

## 30-Stocks To Add Some "Magic" To Your Portfolio



Index giant Vanguard manages more than \$5 trillion of capital today, [up from \\$1 trillion in 2010](#). Vanguard manages assets mostly indexed on a capitalization weighted scale, meaning companies are ranked according to their stock market value. But, while Vanguard and other traditional index providers have grown dramatically, a slew of alternative index funds called "smart beta" has also become popular. These funds rank stocks on metrics such as their underlying businesses' economic footprint, valuation metrics, price momentum, volatility, and other "factors." One of the more interesting smart beta strategies is Joel Greenblatt's "magic formula," which is a simple two-factor model. A former hedge fund manager who enjoyed wild success trafficking in special situations like spinoffs and corporate restructurings, Greenblatt published two books called [The Little Book that Beats the Market](#) and [The Big Secret for the Small Investor](#) detailing a formula that ranks stocks based on their EBIT/Enterprise Value (a modified earnings yield or E/P ratio) and

return on invested capital (ROIC). Cheapness is generally what the great value investor Benjamin Graham stood for, and business quality or returns on invested capital is generally what Graham's most famous student, Warren Buffett, stands for. Combining the two investment touchstones, the strategy simply owns the stocks with the best combination of these two metrics, and swaps them out for whichever ones score best the next year. When I was at Morningstar I calculated that the strategy beat the S&P 500 Index, including dividends, by 10 percentage points annualized from 1988 through September of 2009, based on Greenblatt's back-tested numbers from his book and funds he was running at that time. That doesn't mean the formula beat the index every single calendar year. In fact it showed patterns of underperforming for as many as three straight years before recovering and overtaking the index again. Value investors must tolerate fallow periods. Greenblatt runs [Gotham Capital](#) now, a firm that offers mutual funds that invest in variations of this strategy. Most of the funds are long the stocks that score best on the two metrics and short the stocks that score worst in various proportions. Rather than looking at fund holdings, which are updated every quarter, we thought it would be interesting to run the screen on Greenblatt's website ([www.magicformulainvesting.com](http://www.magicformulainvesting.com)), which is more up to date, to see which stocks score the best on the screen. We ran it for the top-30 companies over \$5 billion in market capitalization. We also included current dividend yields, although that's not part of Greenblatt's screen. Dividend yields can be misleading when screening for stocks because high yields can be indications that the dividend is about to be cut. They also don't tell you anything directly about profitability and cheapness, although some analysts make inferences about profitability from them. Nevertheless,

<b>Magic Formula, Top-30 stocks &gt; \$5 million in market capitalization</b>		
<b>Company</b>	<b>Ticker</b>	<b>Dividend Yield</b>
Allison Transmission Holdings, Inc.	ALSN	1.22%
Altria Group, Inc.	MO	5.47%
AmerisourceBergen Corp.	ABC	1.17%
Amgen, Inc.	AMGN	2.66%
Applied Materials, Inc.	AMAT	1.84%
Best Buy Co., Inc.	BBY	2.23%
Biogen, Inc.	BIIB	
Block H&R, Inc.	HRB	3.83%
CBS Corp.	CBS	1.35%
CVS Health Corp.	CVS	2.67%
Dun & Bradstreet Corp.	DNB	1.46%
DXC Technology Company	DXC	0.84%
Express Scripts Holding Co.	ESRX	
Gilead Sciences, Inc.	GILD	3.04%
HP, Inc.	HPQ	2.28%
Interpublic Group of Companies, Inc.	IPG	3.60%
KLA-Tencor Corp.	KLAC	2.56%
Lam Research Corp.	LRCX	2.53%
Lear Corp.	LEA	1.66%
ManpowerGroup, Inc.	MAN	2.14%
McKesson Corp.	MCK	1.20%
MKS Instruments, Inc.	MKSI	0.85%
Nektar Therapeutics	NKTR	
Omnicom Group, Inc.	OMC	3.46%
Philip Morris Intl., Inc.	PM	5.74%

On this screen they can capture a lot of stocks, it's doubtful that you'll be able to screen stocks from \$1 million to \$5 billion. I recently ran an article highlighting 10 of the Greenblatt screen made a list of healthcare supply companies. Analysts use a discounted cash flow model to determine a stock's value rating, forecasting future cash flows. Here's the Greenblatt list:

*LLC currently, or is planning to, hold positions in KLAC and CVS.*