GICS Industry Group**

Assignment according to the S&P/MSCI Global Industry Classification Standard (GICS).

### **GICS Sector**

Assignment according to the S&P/MSCI Global Industry Classification Standard (GICS).

### **GICS Sub-Industry**

Assignment according to the S&P/MSCI Global Industry Classification Standard (GICS).

## H

### **Historical Growth Rates Of Per Share Values (%) Chart**

Shows the full history, five-year, 12-month, and previous quarter per share growth rates for earnings, sales, book value, cash flow, and dividends.

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## M

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### Market Beta

The relative measure of an asset's risk against the market portfolio. A beta greater than one means the asset is riskier than the market, a beta of one means equally risky, and a beta less than one means less risky than the market.

---

### Market Capitalization

The price of a stock multiplied by the number of shares outstanding.

---

### Marketweight

Maintain the benchmark weight allocation for the asset.

---

### Mean

Average. Sum of the values in the data set divided by the number of values in the data set.

---

### Moving Average

The average price of a security over a period of time. Moving averages are used to smooth out price and volume fluctuations (noise) in order to view trends.

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## N

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### NDRG Insider Rating

Stock classification of corporate insider activity. The NDRG Insider Rating consists of the following categories: Heavy Selling, Light Selling, Neutral, Light Buying, and Heavy Buying.

---

### Neutral Rating

Neither a positive or negative outlook. No expectation regarding a stock's price trend.

---

## O

---

### Overweight

Hold more than the benchmark weight allocation for the asset.

---

## P

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### Percent Return

A value represented as the percentage of an earlier value.

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### Price-to-book Ratio

The price of the stock divided by book value.

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### Price-to-cash flow Ratio

The price of the stock divided by cash flow (ttm).

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### Price-to-earnings (P/E) Ratio

The price of the stock divided by earnings (ttm). Also known as Price Multiple.

---

### Price-to-sales Ratio

The price of the stock divided by sales (ttm).

---

### EFR Profitability Rank

A component of the NDRG Composite Rank that combines return on assets, asset turnover, ebit/assets, retained earnings/assets, and standardized unexpected earnings. This 0-100 rank uses a static (constant) weighting scheme on the individual profitability metrics. A higher rank is better.

---

## Q

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### Quality Classification

A stock's inclusion in the NDRG High Quality Index requires an S&P Quality Rating of B+ and above, while inclusion in the NDRG Low Quality Index requires a S&P Quality Rating of B and below.

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### Quintile

A subset of a population containing 20% of the values.

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## S

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### Seasonal Cycle Chart

Shows the current year's price (rescaled to start at 100), the historical cycle pattern (scaled to start at 100), the percentage of time for each month in which the stock outperformed the S&P 500 Index, and the average magnitude of the excess gain.

---

### Sell Rating

A recommendation to sell a stock due to a NDRG Equity Focus Rank less than 10. Stocks on a sell rating are expected to decline over the life of the signal.

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## Short Interest Ratio

Short interest divided by average daily volume. Short Interest is the number of shares borrowed from brokerage firms and sold (which the sellers expect to buy back at lower prices). The ratio indicates the number of days, on average, for short sellers to cover their positions.

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## Style Classification

NDRG Growth, Value, or Core classification determined by a unique process using widely accepted valuation measures with four distinct factors (each for value and growth).

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## T

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### EFR Technical Rank

A component of the NDRG Equity Focus Rank that consists of sector, sub-industry, and firm-specific statically (constant) weighted variables. This 0-100 rank typically favors a trend-following approach, but inverts when mean reversion outpaces momentum. A higher rank is better.

---

### ttm

An accumulation over the trailing twelve months.

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## U

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### Underweight

Hold less than the benchmark weight allocation for the asset.

---

## V

---

### EFR Valuation Rank

A component of the NDRG Equity Focus Rank that compares earnings, sales, free cash flow, and operating cash flow to market value. This 0-100 rank uses a static (constant) weighting scheme on the individual valuation metrics. A higher rank is better.

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### Volume

The number of shares traded in a period. Higher volume during a price change indicates more significant movement than lower volume.

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### Volume Turnover

Total volume divided by common shares outstanding.

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## W

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### Weeks Down

The number of weeks in which the price closed lower.

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### Weeks Up

The number of weeks in which the price closed higher.

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## Y

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### YTD

Year-to-date. A calculation from the beginning of the year to the current date.

## NED DAVIS RESEARCH GROUP

sales@ndr.com  
www.ndr.com  
(800) 241-0621

### VENICE

600 Bird Bay Drive West  
Venice, FL 34285  
(941) 412-2300

### BOSTON

50 Federal Street  
2<sup>nd</sup> Floor  
Boston, MA 02110  
(617) 279-4860

### ATLANTA

2100 RiverEdge Parkway  
Suite 750  
Atlanta, GA 30328  
(770) 308-1128

### SAN FRANCISCO

50 California Street  
Suite 1500  
San Francisco, CA 94111  
(415) 277-5477

### LONDON

Nestor House  
Playhouse Yard  
London EC4V 5EX  
+44 (0)20 7779 8579



Ned Davis  
Research  
Group

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