ZACKS
INVESTMENT RESEARCH

Lesson 1-2

Disclaimer

The performance calculations for the Research Wizard strategies were produced through the backtesting feature of the Research Wizard using the DBCMHIST database and consist of the total return (price changes + dividends) of an equal weighted portfolio. Returns are calculated on a specified periodic basis (most often one or four weeks) and assume no transaction costs. The portfolio is rebalanced at the start of each new period. Returns can be stated as either annualized or compounded.

Stock trading/investing involves risk and you can lose some or all of your investment. Hypothetical or backtested results may not always be duplicated in the real world. Backtesting can at times produce an unintended look-ahead bias. Results can also at times be over or understated due to the exclusion of inactive companies. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading, not the least of which is the ability to withstand losses or to adhere to a particular trading strategy in spite of trading losses. These are material points which can also adversely affect actual trading results. The backtested results prepared for these materials were done using the DBCMHIST database and consisted of only active companies. The Research Wizard program has been aligned, to the extent possible, to eliminate look-ahead bias. Zacks however cannot make any guarantees in regard to this or any other possible limitation. For more information on backtesting, please go to: http://www.zacks.com/performance.

The performance of the Zacks Rank portfolios for annual and year-to-date periods are the linked monthly total returns (price changes + dividends) of equal weighted hypothetical portfolios, consisting of those stocks with the indicated Zacks Rank, assuming monthly rebalancing and zero transaction costs. These are not the returns of actual portfolios. The hypothetical portfolios were created at the beginning of each month from January 1988 forward based on the values of the Zacks Rank available to Zacks' clients before the beginning of each month. The portfolios created monthly from 1988 through September 2006 exclude ADRs and are comprised of stocks that have the indicated Zacks Rank and were covered by at least two analysts at the time of the stocks inclusion in the portfolio. Starting in October 2006 and going forward, the portfolios are comprised of all stocks with the indicated Zacks Rank and do not exclude ADRs, which is more reflective of the list of stocks that customers will find on the Zacks web sites. These performance numbers have been audited from 1995 through 2003 by Virchow, Krause & Company, LLP.

The S&P 500 Index ("S&P 500") is a well-known, unmanaged index of the prices of 500 large-company common stocks selected by Standard & Poor's. The S&P 500 includes the reinvestment of all dividends, no transaction costs, and represents the gross returns before management fees.

Table of Contents

Symbol Guide

To assist you in the use of this ***Zacks Method for Trading: Home Study Course Workbook***, icons have been used to identify specific areas of interest. They include:

Assignment: Identifies areas that require completion before moving on to the next lesson in the workbook.

Exercise: Identifies activities or exercises used to review or test your knowledge in the application of the tools or strategies.

Key Point: Identifies objects, lessons, main ideas or terms to help you gain expertise while developing strategies for trading.

Lesson: Designates practical information helpful in gaining knowledge and understanding of the Zacks Method for Trading in the stock market.

Notes: Indicates an area provided in your workbook allowing you to take notes and record additional information from your personal studies.

Objectives: Identifies information as well as targeted areas for discussion to be covered during your home study course.

Lesson Snapshot: Provides a brief summary or recap of topics or concepts covered in the lesson.

Web Address: Indicates a website or web address with supporting information or additional resources to help develop your skills.

Lesson One—
Trading the Zacks Rank

Objectives

The objectives for this lesson include:

- Trading the Zacks Rank
- Harnessing the Power of Earnings Estimate Revisions
- How the Zacks Rank Model Works
- The Four Factors behind the Zacks Rank
  – Agreement
  – Magnitude
  – Upside
  – Surprise

Assignments and Exercises

The following assignments will help you in understanding the information in this lesson:

- **Watch DVD Disc 2: Trading with the Zacks Rank**
- **Read The Zacks Rank Guide**

Plan to devote a minimum of 15-30 minutes per day to completing the assignments and exercises for each lesson. It is imperative to spend time educating yourself about the market in order to have long-term success and consistency in profitable investing.

Trading the Zacks Rank

One of the simplest and one of the best strategies for trading is to buy the stocks that have a Zacks Rank of 1 and sell them when they're no longer a #1 Rank (i.e., have a Zacks Rank of 2, 3, 4 or 5). Since 1988, simply buying the Zacks #1 Rank stocks and selling them a month later if they're no longer Ranked a #1 has shown an average annual return of about 32%.

This is in stark contrast to the S&P 500's approximate return of only 12%. In fact, $10,000 back in 1988, using this strategy (just the Zacks #1 Rank stocks), would have compounded into over $1,961,825 for a 19,518% increase (gross).

But before we go any further, in order to fully understand why this strategy works so well, it's important to understand what the Zacks Rank is and how it's calculated.

Trading the Zacks Rank

Lesson 1: Trading the Zacks Rank

Zacks Rank - Annual Returns

Year	#1 Rank	#2 Rank	#3 Rank	#4 Rank	#5 Rank	S&P 500
1988	37.46%	29.69%	20.79%	19.13%	18.39%	16.20%
1989	36.09%	26.84%	15.85%	9.55%	-5.10%	31.70%
1990	-2.97%	-13.69%	-21.32%	-23.85%	-34.71%	-3.10%
1991	79.79%	56.80%	45.98%	36.60%	34.35%	30.40%
1992	40.65%	29.63%	18.04%	12.24%	17.31%	7.51%
1993	44.41%	26.86%	14.78%	8.59%	9.54%	10.07%
1994	14.34%	5.15%	-3.56%	-11.14%	-10.90%	0.59%
1995	54.99%	46.84%	30.63%	17.35%	9.11%	36.31%
1996	40.93%	28.60%	16.07%	7.71%	8.02%	22.36%
1997	43.91%	33.87%	22.93%	10.17%	3.05%	33.25%
1998	19.52%	12.92%	-3.47%	-8.77%	-14.84%	28.57%
1999	45.92%	35.53%	31.02%	18.46%	17.69%	21.03%
2000	14.31%	-1.47%	-17.75%	-19.52%	-3.95%	-9.10%
2001	24.27%	11.70%	14.09%	17.93%	20.20%	-11.88%
2002	1.22%	-14.51%	-19.39%	-23.50%	-17.59%	-22.10%
2003	74.74%	71.02%	66.69%	57.34%	55.99%	28.69%
2004	28.79%	23.26%	18.51%	11.92%	16.63%	10.87%
2005	17.97%	12.01%	6.54%	-1.31%	-5.08%	4.90%
2006	23.69%	26.63%	18.09%	15.17%	16.88%	15.80%
Annual Average	32.03%	21.72%	12.46%	6.34%	5.24%	12.00%

almost 3 x the S&P

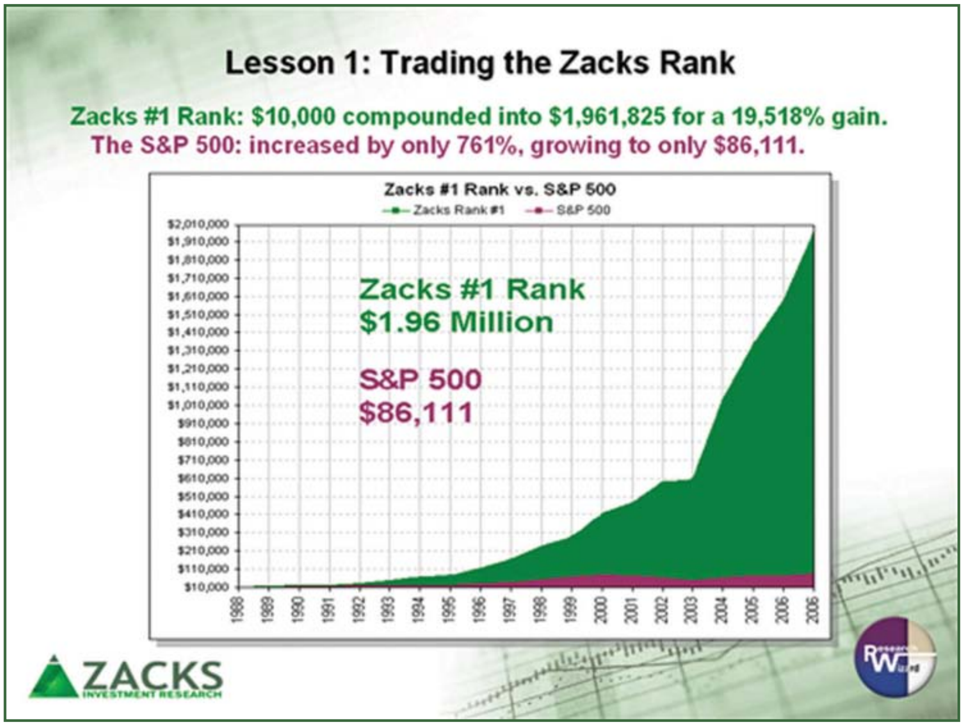
ZACKS INVESTMENT RESEARCH

Notes

Key Point–

A $10,000 trading account in 1988 using the Zacks Rank would have compounded into over $1,961,825, for a 19,518% increase (gross).

The Zacks Rank vs the S&P 500



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(Optional) Assignment—The Zacks Rank Guide

Read **The Zacks Rank Guide** included with this course. See the Appendix at the end of this workbook.

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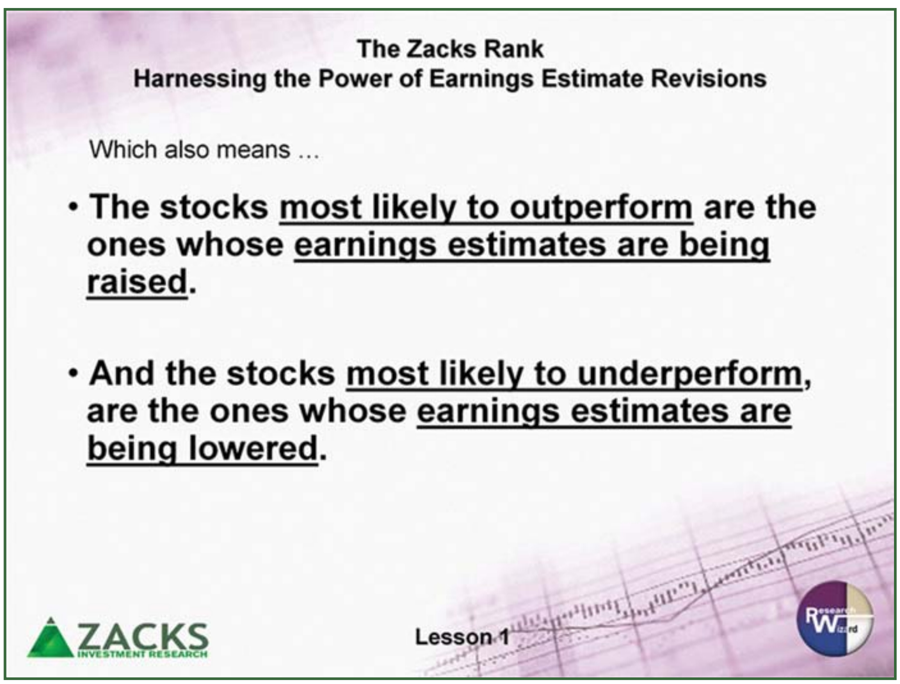
Key Point–
The Research Wizard makes finding the right stocks and trading them simple and easy. Whether you're a beginner or a seasoned pro, the Research Wizard can help you with virtually all of your trading needs and goals.

Harnessing the Power of Earnings Estimate Revisions

The foundation of the Zacks Rank is based on earnings estimate revisions. Stocks with rising estimates, as a group, have outperformed the S&P 500 year after year. While stocks with falling estimates have underperformed the S&P 500 year after year. The stocks most likely to outperform are the ones whose earnings estimates are being raised. And the stocks most likely to underperform are the ones whose earnings estimates are being lowered.

The Zacks Rank
Harnessing the Power of Earnings Estimate Revisions



Notes

Zacks (through the Zacks Rank) has made the process of identifying stocks with changing earnings estimates easy and very profitable. Since 1978, Zacks has been compiling and analyzing brokerage research for both institutional and individual investors.

Today, we process information from roughly 3,000 analysts from over 150 different brokerage firms. And at any given point in time, we're monitoring well over 200,000 earnings estimates and other related data, looking for any change.

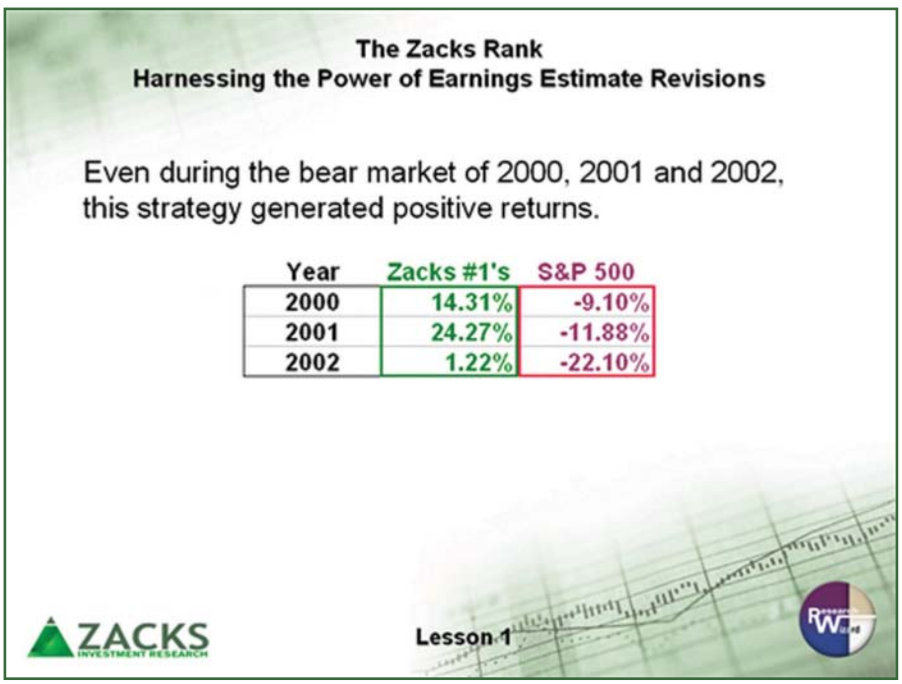
Our ability to gather, analyze and distribute this information on a timely basis, makes Zacks research among the most widely used investment research. Zacks performance of course is another reason. And as mentioned earlier, a portfolio constructed of just the Zacks #1 Rank stocks has generated an average annual return of about 32%.

Generating Positive Results

Even during the bear market of 2000, 2001 and 2002, this strategy generated positive returns.

The Zacks Rank

Harnessing the Power of Earnings Estimate Revisions



Notes

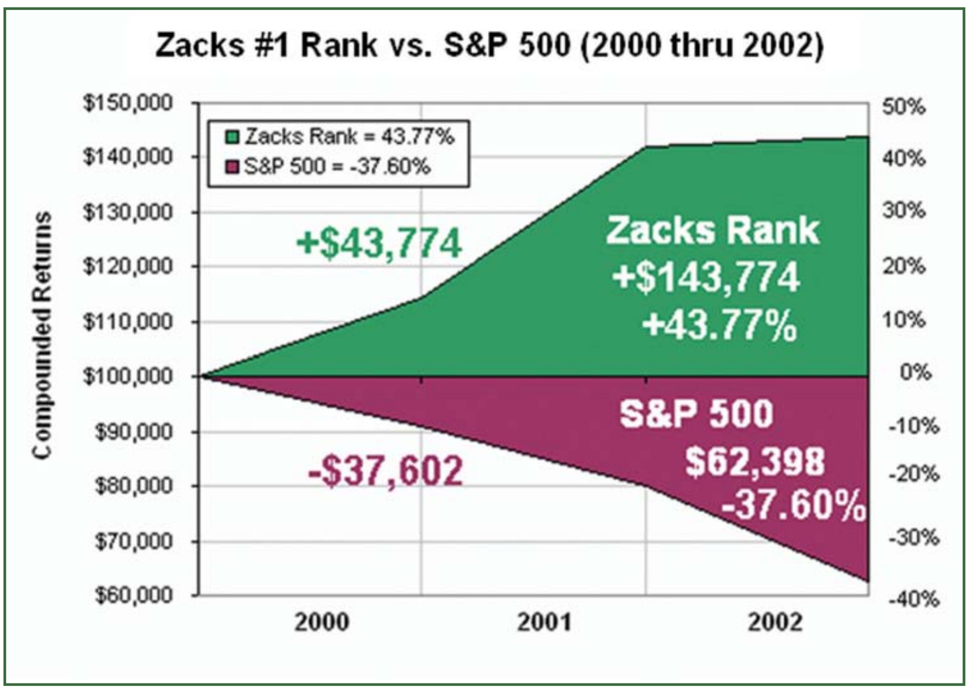
The compounded returns of the Zacks #1 Rank stocks during one of the worst bearish periods in recent history was actually up 43.77%. The S&P 500 during that same bear move lost 37.6%.

Zacks Rank versus the S&P 500

On a $100,000 account, that's the difference between a $43,774 gain and a $37,602 loss. That's over an 81% difference in fortune or a difference of more than $81,000.

Imagine if you were considering retirement during those three years? What if you had you been on the negative side that? In reality, that bearish period forced some people to postpone their retirement. Or worse, changed how they planned on living out their retirement years altogether. On the other hand, if you were on the winning side of that equation, the difference was huge.

The Zacks Rank vs. S&P 500
(2000 through 2002)



Notes

How the Zacks Rank Model Works

The Zacks Performance Rank, which is the core of the Zacks investment philosophy, has delivered annualized returns of about 32%. It is a proprietary quantitative stock ranking model based on the pattern of revisions in analysts' earnings estimates.

Through years of quantitative study, we have demonstrated that the changes that analysts make today to their earnings estimates are strong and accurate predictors of future stock performance.

We then use this information to classify stocks into five groups:

#1 – Strong Buy
#2 – Buy
#3 – Hold
#4 – Sell
#5 – Strong Sell

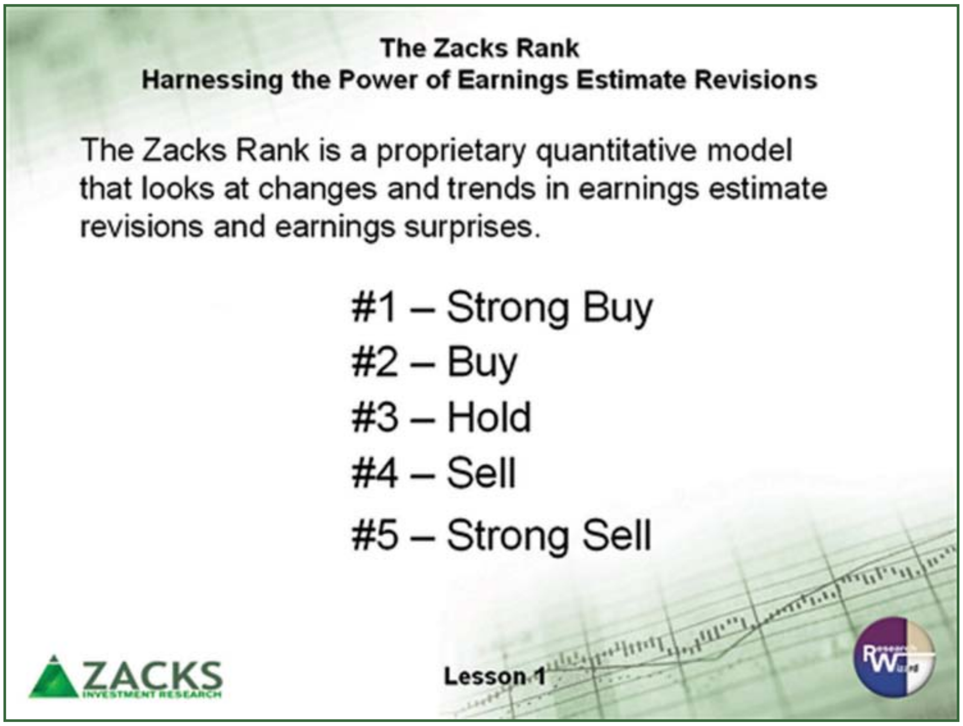
But don't confuse this with what the brokers do, as it couldn't be more different. First, the Zacks Rank is proportionately applied to the approximate 4,400 stocks for which sell-side analyst estimates are available.

What is meant by "proportionate" is that only the top 5% of the stocks assigned a Zacks Rank can receive the coveted position of a Zacks #1 Rank – Strong Buy. It's also important to know that the same number of stocks are assigned a Zacks #5 Rating – which is a Strong Sell.

This equality between Strong Buy and Strong Sell recommendations makes the Zacks Rank a much more reliable indicator than the typical brokerage recommendations. In general, brokerage recommendations are significantly biased towards "Buy" ratings with a reluctance to say "Sell". This same reluctance let many people down during the market meltdown between 2000 and 2002.

Notes

The Zacks Rank
Harnessing the Power of Earnings Estimate Revisions



The Zacks Rank Model

Zacks Rank	% of Stock Universe (Approximate)	# of Stocks (Approximate)	Recommendation	Average Annual Return
1	5%	220	Strong Buy	**32.03%**
2	15%	660	Buy	**21.72%**
3	60%	2640	Hold	**12.46%**
4	15%	660	Sell	**6.34%**
5	5%	220	Strong Sell	**5.24%**

- A Zacks #1 Rank (or Strong Buy) should outperform the market the most. (And by market, we are using the S&P 500 as this benchmark, since it's one of the most commonly used benchmarks for referencing the market.)

Notes

- A Zacks #2 Rank (or Buy) should outperform the market.
- A Zacks #3 Rank (or Hold) should perform in line with the market.
  (The market's performance over the last 19 years (since 1988) has shown an average annual return of approximately 12%.)
- A Zacks #4 Rank (or Sell) should underperform the market.
- And a Zacks #5 Rank (or Strong Sell) should underperform the market the most.

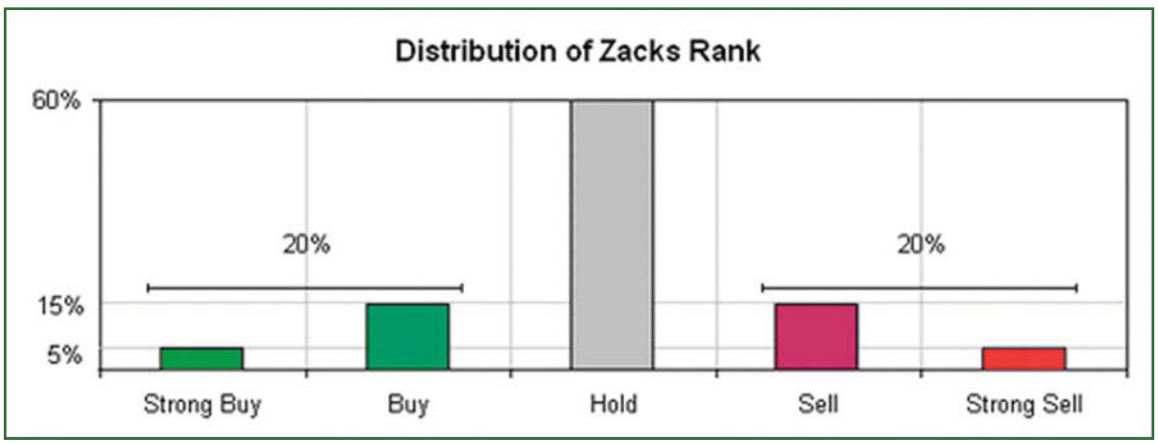
Note: The previous table illustrates how all of the Zacks Ranks have performed.

Distribution of the Zacks Rank

You will notice too that the entire assignment of the Zacks Rank is like a bell curve – an equal number of 'buys' and 'sells', with a larger number of 'holds' in the middle. (See illustration below.)

- 5% of the stocks are Ranked a #1 or Strong Buy
- 15% of the stocks are Ranked a #2 or Buy
- 60% of the stocks are Ranked a #3 or Hold
- 15% of the stocks are Ranked a #4 or Sell
- 5% of the stocks are Ranked a #5 or Strong Sell

Distribution of the Zacks Rank Graph



Notes

As you can see, the Strong Buys are Buys together make up 20% of the recommendations. And the Sells and Strong Sells make up an equal 20% of the recommendations. Accurately outperforming and underperforming the market accordingly. The 'bell curve' distribution of the Zacks Rank is in sharp contrast to the distribution of broker ratings, as you will see in a moment. The Zacks Rank always has the same number of "strong buy" and "strong sell" recommendations, whereas broker ratings are biased towards "strong buy" and "buy".

Key Point–

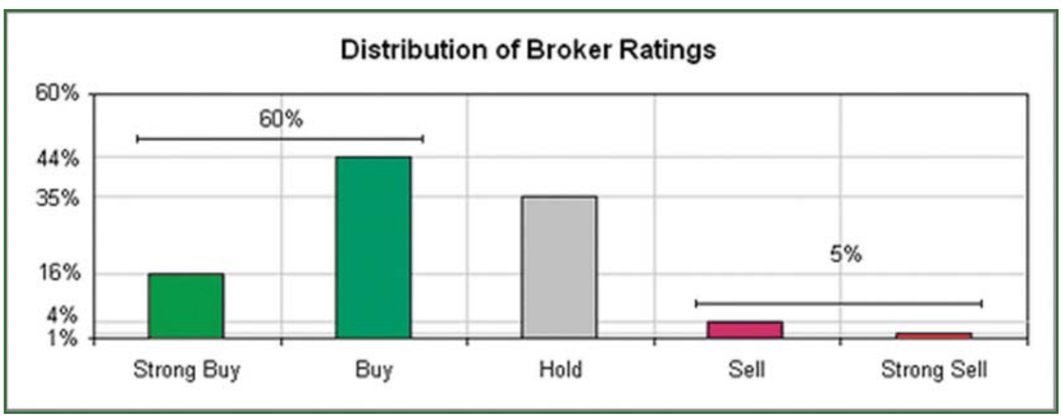
The Zacks Rank is a more powerful indicator than broker ratings. The Zacks Rank looks at earnings surprises and revisions in earnings estimates. Additionally, the Zacks Rank always has the same number of "strong buy" and "strong sell" ratings.

Average Broker Rating

The distribution of the Average Broker Rating (as illustrated below) is somewhat lopsided.

- 16% of stocks with a broker rating have an average rating of Strong Buy
- 44% have an average rating of Buy
- 35% have an average rating of Hold
- 4% have an average rating of Sell
- Only 1% have an average rating of Strong Sell

Distribution of Broker Rating



Notes

The combined average broker ratings of Strong Buy and Buy equal 60% of all the broker ratings, while the combined average broker ratings of Sell and Strong Sell amount to only 5% of the stocks. Unfortunately, 60% of the stocks do not outperform the market and far more than 5% underperform the market. To be fair, the average broker rating can be useful, but it's the change in the rating that carries the most value.

While analysts are not usually great at making subjective buy and sell predictions, they are good at providing earnings estimates. There's a reason why brokerage companies literally spend billions of dollars a year on analysts to research stocks.

These analysts must know something. And they do. The typical analyst at a brokerage firm will work 80 hours a week – devoting all of his/her time to at most, around 20 companies. Many companies are followed by 5 to 10 analysts or more. One of the main tasks of an analyst is to determine a company's earnings.

This is where the analysts excel -- not in their ratings, but in their earnings estimates.

Earnings Matter

The reason why earnings matter is because at the end of the day, earnings are what gives a stock its intrinsic value. And when trying to determine the future direction of a stock's price move, you need to look at what a company will earn in the future. This is why earnings expectations (or earnings estimates) are so important. And it's the changes in the earnings estimates that have proven to be the most important.

Why? Because stocks that receive upward earnings estimate revisions are more likely to receive even more upward earnings estimate revisions in the future. This is true because many analysts will revise their earnings estimates slowly and incrementally.

For example, if an analyst raised his earnings estimates last month, he's likely to do it again this month. And other analysts are likely to do the same. Since stock prices respond to earnings estimate revisions, it's very profitable to buy stocks whose estimates are being raised. And by getting into stocks whose earnings estimates are being raised, you're likely getting into companies whose future earnings estimates will be raised as well, potentially influencing stock prices even more.

Notes

As a result, stocks receiving upward earnings estimate revisions tend to outperform over the next one to three months.

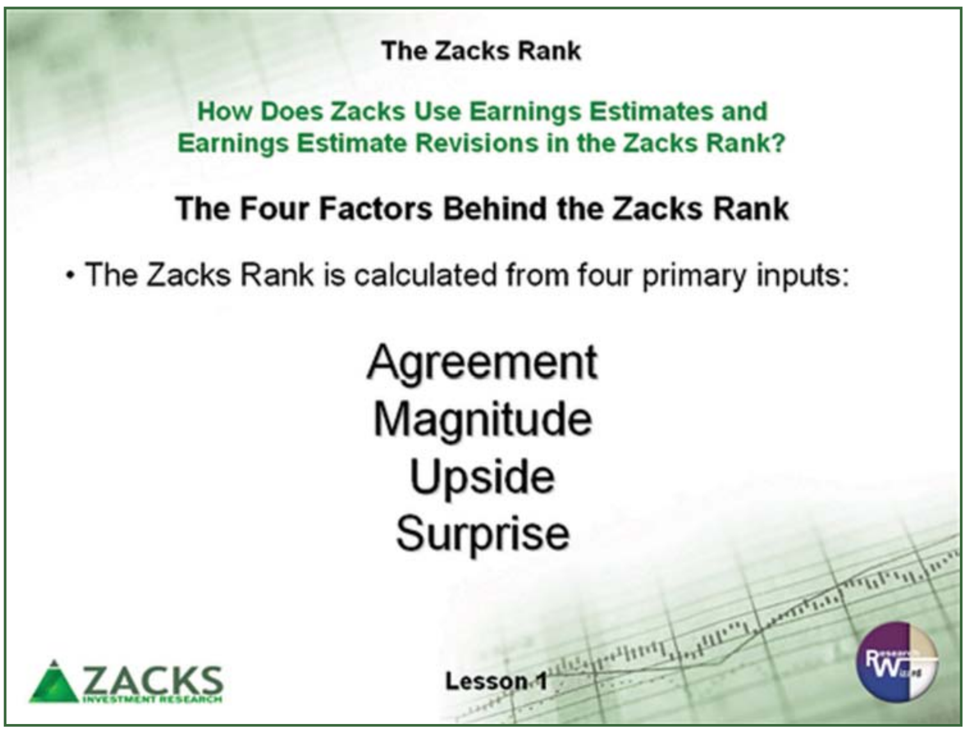
Four Factors behind the Zacks Rank

The Four Primary Inputs

How Does Zacks Use Earnings Estimates and Earnings Estimate Revisions in the Zacks Rank? The Zacks Rank is calculated from four primary inputs:

- **Agreement**
- **Upside**
- **Magnitude**
- **Surprise**

The Four Factors behind the Zacks Rank



Notes

Agreement

The extent to which all brokerage analysts are revising their EPS estimates in the same direction. The more analysts that are revising estimates upward, the higher the Zacks Rank.

Magnitude

The size of recent changes in the consensus estimate for the current fiscal year and the next fiscal year. For example, an earnings estimate revision that causes the consensus estimate to increase by 5% is a more powerful signal than an earnings estimate revision that causes a 2% rise in the consensus estimate.

Upside

This is the difference between the most accurate estimate and the consensus estimate.

Surprise

The Zacks Rank factors in the last quarter's EPS Surprise as well. Companies with a positive earnings surprise are more likely to surprise again in the future (or miss again if recently missed).

Calculating the Zacks Rank

Each one of these components is given a raw score. Zacks recalculates the scores every night from all of the data received from over 3,000 analysts at over 150 brokerage firms.

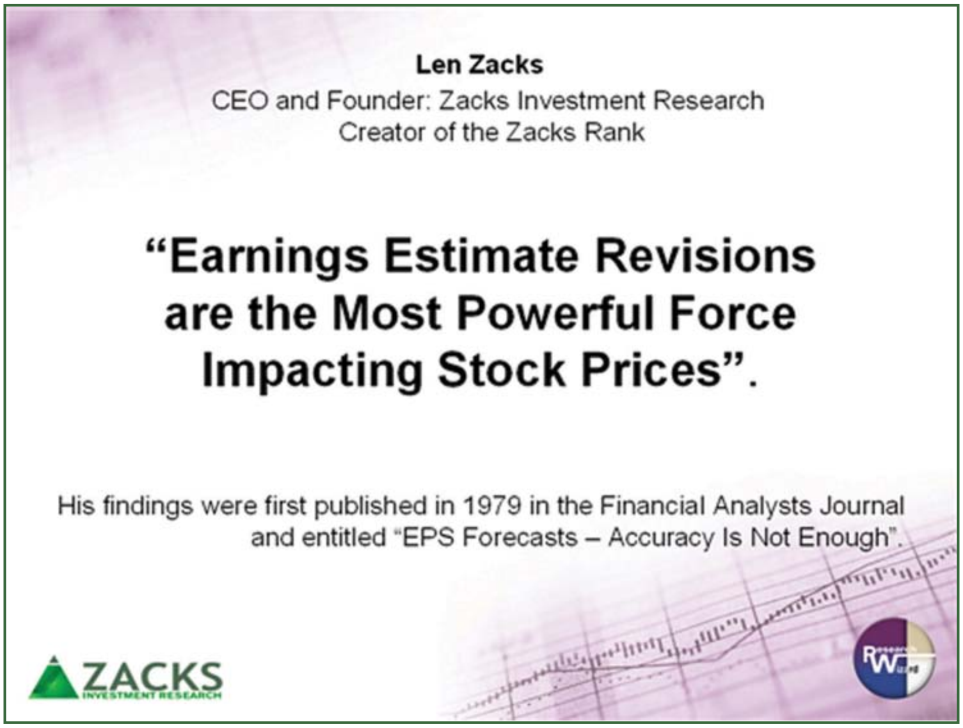
These raw scores are then compiled into the Zacks Rank and are made available to investors every day, helping them beat the market.

Key Point–

The compounded returns of the Zacks #1 Rank stocks during one of the worst bearish periods in recent history was actually up 43.77%. The S&P 500 during that same bear move lost 37.6%.

Notes

Earnings Estimate Revisions



Key Point–
The Zacks Rank looks at Earnings Estimates Revisions for the current year and the next year.

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Lesson Two—
Beyond the Zacks Rank

Objectives

The objectives for this lesson include:

- Zacks Investment Management or Research Wizard
- The Filtered Zacks Rank
- Narrowing Down the Number of Stocks Even More
- Upgrades and Revisions2
- Return on Equity2

Assignments and Exercises

The following assignments will help you in understanding the information in this lesson:

- **Watch DVD Disc 2: Trading with the Zacks Rank**
- **Complete Exercises 2.1 - 2.7**

Plan to devote a minimum of 15-30 minutes per day to completing the assignments and exercises for each lesson. It is imperative to spend time educating yourself about the market in order to have long-term success and consistency in profitable investing.

Beyond the Zacks Rank

Introduction

While the Zacks Rank has proven itself to be one of the best rating systems available, there's only one drawback to stopping at 'just' the Zacks Rank. And that is…

- over 200 stocks are assigned a Zacks #1 Rank on any given day making it virtually impossible for most traders to trade them all.

One solution that has been selected by over 3,000 investors so far is to have Zacks Investment Management, a Registered Investment Advisor that is registered with the SEC, make the trading decisions for you. The other solution, also selected by over 10,000 traders and investors, is to use the Research Wizard to narrow that list of 200+ stocks down to a smaller, more manageable number of stocks for a real life portfolio.

Zacks Investment Management or Research Wizard

The starting point for Zacks Investment Management was the book ***Ahead of the Market*** by Mitch Zacks, (Harper Collins, 2003). Mitch is a Senior Portfolio Manager at Zacks Investment Management.

Zacks Investment Management, the investment management arm of Zacks Investment Research, has an account minimum of $250,000. If your portfolio is larger than this amount and you would rather have Mitch and his team manage your investments, you will receive a full credit for the cost of this Home Study Course.

Now that we have made you aware of the Zacks Investment Management option, let's focus on how you can use the proven, profitable strategies within Research Wizard to illustrate how you can begin trading the Zacks Rank right away.

Notes

The Filtered Zacks Rank
(A Practical Method for Trading the Zacks Rank)

The Filtered Zacks Rank screen adds two additional items to the Zacks #1 Rank stocks. These two items, when added to the list of Zacks #1's, not only narrow the number of stocks to a more practical portfolio size (around 10-12 stocks), but often increase performance as well.

This strategy comes loaded with the Research Wizard program and, like all of the strategies that come with the program, is very easy to use.

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Exercise 2.1: The Strategy
The Filtered Zacks Rank

Follow along with the procedure on your DVDs. Then, duplicate the steps illustrated by the instructor. The parameters for the screen are listed on the following page. Record your notes in the space provided.

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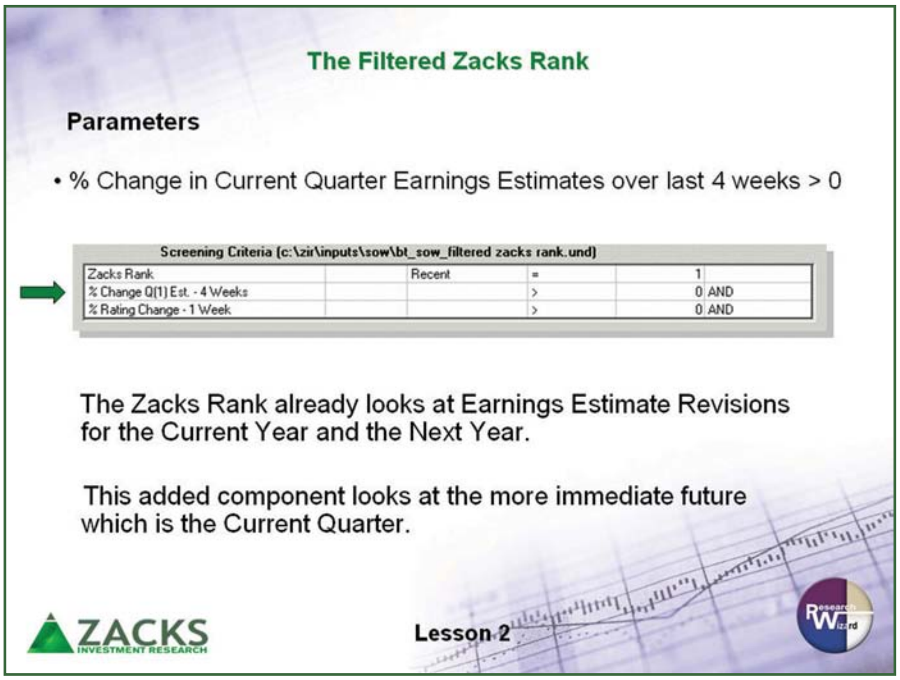
Parameters for the Screen

The first item applied to the list of the Zacks #1 Rank stocks is:

1. The % Change in Current Quarter Earnings Estimates over last 4 weeks > 0

   The Zacks Rank already looks at Earnings Estimates Revisions for the Current Year and the Next Year. This added component looks at the more immediate future which is the Current Quarter.

The Filtered Zacks Rank



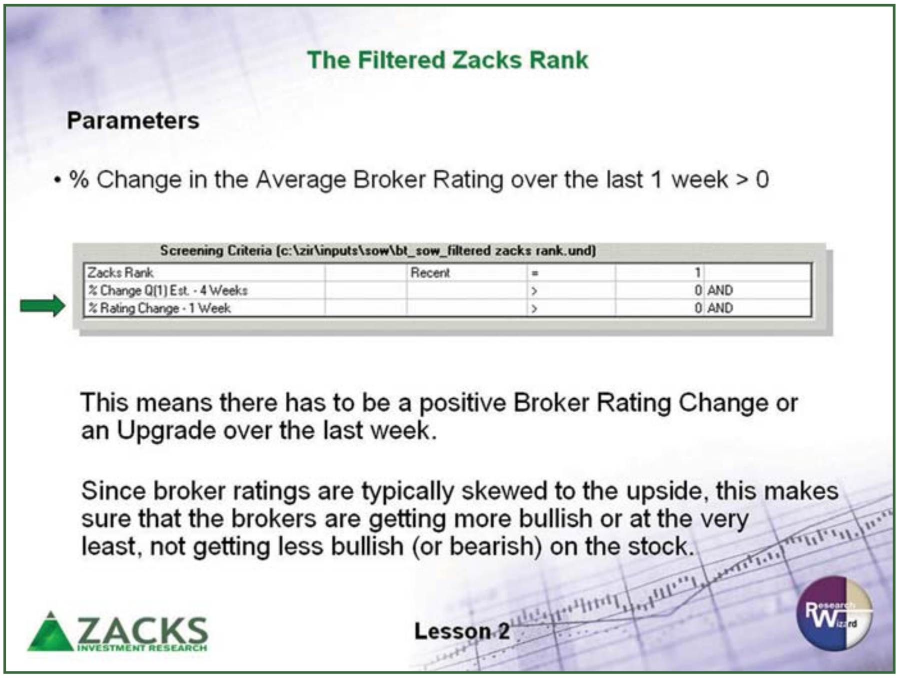
Notes

The next item is:

2. The % Change in the Average Broker Rating over the last 1 week > 0

This parameter looks for a positive Broker Rating Change or an Upgrade over the last week.

The Filtered Zacks Rank



Since broker ratings are typically skewed to the upside, we want to make sure that the brokers are more bullish or at the very least, not getting less bullish (or bearish) on the stock. These two items added to the Zacks #1 Rank Stocks produce powerful results!

Key Point–

These two items added to the Zacks #1 Rank Stocks produce powerful results! For a great and reliable way to trade some of the best of the Zacks #1 Rank stocks, try the Filtered Zacks Rank and trade fewer stocks for even bigger returns.

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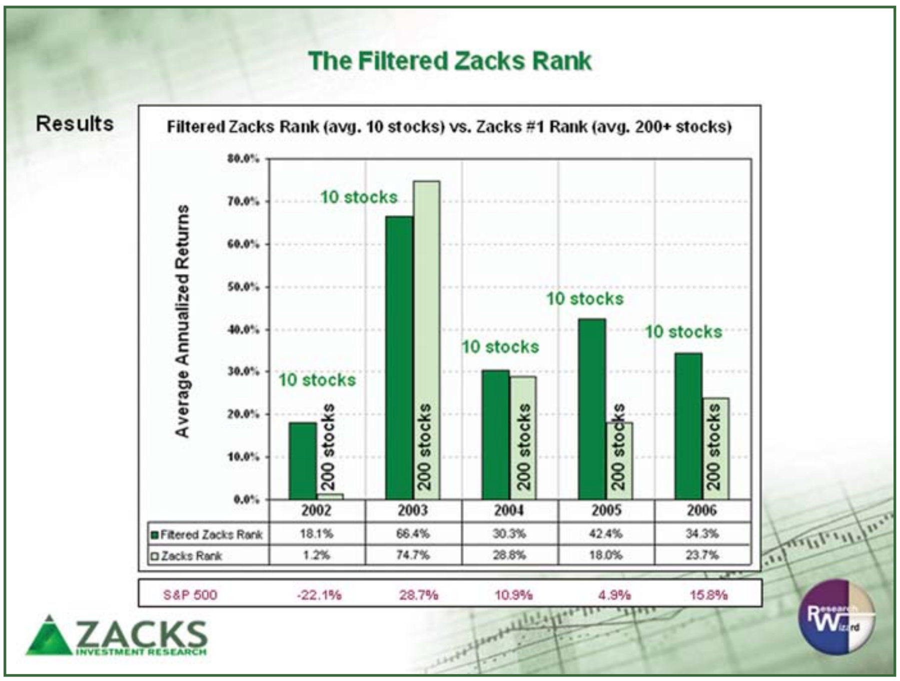
Exercise 2.2: Strategy Results
The Filtered Zacks Rank

Refer to the DVDs. Listen to the instructor as he explains the results of the screen. Record your notes in the space provided.

The Filtered Zacks Rank



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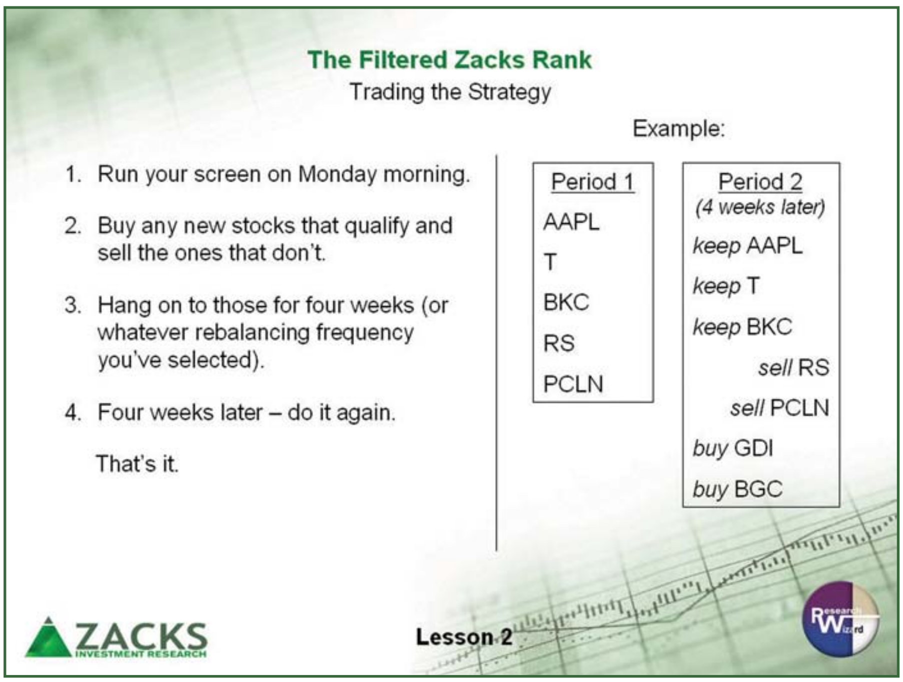
Trading the Strategy

Trading this strategy is quite simple. You'll run your screen only once a month (actually every four weeks). On the first week – Monday morning – buy all the stocks that make it through your screen. This will be approximately 10 stocks. Each stock should be purchased with an equal dollar amount. In other words, an equal amount of money would be put into each stock for an equal dollar-weighted portfolio.

You're then going to hang on to these stocks for the duration of the holding period—which in this case is four weeks.   Four weeks later, run the screen again and see what stocks come through. This time, you'll keep the stocks that still qualify, sell the ones that no longer qualify (whether it be at a profit or a loss – sell them) and buy any new stock(s) that comes through. That's all you have to do!

The Filtered Zacks Rank



Notes

Review

For your first time:

1. Run your screen on Monday morning.
2. Buy the stocks that come through, putting an equal amount of money in to each one.
3. Hang on to those stocks for four weeks.

Then:

1. Every four weeks, you'll run your screen again.
2. Sell the stocks that no longer qualify and buy any new ones that do.
3. Hang on to those for four weeks.

Four weeks later – do it again. It's that easy!

Key Point–

The same process applies if you prefer to follow a shorter time period (i.e., one or two weeks) or a longer time period (i.e.,12 weeks or longer). Simply add and delete your stocks at the start of each new trading period.

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Exercise 2.3: Practice Trading the Strategy

Follow the trading strategy on the DVDs. Practice trading the same strategy. Record your notes in the space provided.

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Notes

Narrowing Down the Number of Stocks Even More

The Filtered Zacks Rank2

For some people, 10 stocks might be too many—especially if you're just starting out with a smaller account. If that's the case, you can narrow your search down even more by changing the operator in the last parameter.

Instead of just saying > 0, meaning there has to be an upgrade in the average broker rating, you can use the operator called 'Top #' and enter '5', meaning now you're picking the five stocks with the largest (best) average broker rating change.

Now the screen will always only give you five stocks to hold in your portfolio at a time. This strategy also comes loaded with the Research Wizard and is called the Filtered Zacks Rank2. The same great returns with even fewer stocks.

This strategy also does great when you trade it on a weekly basis as well. And having only five stocks to trade makes weekly rebalancing even easier.

Key Point–
The Filtered Zacks Rank strategies (both 1 and 2) already come pre-loaded with the program. So getting started is as easy as pointing and clicking your mouse.

The Filtered Zacks Rank strategies are only two of many proven, profitable strategies included with the Research Wizard.

In the next section, we will go over some of the other strategies, but before we do, let's take a look at the Research Wizard where all of these strategies were created and where you can go to get them.

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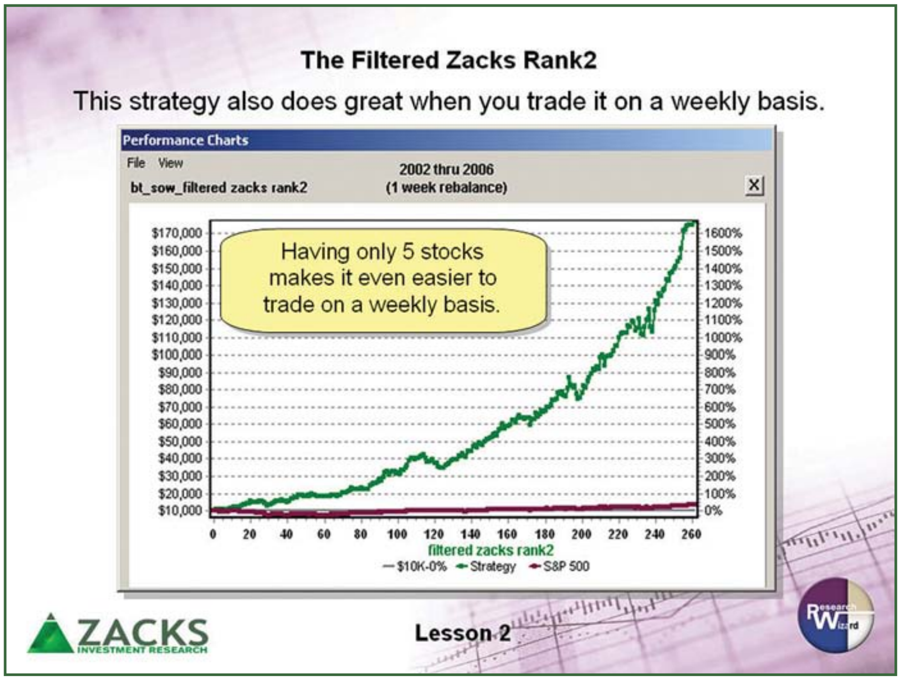
The Filtered Zacks Rank2



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Upgrades and Revisions2

A Winning Strategy for Beating the Market

This strategy focuses primarily on stocks with Upward Earnings Estimate Revisions and Rating Upgrades–similar to the Filtered Zacks Rank–but the similarities end there. In fact, this method by far, has the most hoops to jump through and the cumulative effect it has on finding the right stocks makes it one of the most ‘rock-solid’ strategies!

There are actually a few variations to this method, but this one is probably the most popular one. It generates an average of 8-10 stocks per run, has an excellent win ratio and has shown consistently impressive returns year after year after year.

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Exercise 2.4: The Strategy

Upgrades and Revisions2

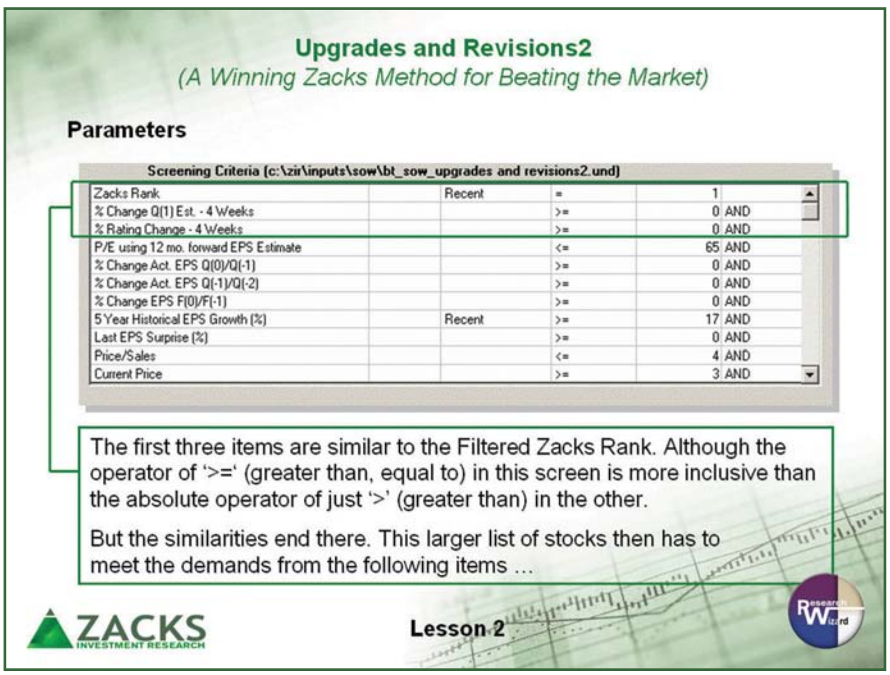
Follow along with the procedure on the DVD presentation. Refer to the parameters listed below. Then, duplicate the steps illustrated by the instructor. Record your notes in the space provided.

Parameters

- Zacks Rank = 1 (Strong Buy)
(Only Zacks' best ranked stocks are allowed through.)
- % Change in Current Quarter Estimates over the last 4 weeks >= 0
(Earnings with fresh upward revisions—or at the very least, no downward revisions.)
- % Rating Change in the Average Broker Rating over 4 weeks >= 0
(Since analysts have an upside bias, anything remotely downgraded is excluded.)

Upgrades and Revisions2

(A Winning Zacks Method for Beating the Market)



Notes

These first three items are similar to the Filtered Zacks Rank. Although the operator of '>=' (greater than, equal to) in this screen is more inclusive than the absolute operator of just '>' (greater than) in the other.

But the similarities end there. This larger list of stocks is then put through the wringer with demands from the following items:

• P/E using 12 mo. Forward EPS Estimates <= 65
(Our studies have shown that stocks with P/E ratios of up to 65, outperform those with P/Es of over 65. So to increase our probabilities of success, we've drawn the line at 65.)

• % Change Actual EPS Q(0)/Q(-1) >= 0
(Positive EPS Growth last quarter over one quarter ago.)

• % Change Actual EPS Q(-1)/Q(-2) >= 0
(Positive EPS growth one quarter ago over two quarters ago.)

In other words, two quarters of positive EPS growth.

• % Change Actual EPS F(0)/F(-1) >= 0
(Positive EPS Growth last year over the year before that.)

• 5 Year Historical EPS Growth Rate >= 17
(The average stock in the Zacks Universe has a five-year historical growth rate of approximately 15%. This screen finds those stocks with a growth rate above that threshold.)

• Last EPS Surprise >= 0
(No negative surprises allowed. Companies that have recently surprised in the past have a tendency to surprise again in the future.)

• Price to Sales Ratio <= 4
(We've had great success with the Price to Sales ratio being between 2, 3 and 4. In general, a lower Price to Sales ratio is better than a higher one. But for this screen, we selected 4 because it didn't narrow the stock selection too much.)

Notes

- **Price >= 3**
  (All the stocks have to be trading at a minimum of $3 and higher. Although, with all the items above, the typical pick has an average stock price of usually $30 and higher.)

Over the last six years, this strategy has shown an average annualized gross return of 49.15% a year, with an average win ratio of 72%. And again, it produces on average of 8-10 stocks for your portfolio each month.

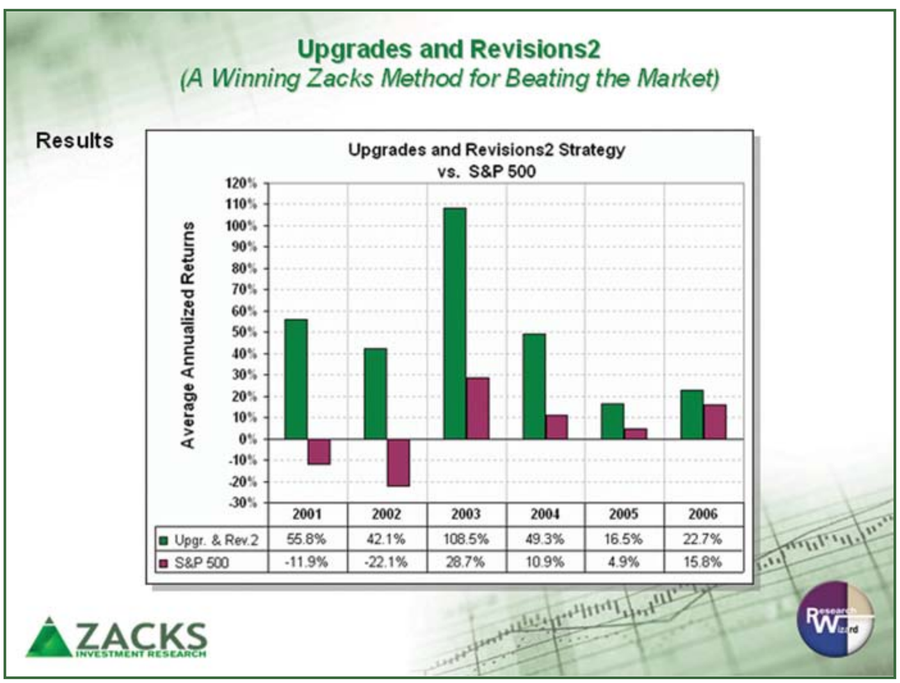
Exercise 2.5: The Results

Upgrades and Revisions2

Refer to the DVDs. Listen to the instructor as he explains the results of the screen. Record your notes in the space provided.

Upgrades and Revisions2

(A Winning Zacks Method for Beating the Market)



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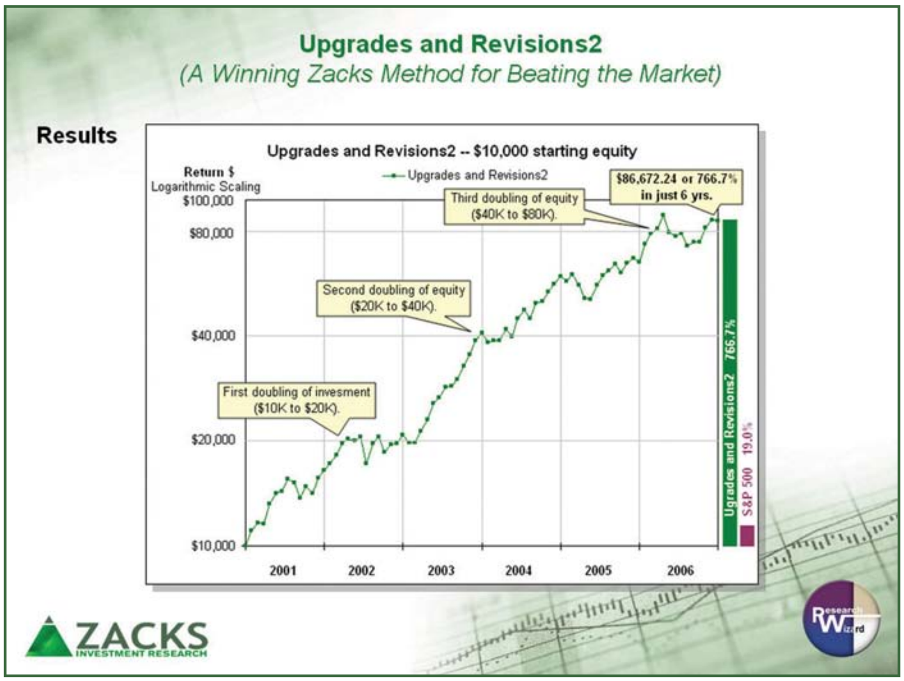
For further illustration, a continuous backtest over the last six years was run starting on 1/5/01 and going through 12/31/06, rebalancing the portfolio every four weeks and then compounding the returns each period to greater simulate how one would invest.

Key Point–

Over the last six years, this strategy has shown a total compounded gross return of 766.7%. On a $10,000 investment, that's an increase of $76,670.

Upgrades and Revisions2

(A Winning Zacks Method for Beating the Market)



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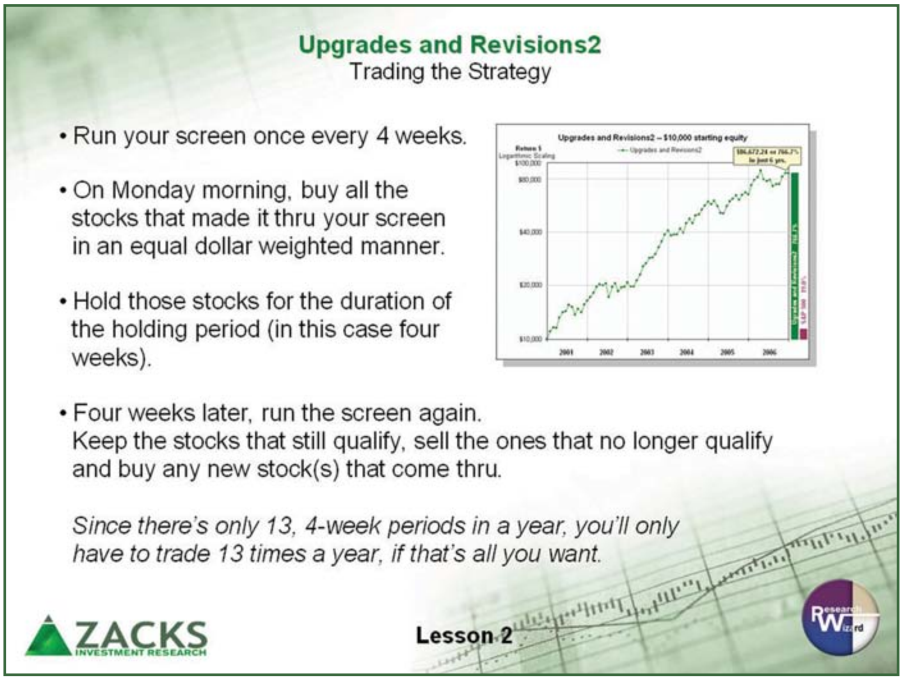
Upgrades and Revisions2
Trading the Strategy



Trading the Strategy

Trading this strategy is just as easy as trading the previous strategies.

First:

1. Simply run your screen once every four weeks.
2. On Monday morning, buy all the stocks (in equal dollar amounts) that made it through your screen.
3. Hang on to those stocks for the duration of the holding period (in this case, four weeks).

Notes

Then:

1. Four weeks later, run the screen again.

2. Rebalance your portfolio:
- Keep the stocks that still qualify.
- Sell the ones that no longer qualify.
- Buy any new stocks that come through the screen.

3. Hang on to those stocks for the next four weeks.

Four weeks later – do it again.

Key Point–
Since there are only 13, four-week periods in a year, you'll only have to trade 13 times a year.

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More Upgrades and Revisions

There are two other versions of the Upgrades and Revisions strategy available in the Research Wizard as well. One of the versions generates on average of only 4-5 stocks per period as opposed to 8-10. All of the parameters are the same except that the Zacks Rank of 1 has to be new or no more than four weeks old—meaning the stocks had to have a Zacks Rank of a #2 or higher four weeks ago and have since been changed (or upgraded) to a Zacks #1 within the last four weeks.

This change will increase your turnover rate, since every four weeks a completely new list of stocks is generated. But you're going to have fewer stocks in your portfolio to begin with.

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Return on Equity2 (ROE2)

Zacks Rank + ROE = Great Returns

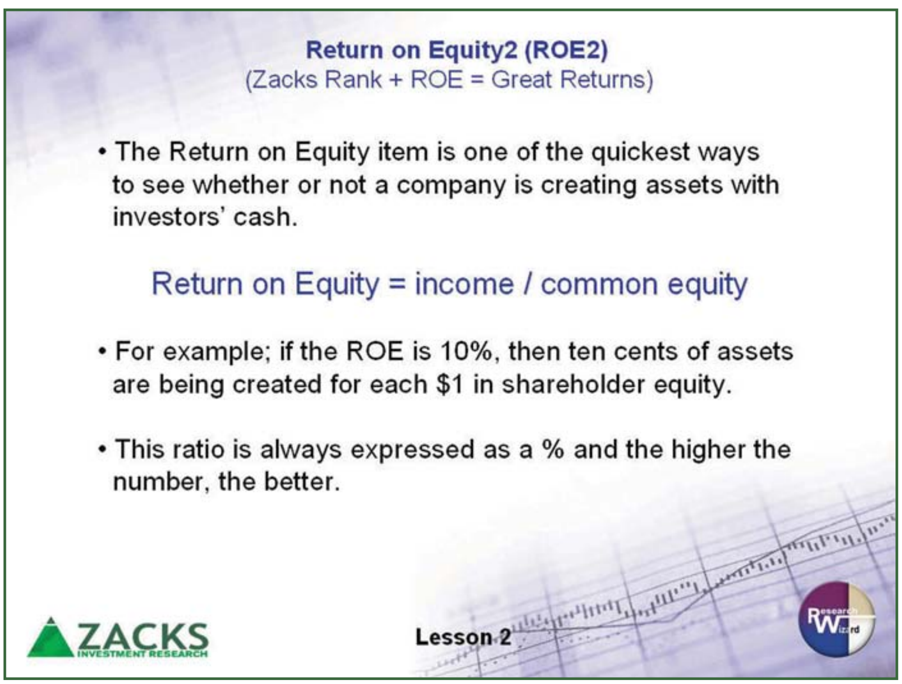
The Return on Equity2 strategy uses the ‘Return on Equity’ measure (or ROE) as one of the main components layered on top of the Zacks Rank. The Return on Equity item is one of the quickest ways to gauge whether a company is creating assets with investors’ cash or gobbling it up. Very simply:

- Return on Equity = income / common equity

For instance, if the ROE is 10%, then ten cents of assets are being created for each $1 in shareholder equity. This ratio is always expressed as a % and the higher the number, the better. Knowing the company is generating assets on invested capital rather than burning through it, is important to know.

Let’s take a look at the parameters that go into this screen.

Return on Equity2 (ROE2)



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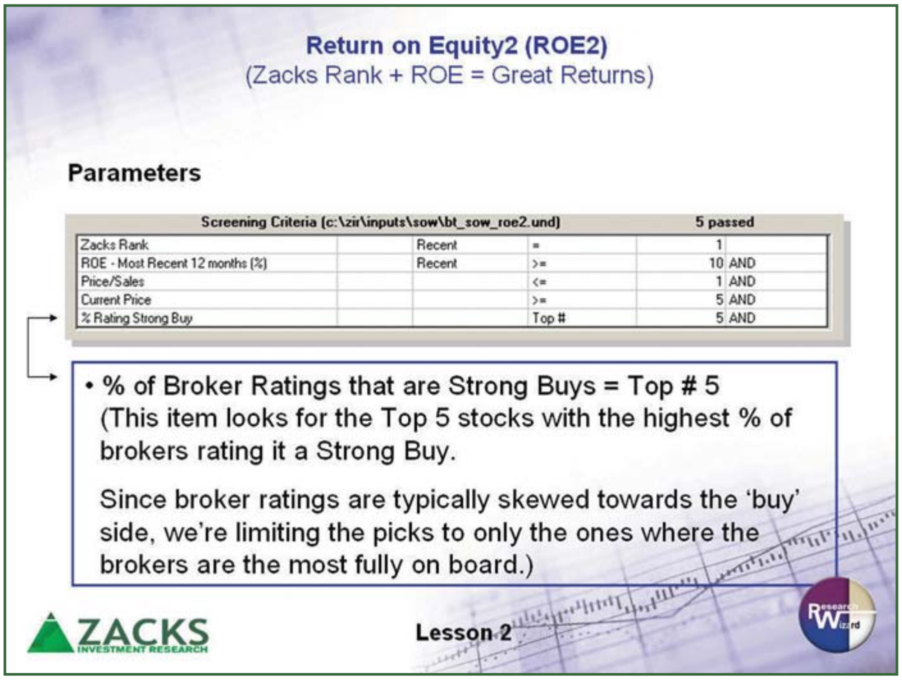
Exercise 2.6: The Strategy

Return on Equity2 (ROE2)

Follow along with the procedure on the DVD presentation. Refer to the parameters listed below. Then, duplicate the steps illustrated by the instructor. Record your notes in the space provided.

Return on Equity2 (ROE2)



Parameters

- **Zacks Rank = 1**
  First, narrow the Universe to Zacks #1 Rank stocks.

- **ROE >= 10**
  The median ROE value for all of the stocks in the Zacks Universe is right around 10%. Therefore, any company under this benchmark is disqualified.

Notes

- **Price to Sales <= 1**

A low Price to Sales ratio (1.0 and below) is usually thought to be of better value, since the investor is paying less for each unit of sales.

Price to Sales Ratio is simply: Price / Sales
It tells you how much you're paying for each dollar of sales the company makes. And paying less than a dollar, for a dollar's worth of something, is a good value.

- **Price >= 5**

Only stocks trading at a minimum of $5 or higher can make it through the screen. Since many money managers won't touch anything under $5, this makes sure the picks can get on their radar screen.

- **% of Broker Ratings that are Strong Buys = Top # 5**

After all of the above items are met, this item looks for the Top 5 stocks with the highest % of brokers rating it a Strong Buy.

And as we mentioned earlier, since broker ratings are typically skewed towards the 'buy' side, we're limiting the picks to only the ones where the brokers are the most fully on board.

Exercise 2.7: The Results

Return on Equity2 (ROE2)

Refer to the DVDs. Listen to the instructor as he explains the results of the screen. Record your notes in the space provided.

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Lesson Snapshot

In this lesson, we covered several strategies to show you how to narrow the list of 200+, Zacks #1 Rank stocks to a smaller, more manageable number of stocks for a real life portfolio.

There are many more strategies that come loaded with the Research Wizard program as well; strategies that use different criteria to find different types of stocks. And any one of these proven, profitable strategies can help you become a better trader immediately.

As you can see, you don't have to live and breathe the markets or understand everything there is to know about the markets to be able to make money in the markets. By understanding and practicing sound, basic concepts as well as focusing on proven, profitable strategies that work, you can become a more confident and profitable trader right away.

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