

How does Alleron Derive Investment Grade?

Alleron rates stocks using three criteria derived on a bottom-up qualitative basis. The criteria are:

1. Quality Score
2. Valuation edge
3. An energy or change argument (the potential energy of a company undergoing a positive transformation)

Figure 1 displays the interaction of the three factors, each influencing the other.

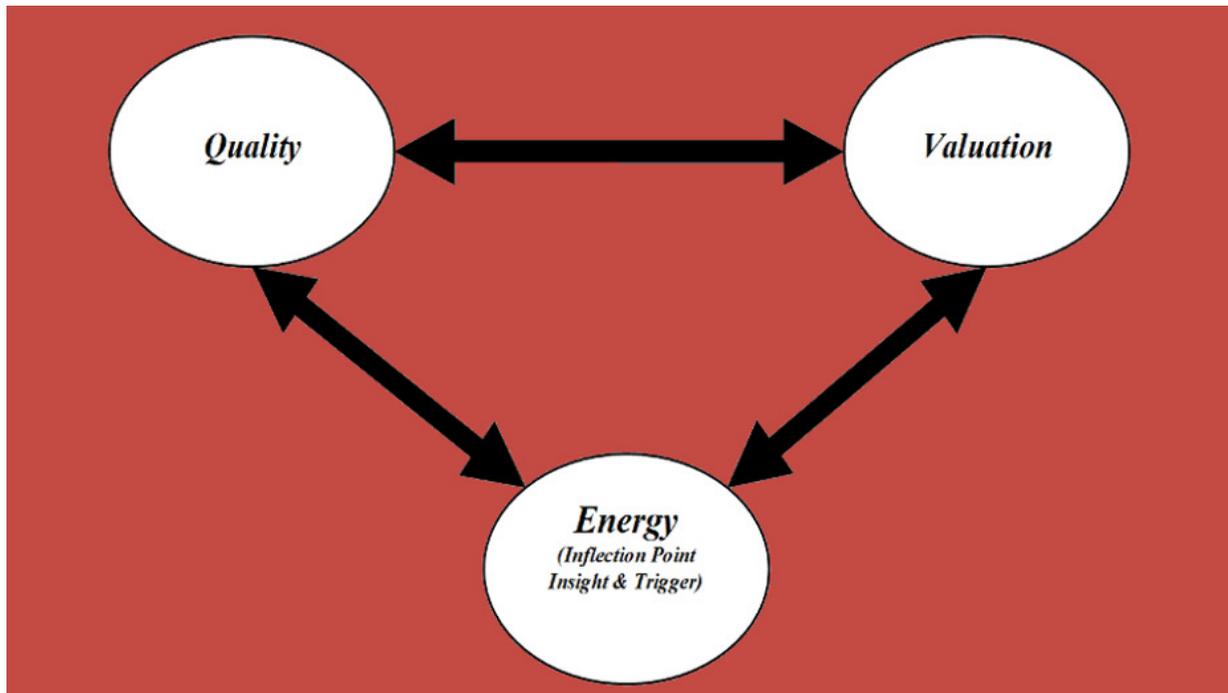


Figure 1: Qualitative Investment Criteria



Alleron assesses each company on the basis of 10 separate criteria (management track record, financial health, growth in competitive advantage...) each scoring 1 to 5. These scores are summed to form a Quality Score from 10 to 50. Additionally the valuation gap of the company is estimated; a gap of 20% indicating the company is undervalued by 20%. These two factors are then combined as shown in Figure 2 to form the Alleron Investment Grade.

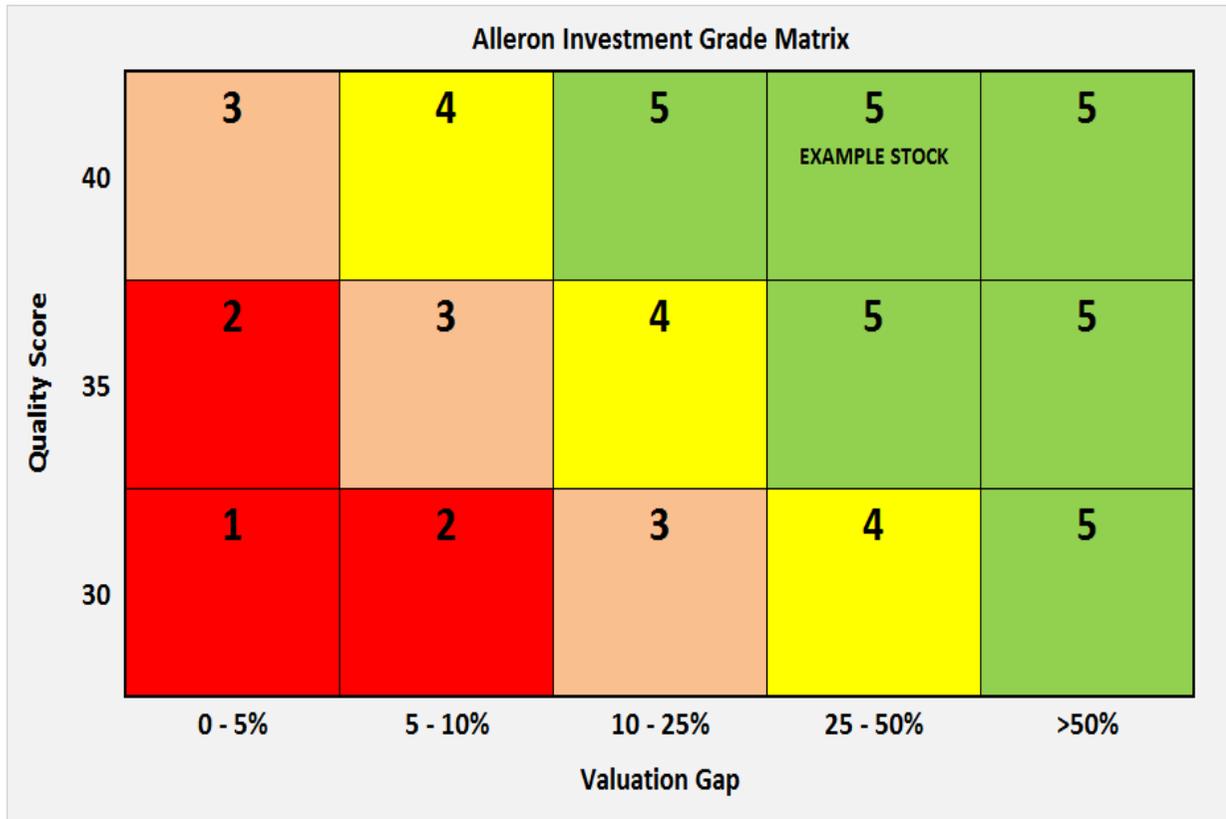


Figure 2: Investment Grade Matrix



In Figure 2, the EXAMPLE STOCK has a valuation gap between 25% and 50% and a Quality Score of 40 or more and is rated Investment Grade 5 (a high-quality under-valued desirable stock). All stocks with Quality Score below 30 and all stocks considered over-valued are Grade 1 or 2. Also note that although the energy/change argument is not shown in Figure 2, it forms an integral part of the assessment of any company.

Given that Investment Grade is fundamental to the Alleron investment process, it is instructive to review the performance of equally-weighted month-end baskets of stocks from the different Investment Grade categories to determine if the process has merit (the analysis below deriving from 3,515 separate research papers).

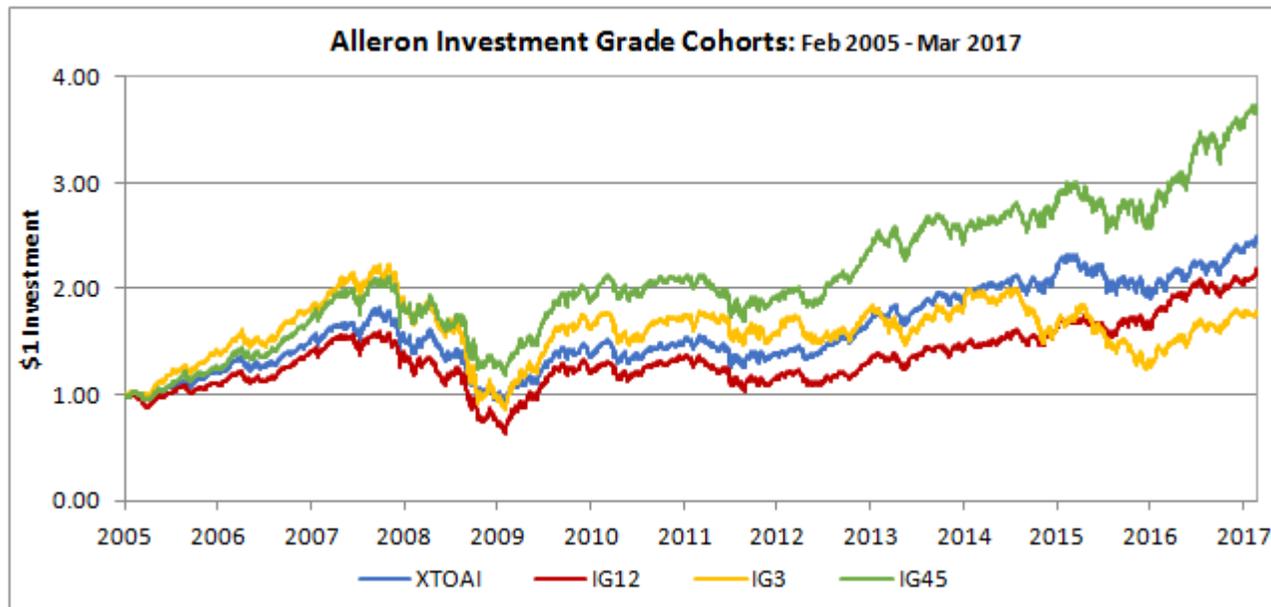


Figure 3: Investment Grade Cohort Performance



Figure 3 shows the ASX 100 accumulation index (XTOAI in blue) for reference. It also shows Investment Grade performance for:

- IG12 - Grades 1 and 2 in red
- IG3 - Grade 3 in yellow*
- IG45 - Grades 4 and 5 in green

From Figure 3, it is clear that Investment Grade 4 and 5 stocks have markedly outperformed those in the 1, 2 or 3 categories. Both the Alleron long-short model and implemented portfolios have been comprised primarily of Grade 4 and 5 stocks in the long portfolio and Grade 1 and 2 stocks in the short portfolio.

* Of note in Figure 3 is that up until mid 2014, Investment Grade 3 stocks outperformed Investment Grade 1 and 2 stocks. Subsequently, Grade 3 stocks suffered a decline, principally caused by significant falls in the resource sector.



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